

Minnesota Attorney General: Administrative Rules Proceedings

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Version 3
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Our File No. 689

RULE REVIEW CHECKLIST

DATE RULE RECEIVED 4/13/81
DATE FOR REVIEW 4/21/81
DATE DUE 4/27/81

Adopted w/a hearing _____
Adopted w/o a hearing ✓
Temporary rule _____

Approved 4/27/81 Disapproved _____ Returned to Agency _____

Resubmitted _____ Due _____
Approved _____ Disapproved _____ Returned to Agency 4/29

Date filed w/Secretary of State 4/28/81

✓ Rule as Adopted

✓ Rule as Proposed

✓ Order Adopting

✓ Notice of Intent to Solicit Outside Opinion

✓ Order for rulemaking
no hearing Date of Hearing

na Certificate of Board's Authorizing Resolution

✓ Notice of rulemaking
2-13-81 Sufficiency

✓ Affidavit of Mailing Notice of rulemaking
2-27-81 At least 30 days prior to hearing/adoption

✓ Mailing list Certificate

✓ Publication in State Register
_____ At least 30/20 days prior to hearing/adoption

na Hearing Examiner's Report

na Chief Hearing Examiner's Report(s)
_____ Approving H.E.'s Report
_____ Approving agency action

na Agency's Findings of Fact

na LCRAR Report or agency Affidavit

na Certificate of Board's Resolution Adopting Rules

na Order Approving Incorporation by Reference

✓ Statement of Need and Reasonableness

na Petition for Adoption of a Rule

✓ Record (includes transcript or tape, exhibits, comments received by agency, requests for a hearing, and other relevant materials)

✓ Certificate of Compliance w/Rulemaking Procedures

✓ Affidavit of Mailing Notice of Submission to Attorney General

✓ Notice of Submission to the Attorney General

SF-00006-02

STATE OF MINNESOTA

DEPARTMENT ATTORNEY GENERAL

Office Memorandum

TO : Clyde E. Allen, Jr.
Commissioner of Revenue

DATE: April 28, 1981

ATTN: Gary P. Mesna

FROM : H. Theodore Grindal HTG
Special Assistant
Attorney General

PHONE: 296-1288

SUBJECT: In the Matter of the Proposed Adoption of Rules of the State Department of Revenue Governing Individual Housing Accounts
(13 MCAR Section 1.6016)

Enclosed herewith are the rules you have submitted for approval. These rules have been approved by this office and filed with the Secretary of State. Please note that they have not been filed with the State Register; this must be done promptly by your agency.

Upon receipt and before transmittal to your agency, however, it is important that you recheck these rules as to:

1. Affixation of stamps of the Attorney General and Secretary of State to the last page of the rules;

2. Coverage by these stamps of all rules submitted; and

3. Inclusion of all pages to the rules in the approved set.

If you have any questions in this regard, please contact me.

HTG:rg
Enc.
cc: Susan Robertson
Duane Harves

Rule as Adopted

Original 2-10-81 ① AG copy

13 MCAR Section 1.6016 - Individual Housing Accounts (All New Material)

A. Definitions

1. IHA. The term "IHA" shall mean an individual housing account established pursuant to this rule and the Young Family Housing Act.
2. Participant. The term "participant" shall mean an individual natural person for whose exclusive benefit an IHA is held. In the case of an IHA held jointly for an individual and his or her spouse, the term shall mean both of them.
3. Deposit. The term "deposit" shall mean a deposit or contribution of cash to an IHA, whether made by the participant or any other person.
4. Withdrawal. The term "withdrawal" shall mean a withdrawal or distribution of any amount from an IHA, whether withdrawn by or distributed to the participant or any other person or entity.
5. Principal residence. The term "principal residence" shall mean the dwelling unit that the participant actually lives in and that the participant intends to be his/her fixed abode. A principal residence shall require both a physical presence in the dwelling unit and an intention to make that dwelling unit one's home. A principal residence shall be that dwelling unit to which, during an absence, the participant intends to return and from which there is no present intention of moving. There shall be a presumption that the dwelling unit in which a person's family lives is that person's principal residence.

   The dwelling unit must be located within Minnesota and may be all or part of a house, townhouse, condominium or cooperative. If a

building contains more than one dwelling unit, only the dwelling unit actually occupied by the participant as his/her residence shall qualify as a residence. If a portion of the building is used for some purpose other than as a dwelling unit, for example, a portion of a building is used for a trade or business, only the portion used as a dwelling unit shall be considered a residence. The purchase price of such a building shall be properly allocated between the dwelling unit and the business portion of the building.

The participant may purchase the residence with others, for example, in joint tenancy, tenancy in common, or as a tenant-stockholder in a cooperative housing corporation. In this case, the dwelling unit shall qualify as a residence only to the extent of the participant's ownership interest therein.

In order to qualify for any of the benefits of the IHA provision, the residence must be the first dwelling unit ever owned and occupied by the participant as his/her own permanent residence. A taxpayer who previously owned or currently owns his/her own residence, whether located in Minnesota or in any other state or country, shall not qualify.

B. General Requirements

1. An IHA shall be a trust established in Minnesota for the exclusive benefit of a participant or, in the case of a married person, for the exclusive benefit of the participant and the participant's spouse, jointly.
2. An IHA shall not be established or maintained for a participant who currently owns or formerly owned a principal residence, whether or not it is (was) located in Minnesota.

3. An IHA shall not be established or maintained for a participant who is currently the participant of another IHA. An individual shall not have two IHAs at one time. However, an IHA may be established for an individual who had an IHA at some time in the past but which was terminated and not used for the purchase of a first principal residence.

4. Contents of Trust Agreement. (For recommended format of Trust Agreement, see Exhibit A.) The IHA trust shall be established pursuant to a written trust agreement which shall contain, in addition to any other provisions, a separate provision for each of the trustee's duties prescribed in Part C of this rule and a statement that the trustee agrees to comply with the law and rules applicable to IHAs.

5. Contents of Disclosure Statement. (For recommended format of Disclosure Statement, see Exhibit B.)

   a. The disclosure statement shall set forth in nontechnical language the income tax consequences of establishing an IHA, the limitations and restrictions on the program, and other matters as follows:

      (1) The ineligibility of individuals who own or have owned a residence;

      (2) The deductibility of deposits to an IHA, the $1,500, $2,500 and $10,000 maximum limitations, and the requirement that the amount be on deposit for six months before a deduction is allowed;

      (3) The tax treatment of a withdrawal from an IHA when the amount withdrawn is used for any purpose other than the purchase of a first principal residence that is located in Minnesota;

(4) The requirement that the first principal residence be purchased within 10 years from the date that the account was first established;

(5) An explanation of the additional taxes that may be due (in addition to the regular tax liability) on withdrawals not used for the purchase of a first principal residence.

(6) An explanation of the additional taxes that may be due (in addition to the regular tax liability) on excess contributions as well as an explanation of what constitutes an excess contribution.

(7) The availability of a tax free transfer of the account to a different financial institution or credit union and an explanation of what constitutes such a transfer.

(8) If the IHA is revocable within seven days after establishment, as provided in subpart C.1.f., the disclosure statement shall include a statement of the circumstances under which the participant may revoke the account and the procedure therefor, including the name, address and telephone number of the person designated to receive the notice of revocation. This explanation shall be prominently displayed at the beginning of the disclosure statement.

(9) A statement that the trustee is authorized by law to act as trustee of IHAs and has received approval to so act from the Commissioner of Banks or is not required to obtain such approval.

(10) A statement that the trustee will abide by all laws and rules applicable to trustees of IHAs.

(11) A statement that it is the participant's responsibility to assure that the financial institution is authorized by law to act as trustee of IHAs and that the particular account set up for that participant meets all of the requirements of the law and this rule.

(12) A statement that upon audit of the participant's income taxes by the Department of Revenue, if it is found that the account or the trustee do not meet all of the requirements of the law and this rule, the deductions under this program may be denied.

b. If the trustee does not furnish a disclosure statement as required by this rule or furnishes one that does not substantially comply with this rule, he shall be liable to the Commissioner for a penalty of $10 for each required disclosure statement that he did not furnish or that did not comply with this rule. A disclosure statement that is false or misleading shall not be considered to comply with this rule.

6. A financial institution or credit union may act as the trustee of of IHAs only if it meets the requirements of the law and this rule and either it has received approval to so act from the Commissioner of Banks or it is not required to obtain such approval.

7. A financial institution or credit union, in order to act as a trustee of IHAs, must actively make residential real estate mortgage loans in Minnesota. This means that the particular financial institution or credit union must originate mortgage loans in Minnesota on Minnesota real estate by lending money to the original mortgagor and taking a mortgage back as security for the loan.

The mere holding of Minnesota mortgages, obtained in the secondary market by an institution that does not originate such loans, does not qualify.

Furthermore, the institution shall, subject to the availability of funds for such purpose, regularly throughout the year be ready and willing to make residential real estate mortgage loans in Minnesota. Whether or not an institution is actively engaged in making such loans shall be determined by reference to the general market conditions affecting all real estate mortgage lenders, rather than by the actual number of such mortgage loans made by the particular institution during a particular period of time. The fact that there is no mortgage money available or that the interest rate is so high that no one desires a mortgage loan shall not, alone, prevent a financial institution from being a trustee. The fact the institution seeking approval to administer IHAs made no such loans during a period of time while other financial institutions were making such loans shall be evidence that the particular financial institution is not actively making residential real estate loans in Minnesota.

8. The participant shall, upon request of the Commissioner, submit copies of the trust agreement and disclosure statement and such other evidence as the Commissioner may request to establish whether or not the particular IHA meets the requirements of the law and this rule. None of the tax benefits of the IHA provisions shall be available to a participant who is unable to show that both the IHA and the trustee meet the requirements of the law and this rule.

C. Duties of Trustee.

1. In General.

a. The trustee shall accept only cash deposits to an IHA. No other property shall be accepted in an IHA trust, such as stocks, bonds, notes, debentures, mutual funds, real estate, or otherwise.

b. The trustee shall not accept deposits to an IHA in excess of $2,500 for a single taxable year or in excess of $10,000 for all taxable years.

c. The trustee shall not establish an IHA for an individual unless he receives a written statement from the individual indicating that the individual does not currently own and has never owned his/her own principal residence, whether in Minnesota or in any other state or country.

d. The trustee shall distribute the entire account to the participant within 10 years after the first deposit to the account. Transfer of the entire amount in the IHA into a different account, which is not an IHA, shall constitute such a distribution but the transfer shall be treated as a withdrawal not used for the purchase of a first principal residence, as provided in Part F. of this rule, and the trustee must withhold tax as prescribed by subpart 3 of this part.

e. For each withdrawal, the trustee shall withhold tax as prescribed by subpart 3 of this part unless it verifies in accordance with this rule that the withdrawal is being used for the purchase of a first principal residence that is located in Minnesota and makes the instrument of payment payable to

the seller or the seller's designee (other than the participant), construction contractor or other vendor of the property. If only a portion of the withdrawal will be used for the purchase of a first principal residence, tax shall be withheld on the portion that will not be so used. This subparagraph is not applicable to a withdrawal attributable to disability or death which is verified in accordance with this rule.

f. The trustee at least seven days prior to the establishment of an IHA shall provide a written disclosure statement in accordance with this rule and a copy of the governing instrument to each person who proposes to establish an IHA with the trustee. In the alternative, the trustee may provide the written disclosure statement to the participant at the time that the IHA is established, but only if the trust agreement provides that the trust shall not constitute an IHA for seven days following execution of the agreement, during which period of time the grantor may revoke the trust.

g. In the case of an amendment to the terms of the account or trust agreement, whether or not made pursuant to a statutory or rule change, a revised disclosure statement shall be furnished to the participant. The revised statement need not repeat material furnished in a prior statement, but it must set forth those matters affected by the amendment.

h. The trustee may invest assets of the trust only in savings or time deposits. Certificates of deposit shall qualify as savings or time deposits. The savings or time deposits must be the trustee's own accounts or certificates; investment in

accounts or certificates of other institutions is not permitted. The savings or time deposits must be fully insured by an agency of the state or federal government. Assets of an IHA trust shall not be invested in any other types of assets, e.g., stocks, bonds, notes, debentures, mutual funds or otherwise.

i. The trustee may commingle funds held in IHA trusts for purposes of investment but the trustee shall maintain individual records on each IHA in accordance with this rule.

2. Reporting Requirements.

a. Annual Report to Commissioner of Revenue.

(1) The trustee shall file a report with the Commissioner of Revenue by February 28 of each year for each IHA administered by him at any time during the preceding calendar year, including the following information on each IHA:

(a) Name, address, and such other identifying information of the trustee as the Commissioner may prescribe.

(b) Name, address and social security number of the participant(s).

(c) Date account was established.

(d) Whether a withdrawal was used for the first purchase of a principal residence in Minnesota. If so, the trustee shall submit with this report the verification form required under subpart c of this part.

(e) Whether a withdrawal was claimed to be attributable to death or disability. If so, the amount thereof shall be indicated and the trustee shall submit

with this report the written declaration required under Part H. of this rule.

(f) Date and amount of each deposit during the preceding calendar year.

(g) Date and amount of each withdrawal during the preceding calendar year.

(h) Amount of interest paid, accrued or credited to the account during the preceding calendar year.

(2) One copy of the report shall be filed with the Commissioner of Revenue; two copies shall be furnished to the individual participant.

b. Report and Verification by Trustee of Withdrawals Used For First Principal Residence in Minnesota.

(1) Before allowing a withdrawal from an IHA, the trustee shall either withhold tax as prescribed by paragraph 3, below, or verify that the withdrawal is being used for the purchase of a first principal residence that is located in Minnesota (unless the trustee determines in accordance with Part H. that the account holder has died or become disabled). The verification shall be supplied on a form prescribed by the Commissioner which is completed by the participant and filed with trustee. The following information shall be included on the form:

(a) Location and description of property being purchased.

(b) Name and address of person or entity from whom the property is being purchased.

(c) Name of realtor, closing company, etc., if any.

(d) Type of ownership anticipated, i.e., whether title will be held alone, as tenancy in common, joint tenancy, or cooperative.

(e) Total purchase price, including any mortgages or contracts given or assumed.

(f) Amount to be financed, i.e., amount to be paid later than closing date, whether by mortgage, contract for deed or otherwise.

(g) Anticipated closing costs and description thereof.

(h) Closing date.

(i) Amount withdrawn from the account during the taxable year.

(j) Portion of amount withdrawn which will be used to purchase the first principal residence.

(k) The person or entity to whom the withdrawal or distribution is to be made payable.

(l) Name and address of trustee.

(m) Name, address and social security number of participant.

(2) The trustee shall file a copy of this form with the Commissioner of Revenue at the time that he files the annual information return for the particular account.

3. Withholding Requirements.

a. The trustee shall withhold tax in an amount equal to 10% of the amount of any withdrawal and remit the amount within 10 days to the Commissioner of Revenue unless the trustee satisfies one of the following requirements:

(1) Verifies in accordance with this rule that the withdrawal is used for the first purchase of a principal

residence located in Minnesota, and makes the withdrawal payable to the person or entity from whom the residence is being purchased, either alone or jointly with the participant, or

(2) verifies in accordance with this rule that the participant has died or is disabled, or

(3) determines that the withdrawal is of an excess contribution and is withdrawn by the due date of the tax return for the taxable year in which the excess contribution was made.

b. The trustee shall be personally liable for the amount of any tax required to be withheld under this section.

4. Penalties. For each instance in which a trustee fails to timely file or furnish a report or return required by this rule with either the Commissioner of Revenue or with the individual participant, a penalty of $10 shall be due from the trustee and shall be paid to the Commissioner of Revenue.

D. Deduction for Contributions to an IHA.

1. The annual deduction for deposits to an IHA shall not exceed $1,500. Moreover, the total amount of all deductions for deposits to an IHA that may be claimed by the participant and his spouse in all taxable years shall not exceed $10,000. These limitations shall not apply to amounts deducted which constitute interest accrued on the IHA.

2. An additional deduction shall be allowed for interest accrued on the IHA during its 10 year existence. However, no deduction shall be allowed for the portion of any interest which is attributable to an excess contribution, as defined in Part G of this rule. And, no deduction shall be allowed for interest paid or accrued

after the termination of the IHA.

3. No deduction shall be allowed under the IHA provisions for any amounts which have already been excluded from gross income or deducted in computing taxable income whether under federal law or under another provision of state law. A taxpayer shall not deduct or exclude the same item twice. For example, if an unmarried participant excludes $200 of interest income, earned from an IHA, in computing federal adjusted gross income under the federal provision allowing a partial exclusion of dividend and interest income received by individuals, he cannot take a deduction for the same $200 of interest under the IHA provisions. If more than $200 of interest was credited to his IHA during the taxable year, he may deduct the excess over $200 under the IHA provisions.
4. To the extent that a deposit is deductible under this rule, no deduction shall be allowed for interest expense in connection with a loan the proceeds of which are deposited to the IHA.
5. The deduction shall be allowed only for amounts on deposit for at least six months at the close of the taxable year. For calendar year taxpayers, the deposit must have occurred prior to July 1 of the taxable year.

Amounts on deposit for less than six months at the close of the taxable year may be deducted only in the next succeeding taxable year and shall be included when determining the $1,500 maximum deduction amount for that next succeeding taxable year. Thus, a deduction not exceeding $1,500 is allowed for deposits to an IHA in the last six months of the preceding taxable year or in the first six months of the current taxable year.

The deduction for interest paid or accrued on an IHA shall be allowed only for interest paid or accrued during the taxable year. Thus, for a deposit made during the last six months of a taxable year, the interest paid or accrued during the last six months of the taxable year shall be allowed as a deduction for that taxable year even though the deposit itself is not deductible until the next taxable year.

6. Married participants shall not each get a $1,500 deduction for each taxable year. The sum of the deductions, not including interest, allowed to the two married participants shall not exceed $1,500. This rule shall apply whether the married participants file separately on separate forms, separately on a combined form, or jointly.

   For married participants who file separate returns, only the individual to whom the money that is deposited actually belongs shall be allowed the deduction. For married participants who file separate returns on a combined form or who file joint returns, the deduction shall be allowed to the spouse to whom the money that is deposited actually belongs or the deduction may be divided between them as they elect.

   Married participants shall not each be allowed deductions totaling $10,000. Rather, the sum of all deductions, not including interest, claimed by the two married participants for deposits to an IHA for all taxable years shall not exceed $10,000. Any amount deposited in excess of $10,000 shall be treated as an excess contribution and subject to the 6% additional tax.

E. Exemption From Tax For Distributions Used For a First Residence.

1. Amounts withdrawn from an IHA which are used exclusively in connection with the first purchase of a principal residence in Minnesota shall not be included in gross income in the taxable year withdrawn.

2. The term "used exclusively in connection with the first purchase of a principal residence" shall mean only those amounts used for items directly related to the initial purchase of the participant's own first residence. In addition to the actual down payment, the term may include fees and other acquisition expenses incurred and actually paid by the participant for the first residence, such as sales commissions, points (those not deductible as interest), title insurance, legal fees, inspection fees, and current or delinquent real estate taxes; provided, however, that each item shall be included in this term only to the extent that the item is not deductible under another provision of state or federal law.

The term shall not include interest (or points, to the extent the points are deductible as interest), since interest is deductible under another provision of law. The term shall not include expenditures for repairs or maintenance of the residence which do not increase its value or extend its useful life, i.e., noncapital expenditures. Also, the term shall not include expenditures for personal property, such as furniture, appliances or other furnishings.

If the participant is building his own new residence or purchasing and remodeling an existing residence (or having a contractor do

it for him or her), the term may include amounts paid for building materials and labor, as well as for the lot or the existing residence being remodeled.

In order to qualify as an amount "used exclusively in connection with the first purchase of a principal residence," the amount withdrawn shall be made payable to the person or entity from whom the property is being purchased. This may include the seller, vendor, contractor, or designee of one of them (other than the participant), or the person or entity from whom the building materials or labor are being purchased. The amount may be made payable to such person or entity, alone, or jointly with the participant.

Use of an amount from an IHA pursuant to a written earnest money agreement shall be considered as used for the first purchase of a principal residence, if all other requirements are met. If the sale is not completed and the money is either forfeited pursuant to the earnest money agreement or immediately redeposited in the IHA, no tax consequences shall result, i.e., the withdrawal for earnest money is ignored. However, if the earnest money is used for any other purpose, the amount withdrawn shall be treated as "not used for the purchase of a first principal residence," as provided in Part F of this rule. The trustee, however, is not required to withhold the 10% additional tax on a withdrawal used for earnest money as long as the trustee makes the withdrawal payable to the escrow agent and obtains from the participant a completed verification that the withdrawal is being used for the

purchase of a first principal residence.

3. In order to be exempt from taxation, the amounts shall be used for the purchase of the principal residence within a reasonable time after withdrawal and shall not be used for any other purpose in the interim.
4. Only the participant of the particular IHA may use the account for the purchase of his/her own first principal residence. It cannot be used to purchase a residence for someone else, for example, by gift, loan, or rental to another.
5. A participant shall not deduct or exclude the same item twice, under different provisions of law. For example, when the participant makes a withdrawal from an IHA and uses it for the first purchase of a principal residence, if any portion of the withdrawal is used to pay interest expense in connection with the purchase of the residence, no deductions shall be allowed for the portion so used, since interest expense is deductible under another provision of law.
6. No adjustment to the basis of the residence that is purchased is required because of the use of amounts from an IHA.
7. A withdrawal used for the first purchase of a principal residence shall not be included in computing the low income alternative tax, the property tax refund, or in the income limitations for purposes of the homemaker credit, the dependent care credit, the farm loss modification, or the charitable deduction.
8. In order to claim exemption from income tax of amounts used for a first principal residence in Minnesota, the participant shall attach to his income tax return for the taxable year a copy of the verification form that he or she provided to the trustee as

well as a copy of the closing statement, if any, from the purchase of the residence. The participant shall also furnish any additional information that the Commissioner may request to verify that all requirements of this rule have been met.

F. Tax Treatment of Distributions Not Used For a First Principal Residence.

1. With certain limited exceptions, amounts withdrawn from an IHA which are not used for the purchase of a first principal residence, are includible in the participant's gross income and subject to an additional 10% tax in the taxable year of the withdrawal. The additional tax is in addition to any tax that is otherwise due on the amount of any withdrawal that must be included in gross income.
2. The amount to be included in gross income is not necessarily the total amount of the withdrawal. Rather, the amount includible in gross income is the portion of the withdrawal attributable to a contribution or accrued interest that was actually deducted under the IHA provisions, either in the current or a prior taxable year. The portion of a withdrawal that is not attributable to either a deductible contribution or deductible interest is not includible in gross income or subject to the 10% additional tax.
3. There is an exception to these rules where the participant has died or become disabled. The 10% additional tax shall not be due from the estate of a participant who has died or from a participant who has become disabled if the death or disability is verified in accordance with Part H of this rule.
4. All amounts withdrawn and not used for the purchase of a first principal residence are ordinary income to the participant. The 10% additional tax is not to be offset by any nonrefundable tax credits.

5. The 10% additional tax shall not apply to a withdrawal of excess contributions where the withdrawal is made within the time for filing a return for the taxable year in which the excess contribution was made. This paragraph shall apply only if the interest attributable to the excess contribution is withdrawn at the same time.

6. The 10% additional tax shall not apply to amounts returned to a prospective participant pursuant to a revocation of the trust within seven days of its establishment, as provided in Part C.1.f of this rule. Until the revocation period has expired, the account shall be treated as not constituting an IHA and the return of the initial deposit shall not be treated as a "withdrawal."

7. Any amounts remaining in the account on the termination date shall be treated as a withdrawal and shall be included in gross income in the taxable year in which the termination date falls and shall be subject to the additional tax for failure to use for a first principal residence.

G. Excess Contributions.

1. An additional tax shall be due from the participant of an IHA in which there are "excess contributions" on deposit. The additional tax shall be an amount equal to 6% of the amount of the excess contributions in the account.

2. The additional tax shall be due in the taxable year in which the excess contribution is made and in each taxable year that the excess contribution remains in the account. When excess contributions are made in more than one taxable year, the amount of the excess contributions made in the current taxable year shall be added to the amount of excess contributions remaining in the

account from previous taxable years in determining the amount of the excess contributions subject to the additional tax.

3. "Excess contributions" are those amounts deposited in an IHA during a particular taxable year which exceed $2,500 or during the 10 year life of the IHA which exceed $10,000. However, an amount in excess of $2,500 deposited during a taxable year shall not be considered an excess contribution and shall not be subject to the 6% additional tax if the excess amount, together with the interest earned on the excess amount, is withdrawn from the account by the date that the tax return is due for the taxable year of the excess contribution. Thus, the 6% additional tax may be avoided by withdrawing the excess amount before the tax return is due. The interest earned on the excess contribution shall not be allowed as a deduction in the taxable year in which the contribution was made, or thereafter. The withdrawn contribution shall not be included in gross income except to the extent that any portion was deducted or otherwise not taxed in the year of the contribution.

4. An excess contribution may also be withdrawn in a year subsequent to the year in which the excess contribution was made. The 6% additional tax shall not be due on the amount of the excess contribution that was withdrawn before the close of the taxable year. There is no requirement that the interest earned on the excess contribution be withdrawn from the account with the excess contribution, as in the previous paragraph.

5. Any withdrawal from an IHA in which there are excess contributions on deposit shall be deemed a withdrawal of the excess contributions to the extent thereof. Thus, any withdrawal will reduce the

amount subject to the excess contribution additional tax, yet will not reduce any allowable deduction or exemption to the extent of the excess contribution.

6. An excess contribution made in one taxable year may be used in another taxable year as a deductible contribution. An amount so used must be included with any deposits made in the current year in determining whether the deduction limitations of $1,500 and $10,000, provided in Part D.1. of this rule, have been met. The deduction allowed for an excess amount in an IHA shall be the amount of the difference between the maximum amount allowable as a deduction and the amount that is actually deposited during the taxable year. A deduction shall not be allowed for an excess contribution in a taxable year prior to the year in which the excess contribution is made.

H. Special Rules.

1. Disability or Death.

a. A withdrawal by a participant who is disabled within the meaning of Minn. Stat. 290A.03, Subd. 10 shall not be subject to the 10% additional tax for not using it for the purchase of a first principal residence. The withdrawal shall, however, be included in the participant's gross income in the year of the withdrawal under the same rules as for a participant who is not disabled. A disabled participant shall be subject to the 6% additional tax on excess contributions.

A participant shall not be treated as disabled unless he furnishes to the trustee at or prior to the time of the withdrawal a signed declaration of his/her disability including

a description of the disability, the name of his/her treating physician and a statement, signed by that physician, stating that the disability prevents the participant from engaging in any kind of substantial gainful work or that the participant is "blind" within the meaning of Minn. Stat. 290A.03, Subd. 10. The trustee shall file a copy of this declaration with the Commissioner of Revenue. Upon request, the participant claiming disability shall furnish to the Commissioner of Revenue a signed statement of a physician describing in detail the nature of the disability and, except in the case of blindness, how it prevents the participant from engaging in any substantial gainful work. In addition, the individual shall furnish such other information as the Commissioner shall determine is necessary to verify that the disability is within the meaning of 290A.03, Subd. 10.

b. Except in the case of an account held jointly between spouses, upon the death of a participant of an IHA, the account shall terminate and become immediately payable to the estate of the deceased participant. The amount in the account as of the date of death, including any accrued interest, shall be treated as a withdrawal and included in the deceased participant's gross income on his/her final income tax return. The 10% additional tax for failure to use a withdrawal for the purchase of a first principal residence shall not be applicable to the deceased participant or his/her estate.

In the case of an account held jointly for the benefit of two spouses, upon the death of one of the spouses, the account

shall continue for the benefit of the surviving spouse. Limitations and restrictions on the IHA shall apply to the surviving spouse as if he or she had made all prior deposits and withdrawals. No additional tax shall be due solely by reason of the death. Also, no additional tax shall be due by reason of a withdrawal attributable to the death. A withdrawal by surviving spouse shall be deemed to be attributable to the death if it is made within six months after the death. Any other withdrawal, not attributable to the death, shall be subject to the additional tax if it is not used for the purchase of a first principal residence. Also, the surviving spouse shall remain subject to the additional tax on excess contributions.

2. Transfers of IHAs.

   a. The term "transfer" shall mean a transfer of the entire amount in an IHA in one financial institution or credit union to a new IHA in another financial institution or credit union.

   b. The participant of an IHA may transfer an IHA from one financial institution or credit union to another. The transfer of an IHA pursuant to this rule shall not be treated as a withdrawal from the first account or as a deposit to the second account as long as each of the requirements of this rule are met with respect to each account. The amount transferred pursuant to this rule shall not be included in gross income in the year of the transfer or subject to the 10% additional tax for not being used for the purchase of a first principal

residence in Minnesota. The 6% additional tax on excess contributions shall apply only if and to the extent that excess contributions are transferred as part of the account.

c. A transfer shall qualify under this rule only if the entire interest in the IHA is transferred to a new IHA and the original IHA is closed and terminated. A participant shall not have more than one IHA at any one time. The funds in an account to be transferred shall be promptly transferred from one financial institution or credit union to another. Any use of the funds for any purpose in the interim shall be treated as a withdrawal not used for a first principal residence and shall be included in gross income and subject to the additional tax.

d. The IHA account receiving the transfer shall terminate 10 years from the date the original IHA account was established and the written trust agreement shall so provide. The participant shall inform the new trustee that the deposit is a transfer of the IHA, rather than a new IHA, and the date of the first deposit to the original IHA.

e. The trustee of the account to be transferred shall not be subject to the withholding requirements of this rule if it received a written declaration from the participant of his or her intention to roll over the account and the name and address of the financial institution or credit union to which the account will be transferred. The original trustee shall make the instrument of payment payable to the new trustee, either

alone or jointly with the participant. The original trustee shall within 10 days file a copy of the declaration with the Commissioner of Revenue.

3. Nonresidents.

An individual who is not a resident of Minnesota shall be allowed to establish an IHA in Minnesota and shall be allowed a deduction for deposits to the account against any income that is assignable in Minnesota. A Minnesota resident who establishes an IHA but later changes his/her residence to another state may maintain the IHA in Minnesota.

A nonresident participant shall be subject to the same rules as a resident with respect to the includibility of withdrawals in gross income and the imposition of additional taxes. Any portion of a withdrawal that is required to be included in gross income shall be assignable to Minnesota. Any amounts upon which an additional tax is imposed shall be assignable to Minnesota.

4. Married Participants.

Whenever two single participants marry, their two accounts shall be treated for tax purposes as one joint account. This treatment, however, shall extend only to the two married participants and shall have no effect whatsoever on the trustees of either account, who shall continue to administer each account as if there was a single participant. Both accounts shall be treated as having terminated 10 years from the date of the first deposit to the account that was established first. Only those deposits made in the taxable year of the marriage and thereafter will be considered in determining the excess contributions. The $1,500, $2,500 and

$10,000 limitations shall apply separately to each participant for taxable years prior to the marriage and shall apply to the two participants together, the same as for other married participants, for the taxable year of the marriage and for all taxable years thereafter in which they are married. If, in the taxable year of the marriage, deposits made by both participants, together, total $10,000 or more, all further deposits shall be excess contributions subject to the 6% additional tax. Interest shall be deductible in the year of the marriage and thereafter only to the extent that it is attributable to the first $10,000 of total combined deposits.

The amounts in the two accounts prior to the tax year of the marriage shall not be considered an excess contribution in the year of the marriage solely because of the two accounts being treated as one.

For example, A set up an IHA in 1981 and deposited $1,500 per year to the account. B set up an IHA in 1981 and deposited $2,500 per year to the account. In 1985, A and B marry. A's account balance in 1985, not including interest or transactions in 1985, is $6,000. B's account balance in 1985, not including interest or transactions in 1985, is $10,000. Upon marriage, the two accounts will be treated as one account for tax purposes. The balance on the marriage date will be $16,000, not including interest. Because the total deposits by the two spouses exceed $10,000, no further deposits will be allowed. Any deposit made in 1985 or thereafter is an excess contribution subject to 6% additional tax. No additional tax shall be imposed for the year of the marriage as long

as no deposits are made during that year or any that were made in 1985 are withdrawn by April 15, 1986. Interest will be deductible only to the extent it is attributable to the first $10,000 of deposits. Interest on the other $6,000 of deposits in the account is not deductible.

5. Termination of Account.

a. The IHA shall terminate in the following cases:

(1) The account shall terminate whenever all or part of the account is used for the purchase of a first principal residence which is located in Minnesota. No deduction shall be allowed for deposits made or interest paid or accrued after the termination.

(2) The account shall terminate 10 years from the date of the first deposit to the account. In the case of an IHA which has received a transfer from another IHA under Part H.2. of this rule, the account shall terminate 10 years from the date of the first deposit to the first account. All amounts in the account on the termination date shall be distributed to the participant. Transfer of the total amount in the IHA to an non-IHA account shall satisfy this distribution requirement. However, it shall be treated as a withdrawal not used for the purchase of a first principal residence.

b. Any amounts remaining in the account on the termination date shall be treated as a withdrawal and shall be included in gross income in the taxable year in which the termination date falls and shall be subject to the additional tax for failure to use for a first principal residence.

6. Marriage Dissolution Transfers.

A transfer of a participant's interest in an IHA to his former spouse pursuant to either a dissolution of marriage decree or a written instrument incident to a dissolution of marriage shall not be treated as a withdrawal and shall not be includible in gross income or subject to additional tax solely by reason of the transfer, as long as the IHA is maintained as such by the transferee. However, the withdrawal of any amounts from the IHA by the transferee shall be treated as any other withdrawal and subject to all of the provisions of this rule. Limitations and restrictions on the IHA shall apply to the transferee as if he or she had made all prior deposits and withdrawals. For example, if the transferee had deducted $9,000 for deposits to the account over a six year period prior to the marriage dissolution transfer, the transferee could deposit only $1,000 more before reaching the $10,000 deduction limitation. The IHA would automatically terminate four years after the transfer since the transferee is treated as having made the first deposit to the account six years prior to the transfer.

I. Exhibits

Exhibit A

PROTOTYPE

INDIVIDUAL HOUSING ACCOUNT

TRUST AGREEMENT

This Agreement is entered into this _____ day of _____, 19___, between:

Individual's Name: _____

Spouse's Name: _____
(If married, both spouses must be listed.)

Social Security Numbers: _____ and _____

Address: _____

_____

hereafter referred to, singularly and collectively, as "Participant," and

Name of Financial Institution: _____

_____

Banking Division's Approval Number: _____
(If none is required, so indicate.)

hereafter referred to as "Trustee,"

For the purpose of establishing a trust which qualifies as an Individual Housing Account under Minnesota Statutes, Section 290.09, Subd. 30 (also referred to as the Young Family Housing Act).

Participant has transferred and delivered to Trustee the sum of _____ Dollars ($_____) in cash, as an initial contribution to the trust account hereby established.

NOW, THEREFORE, IT IS AGREED by and between Participant and Trustee that each party will abide by the laws and rules applicable to Individual Housing Accounts and that contributions made to the trust will be held and distributed pursuant to the terms of this Agreement as follows:

ARTICLE I. REPRESENTATIONS

1.1 Trustee is a financial institution authorized by law to act as Trustee for Individual Housing Accounts.

1.2 Trustee actively makes residential real estate mortgage loans in Minnesota.

1.3 Participant does not now own and has never owned a principal residence wherever located.

1.4 Participant does not now have another IHA either with this institution or any other institution.

ARTICLE II. REVOCATION

2.1 Unless Trustee has furnished a disclosure statement to Participant at least seven days prior to the date of this Agreement, the Trust shall not take effect until seven days after the date of this Agreement.

2.2 During the seven day period provided in paragraph 2.1, Participant may revoke this Agreement and receive back any deposits made to Trustee. The Agreement shall not constitute an Individual Housing Account. The Trustee will not withhold tax upon the revocation.

2.3 If during the period provided in paragraph 2.1, Participant does not revoke the Agreement, the trust shall relate back in time to the date of this Agreement.

ARTICLE III. CONTRIBUTIONS

3.1 Trustee will accept additional deposits which shall become part of the corpus of this trust.

3.2 Participant will contribute and Trustee will accept no more than $2,500 of total deposits to the trust in any taxable year and no more than $10,000 of total deposits to the trust for all taxable years.

3.3 All deposits will be made in cash.

ARTICLE IV. INVESTMENTS

4.1 The assets of the trust will be invested only in savings or time deposits in amounts fully insured by a Minnesota agency or a federal agency established for the purpose of insuring accounts in financial institutions.

4.2 The assets of the trust may be commingled for purposes of investment provided that individual records are maintained by Trustee for Participant, as prescribed by the Commissioner of Revenue.

ARTICLE V. WITHDRAWALS

5.1 Participant may withdraw amounts from the trust at any time by written notice to the Trustee.

5.2 Trustee shall deduct and withhold from any amount withdrawn a tax in the amount of 10 percent of the amount withdrawn unless Trustee receives from Participant a written verification statement pursuant to paragraphs 5.3 or 5.4.

5.3 Trustee will not deduct and withhold tax from any amount withdrawn if he receives from Participant a written statement, in accordance with rules of the Commissioner of Revenue, verifying that the amount withdrawn is being used for the purchase of Participant's first principal residence and the residence is located in Minnesota. In this case Trustee will make the amount withdrawn payable to the seller, or the seller's designee (other than the buyer/Participant).

5.4 Trustee will not deduct and withhold tax from any amount withdrawn if he receives a written statement verifying, in accordance with

rules of the Commissioner of Revenue, that Participant has died or has become disabled.

5.5 Trustee will remit and pay the tax deducted and withheld under paragraph 5.2 to the Commissioner of Revenue as required by law.

ARTICLE VI. TERMINATION

6.1 This trust will terminate no later than 10 years after the date of this agreement.

6.2 Upon termination, Trustee will deduct and withhold from the trust corpus a tax in the amount of 10 percent of the corpus and remit and pay the tax to the Commissioner of Revenue, as required by law.

6.3 Upon termination, Trustee will distribute the corpus of the trust to Participant, less the taxes deducted and withheld under the preceding paragraph, in accordance with rules of the Commissioner of Revenue.

6.4 The trust shall terminate upon the death of Participant, or the survivor of the Participants, in which case Trustee will pay over the entire corpus of the trust and earnings thereon to the decedent's estate. No taxes will be withheld.

ARTICLE VII. RECORDS AND REPORTS

7.1 Trustee will keep records and accounts of its administration of the trust.

7.2 Trustee will provide reports to Participant and to the Commissioner of Revenue at the times and in the manner prescribed by the Commissioner of Revenue.

7.3 Participant will furnish to Trustee the information prescribed by the Commissioner of Revenue.

ARTICLE VIII. OTHER PROVISIONS

(Other provisions that do not conflict with any laws, rules or other provisions of this trust agreement may be added here.)

IN WITNESS WHEREOF, the parties hereto set their hand the day and year first written above.

_____
Participant

_____
Participant

_____
Trustee

By_____

Its_____

Exhibit B

DISCLOSURE STATEMENT FOR

INDIVIDUAL HOUSING ACCOUNTS

NOTICE: YOU MAY REVOKE this account by contacting the following person within seven days from the date of your trust agreement. (See Part VIII of this statement for explanation.)

Name: _____

Address: _____

Telephone Number: _____

I. INTRODUCTION

The Individual Housing Account (IHA) is designed to help a first-time home buyer save up money for the purchase of his or her home by not taxing as income the first $1,500 that you contribute to an IHA each taxable year, and by not taxing the interest earned on the account, with certain limitations that are explained in this statement.

BEWARE, however, that there will be a substantial tax penalty due if you use any of the money from this account for any other purpose than your first home. In fact, the trustee must withhold and send to the Department of Revenue 10 percent of any withdrawal that you make if you are not going to use the amount for the purchase of your first residence.

II. ELIGIBILITY

To be eligible to set up an IHA, you or your spouse must not now own and never have owned your own principal residence.

Furthermore, you or your spouse must not now have another IHA, whether at this institution or any other financial institution.

III. TAX DEDUCTION AND LIMITS THEREON

Amounts that you deposit in your IHA may be deducted for Minnesota income tax purposes for the tax year in which you make the deposit. However, to be deductible, the amount must have been on deposit in the account for at least six months during the tax year. And your deduction for deposits to the account cannot exceed $1,500 for any one tax year and your total deductions for deposits for all tax years cannot exceed $10,000.

In addition to the deduction for the amounts that you deposit in your IHA, you are allowed an income tax deduction for the interest earned on your IHA during the tax year. This deduction for interest, however, is limited to interest on deposits of $2,500 or less per year or on total deposits of $10,000 or less for all taxable years. Interest cannot be deducted on amounts in excess of these limits.

IV. PENALTY TAX FOR NOT USING IHA FOR FIRST RESIDENCE

Your IHA is supposed to be used to purchase your first principal residence. The residence must be located in Minnesota. If you withdraw money from your IHA and do not use it for the purchase of your first principal residence, which is located in Minnesota, there is a substantial tax penalty due. Not only will you have to include the amount you withdraw in your income for Minnesota tax purposes and pay income tax on it,

but you will also have to pay an additional tax of 10 percent of the amount withdrawn. The additional 10 percent tax will not, however, be due if the withdrawal was made because of your disability or death.

Your IHA can last only 10 years. Therefore, you must use the IHA to purchase your first residence within 10 years after the IHA is opened. If you do not use the IHA within 10 years, the IHA automatically terminates and the taxes and penalties explained in the preceding paragraph are applicable just as if you had made a withdrawal of all of the money in the account.

You are not allowed to use or pledge your IHA as security for a loan. If you do so, the amount so pledged will be treated as a withdrawal. You will have to include the amount pledged in your Minnesota taxable income and pay the 10 percent additional tax, just as if you had made a withdrawal of that amount and not used it for your first principal residence.

V. TRUSTEE MUST WITHHOLD TAX ON CERTAIN WITHDRAWALS

If you make a withdrawal from your IHA which will not be used to purchase your first principal residence or the residence you do purchase is not located in Minnesota, the trustee must withhold as tax 10 percent of the amount of your withdrawal. The trustee must send the amount withheld to the Department of Revenue to be applied against your additional tax liability. If the withdrawal is due to your death or disability, however, the trustee is not required to withhold this tax.

The trustee also must withhold the 10 percent tax whenever the IHA terminates because the account was not used for your first residence within 10 years from the date that you established the account.

VI. LIMITATIONS ON THE AMOUNT THAT YOU MAY DEPOSIT IN THE IHA

You are permitted to deposit no more than $2,500 to your IHA in any one tax year. Moreover, you are permitted to deposit no more than a total of $10,000 to your IHA for all taxable years. If you deposit more than you are allowed, you must pay an additional tax of six percent of the amount which exceeds these limits. This six percent additional tax is in addition to your regular income tax liability and is due for every year in which the excess deposit remains in your account.

VII. TRANSFERS OF YOUR ACCOUNT TO A DIFFERENT FINANCIAL INSTITUTION

You may transfer your IHA to another financial institution. If you follow the rules explained in this paragraph, your transfer of funds will not be treated as a withdrawal and not subject to tax or penalty. To transfer the IHA tax free, you must:

(1) Have the entire amount in the account made payable to the new trustee or financial institution.

(2) Transfer the entire account to a different financial institution and close out the original account. You cannot have more than one IHA at a time.

(3) Have the new IHA terminate 10 years from the date that you opened the original IHA. To do this you must inform the new trustee of the date on which you opened your

original IHA and have him put the proper termination date in the new trust agreement.

VIII. REVOCATION OF YOUR IHA

You must be given seven days to read this statement and consider your decision to participate in the IHA program. Your IHA does not become final until this seven day period is over. During the seven day period, you may revoke your IHA and receive your money back without it being treated as a "withdrawal." Therefore, the regular taxes and additional taxes for failure to use the account for the purchase of your first principal residence, as explained in Part IV of this disclosure statement, will not be due. After this seven day period, however, any withdrawal that you make and do not use for your first residence, will be subject to both regular tax and additional tax, as explained in Part IV.

The name of the person to contact if you wish to revoke this account is listed at the beginning of this disclosure statement.

IX. AUTHORITY AND QUALIFICATIONS OF TRUSTEE

This financial institution is authorized by law to act as the trustee of your IHA. The trustee has either been approved by the Minnesota Commissioner of Banks to act as the trustee of IHAs or under federal law is not required to obtain this approval.

Your IHA meets all of the requirements of Minn. Stat. 290.09, Subd. 30 and any applicable rules issued by the Minnesota

Commissioner of Revenue. Furthermore, the trustee agrees to abide by all laws and rules applicable to IHAs.

X. YOUR RESPONSIBILITIES

You, as the participant of this IHA, have certain duties and responsibilities imposed on you. You must be sure that the financial institution is qualified to act as the trustee of your IHA. Also, you must be sure that the trustee will abide by any laws or rules applicable to IHAs. Finally, you must be sure that your IHA is set up according to the law and rules.

If at some future time it is discovered that your trustee is not qualified or is not abiding by the laws or rules or your IHA does not meet all the requirements of the laws and rules, you will not be allowed a tax deduction for the years involved.

Finally, there are certain forms you must file and information you must furnish to either the trustee or the Minnesota Department of Revenue. As mentioned in Part V of this disclosure statement, the trustee must withhold as tax 10 percent of any withdrawal that you make unless you are using the amount withdrawn for your first principal residence. In order to avoid this withholding of tax, you must furnish to the trustee a written statement, verifying that you are using the withdrawal for your first principal residence and that the residence is located in Minnesota. In this case, the trustee must make the withdrawal payable to the seller. The trustee cannot make the withdrawal payable to you alone. The withholding of tax may also be avoided if you die or become disabled by furnishing

the trustee with a verification form certifying that you have died or become disabled. If you fail to furnish completed and signed verification forms to the trustee, the trustee is required by law to withhold the 10 percent tax.

To claim the income tax deduction on your Minnesota income tax return, you must attach a copy of the statement or statements of account that you receive from the trustee which show the date and amount of your deposits to the IHA and the date and amounts of any withdrawals during the entire tax year.

APPROVED AS TO FORM AND LEGALITY

April 27 1981

WARREN SPANNAUS, ATTORNEY GENERAL

BY /s/ Deborah Swedlund

SPECIAL ASSISTANT ATTORNEY GENERAL

STATE OF MINNESOTA
DEPARTMENT OF STATE
FILED
APR 28 1981

Joan Anderson Growe
Secretary of State

2:55 p.m.

STATE OF MINNESOTA
DEPARTMENT OF REVENUE
CENTENNIAL OFFICE BUILDING
SAINT PAUL, MINNESOTA 55145
PHONE: (612) 296-3439

April 13, 1981

Office of Attorney General
G-25 State Administration Building
50 Sherburne Avenue
St. Paul, Minnesota 55155

Re: Review of Rule on Individual Housing Accounts

Dear Sir or Madam:

In accordance with Minn. Stat. Section 15.0412, Subd. 4h and 1 MCAR Section 1.203, we enclose the following documents for your review:

1. Rule as Adopted (original and three copies). There were no changes made in the rule as originally published. The copies are of the proposed rule as published in the State Register.
2. Order Adopting (two copies).
3. Notice of Intent to Solicit Outside Opinion.
4. Written material received by agency prior to publication of proposed rule.
5. Order for Notice of Intent to Adopt a Rule Without Public Hearing.
6. Notice of Intent to Adopt a Rule Without Public Hearing.
7. Affidavit of Mailing (Notice of Intent to Adopt a Rule Without Public Hearing).
8. Certificate of Completeness and Accuracy (Mailing List Certificate).
9. Rule as Proposed.
10. Statement of Need and Reasonableness.
11. Written comments on the proposed rule received by this agency.

12. Certificate of Compliance with Rulemaking Procedure.

13. Notice of Submission to the Attorney General.

14. Affidavit of Mailing Notice of Submission to the Attorney General.

Please contact the undersigned if there are any questions.

Sincerely,

Gary P. Mesna

Gary P. Mesna, Attorney
Income Tax Division

GPM/ml

Enclosures

RECEIVED
APR 13 19
ATTORNEY GENERAL
ADMINISTRATIVE AGENCIES

12 MCAR § 2.016 (formerly 2.020) (adopted) 1191
12 MCAR § 2.185 (adopted) 1263
Part 3 Housing Finance Agency
12 MCAR §§ 3.053-3.054 (proposed) 1189
TITLE 13 TAXATION
Part 1 Revenue Department
13 MCAR § 1.6016 (proposed) 1313

PROPOSED RULES

Pursuant to Minn. Laws of 1980, § 15.0412, subd. 4h, an agency may propose to adopt, amend, suspend or repeal rules without first holding a public hearing, as long as the agency determines that the rules will be noncontroversial in nature. The agency must first publish a notice of intent to adopt rules without a public hearing, together with the proposed rules, in the *State Register*. The notice must advise the public:

1. that they have 30 days in which to submit comment on the proposed rules;
2. that no public hearing will be held unless seven or more persons make a written request for a hearing within the 30-day comment period;
3. of the manner in which persons shall request a hearing on the proposed rules;

and

4. that the rule may be modified if modifications are supported by the data and views submitted.

If, during the 30-day comment period, seven or more persons submit to the agency a written request for a hearing of the proposed rules, the agency must proceed under the provisions of § 15.0412, subds. 4 through 4g, which state that if an agency decides to hold a public hearing, it must publish in the *State Register* a notice of its intent to do so. This notice must appear at least 30 days prior to the date set for the hearing, along with the full text of the proposed rules. (If the agency has followed the provisions of subd. 4h and has already published the proposed rules, a citation to the prior publication may be substituted for republication.)

Pursuant to Minn. Stat. § 15.0412, subd. 5, when a statute, federal law or court order to adopt, suspend or repeal a rule does not allow time for the usual rulemaking process, temporary rules may be proposed. Proposed temporary rules are published in the *State Register*, and for at least 30 days thereafter, interested persons may submit data and views in writing to the proposing agency.

Department of Revenue
Income Tax Division

Proposed Rule Governing Individual Housing Accounts (13 MCAR § 1.6016)

Notice of Intent to Adopt Rule without A Public Hearing

Notice is hereby given that the Department of Revenue proposed to adopt the above-entitled rule without a public hearing. The commissioner has determined that the proposed adoption of this rule will be noncontroversial in nature and has elected to follow the procedures set forth in Minnesota Statutes, § 15.0412, subdivision 4h (1980).

Persons interested in this rule shall have 30 days to submit comments on the proposed rule. The proposed rule may be modified if the modifications are supported by the data and views submitted to the agency and do not result in a substantial change in the proposed language.

Unless seven or more persons submit written requests for a public hearing on the proposed rule within the 30-day comment period, a public hearing will not be held. In the event a public hearing is required, the agency will proceed according to the provisions of Minnesota Statutes, § 15.0412, subds. 4-4f.

Persons who wish to submit comments or a written request for a public hearing should submit such comments or request to:

Mr. Gary P. Mesna
Attorney, Income Tax Division
Minnesota Department of Revenue
Centennial Office Building
St. Paul, Minnesota 55145
(612) 296-3439

KEY: PROPOSED RULES SECTION — Underlining indicates additions to existing rule language. ~~Strike outs~~ indicate deletions from existing rule language. If a proposed rule is totally new, it is designated "all new material." ADOPTED RULES SECTION — Underlining indicates additions to proposed rule language. ~~Strike outs~~ indicate deletions from proposed rule language.

Authority for the adoption of this rule is contained in Minnesota Statutes, §§ 290.09, subd. 30, and 290.52. Additionally, a Statement of Need and Reasonableness that describes the need for and reasonableness of each provision of the proposed rule and identifies the data and information relied upon to support the proposed rule has been prepared and is available from Mr. Mesna upon request.

Upon adoption of the final rule without a public hearing, the proposed rule, this notice, the Statement of Need and Reasonableness, all written comments received, and the final rule as adopted will be delivered to the Attorney General for review as to form and legality, including the issue of substantial change. Persons who wish to be advised of the submission of this material to the Attorney General, or who wish to receive a copy of the final rule as proposed for adoption, should submit a written statement of such request to Mr. Mesna.

The proposed rule, if adopted, would impose or clarify certain duties on the trustee of an Individual Housing Account (IHA) with respect to qualification, reporting of information and withholding of tax and impose penalties for failure to comply.

The proposed rule requires that certain provisions be included in the trust agreement for an IHA. Also required is a disclosure statement, which the trustee must furnish a prospective participant.

Explained and clarified in the proposed rule are the deduction for contributions to an IHA, the exemption from tax for distributions used for the participant's first principal residence in Minnesota, and the tax treatment of distributions not so used.

Also covered by the proposed rule are certain special situations, such as disability or death, nonresidents, married participants, transfers of the account to a different trustee, and termination of the account.

Copies of this Notice and the proposed rule are available and may be obtained by contacting Mr. Mesna.

February 13, 1981

Clyde E. Allen, Jr.
Commissioner of Revenue

Rule as Proposed

13 MCAR § 1.6016 Individual housing accounts.

A. Definitions.

1. IHA. The term "IHA" shall mean an individual housing account established pursuant to this rule and the Young Family Housing Act.

2. Participant. The term "participant" shall mean an individual natural person for whose exclusive benefit an IHA is held. In the case of an IHA held jointly for an individual and his or her spouse, the term shall mean both of them.

3. Deposit. The term "deposit" shall mean a deposit or contribution of cash to an IHA, whether made by the participant or any other person.

4. Withdrawal. The term "withdrawal" shall mean a withdrawal or distribution of any amount from an IHA, whether withdrawn by or distributed to the participant or any other person or entity.

5. Principal residence. The term "principal residence" shall mean the dwelling unit that the participant actually lives in and that the participant intends to be his/her fixed abode. A principal residence shall require both a physical presence in the dwelling unit and an intention to make that dwelling unit one's home. A principal residence shall be that dwelling unit to which, during an absence, the participant intends to return and from which there is no present intention of moving. There shall be a presumption that the dwelling unit in which a person's family lives is that person's principal residence.

The dwelling unit must be located within Minnesota and may be all or part of a house, townhouse, condominium or cooperative. If a building contains more than one dwelling unit, only the dwelling unit actually occupied by the participant as his/her residence shall qualify as a residence. If a portion of the building is used for some purpose other than as a dwelling unit, for example, a portion of a building is used for a trade or business, only the portion used as a dwelling unit shall be considered a residence. The purchase price of such a building shall be properly allocated between the dwelling unit and the business portion of the building.

The participants may purchase the residence with others, for example, in joint tenancy, tenancy in common, or as a tenant-stockholder in a cooperative housing corporation. In this case, the dwelling unit shall qualify as a residence only to the extent of the participant's ownership interest therein.

In order to qualify for any of the benefits of the IHA provision, the residence must be the first dwelling unit ever owned and occupied by the participant as his/her own permanent residence. A taxpayer who previously owned or currently owns his/her own residence, whether located in Minnesota or in any other state or country, shall not qualify.

B. General requirements.

1. An IHA shall be a trust established in Minnesota for the exclusive benefit of a participant or, in the case of a married person, for the exclusive benefit of the participant and the participant's spouse, jointly.

2. An IHA shall not be established or maintained for a participant who currently owns or formerly owned a principal residence, whether or not it is (was) located in Minnesota.

3. An IHA shall not be established or maintained for a participant who is currently the participant of another IHA. An individual shall not have two IHAs at one time. However, an IHA may be established for an individual who had an IHA at some time in the past but which was terminated and not used for the purchase of a first principal residence.

4. Contents of Trust Agreement. (For recommended format of Trust Agreement, see Exhibit A.) The IHA trust shall be established pursuant to a written trust agreement which shall contain, in addition to any other provisions, a separate provision for each of the trustee's duties prescribed in Part C. of this rule and a statement that the trustee agrees to comply with the law and rules applicable to IHAs.

5. Contents of disclosure statement. (For recommended format of disclosure statement, see Exhibit B.)

a. The disclosure statement shall set forth in nontechnical language the income tax consequences of establishing an IHA, the limitations and restrictions on the program, and other matters as follows:

(1) The ineligibility of individuals who own or have owned a residence;

(2) The deductibility of deposits to an IHA, the $1,500, $2,500 and $10,000 maximum limitations, and the requirement that the amount be on deposit for six months before a deduction is allowed;

(3) The tax treatment of a withdrawal from an IHA when the amount withdrawn is used for any purpose other than the purchase of a first principal residence that is located in Minnesota;

(4) The requirement that the first principal residence be purchased within 10 years from the date that the account was first established;

(5) An explanation of the additional taxes that may be due (in addition to the regular tax liability) on withdrawals not used for the purchase of a first principal residence.

(6) An explanation of the additional taxes that may be due (in addition to the regular tax liability) on excess contributions as well as an explanation of what constitutes an excess contribution.

(7) The availability of a tax free transfer of the account to a different financial institution or credit union and an explanation of what constitutes such a transfer.

(8) If the IHA is revocable within seven days after establishment, as provided in subpart C.1.f., the disclosure statement shall include a statement of the circumstances under which the participant may revoke the account and the procedure therefor, including the name, address and telephone number of the person designated to receive the notice of revocation. This explanation shall be prominently displayed at the beginning of the disclosure statement.

(9) A statement that the trustee is authorized by law to act as trustee of IHAs and has received approval to so act from the Commissioner of Banks or is not required to obtain such approval.

(10) A statement that the trustee will abide by all laws and rules applicable to trustees of IHAs.

(11) A statement that it is the participant's responsibility to assure that the financial institution is authorized by law to act as trustee of IHAs and that the particular account set up for that participant meets all of the requirements of the law and this rule.

(12) A statement that upon audit of the participant's income taxes by the Department of Revenue, if it is found that the account or the trustee do not meet all of the requirements of the law and this rule, the deductions under this program may be denied.

b. If the trustee does not furnish a disclosure statement as required by this rule or furnishes one that does not substantially comply with this rule, he shall be liable to the commissioner for a penalty of $10 for each required disclosure statement that he did not furnish or that did not comply with this rule. A disclosure statement that is false or misleading shall not be considered to comply with this rule.

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6. A financial institution or credit union may act as the trustee of IHAs only if it meets the requirements of the law and this rule and either it has received approval to so act from the Commissioner of Banks or it is not required to obtain such approval.

7. A financial institution or credit union, in order to act as a trustee of IHAs, must actively make residential real estate mortgage loans in Minnesota. This means that the particular financial institution or credit union must originate mortgage loans in Minnesota on Minnesota real estate by lending money to the original mortgagor and taking a mortgage back as security for the loan.

The mere holding of Minnesota mortgages, obtained in the secondary market by an institution that does not originate such loans, does not qualify.

Furthermore, the institution shall, subject to the availability of funds for such purpose, regularly throughout the year be ready and willing to make residential real estate mortgage loans in Minnesota. Whether or not an institution is actively engaged in making such loans shall be determined by reference to the general market conditions affecting all real estate lenders, rather than by the actual number of such mortgage loans made by the particular institution during a particular period of time: The fact that there is no mortgage money available or that the interest rate is so high that no one desires a mortgage loan shall not, alone, prevent a financial institution from being a trustee. The fact the institution seeking approval to administer IHAs made no such loans during a period of time while other financial institutions were making such loans shall be evidence that the particular financial institution is not actively making residential real estate loans in Minnesota.

8. The participant shall, upon request of the commissioner, submit copies of the trust agreement and disclosure statement and such other evidence as the commissioner may request to establish whether or not the particular IHA meets the requirements of the law and this rule. None of the tax benefits of the IHA provisions shall be available to a participant who is unable to show that both the IHA and the trustee meet the requirements of the law and this rule.

C. Duties of trustee.

1. In general.

a. The trustee shall accept only cash deposits to an IHA. No other property shall be accepted in an IHA trust, such as stocks, bonds, notes, debentures, mutual funds, real estate, or otherwise.

b. The trustee shall not accept deposits to an IHA in excess of $2,500 for a single taxable year or in excess of $10,000 for all taxable years.

c. The trustee shall not establish an IHA for an individual unless he receives a written statement from the individual indicating that the individual does not currently own and has never owned his/her own principal residence, whether in Minnesota or in any other state or country.

d. The trustee shall distribute the entire account to the participant within 10 years after the first deposit to the account. Transfer of the entire amount in the IHA into a different account, which is not an IHA, shall constitute such a distribution but the transfer shall be treated as a withdrawal not used for the purchase of a first principal residence, as provided in Part F. of this rule, and the trustee must withhold tax as prescribed by subpart 3. of this part.

e. For each withdrawal, the trustee shall withhold tax as prescribed by subpart 3. of this part unless it verifies in accordance with this rule that the withdrawal is being used for the purchase of a first principal residence that is located in Minnesota and makes the instrument of payment payable to the seller or the seller's designee (other than the participant), construction contractor or other vendor of the property. If only a portion of the withdrawal will be used for the purchase of a first principal residence, tax shall be withheld on the portion that will not be so used. This subparagraph is not applicable to a withdrawal attributable to disability or death which is verified in accordance with this rule.

f. The trustee at least seven days prior to the establishment of an IHA shall provide a written disclosure statement in accordance with this rule and a copy of the governing instrument to each person who proposes to establish an IHA with the trustee. In the alternative, the trustee may provide the written disclosure statement to the participant at the time that the IHA is established, but only if the trust agreement provides that the trust shall not constitute an IHA for seven days following execution of the agreement, during which period of time the grantor may revoke the trust.

g. In the case of an amendment to the terms of the account or trust agreement, whether or not made pursuant to a statutory or rule change, a revised disclosure statement shall be furnished to the participant. The revised statement need not repeat material furnished in a prior statement, but it must set forth those matters affected by the amendment.

h. The trustee may invest assets of the trust only in savings or time deposits. Certificates of deposit shall qualify as savings or time deposits. The savings or time deposits must be the trustee's own accounts or certificates; investment in accounts or certificates of other institutions is not permitted. The savings or time deposits must be fully insured by an agency of the state

or federal government. Assets of an IHA trust shall not be invested in any other types of assets, e.g., stocks, bonds, notes, debentures, mutual funds or otherwise.

i. The trustee may commingle funds held in IHA trusts for purposes of investment but the trustee shall maintain individual records on each IHA in accordance with this rule.

2. Reporting requirements.

a. Annual report to Commissioner of Revenue.

(1) The trustee shall file a report with the Commissioner of Revenue by February 28 of each year for each IHA administered by him at any time during the preceding calendar year, including the following information on each IHA:

(a) Name, address, and such other identifying information of the trustee as the commissioner may prescribe.

(b) Name, address and social security number of the participant(s).

(c) Date account was established.

(d) Whether a withdrawal was used for the first purchase of a principal residence in Minnesota. If so, the trustee shall submit with this report the verification form required under subpart c. of this part.

(e) Whether a withdrawal was claimed to be attributable to death or disability. If so, the amount thereof shall be indicated and the trustee shall submit with this report the written declaration required under Part H. of this rule.

(f) Date and amount of each deposit during the preceding calendar year.

(g) Date and amount of each withdrawal during the preceding calendar year.

(h) Amount of interest paid, accrued or credited to the account during the preceding calendar year.

(2) One copy of the report shall be filed with the Commissioner of Revenue; two copies shall be furnished to the individual participant.

b. Report and verification by trustee of withdrawals used for first principal residence in Minnesota.

(1) Before allowing a withdrawal from an IHA, the trustee shall either withhold tax as prescribed by paragraph 3, below, or verify that the withdrawal is being used for the purchase of a first principal residence that is located in Minnesota (unless the trustee determines in accordance with Part H. that the account holder has died or become disabled). The verification shall be supplied on a form prescribed by the commissioner which is completed by the participant and filed with trustee. The following information shall be included on the form:

(a) Location and description of property being purchased.

(b) Name and address of person or entity from whom the property is being purchased.

(c) Name of realtor, closing company, etc., if any.

(d) Type of ownership anticipated, i.e., whether title will be held alone, as tenancy in common, joint tenancy, or cooperative.

(e) Total purchase price, including any mortgages or contracts given or assumed.

(f) Amount to be financed, i.e., amount to be paid later than closing date, whether by mortgage, contract for deed or otherwise.

(g) Anticipated closing costs and description thereof.

(h) Closing date.

(i) Amount withdrawn from the account during the taxable year.

(j) Portion of amount withdrawn which will be used to purchase the first principal residence.

(k) The person or entity to whom the withdrawal or distribution is to be made payable.

(l) Name and address of trustee.

(m) Name, address and social security number of participant.

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(2) The trustee shall file a copy of this form with the Commissioner of Revenue at the time that he files the annual information return for the particular account.

3. Withholding requirements.

a. The trustee shall withhold tax in an amount equal to 10% of the amount of any withdrawal and remit the amount within 10 days to the Commissioner of Revenue unless the trustee satisfies one of the following requirements:

(1) Verifies in accordance with this rule that the withdrawal is used for the first purchase of a principal residence located in Minnesota, and makes the withdrawal payable to the person or entity from whom the residence is being purchased, either alone or jointly with the participant, or

(2) verifies in accordance with this rule that the participant has died or is disabled, or

(3) determines that the withdrawal is of an excess contribution and is withdrawn by the due date of the tax return for the taxable year in which the excess contribution was made.

b. The trustee shall be personally liable for the amount of any tax required to be withheld under this section.

4. Penalties. For each instance in which a trustee fails to timely file or furnish a report or return required by this rule with either the Commissioner of Revenue or with the individual participant, a penalty of $10 shall be due from the trustee and shall be paid to the Commissioner of Revenue.

D. Deduction for contributions to an IHA.

1. The annual deduction for deposits to an IHA shall not exceed $1,500. Moreover, the total amount of all deductions for deposits to an IHA that may be claimed by the participant and his spouse in all taxable years shall not exceed $10,000. These limitations shall not apply to amounts deducted which constitute interest accrued on the IHA.

2. An additional deduction shall be allowed for interest accrued on the IHA during its 10 year existence. However, no deduction shall be allowed for the portion of any interest which is attributable to an excess contribution, as defined in Part G. of this rule. And, no deduction shall be allowed for interest paid or accrued after the termination of the IHA.

3. No deduction shall be allowed under the IHA provisions for any amounts which have already been excluded from gross income or deducted in computing taxable income whether under federal law or under another provision of state law. A taxpayer shall not deduct or exclude the same item twice. For example, if an unmarried participant excludes $200 of interest income, earned from an IHA, in computing federal adjusted gross income under the federal provision allowing a partial exclusion of dividend and interest income received by individuals, he cannot take a deduction for the same $200 of interest under the IHA provisions. If more than $200 of interest was credited to his IHA during the taxable year, he may deduct the excess over $200 under the IHA provisions.

4. To the extent that a deposit is deductible under this rule, no deduction shall be allowed for interest expense in connection with a loan the proceeds of which are deposited to the IHA.

5. The deduction shall be allowed only for amounts on deposit for at least six months at the close of the taxable year. For calendar year taxpayers, the deposit must have occurred prior to July 1 of the taxable year.

Amounts on deposit for less than six months at the close of the taxable year may be deducted only in the next succeeding taxable year and shall be included when determining the $1,500 maximum deduction amount for that next succeeding taxable year. Thus, a deduction not exceeding $1,500 is allowed for deposits to an IHA in the last six months of the preceding taxable year or in the first six months of the current taxable year.

The deduction for interest paid or accrued on an IHA shall be allowed only for interest paid or accrued during the taxable year. Thus, for a deposit made during the last six months of a taxable year, the interest paid or accrued during the last six months of the taxable year shall be allowed as a deduction for that taxable year even though the deposit itself is not deductible until the next taxable year.

6. Married participants shall not each get a $1,500 deduction for each taxable year. The sum of the deductions, not including interest, allowed to the two married participants shall not exceed $1,500. This rule shall apply whether the married participants file separately on separate forms, separately on a combined form, or jointly.

For married participants who file separate returns, only the individual to whom the money that is deposited actually belongs shall be allowed the deduction. For married participants who file separate returns on a combined form or who file joint returns, the deduction shall be allowed to the spouse to whom the money that is deposited actually belongs or the deduction may be divided between them as they elect.

Married participants shall not each be allowed deductions totaling $10,000. Rather, the sum of all deductions, not

including interest, claimed by the two married participants for deposits to an IHA for all taxable years shall not exceed $10,000. Any amount deposited in excess of $10,000 shall be treated as an excess contribution and subject to the 6% additional tax.

E. Exemption from tax for distributions used for a first residence.

1. Amounts withdrawn from an IHA which are used exclusively in connection with the first purchase of a principal residence in Minnesota shall not be included in gross income in the taxable year withdrawn.

2. The term "used exclusively in connection with the first purchase of a principal residence" shall mean only those amounts used for items directly related to the initial purchase of the participant's own first residence. In addition to the actual down payment, the term may include fees and other acquisition expenses incurred and actually paid by the participant for the first residence, such as sales commissions, points (those not deductible as interest), title insurance, legal fees, inspection fees, and current or delinquent real estate taxes; provided, however, that each item shall be included in this term only to the extent that the item is not deductible under another provision of state or federal law.

The term shall not include interest (or points, to the extent the points are deductible as interest), since interest is deductible under another provision of law. The term shall not include expenditures for repairs or maintenance of the residence which do not increase its value or extend its useful life, i.e., noncapital expenditures. Also, the term shall not include expenditures for personal property, such as furniture, appliances or other furnishings.

If the participant is building his own new residence or purchasing and remodeling an existing residence (or having a contractor do it for him or her), the term may include amounts paid for building materials and labor, as well as for the lot or the existing residence being remodeled.

In order to qualify as an amount "used exclusively in connection with the first purchase of a principal residence," the amount withdrawn shall be made payable to the person or entity from whom the property is being purchased. This may include the seller, vendor, contractor, or designee of one of them (other than the participant), or the person or entity from whom the building materials or labor are being purchased. The amount may be made payable to such person or entity, alone, or jointly with the participant.

Use of an amount from an IHA pursuant to a written earnest money agreement shall be considered as used for the first purchase of a principal residence, if all other requirements are met. If the sale is not completed and the money is either forfeited pursuant to the earnest money agreement or immediately redeposited in the IHA, no tax consequences shall result, i.e., the withdrawl for earnest money is ignored. However, if the earnest money is used for any other purpose, the amount withdrawn shall be treated as "not used for the purchase of a first principal residence," as provided in Part F. of this rule. The trustee, however, is not required to withhold the 10% additional tax on a withdrawal used for earnest money as long as the trustee makes the withdrawal payable to the escrow agent and obtains from the participant a completed verification that the withdrawal is being used for the purchase of a first principal residence.

3. In order to be exempt from taxation, the amounts shall be used for the purchase of the principal residence within a reasonable time after withdrawal and shall not be used for any other purpose in the interim.

4. Only the participant of the particular IHA may use the account for the purchase of his/her own first principal residence. It cannot be used to purchase a residence for someone else, for example, by gift, loan, or rental to another.

5. A participant shall not deduct or exclude the same item twice, under different provisions of law. For example, when the participant makes a withdrawal from an IHA and uses it for the first purchase of a principal residence, if any portion of the withdrawal is used to pay interest expense in connection with the purchase of the residence, no deductions shall be allowed for the portion so used, since interest expense is deductible under another provision of law.

6. No adjustment to the basis of the residence that is purchased is required because of the use of amounts from an IHA.

7. A withdrawal used for the first purchase of a principal residence shall not be included in computing the low income alternative tax, the property tax refund, or in the income limitations for purposes of the homemaker credit, the dependent care credit, the farm loss modification, or the charitable deduction.

8. In order to claim exemption from income tax of amounts used for a first principal residence in Minnesota, the participant shall attach to his income tax return for the taxable year a copy of the verification form that he or she provided to the

trustee as well as a copy of the closing statement, if any, from the purchase of the residence. The participants shall also furnish any additional information that the commissioner may request to verify that all requirements of this rule have been met.

F. Tax treatment of distributions not used for a first principal residence.

1. With certain limited exceptions, amounts withdrawn from an IHA which are not used for the purchase of a first principal residence, are includible in the participant's gross income and subject to an additional 10% tax in the taxable year of the withdrawal. The additional tax is in addition to any tax that is otherwise due on the amount of any withdrawal that must be included in gross income.

2. The amount to be included in gross income is not necessarily the total amount of the withdrawal. Rather, the amount includible in gross income is the portion of the withdrawal attributable to a contribution or accrued interest that was actually deducted under the IHA provisions, either in the current or a prior taxable year. The portion of a withdrawal that is not attributable to either a deductible contribution or deductible interest is not includible in gross income or subject to the 10% additional tax.

3. There is an exception to these rules where the participant has died or become disabled. The 10% additional tax shall not be due from the estate of a participant who has died or from a participant who has become disabled if the death or disability is verified in accordance with Part H. of this rule.

4. All amounts withdrawn and not used for the purchase of a first principal residence are ordinary income to the participant. The 10% additional tax is not to be offset by any nonrefundable tax credits.

5. The 10% additional tax shall not apply to a withdrawal of excess contributions where the withdrawal is made within the time for filing a return for the taxable year in which the excess contribution was made. This paragraph shall apply only if the interest attributable to the excess contribution is withdrawn at the same time.

6. The 10% additional tax shall not apply to amounts returned to a prospective participant pursuant to a revocation of the trust within seven days of its establishment, as provided in Part C.1.f. of this rule. Until the revocation period has expired, the account shall be treated as not constituting an IHA and the return of the initial deposit shall not be treated as a "withdrawal."

7. Any amounts remaining in the account on the termination date shall be treated as a withdrawal and shall be included in gross income in the taxable year in which the termination date falls and shall be subject to the additional tax for failure to use for a first principal residence.

G. Excess contributions.

1. An additional tax shall be due from the participant of an IHA in which there are "excess contributions" on deposit. The additional tax shall be an amount equal to 6% of the amount of the excess contributions in the account.

2. The additional tax shall be due in the taxable year in which the excess contribution is made and in each taxable year that the excess contribution remains in the account. When excess contributions are made in more than one taxable year, the amount of the excess contributions made in the current taxable year shall be added to the amount of excess contributions remaining in the account from previous taxable years in determining the amount of the excess contributions subject to the additional tax.

3. "Excess contributions" are those amounts deposited in an IHA during a particular taxable year which exceed $2,500 or during the 10 year life of the IHA which exceed $10,000. However, an amount in excess of $2,500 deposited during a taxable year shall not be considered an excess contribution and shall not be subject to the 6% additional tax if the excess amount, together with the interest earned on the excess amount, is withdrawn from the account by the date that the tax return is due for the taxable year of the excess contribution. Thus, the 6% additional tax may be avoided by withdrawing the excess amount before the tax return is due. The interest earned on the excess contribution shall not be allowed as a deduction in the taxable year in which the contribution was made, or thereafter. The withdrawn contribution shall not be included in gross income except to the extent that any portion was deducted or otherwise not taxed in the year of the contribution.

4. An excess contribution may also be withdrawn in a year subsequent to the year in which the excess contribution was made. The 6% additional tax shall not be due on the amount of the excess contribution that was withdrawn before the close of the taxable year. There is no requirement that the interest earned on the excess contribution be withdrawn from the account with the excess contribution, as in the previous paragraph.

5. Any withdrawal from an IHA in which there are excess contributions on deposit shall be deemed a withdrawal of the excess contributions to the extent thereof. Thus, any withdrawal will reduce the amount subject to the excess contribution additional tax, yet will not reduce any allowable deduction or exclusion to the extent of the excess contribution.

6. An excess contribution made in one taxable year may be used in another taxable year as a deductible contribution. An amount so used must be included with any deposits made in the current year in determining whether the deduction limitations of

$1,500 and $10,000, provided in Part D.1. of this rule, have been met. The deduction allowed for an excess amount in an IHA shall be the amount of the difference between the maximum amount allowable as a deduction and the amount that is actually deposited during the taxable year. A deduction shall not be allowed for an excess contribution in a taxable year prior to the year in which the excess contribution is made.

H. Special rules.

1. Disability or death.

a. A withdrawal by a participant who is disabled within the meaning of Minn. Stat. § 290A.03, subd. 10 shall not be subject to the 10% additional tax for not using it for the purchase of a first principal residence. The withdrawal shall, however, be included in the participant's gross income in the year of the withdrawal under the same rules as for a participant who is not disabled. A disabled participant shall be subject to the 6% additional tax on excess contributions.

A participant shall not be treated as disabled unless he furnishes to the trustee at or prior to the time of the withdrawal a signed declaration of his/her disability including a description of the disability, the name of his/her treating physician and a statement, signed by that physician, stating that the disability prevents the participant from engaging in any kind of substantial gainful work or that the participant is "blind" within the meaning of Minn. Stat. § 290A.03, subd. 10. The trustee shall file a copy of this declaration with the Commissioner of Revenue. Upon request, the participant claiming disability shall furnish to the Commissioner of Revenue a signed statement of a physician describing in detail the nature of the disability and, except in the case of blindness, how it prevents the participant from engaging in any substantial gainful work. In addition, the individual shall furnish such other information as the commissioner shall determine is necessary to verify that the disability is within the meaning of § 290A.03, subd. 10.

b. Except in the case of an account held jointly between spouses, upon the death of a participant of an IHA, the account shall terminate and become immediately payable to the estate of the deceased participant. The amount in the account as of the date of death, including any accrued interest, shall be treated as a withdrawal and included in the deceased participant's gross income on his/her final income tax return. The 10% additional tax for failure to use a withdrawal for the purchase of a first principal residence shall not be applicable to the deceased participant or his/her estate.

In the case of an account held jointly for the benefit of two spouses, upon the death of one of the spouses, the account shall continue for the benefit of the surviving spouse. Limitations and restrictions on the IHA shall apply to the surviving spouse as if he or she had made all prior deposits and withdrawals. No additional tax shall be due solely by reason of the death. Also, no additional tax shall be due by reason of a withdrawal attributable to the death. A withdrawal by surviving spouse shall be deemed to be attributable to the death if it is made within six months after the death. Any other withdrawal, not attributable to the death, shall be subject to the additional tax if it is not used for the purchase of a first principal residence. Also, the surviving spouse shall remain subject to the additional tax on excess contributions.

2. Transfers of IHAs.

a. The term "transfer" shall mean a transfer of the entire amount in an IHA in one financial institution or credit union to a new IHA in another financial institution or credit union.

b. The participant of an IHA may transfer an IHA from one financial institution or credit union to another. The transfer of an IHA pursuant to this rule shall not be treated as a withdrawal from the first account or as a deposit to the second account as long as each of the requirements of this rule are met with respect to each account. The amount transferred pursuant to this rule shall not be included in gross income in the year of the transfer or subject to the 10% additional tax for not being used for the purchase of a first principal residence in Minnesota. The 6% additional tax on excess contributions shall apply only if and to the extent that excess contributions are transferred as part of the account.

c. A transfer shall qualify under this rule only if the entire interest in the IHA is transferred to a new IHA and the original IHA is closed and terminated. A participant shall not have more than one IHA at any one time. The funds in an account to be transferred shall be promptly transferred from one financial institution or credit union to another. Any use of the funds for any purpose in the interim shall be treated as a withdrawal not used for a first principal residence and shall be included in gross income and subject to the additional tax.

d. The IHA account receiving the transfer shall terminate 10 years from the date the original IHA account was

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established and the written trust agreement shall so provide. The participant shall inform the new trustee that the deposit is a transfer of the IHA, rather than a new IHA, and the date of the first deposit to the original IHA.

e. The trustee of the account to be transferred shall not be subject to the withholding requirements of this rule if it received a written declaration from the participant of his or her intention to roll over the account and the name and address of the financial institution or credit union to which the account will be transferred. The original trustee shall make the instrument of payment payable to the new trustee, either alone or jointly with the participant. The original trustee shall within 10 days file a copy of the declaration with the Commissioner of Revenue.

3. Nonresidents. An individual who is not a resident of Minnesota shall be allowed to establish an IHA in Minnesota and shall be allowed a deduction for deposits to the account against any income that is assignable in Minnesota. A Minnesota resident who establishes an IHA but later changes his/her residence to another state may maintain the IHA in Minnesota.

A nonresident participant shall be subject to the same rules as a resident with respect to the includibility of withdrawals in gross income and the imposition of additional taxes. Any portion of a withdrawal that is required to be included in gross income shall be assignable to Minnesota. Any amounts upon which an additional tax is imposed shall be assignable to Minnesota.

4. Married participants. Whenever two single participants marry, their two accounts shall be treated for tax purposes as one joint account. This treatment, however, shall extend only to the two married participants and shall have no effect whatsoever on the trustees of either account, who shall continue to administer each account as if there was a single participant. Both accounts shall be treated as having terminated 10 years from the date of the first deposit to the account that was established first. Only those deposits made in the taxable year of the marriage and thereafter will be considered in determining the excess contributions. The $1,500, $2,500 and $10,000 limitations shall apply separately to each participant for taxable years prior to the marriage and shall apply to the two participants together, the same as for other married participants, for the taxable year of the marriage and for all taxable years thereafter in which they are married. If, in the taxable year of the marriage, deposits made by both participants, together, total $10,000 or more, all further deposits shall be excess contributions subject to the 6% additional tax. Interest shall be deductible in the year of the marriage and thereafter only to the extent that it is attributable to the first $10,000 of total combined deposits.

The amounts in the two accounts prior to the tax year of the marriage shall not be considered an excess contribution in the year of the marriage solely because of the two accounts being treated as one.

For example, A set up an IHA in 1981 and deposited $1,500 per year to the account. B set up an IHA in 1981 and deposited $2,500 per year to the account. In 1985, A and B marry. A's account balance in 1985, not including interest or transactions in 1985, is $6,000. B's account balance in 1985, not including interest or transactions in 1985, is $10,000. Upon marriage, the two accounts will be treated as one account for tax purposes. The balance on the marriage date will be $16,000, not including interest. Because the total deposits by the two spouses exceed $10,000, no further deposits will be allowed. Any deposit made in 1985 or thereafter is an excess contribution subject to 6% additional tax. No additional tax shall be imposed for the year of the marriage as long as no deposits are made during that year or any that were made in 1985 are withdrawn by April 15, 1986. Interest will be deductible only to the extent it is attributable to the first $10,000 of deposits. Interest on the other $6,000 of deposits in the account is not deductible.

5. Termination of account.

a. The IHA shall terminate in the following cases:

(1) The account shall terminate whenever all or part of the account is used for the purchase of a first principal residence which is located in Minnesota. No deduction shall be allowed for deposits made or interest paid or accrued after the termination.

(2) The account shall terminate 10 years from the date of the first deposit to the account. In the case of an IHA which has received a transfer from another IHA under Part H.2. of this rule, the account shall terminate 10 years from the date of the first deposit to the first account. All amounts in the account on the termination date shall be distributed to the participant. Transfer of the total amount in the IHA to an non-IHA account shall satisfy this distribution requirement. However, it shall be treated as a withdrawal not used for the purchase of a first principal residence.

b. Any amounts remaining in the account on the termination date shall be treated as a withdrawal and shall be included in gross income in the taxable year in which the termination date falls and shall be subject to the additional tax for failure to use for a first principal residence.

6. Marriage dissolution transfers. A transfer of a participant's interest in an IHA to his former spouse pursuant to either a dissolution of marriage decree or a written instrument incident to a dissolution of marriage shall not be treated as a withdrawal and shall not be includible in gross income or subject to additional tax solely by reason of the transfer, as long as the IHA is

maintained as such by the transferee. However, the withdrawal of any amounts from the IHA by the transferee shall be treated as any other withdrawal and subject to all of the provisions of this rule. Limitations and restrictions on the IHA shall apply to the transferee as if he or she had made all prior deposits and withdrawals. For example, if the transferee had deducted $9,000 for deposits to the account over a six year period prior to the marriage dissolution transfer, the transferee could deposit only $1,000 more before reaching the $10,000 deduction limitation. The IHA would automatically terminate four years after the transfer since the transferee is treated as having made the first deposit to the account six years prior to the transfer.

I. Exhibits

Exhibit A

PROTOTYPE
INDIVIDUAL HOUSING ACCOUNT
TRUST AGREEMENT

This Agreement is entered into this _____ day of _____, 19 _____, between:

Individual's Name: _____

Spouse's Name: _____
(If married, both spouses must be listed.)

Social Security Numbers: _____ and _____

Address: _____

_____

hereafter referred to, singularly and collectively, as "Participant," and

Name of Financial Institution: _____

_____

Banking Division's Approval Number: _____
(If none is required, so indicate.)
hereafter referred to as "Trustee,"

For the purpose of establishing a trust which qualifies as an Individual Housing Account under Minnesota Statutes, Section 290.09, Subd. 30 (also referred to as the Young Family Housing Act).

Participant has transferred and delivered to Trustee the sum of _____ Dollars ($_____) in cash, as an initial contribution to the trust account hereby established.

NOW, THEREFORE, IT IS AGREED by and between Participant and Trustee that each party will abide by the laws and rules applicable to Individual Housing Accounts and that contributions made to the trust will be held and distributed pursuant to the terms of this Agreement as follows:

ARTICLE I. REPRESENTATIONS

1.1 Trustee is a financial institution authorized by law to act as Trustee for Individual Housing Accounts.

1.2 Trustee actively makes residential real estate mortgage loans in Minnesota.

1.3 Participant does not now own and has never owned a principal residence wherever located.

1.4 Participant does not now have another IHA either with this institution or any other institution.

ARTICLE II. REVOCATION

2.1 Unless Trustee has furnished a disclosure statement to Participant at least seven days prior to the date of this Agreement, the Trust shall not take effect until seven days after the date of this Agreement.

2.2 During the seven day period provided in paragraph 2.1, Participant may revoke this Agreement and receive back any deposits made to Trustee. The Agreement shall not constitute an Individual Housing Account. The Trustee will not withhold tax upon the revocation.

2.3 If during the period provided in paragraph 2.1, Participant does not revoke the Agreement, the trust shall relate back in time to the date of this Agreement.

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ARTICLE III. CONTRIBUTIONS

3.1 Trustee will accept additional deposits which shall become part of the corpus of this trust.

3.2 Participant will contribute and Trustee will accept no more than $2,500 of total deposits to the trust in any taxable year and no more than $10,000 of total deposits to the trust for all taxable years.

3.3 All deposits will be made in cash.

ARTICLE IV. INVESTMENTS

4.1 The assets of the trust will be invested only in savings or time deposits in amounts fully insured by a Minnesota agency or a federal agency established for the purpose of insuring accounts in financial institutions.

4.2 The assets of the trust may be commingled for purposes of investment provided that individual records are maintained by Trustee for Participant, as prescribed by the Commissioner of Revenue.

ARTICLE V. WITHDRAWALS

5.1 Participant may withdraw amounts from the trust at any time by written notice to the Trustee.

5.2 Trustee shall deduct and withhold from any amount withdrawn a tax in the amount of 10 percent of the amount withdrawn unless Trustee receives from Participant a written verification statement pursuant to paragraphs 5.3 or 5.4.

5.3 Trustee will not deduct and withhold tax from any amount withdrawn if he receives from Participant a written statement, in accordance with rules of the Commissioner of Revenue, verifying that the amount withdrawn is being used for the purchase of Participant's first principal residence and the residence is located in Minnesota. In this case Trustee will make the amount withdrawn payable to the seller, or the seller's designee (other than the buyer/Participant).

5.4 Trustee will not deduct and withhold tax from any amount withdrawn if he receives a written statement verifying, in accordance with rules of the Commissioner of Revenue, that Participant has died or has become disabled.

5.5 Trustee will remit and pay the tax deducted and withheld under paragraph 5.2 to the Commissioner of Revenue as required by law.

ARTICLE VI. TERMINATION

6.1 This trust will terminate no later than 10 years after the date of this agreement.

6.2 Upon termination, Trustee will deduct and withhold from the trust corpus a tax in the amount of 10 percent of the corpus and remit and pay the tax to the Commissioner of Revenue, as required by law.

6.3 Upon termination, Trustee will distribute the corpus of the trust to Participant, less the taxes deducted and withheld under the preceding paragraph, in accordance with rules of the Commissioner of Revenue.

6.4 The trust shall terminate upon the death of Participant, or the survivor of the Participants, in which case Trustee will pay over the entire corpus of the trust and earnings thereon to the decedent's estate. No taxes will be withheld.

ARTICLE VII. RECORDS AND REPORTS

7.1 Trustee will keep records and accounts of its administration of the trust.

7.2 Trustee will provide reports to Participant and to the Commissioner of Revenue at the times and in the manner prescribed by the Commissioner of Revenue.

7.3 Participant will furnish to Trustee the information prescribed by the Commissioner of Revenue.

ARTICLE VIII. OTHER PROVISIONS

(Other provisions that do not conflict with any laws, rules or other provisions of this trust agreement may be added here.)

IN WITNESS WHEREOF, the parties hereto set their hand the day and year first written above.

_____

Participant

_____

Participant

_____

Trustee

By _____

Its _____

Exhibit B

DISCLOSURE STATEMENT FOR
INDIVIDUAL HOUSING ACCOUNTS

NOTICE: YOU MAY REVOKE this account by contacting the following person within seven days from the date of your trust agreement. (See Part VIII of this statement for explanation.)

Name: _____

Address: _____

Telephone Number: _____

I. INTRODUCTION

The Individual Housing Account (IHA) is designed to help a first-time home buyer save up money for the purchase of his or her home by not taxing as income the first $1,500 that you contribute to an IHA each taxable year, and by not taxing the interest earned on the account, with certain limitations that are explained in this statement.

BEWARE, however, that there will be a substantial tax penalty due if you use any of the money from this account for any other purpose than your first home. In fact, the trustee must withhold and send to the Department of Revenue 10 percent of any withdrawal that you make if you are not going to use the amount for the purchase of your first residence.

II. ELIGIBILITY

To be eligible to set up an IHA, you or your spouse must not now own and never have owned your own principal residence. Furthermore, you or your spouse must not now have another IHA, whether at this institution or any other financial institution.

III. TAX DEDUCTION AND LIMITS THEREON

Amounts that you deposit in your IHA may be deducted for Minnesota income tax purposes for the tax year in which you make the deposit. However, to be deductible, the amount must have been on deposit in the account for at least six months during the tax year. And your deduction for deposits to the account cannot exceed $1,500 for any one tax year and your total deductions for deposits for all tax years cannot exceed $10,000.

In addition to the deduction for the amounts that you deposit in your IHA, you are allowed an income tax deduction for the interest earned on your IHA during the tax year. This deduction for interest, however, is limited to interest on deposits of $2,500 or less per year or on total deposits of $10,000 or less for all taxable years. Interest cannot be deducted on amounts in excess of these limits.

IV. PENALTY TAX FOR NOT USING IHA FOR FIRST RESIDENCE

Your IHA is supposed to be used to purchase your first principal residence. The residence must be located in Minnesota. If you withdraw money from your IHA and do not use it for the purchase of your first principal residence, which is located in Minnesota, there is a substantial tax penalty due. Not only will you have to include the amount you withdraw in your income for Minnesota tax purposes and pay income tax on it, but you will also have to pay an additional tax of 10 percent of the amount withdrawn. The additional 10 percent tax will not, however, be due if the withdrawal was made because of your disability or death.

Your IHA can last only 10 years. Therefore, you must use the IHA to purchase your first residence within 10 years after the IHA is opened. If you do not use the IHA within 10 years, the IHA automatically terminates and the taxes and penalties explained in the preceding paragraph are applicable just as if you had made a withdrawal of all of the money in the account.

You are not allowed to use or pledge your IHA as security for a loan. If you do so, the amount so pledged will be treated as a withdrawal. You will have to include the amount pledged in your Minnesota taxable income and pay the 10 percent additional tax, just as if you had made a withdrawal of that amount and not used it for your first principal residence.

V. TRUSTEE MUST WITHHOLD TAX ON CERTAIN WITHDRAWALS

If you make a withdrawal from your IHA which will not be used to purchase your first principal residence or the residence you do purchase is not located in Minnesota, the trustee must withhold as tax 10 percent of the amount of your

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withdrawal. The trustee must send the amount withheld to the Department of Revenue to be applied against your additional tax liability. If the withdrawal is due to your health or disability, however, the trustee is not required to withhold this tax.

The trustee also must withhold the 10 percent tax whenever the IHA terminates because the account was not used for your first residence within 10 years from the date that you established the account.

VI. LIMITATIONS ON THE AMOUNT THAT YOU MAY DEPOSIT IN THE IHA

You are permitted to deposit no more than $2,500 to your IHA in any one tax year. Moreover, you are permitted to deposit no more than a total of $10,000 to your IHA for all taxable years. If you deposit more than you are allowed, you must pay an additional tax of six percent of the amount which exceeds these limits. This six percent additional tax is in addition to your regular income tax liability and is due for every year in which the excess deposit remains in your account.

VII. TRANSFERS OF YOUR ACCOUNT TO A DIFFERENT FINANCIAL INSTITUTION

You may transfer your IHA to another financial institution. If you follow the rules explained in this paragraph, your transfer of funds will not be treated as a withdrawal and not subject to tax or penalty. To transfer the IHA tax free, you must:

(1) Have the entire amount in the account made payable to the new trustee or financial institution.

(2) Transfer the entire account to a different financial institution and close out the original account. You cannot have more than one IHA at a time.

(3) Have the new IHA terminate 10 years from the date that you opened the original IHA. To do this you must inform the new trustee of the date on which you opened your original IHA and have him put the proper termination date in the new trust agreement.

VIII. REVOCATION OF YOUR IHA

You must be given seven days to read this statement and consider your decision to participate in the IHA program. Your IHA does not become final until this seven day period is over. During the seven day period, you may revoke your IHA and receive your money back without it being treated as a "withdrawal." Therefore, the regular taxes and additional taxes for failure to use the account for the purchase of your first principal residence, as explained in Part IV of this disclosure statement, will not be due. After this seven day period, however, any withdrawal that you make and do not use for your first residence, will be subject to both regular tax and additional tax, as explained in Part IV.

The name of the person to contact if you wish to revoke this account is listed at the beginning of this disclosure statement.

IX. AUTHORITY AND QUALIFICATIONS OF TRUSTEE

This financial institution is authorized by law to act as the trustee of your IHA. The trustee has either been approved by the Minnesota Commissioner of Banks to act as the trustee of IHAs or under federal law is not required to obtain this approval.

Your IHA meets all of the requirements of Minn. Stat. § 290.09, subd. 30 and any applicable rules issued by the Minnesota Commissioner of Revenue. Furthermore, the trustee agrees to abide by all laws and rules applicable to IHAs.

X. YOUR RESPONSIBILITIES

You, as the participant of this IHA, have certain duties and responsibilities imposed on you. You must be sure that the financial institution is qualified to act as the trustee of your IHA. Also, you must be sure that the trustee will abide by any laws or rules applicable to IHAs. Finally, you must be sure that your IHA is set up according to the law and rules.

If at some future time it is discovered that your trustee is not qualified or is not abiding by the laws or rules or your IHA does not meet all the requirements of the laws and rules, you will not be allowed a tax deduction for the years involved.

Finally, there are certain forms you must file and information you must furnish to either the trustee or the Minnesota Department of Revenue. As mentioned in Part V of this disclosure statement, the trustee must withhold as tax 10 percent of any withdrawal that you make unless you are using the amount withdrawn for your first principal residence. In order to avoid this withholding of tax, you must furnish to the trustee a written statement, verifying that you are using the withdrawal for your first principal residence and that the residence is located in Minnesota. In this case, the trustee must make the withdrawal payable to the seller. The trustee cannot make the withdrawal payable to you alone. The withholding of tax may also be avoided if you die or become disabled by furnishing the trustee with a verification form certifying that you have died or become disabled. If you fail to furnish completed and signed verification forms to the trustee, the trustee is required by law to withhold the 10 percent tax.

To claim the income tax deduction on your Minnesota income tax return, you must attach a copy of the statement or statements of account that you receive from the trustee which show the date and amount of your deposits to the IHA and the date and amounts of any withdrawals during the entire tax year.

ADOPTED RULES

The adoption of a rule becomes effective after the requirements of Minn. Stat. § 15.0412, subd. 4, have been met and five working days after the rule is published in the *State Register*, unless a later date is required by statutes or specified in the rule.

If an adopted rule is identical to its proposed form as previously published, a notice of adoption and a citation to its previous *State Register* publication will be printed.

If an adopted rule differs from its proposed form, language which has been deleted will be printed with strike outs and new language will be underlined, and the rule's previous *State Register* publication will be cited.

A temporary rule becomes effective upon the approval of the Attorney General as specified in Minn. Stat. § 15.0412, subd. 5. Notice of his decision will be published as soon as practicable, and the adopted temporary rule will be published in the manner provided for adopted rules under subd. 4.

Department of Administration
Building Codes and Standards Division

Adopted Rules for Energy Conservation Standards for Existing Residences

The proposed amendments to rules for energy conservation standards for existing residences published at *State Register*, Volume 4, Number 48, ppg. 1882-1890 (4 S.R. 1882) June 2, 1980 are now adopted with the following amendments:

Amendments as Adopted

RULES FOR ENERGY CONSERVATION STANDARDS FOR EXISTING RESIDENCES

2 MCAR § 1.16201 Authority. These rules are promulgated pursuant to Minn. Stat. § 116H.129 (1978) and (1979 supp.).

2 MCAR § 1.16202 Enforcement. The Minnesota Energy Agency shall conduct random inspections of certain renter occupied residences as provided in Minn. Stat. § 116H.129, subds. 3 and 4 (1978).

2 MCAR § 1.16203 Purpose and scope. The purpose of these rules is to establish minimum energy efficiency standards for existing residences. Such standards shall ~~be applicable to certain rental residences as provided in Minn. Stat. Sec. 116H.129, subds. 3 and 4 (1978) and shall~~ be utilized in the energy disclosure program required by Minn. Stat. § 116H.129, subds. 5, 6, and 7 (1978), and shall be applicable to certain rental residences as provided in Minn. Stat. § 116H.129, subds. 3 and 4 (1978).

The scope of these standards addresses two ~~the following~~ areas of energy savings:

A. The reduction of air infiltration as it relates to air leakage through the exterior envelope.

CAUTION: When infiltration is reduced it may be necessary to provide combustion air by other means as provided for in the Minnesota State Building Code.

B. The improvement of the thermal efficiency of the structure as it relates to the transfer of heat through the exterior envelope.

~~C. Reduction of energy usage by mechanical or electrical systems.~~

The rules also contain the methods for calculating energy savings and determining the economic feasibility of each minimum energy efficiency standard for each residence.

2 MCAR § 1.16204 Definitions.

A. Accessible. Shall mean exposed, without the removal of permanent parts of the structure.

B. Attic. The space between the ceiling joists and the rafters immediately above. The space between rafters formed where interior finish material is affixed directly to the rafters shall not be construed to be an attic space.

~~C. Clock thermostats. Shall mean a device which is designed to reduce energy consumption by regulating the demand on the heating or cooling system in which it is installed, and uses:~~

~~1. A temperature control device for interior spaces incorporating more than one temperature control level, and~~

~~2. A clock or other automatic mechanism for switching form one control level to another.~~

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STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of Rules of the State Department of Revenue Governing Individual Housing Accounts (13 MCAR Section 1.6016)

ORDER ADOPTING RULES

Notice of the Commissioner's intent to adopt the above-entitled rules without a public hearing was published in the State Register on March 2, 1981 and was sent by the United States mail to all persons on the list maintained by the agency pursuant to Minnesota Statutes section 15.0412, subdivision 4 on February 27, 1981. After affording interested and affected persons an opportunity to submit comments for 30 days after Notice, receiving fewer than seven written requests for a public hearing within the 30-day comment period, reviewing and considering the comments, and determining the need for and reasonableness of the above-captioned rules.

NOW, THEREFORE, IT IS ORDERED that these rules identified as 13 MCAR section 1.6016 are adopted this 13th day of April, 1981 pursuant to authority vested in me by Minnesota Statutes section 290.52 and 290.09, Subd. 30(e).

STATE OF MINNESOTA

Clyde E. Allen, Jr.

Clyde E. Allen, Jr.
Commissioner of Revenue

Any written material received by the agency shall become a part of the hearing record in the event amended rules governing this subject are promulgated.

Department of Revenue Income Tax Division

Notice of Intent to Solicit Outside Opinion Regarding Rules Concerning the Deduction for Contribution to Individual Housing Accounts

The Income Tax Division of the Department of Revenue is beginning to draft rules concerning the deduction for contributions to individual housing accounts contained in Laws of 1980, ch. 512.

The department invites interested persons or organizations to provide information, comments, and advice on the subject. Comments should be submitted in writing or orally within 30 days to Gary P. Mesna, Attorney, Income Tax Division, Department of Revenue, Centennial Office Building, St. Paul, Minnesota 55145 or (612) 296-3439.

Written statements will be made part of the public hearing record.

Errata

The notice of adoption of Clean Indoor Air rules published at *State Register* Volume 4, Number 40, pp. 1608-1609 (April 7, 1980) contained the following errors:

1. The notice stated that rules 7 MCAR §§ 1.442-1.444 were adopted. That statement should have included rule 7 MCAR § 1.441, which was adopted without amendment.

2. At 7 MCAR § 1.443 C., the numbers "2." and "3." should have been underlined.

3. At 7 MCAR § 1.444 B.1., first line, change "7 MCAR § 1.443 C.B.1." to read "7 MCAR § 1.443 ~~C.~~ B. 1."

4. At 7 MCAR § 1.444 C.1. Offices., paragraph one appears struck out. That paragraph should be underlined.

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Department of Revenue Governing Individual Housing Accounts (13 MCAR Section 1.6016)	ORDER FOR NOTICE OF INTENT TO ADOPT RULES WITHOUT PUBLIC HEARING

IT IS ORDERED this 13th day of February, 1981 that Notice of Intent to Adopt Rules Without Public Hearing in the above-entitled matter be given to all persons who have registered their names with the Department of Revenue for that purpose and be published in the State Register.

STATE OF MINNESOTA

Clyde E. Allen, Jr.
Commissioner of Revenue

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

INCOME TAX DIVISION

In the Matter of the Proposed Adoption of Rules Governing Individual Housing Accounts (13 MCAR Section 1.6016)

NOTICE OF INTENT TO ADOPT RULES WITHOUT A PUBLIC HEARING

Notice is hereby given that the Department of Revenue proposed to adopt the above-entitled rules without a public hearing. The Commissioner has determined that the proposed adoption of these rules will be noncontroversial in nature and has elected to follow the procedures set forth in Minnesota Statutes section 15.0412, subdivision 4h (1980).

Persons interested in these rules shall have 30 days to submit comments on the proposed rules. The proposed rules may be modified if the modifications are supported by the data and views submitted to the agency and do not result in a substantial change in the proposed language.

Unless seven or more persons submit written requests for a public hearing on the proposed rules within the 30-day comment period, a public hearing will not be held. In the event a public hearing is required, the agency will proceed according to the provisions of Minnesota Statutes section 15.0412, subdivisions 4-4f.

Persons who wish to submit comments or a written request for a public hearing should submit such comments or request to:

Mr. Gary P. Mesna
Attorney, Income Tax Division
Minnesota Department of Revenue
Centennial Office Building
St. Paul, Minnesota 55145
(612) 296-3439

Authority for the adoption of these rules is contained in Minnesota Statutes sections 290.09, subdivision 30, and 290.52. Additionally, a Statement of Need and Reasonableness that describes the need for and reasonableness of each provision of the proposed rules and identifies the data and information relied upon to support the proposed rules has been prepared and is available from Mr. Mesna upon request.

Upon adoption of the final rules without a public hearing, the proposed rules, this Notice, the Statement of Need and Reasonableness, all written comments received, and the final Rules as Adopted will be delivered to the Attorney General for review as to form and legality, including the issue of substantial change. Persons who wish to be advised of the submission of this material to the Attorney General, or who wish to receive a copy of the final rules as proposed for adoption, should submit a written statement of such request to Mr. Mesna.

The proposed rules, if adopted would impose or clarify certain duties on the trustee of an Individual Housing Account (IHA) with respect to qualification, reporting of information and withholding of tax and impose penalties for failure to comply.

The proposed rules require that certain provisions be included in the trust agreement for an IHA. Also required is a disclosure statement, which the trustee must furnish a prospective participant.

Explained and clarified in the proposed rules are the deduction for contributions to an IHA, the exemption from tax for distributions used for the participant's first principal residence in Minnesota, and the tax treatment of distributions not so used.

Also covered by the proposed rules are certain special situations, such as disability or death, nonresidents, married participants, transfers of the account to a different trustee, and termination of the account.

Copies of this Notice and the proposed rules are available and may be obtained by contacting Mr. Mesna.

February 13, 1981

State of Minnesota

Clyde E. Allen, Jr.
Commissioner of Revenue

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of Rules of the State Department of Revenue Governing the Income Tax Deduction for Contributions to An Individual Housing Account (13 MCAR Section 1.6016)

AFFIDAVIT OF MAILING

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

Kathleen D. Franssen, being first duly sworn, deposes and says:

That on the 27th day of February, 1981, at the City of St. Paul, County of Ramsey, State of Minnesota, she served the attached Notice of Intent to Adopt Rules Without Public Hearing by depositing in the United States mail at said City of St. Paul, a copy thereof, properly enveloped, with postage prepaid, on all persons and associations who have requested that their names be placed on file with the State of Minnesota, Department of Revenue for the purpose of receiving notice of the proposed adoption of rules by this Department.

Kathleen D. Franssen

Subscribed and sworn to before me this 27th day of February, 1981.

Laurene R. Page

LAURENE R. PAGE
NOTARY PUBLIC—MINNESOTA
RAMSEY COUNTY
My Commission Expires Nov. 9, 1984

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of Rules of the Income Tax Division Relating to the Income Tax Deduction for Contributions to an Individual Housing Account

CERTIFICATE OF COMPLETENESS AND ACCURACY

I hereby certify that the attached fourteen sheets consisting of two hundred and seventy-five typewritten names and addresses constitute the complete list of persons, associations and other interested groups who, as of 8 o'clock a.m., this 25th day of February, 1981, have requested, pursuant to Minn. Stat. § 15,0412, subd. 4, that their names be placed on file with the Department of Revenue for the purposes of receiving notice of public hearing on proposed rules on the subject captioned above.

STATE OF MINNESOTA
CLYDE E. ALLEN, JR.
COMMISSIONER OF REVENUE

By Dorothy A. McClung
DOROTHY A. McCLUNG, Director
Legal Research Division

MAILING LIST FOR OFFICIAL NOTICE OF AGENCY RULEMAKING

INDEP. BANKERS OF MN
Attn: Norbert McCrady, Exec. V.P
327 Plymouth Building
12 South 6th Street
Minneapolis, MN 55402

Paul M. Leegard
Personnel Administrator
White Motor-Hopkins
130 - 9th Avenue South
Hopkins, MN 55343

Advocate for the Blind
1821 University Avenue, Rm. 389S
St. Paul, MN 55104

Peter S. Popovich
Peterson Popovich, Knutson
and Flynn,
314 Minnesota Building
St. Paul, MN 55101

James C. Shipman
Executive Director
Association of MN Counties
2305 Ford Parkway
St. Paul, MN 55116

Paul J Huber LTD
Certified Public Accountants
1821 University Avenue
St Paul, MN 55104

Kent E. Eklund, Commissioner
MN Dept. of Economic Development
480 Cedar Street
St. Paul, MN 55101

Richard C Buske
MN Dept. of Economic Development
480 Cedar Street
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Charles Schaffer
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Susan P Robertson, Exec Dir.
Legis. Comm. to Review
Admin. Rules
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St Paul, MN 55155

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MN Railroads Association
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Olson, Gunn and Seran, Ltd.
315 Peavey Building
730 Second Avenue South
Minneapolis, MN 55402

Darrel Johnson, Finance Dir.
City of Winona
City Hall
4th & Lafayette St.
Winona, MN 55987

Mr. James N Denn
MN Motor Transport Assoc.
1821 University Avenue, Rm 134N
St Paul, MN 55104

John T Farmer, Exec. Dir.
MN Manufactured Housing Assoc.
222 E Little Canada Rd, Ste. 222
Little Canada, MN 55117

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Minn. Multi-Housing Ass'n.
3100 West Lake Street
Minneapolis, MN 55416

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Moss Flaherty, Clarkson &
Fletcher
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Minneapolis, MN 55402

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Pickands Mather & Co.
Ste 811, 200 W Superior St.
Duluth, MN 55802

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Pickands Mather & Co.
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Minnesota Transport Services Association
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James C. Berger, Vice President
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608 - 2nd Avenue South
Minneapolis, MN 55402

MN Chapter of Associated Builders &
Contractors, Inc.
Attn: Donald E. Montgomery, Exec. Director
6300 Walker Street, Ste. 109
(Hwy 7 at Woodale)
Minneapolis, MN 55416

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Briggs & Morgan, P.A.
W-2200 First National Bank Building
St. Paul, MN 55101

Philip M. Hanft
Attorney at Law
1200 Alworth Building
Duluth, MN 55802

General Mills, Inc.
c/o R. D. Mueller, Tax Manager
P. O. Box 1113
Minneapolis, MN 55440

Corporate Tax Division/3M
Attention: W. R. Spangler
Director of Tax Compliance
P. O. Box 33441
St. Paul, MN 55133

President
Interstate Power Company
1000 Main Street
Dubuque, IA 52001

Hilory Soltanoff
Staff Attorney
Office of the Legislative Auditor
Program Evaluation Division
1st Floor, Veterans Service Building
St. Paul, MN 55155

LARSON, ALLEN, WEISHAIR & CO.
Certified Public Accountants
Attention: David A. Krahn, CPA
Shelard Tower, Ste. 1560
600 South Co. Rd. 18
Minneapolis, MN 55426

Tri-County Community Action
Program, Inc.
Attention: Mark G. Sexton, Planner
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Little Falls, MN 56345

G. F. Blissenbach, Income Tax Spec.
3M
3M Center, Tax Division
220-13W
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Corporate Tax Manager
Super Valu Stores, Inc.
101 Jefferson Avenue South
Hopkins, MN 55343

Rosa Richs
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Lake Superior Industrial Bureau
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459 Rice Street
St. Paul, MN 55103

Don G. Paterick
Executive Director
MN Taxpayers Association
280 Cedar Street
St. Paul, MN 55101

H & R Block, Inc.
Regional Office
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STATE OF MINNESOTA

DEPARTMENT OF REVENUE

IN THE MATTER OF THE PROPOSED
ADOPTION OF RULES OF THE DEPARTMENT
OF REVENUE GOVERNING THE INCOME TAX
DEDUCTION FOR CONTRIBUTIONS TO AN
INDIVIDUAL HOUSING ACCOUNT

STATEMENT OF NEED
AND REASONABLENESS

This document is intended as a verbatim affirmative presentation of the facts necessary to establish the statutory authority, need for and reasonableness of the proposed new rules. It is prepared pursuant to Minn. Stat. 15.0412, Subd. 4h and 9 MCAR Section 2.104.

A Notice of Intent to Solicit Outside Opinion regarding the proposed rule was published in the State Register on April 21, 1980. The proposed rule was submitted for comment to those people and organizations that requested it, to the members of the Commissioner's Advisory Committee, to various legislative staff persons and to various financial institutions and banking associations. Suggestions and comments that were received have been duly considered.

Minn. Stat. 290.52 grants the Commissioner of Revenue statutory authority to promulgate rules concerning the income tax laws. Moreover, Laws 1980, Chapter 512, Section 5 grants additional authority to the Commissioner to promulgate rules regarding the reporting requirements imposed on the trustee of an individual housing account.

Individual housing accounts are authorized by Laws 1980, Chapter 512. Section 5 of the law adds subdivision 30 to Minn. Stat. 290.09, and is referred to as the Young Family Housing Act. For purposes of this Statement of Need, Minn. Stat. 290.09, Subd. 30 will be referred to simply as "the Act."

Rule 13 MCAR Section 1.6016 - Individual Housing Accounts

Statement of Need and Reasonableness

A. Definitions.

1. The term "IHA" is used simply as an abbreviation.
2. The term "participant" is used as a concise way to refer to the individual for whose benefit the IHA was established. Including the requirement that the individual be a "natural person" makes it clear that artificial persons, such as corporations, trusts, estates and the like cannot be participants.
3. The term "deposit" is used in place of the statutory term "contribution." Both terms mean the same, yet "deposit" is more descriptive of the action being described and is more familiar and more easily understandable to the ordinary person.
4. The term "withdrawal" is used in place of the statutory term "distribution" for the same reason expressed in the preceding paragraph.
5. The definition of "principal residence" contains three elements. First, it must be a dwelling unit. Second, the participant must actually live in the unit. Third, the participant must have the intention to make the unit a "fixed abode."

This definition is needed to assure that the IHA is used for the purpose intended by the legislature, i.e., to purchase the participant's first principal residence. The first two requirements are obvious and inherent in the common meaning of the noun "residence." The third requirement explains the adjective "principal."

If the third element of the definition was not adopted, an individual could easily circumvent the legislative intent and use the IHA program to help finance the purchase of a vacation home or income property. The definition plugs these loopholes by requiring some degree of permanence in the use of a dwelling unit as a residence. Simply moving into a dwelling unit for a day or two will not suffice.

This definition is consistent with the closely analagous definitions of "resident" in Minn. Stat. 290.01, Subd. 7 and Income Tax Rule 2001(7).

The requirement that the dwelling unit be located in Minnesota is taken from the Act. It is repeated in the rule for purposes of continuity and emphasis. If many of the requirements regarding the residence are included in the rule, it is almost misleading to leave out other requirements.

The rule adopts a liberal interpretation of what structures may qualify as a residence, allowing any type of dwelling unit which the participant will actually own or have an ownership interest in and in which the participant will actually reside.

If the building contains more than one dwelling unit, each unit is a separate residence. Only the participant's own principal residence can qualify and the rule so states.

And it seems quite reasonable to provide that if a building is divided into a residential area and a business area, only the residential area will qualify for the special IHA benefits.

There is no requirement in the Act that the participant purchase the residence in his or her own name, individually. Therefore, the rule provides that it is permissible to purchase the residence with others in various types of co-ownership. The rule goes on to provide a very logical corollary--that it will qualify as a residence only to the extent of the participant's ownership interest therein. This is best illustrated by a simple example. If three individuals purchase a residence in joint tenancy at a total cost of $30,000, each individual will be treated as owning one-third of the residence. Therefore, one-third of the purchase price is attributable to each. The IHA holder cannot use more than $10,000 (1/3 of $30,000) out of the IHA for the residence, because that is the extent of the participant's ownership interest.

Any excess in the account over $10,000 cannot be used for the residence and will be treated as a withdrawal not used for the purchase of a first principal residence so that it will be included in gross income and subject to the 10 percent additional tax.

There is ambiguity in the statutory phrase "first purchase of a principal residence in Minnesota," found in clause (c)(1) of the Act. Does it mean the first purchase in Minnesota (of a principal residence)? Or the first purchase of a principal residence (which also must be located in Minnesota)? The ambiguity can be cleared

up by looking at a similar phrase in clause (a) of the Act. There the legislature used the phrase "the purchase of his first principal residence." The requirement that it be in Minnesota is not present. Looking at the two phrases together leads one to the conclusion that the legislature intended the IHA program to benefit an individual in the purchase of his first principal residence. If he owns a residence (or owned one in the past) outside of Minnesota, he is still precluded from the IHA benefits. The language "in Minnesota" is simply an additional requirement--that the residence for which the IHA benefits are applicable be located in Minnesota. This is the interpretation adopted in the rule. Thus, a person who owns (or owned) a residence in another state or country is not eligible for the IHA benefits, even though he seeks to purchase his first principal residence in Minnesota. To hold otherwise would unfairly discriminate in favor of individuals who owned residences outside of Minnesota, a doubtful legislative intent.

B. General Requirements.

1. Part B makes it clear that the IHA must be a trust account for the exclusive benefit of one individual participant. If the participant is married, the account must be established for the joint benefit of the participant and his or her spouse. Although these provisions paraphrase the statute, they are necessary for emphasis, clarity and continuity.

2. Since an IHA may be used only for the purchase of a first principal residence that is located in Minnesota (see the explanation of this requirement in Part A.5, above), it is reasonable to prohibit an individual who already owns or did own a residence from

establishing an IHA. For purposes of clarity, it is necessary to again emphasize the previous rule that the residence must be the first residence ever owned by the participant (anywhere) and that it be located in Minnesota.

3. Since an individual may deposit more than he may deduct, there is no necessity of having more than one account. Moreover, an individual may "transfer" the account to another bank. If more than one account at a time was permitted, the reporting requirements would be extremely difficult for the banks and it would also be much more difficult for the participant to compute the proper deductions and taxes. It would likely produce many complaints, calls for help in preparing returns and audit adjustments. The rule takes a liberal position and allows an individual who had an IHA, but which was terminated, to establish another IHA. There is no express prohibition of this in the statute, although it is arguable under the 10 year rule.
4. If the trustee has a duty, statutorily or by this rule, it is reasonable to include that duty in the trust agreement. That way the trustee is agreeing with the participant to perform those duties. This may give the grantor a cause of action against the trustee for failure to perform those duties, which is quite reasonable, especially if the trustee's failure to perform a duty results in the loss of a tax benefit for the participant.

It should be noted, however, that neither the rule nor this statement of need takes a position with respect to any potential liability on the part of the trustee or the participant. Such matters are best left to the parties involved.

The specific duties will be discussed in a subsequent part of this statement of need.

5. a. The idea for a disclosure statement was taken from the IRS rules applicable to Individual Retirement Accounts. The authority for this requirement is clause (e) of the Act, which requires the trustee to make reports regarding the account to the individual for whom the account is maintained with respect to contributions, deductions and other matters, as the Commissioner may require under rules. The disclosure statement deals with "contributions" and "distributions" by requiring a report to the participant that explains the tax consequences thereof. "Other matters" are also covered by the disclosure statement. Almost identical statutory language provided the authority for the federal rule. See IRC Sec. 408(i) and IRS Reg. 1.408-1(d)(4).

The disclosure statement is needed and reasonable as a consumer protection device. The statement will, hopefully, protect individual taxpayers from overzealous financial institutions who, in the interest of competition, stress only the potential benefits of the IHA program without mentioning the drawbacks and pitfalls, thereby not presenting a balanced picture. It must be remembered that the Young Family Housing Act is not only a very new, but also a very complicated statute. The average unsophisticated taxpayer is not likely to be familiar with it.

The need and reasonableness of each required item of the disclosure statement is as follows:

(1) Informing the potential participant of the ineligibility of individuals who own or have owned a residence will prevent a person from establishing an IHA if the person is not eligible. If an ineligible person opened an IHA, not only would he get no tax deduction, but he would be stuck with the 10 percent additional tax upon withdrawal.

(2) It is certainly reasonable to make the taxpayer aware of the limitations, both on deductions and on deposits. These limitations limit the benefits available under the IHA program. Only if a person is aware of these limits can he properly evaluate the advantages and disadvantages of participating in the IHA program.

(3) Probably the most severe limitation on the IHA program is the tax treatment of a withdrawal that is not used for the purchase of the participant's first principal residence that is located in Minnesota. It is vital to clearly explain the tax consequences in this situation so that the potential participant can make an informed decision on whether to participate.

(4) It is important to let a participant know that he must use the account within 10 years for the purchase of his first principal residence in Minnesota. If he waits too long to buy the residence, he will incur severe tax consequences.

(5) Corresponding with (3), above, is the 10 percent additional tax that is due when a withdrawal is not used

for the purchase of the first principal residence in Minnesota. It is important to make it very clear that the 10 percent additional tax is in addition to the regular tax liability that will result from including a withdrawal in gross income in the tax year of the withdrawal.

(6) Another trap for the unwary is the six percent additional tax imposed on deposits in excess of $2,500 during a taxable year or in excess of $10,000 for all taxable years. In order that a participant does not fall into this trap unknowingly, the disclosure statement clearly points it out.

(7) A participant should be aware that he may transfer the IHA to another trustee. Yet it is doubtful that the trustee would voluntarily inform him of this opportunity, since the trustee would have an economic interest in keeping the business himself. Therefore, the disclosure is required.

(8) The disclosure statement would lose much of its value if read only after the IHA was established. Therefore, the rule gives the participant seven days to read the disclosure statement before the IHA is final. The participant should be made aware of this revocation period and so the disclosure is included.

(9) Since it is the participant's responsibility to assure that the financial institution is authorized by law to act as trustee of IHAs, it is essential that this is disclosed to the participant.

(10) Likewise, since it is the participant's responsibility to assure that the trustee abides by all applicable laws and rules, it is essential that the trustee agree to do so and disclose this agreement.

(11) There can be little question of the need for and reasonableness of a disclosure that the participant has the sole responsibility to assure that the trustee is qualified and authorized and that the account itself is according to the laws and rules. In the absence of such a disclosure, it is likely that the participant would think that he could rely on the trustee's representations.

(12) The final disclosure reveals to the participant the consequences of a failure to carry out the responsibility mentioned in (11), above. Only when the participant considers the consequences can he properly evaluate the responsibility.

5. b. The penalty is provided by statute, clause (e) of the Act, whenever the trustee fails to furnish a report required by that provision. It is reasonable to treat a statement that does not substantially comply as not being furnished at all. Otherwise, it would be simply too easy to circumvent the disclosure statement requirement. Yet requiring only "substantial" compliance assures that the penalty will not be imposed arbitrarily or capriciously whenever the "i's" are not dotted or "t's" not crossed. A statement that is false or misleading certainly does not achieve the desired purpose and should at least be treated as not in "substantial compliance."

6. State chartered financial institutions are required to obtain approval to act as the trustee of IHAs from the Minnesota

Commissioner of Banks. See Minn. Stat. Sections 48.159, Subd. 2, 50.157, Subd. 2, 51A.21, Subd. 16a, and 52.136. National banks, federal savings and loan associations and federal credit unions, under federal law, cannot be regulated by state agencies. Therefore, the federal institutions are not required to obtain the approval of the Minnesota Commissioner of Banks.

7. The purpose of the statutory provision requiring a trustee to actively make residential real estate mortgage loans in Minnesota is not entirely clear. Two purposes come to mind. First, the fact that the program is designed to aid individuals with the purchase of a home makes it likely that the provision was intended to aid the individual in obtaining financing by making money available at the same financial institution in which the individual has his IHA. A secondary purpose may be to make it at least possible that the money taken in by the financial institution as deposits to IHAs is pumped back into real estate mortgage loans. If an institution makes no such loans, it is impossible for the IHA deposits taken in to go into real estate mortgage loans.

It is in view of these two purposes that the rule provides that the financial institution must originate real estate mortgage loans. Only if the institution originates such loans can it be said that the statutory provision aids the individual in obtaining financing.

The rule next addresses the problem of determining which institutions are actively making (originating) residential real estate

mortgage loans in Minnesota. The rule attempts to make a reasonable, yet liberal, distinction between those financial institutions and credit unions that make residential real estate mortgage loans in Minnesota and those that do not. An institution will not be disqualified merely because it makes only a few such loans. Nor will it be disqualified solely because of poor market conditions--something beyond its control. Rather, the rule seeks to focus solely on the institution's actual lending policy, which is the most reasonable approach.

The authority to require a taxpayer to submit evidence to substantiate any tax deduction or exemption is contained in Minn. Stats. 290.46 and 290.56.

8. Rather than requiring every participant in the IHA program to submit to the Commissioner of Revenue copies of the trust agreement and disclosure statement, the rule takes a much less onerous approach. The participant must submit the documents only when requested to do so by the Commissioner. Such a request will occur only when there is some question raised concerning those instruments.

The statute allows an income tax deduction only for contributions to an individual housing account which meets the requirements of the statute. If either the trustee or the account does not meet the statutory requirements, no deductions are allowable. Placing the burden of proof on a participant to prove that he is entitled to a deduction is in accordance with many court decisions. See, for example, Northern National Gas Company v. Commissioner of

Revenue, 312 Minnesota 177, 251 NW 2d 125 (1977).

C. Duties of Trustee.

1. a. Since the IHA deduction is allowed only for cash paid to the account, under clause (a), it is reasonable to require that the trustee accept only deposits of cash. It does not appear from the statute that the legislature intended that contributions of other types of assets be allowed, e.g., stocks, bonds, partnership interests, etc.

1. b. Since the trust agreement must contain a provision that the contributions will not be accepted for a taxable year in excess of $2,500 or in excess of $10,000 for all taxable years, it is reasonable for the Commissioner to prohibit the trustee from so doing.

1. c. The Young Family Housing Act was obviously designed to aid a person or a young family who seeks to purchase his or her first home. A person who already owns a home cannot, by statute, use an IHA for the purchase of a first residence, Therefore, he should be prohibited from establishing an IHA. The most practical way to accomplish this is to prohibit the trustee from accepting deposits from an individual who already owns a home. It is reasonable because the rule only requires the trustee to ask a depositor whether he owns a home. The trustee is not required to verify the answer.

1. d. The rule paraphrases the statutory requirement that the account shall be distributed to the participant within 10 years after the first deposit. This is done for the purposes of introduction as well as continuity. The rule allows the trustee to simply transfer the amount in the IHA into a

different, non-IHA account, rather than requiring the actual receipt of the distribution by the participant. This eliminates the problem of locating and making actual delivery of the money from the account to the participant on the very last day. Yet the rule makes it clear that such a distribution, since it is not used for a first residence, will be so treated, i.e., the trustee must withhold tax and the participant must include it in income and pay the additional 10 percent tax.

1. e. The rule clarifies the confusing language of clause (b)(5) of the Act regarding withholding and the exceptions thereto. It also spells out how the trustee is to handle withholding where only part of a withdrawal is used for a first residence.

Requiring withholding on the part of a withdrawal not used for a first residence is consistent with the statute and prevents a participant from circumventing the withholding requirements by using only a small part of the IHA for a first residence and the rest for tax deferral or other reasons.

1. f. The authority, need and reasonableness of the disclosure statement are discussed at Part B.5.a, above. Requiring the statement seven days prior to the establishment of an account is a reasonable consumer protection, allowing the consumer a limited period of time to read the statement and seek opinions of others, whether family, friends or professionals. It is a requirement similar to the "cooling off" periods provided by modern consumer legislation. The seven day period is the same period allowed by the IRS for individual retirement accounts. See IRS Reg. 1.408-1(d)(4)(ii)(A)(1).

An option is allowed the trustee. If the trust agreement provides that the trust does not become final and does not constitute an IHA for seven days following execution of the agreement, during which period the agreement is revocable, then the disclosure statement may be furnished at the time that the agreement is signed. This will also give the prospective participant seven days to read the statement and decide whether an IHA is best for him. This procedure is more practical than requiring a disclosure statement seven days prior to execution of the trust agreement because it does not necessitate the prospective participant making another trip to the financial institution seven days later to sign the agreement. He can, in effect, open the account with only one trip to the financial institution even though it won't be effective for seven days, during which time he has a "cooling off period."

If, during the "cooling off period," the prospective participant decides to revoke the agreement and not establish the IHA, the 10 percent additional tax will not be applicable because the IHA was never established. Therefore, the revocation does not constitute a withdrawal from an IHA that is not used for a first principal residence in Minnesota. This is also discussed at Part F.6 of the rule and the corresponding section of this statement of need.

It is reasonable to require that the trustee furnish a copy of the governing instrument to the participant. Every party

to a binding legal commitment should have a copy of the governing legal document.

1. g. Following the rationale for the disclosure statement, the rule requires a similar disclosure for amendments to the trust agreement or to the statute or rules. The disclosure seems even more justified in the case of an amendment because the amendment may have been made with no knowledge of it on the part of the participant.

1. h. It is reasonable, by rule, to impose a duty on the trustee that, by statute, the trustee must agree to perform (since it must be part of the trust agreement). Therefore, the rule prescribes that the trustee may invest trust assets only in savings or time deposits fully insured by a state or federal agency. See clause (b)(3) of the Act. By negative inference, the trustee may not invest in other types of assets, such as stocks, bonds, notes, debentures, mutual funds or otherwise. The rule requires that the savings or time deposits in which the trustee invests trust assets be the trustee's own accounts or certificates. This requirement is based on a recommendation from Northwest Bancorporation, in order to allow a national bank which does not have trust powers to act as trustee. See Exhibit A. Moreover, Minn. Stat. 48.159 has a similar restriction for Individual Retirement Accounts (IRAs).

1. i. The statutory language allowing commingling of funds for investment purposes is paraphrased for purposes of clarity and continuity.

2. a. The reporting requirements are authorized by clause (e) of the Act. February 28 is a reasonable date for the reports because not only does it allow two months for the trustee to prepare the reports but it also is the same date that the federal Form 1099 information return is due. Moreover, it is a longer period of time than exists for individual retirement account reports, which must be filed within 30 days after the close of the individual's taxable year. See Proposed IRS Rule 1.408-1(d).

The necessity and reasonableness of the identification data is obvious. The reports would be worthless if we did not know who filed them and the taxpayer to whom they pertained.

The date the account was established is needed to determine the date that the account terminates. The account can only last 10 years. If within that time a first principal residence in Minnesota is not purchased, the IHA terminates and the entire amount in the IHA is subject to both regular Minnesota income tax and the 10 percent additional tax.

The verification form for amounts used for a first principal residence is needed to determine whether a taxpayer is entitled to exempt from income withdrawals that are used for a first principal residence. It also verifies that the trustee was not required to withhold tax on the withdrawal.

The forms verifying death or disability are required to establish those facts which exempt the amounts withdrawn from additional tax or withholding.

The date and amount of each deposit is required to determine the amount of the deduction allowable for the particular tax year in light of the $1,500 limitation and the six-month deposit limitation. The information is also necessary to determine the amount, if any, of additional tax for excess contributions (deposits in excess of $2,500 during any taxable year).

The date and amount of each withdrawal is needed to determine the amount, if any, of additional tax for withdrawals not used for a first principal residence. It is also used to determine the amount that may be exempt because it was used for a first principal residence.

The amount of interest paid is necessary in order to determine the amount of the allowable deduction for interest earned on an IHA.

It must be emphasized that although the Commissioner needs all of the above information in order to audit the participant, it is even more important that the participant receive the information, since it is essential in order to compute his tax liability and prepare his return.

Two copies are to be furnished to the participant, allowing the participant to file one with his tax return, much like a Wage and Tax Statement, Form W-2, and keep one for his records.

2. b. The requirement that the trustee verify that a withdrawal is used for a first principal residence in Minnesota is authorized by clause (b)(5) of the Act. The requirement that the trustee report this verification information to the Commissioner is authorized by clause (e) of the Act.

The specific information requested on the verification form is needed in order for the Commissioner to audit the participant's return and to assure that the withdrawal was in fact used for the purchase of a first principal residence in Minnesota. Certain of the requested information is obviously necessary and reasonable to the accomplishment of this purpose, specifically: location and description of property being purchased, name and address of person or entity from whom the property is being purchased, amount withdrawn from the account during the taxable year, and portion of the amount withdrawn which will be used to purchase the first principal residence. Justification for requesting the other items of information is as follows: the name of the realtor, closing company, etc. will help in determining or verifying any of the other information. The type of ownership anticipated is necessary to determine or verify whether the entire amount withdrawn is exempt from tax because it is used for a first residence or whether a portion of the amount is not used for a first residence. For example, if $10,000 is withdrawn from the IHA and the down payment on the residence is $10,000, it does not necessarily follow that the whole $10,000 withdrawal is exempt from tax. If the residence is being purchased in joint tenancy, one-half ownership by the participant and one-half

ownership by a third party, only one-half of the $10,000 down payment is attributable to the participant's portion, so that only one-half of the $10,000 withdrawal is exempt from tax.

The total purchase price and the amount to be financed also help to determine or verify the amount of the down payment and the portion of the withdrawal that is exempt. Closing costs are considered used exclusively for the first residence, and so, must be determined. The closing date is asked for to verify the completion of the sale. If the closing date was long after the withdrawal date, it would raise some suspicions which would require further investigation. The name of the person or entity from whom the withdrawal was made payable is requested to verify the statutory requirement that it be made so payable and also, generally, to verify the legitimacy and completion of the purchase.

Allowing the trustee to wait on filing this verification form until the time for filing the annual information return is a benefit to the trustee in that he doesn't have to go to the trouble of sending in the report until the end of the year when he is sending in other reports anyway.

3. With respect to the withholding requirements, the rule begins by paraphrasing the statutory requirements found in clause (b)(5) of the Act. This is necessary to make the statutory requirements clear and understandable. The statutory language is very confusing.

The rule provides that the trustee is personally liable for the withheld tax. Although this is not expressly provided in the statute, it nevertheless follows under general trust law. As a "trustee," the financial institution has many specific duties which it must perform, including the withholding of tax. The duties arise not only from statute but also from the trust agreement. When a trustee fails to perform these duties, he is absolutely liable. Consequently, the trustee is personally liable for the amount of any tax required to be withheld.

There is a further reason for holding the trustee personally liable for withheld tax where the trustee actually withheld the tax but did not pay it over to the Commissioner of Revenue. This further liability arises under the doctrine of constructive trust. The amounts withheld from a withdrawal are not the property of the trustee. Rather, the amounts actually withheld are the property of the participant. The trustee is only to send those amounts to the Commissioner of Revenue to be applied against the participant's tax liability. If he does not do so and instead converts the property to his own use, he is violating that constructive trust. The trustee is personally liable for the amount so converted.

4. The penalties in the rule are expressly authorized by clause (e) of the Act. The rule makes it clear just when these penalties will be imposed.

D. Deduction for Contributions to an IHA.

1. The statutory language limiting the deduction to $1,500 per year and $10,000 for all years is paraphrased in the rule for the sake of continuity and clarity.

2. The statutory language is somewhat ambiguous on whether the deduction limitation of $1,500 applies only to contributions (deposits) to the account or whether it includes interest accrued on the account. The Department has also received a number of inquiries on this point. The rule again takes a liberal approach and provides that the limitation applies only to the contributions to the account. In other words, there are really two deductions allowed by the IHA provisions, a $1,500 deduction for contributions and a deduction for interest which has accrued on the account. Support for this interpretation can be found in the last paragraph of clause (a) of the Act, where the $10,000 deduction limitation is made applicable only to "amounts paid in cash." The amounts paid in cash are the contributions and not the accrued interest. Since the $10,000 deduction limitation is applicable only to contributions and not to accrued interest, the $1,500 deduction limitation should be interpreted in a similar manner.

   Since the trustee is prohibited from accepting contributions in excess of $2,500 for a taxable year or in excess of $10,000 for all taxable years by clause (b)(1) of the Act, it is reasonable to prohibit the deduction of interest accrued on such "prohibited" contributions.

3. A basic principle of arithmetic is that you cannot subtract more than you have. Thus, it is reasonable to prohibit the deduction under the IHA provisions of amounts which have already been deducted or excluded under some other provision of law. It is only common sense.

4. The rule makes it clear that the prohibitions contained in Minn. Stat. 290.10(9) and (10) apply to individual housing accounts. In other words, the deduction for interest expense is prohibited where the interest expense is from a loan which was deposited in an IHA in order to get the IHA deduction.
5. The six month deposit requirement is prescribed by clause (a) of the Act, and is paraphrased in the rule for purposes of clarity and continuity.

The statute specifically provides that "any amount deposited less than six months before the close of the taxpayer's taxable year may be taken as a deduction only for the next succeeding taxable year." The rule provides that such an amount that is deducted in the succeeding year counts against the $1,500 maximum deduction limitation for that succeeding year, rather than for the year in which the deposit was made. This is a reasonable interpretation because it is the deduction that is limited to $1,500 per year, not the contribution. So the limitation should apply in the year that the deduction is claimed rather than the year that the deposit is made. On the other hand, the year that the deposit is made controls the contribution limitation of $2,500 per tax year.

For example, for a calendar year taxpayer, if $3,000 is deposited August 1, 1985 and another $3,000 is deposited May 1, 1986, and both amounts remain on deposit until at least December 31, 1986, the participant would get no deduction in 1985 because the $3,000

was not on deposit for at least six months by the close of the 1985 taxable year. Since the $3,000 exceeds the $2,500 limitation on deposits, there is a six percent excess contribution penalty due in 1985 on the excess of $500. In 1986, the participant is entitled to a deduction of $1,500, which is the maximum deduction allowed for a taxable year. Again, there is an excess contribution in 1986 of $500, since the maximum contribution permitted in a taxable year is $2,500. The six percent excess contribution penalty, however, applies on $1,000 in 1986, which is the excess contributions of $500 in 1986 and $500 in 1985 (since the 1985 excess contribution remained in the account in 1986).

The rule also points out that while there is a six month deposit requirement in order to get a deduction for a deposit, there is no such requirement with respect to the deduction for interest accruing on an IHA. This is done because great confusion already exists on this point and more confusion can be expected. The confusion results from the unusual statutory scheme which, in a sense, creates two different taxable years for the two different IHA deductions, i.e., contributions, which are deductible for a calendar year taxpayer in the current taxable year if made between July 1 of the preceding taxable year and June 30 of the current taxable year (and remain on deposit for at least six months), and interest, which is deductible in the current taxable year if it accrued in the current taxable year.

E. Exemption From Tax For Distributions Used For a First Residence.

1. Once again the rule seeks to obtain a greater degree of clarity and continuity by reorganizing and rewording the provisions of the Act.

2. The rule seeks a reasonable and practical interpretation of the phrase "used exclusively in connection with the first purchase of a principal residence," found in clause (c)(1) of the Act. In addition to amounts actually spent for the residence itself, the rule permits amounts to be spent for the land upon which the residence sits and for the expenses incurred in acquiring the residence, such as closing costs, sales commissions, etc. The items listed in the rule are only meant as examples. Other items may qualify if it can be shown that they are directly related to the first purchase of a principal residence.

Items which are deductible under some other provision of law, for example, interest, which is deductible under Minn. Stat. 290.09, Subd. 3, are excluded from the meaning of the term in order to prevent the taxpayer from getting a double deduction. After all, if an item has already been removed from a taxpayer's taxable income, how can it be removed again?

"Points" are included within the term under the rationale that they are a cost of acquiring the property. However, if the points are deductible as interest, they do not qualify since it would cause a double deduction. The "points" that are deductible as interest are those paid as a bonus or premium to get a mortgage loan, often termed a "loan processing fee," which are paid for the forebearance of money and not for services rendered. IRS Rev. Rul. 69-188, 1969-1 C.B. 54; IRS Rev. Rul. 69-582, 1969-2 C.B. 29. If the "points" are paid for services rendered and not for the forebearance of money, as a service charge or a

"loan origination fee," the "points" are not deductible as interest. IRS Rev. Rul. 67-297, 1967-2 C.B. 87.

As previously stated, the items must be for the residence itself or directly related to the acquisition of the residence. Payments for maintenance or repairs of the residence are neither for the residence itself nor directly related to the acquisition of the residence. Therefore, repairs and maintenance are not allowed. Similarly, furnishings are not allowed.

It does not seem reasonable to limit the IHA program to the purchase of existing homes. There is nothing to indicate that an individual who builds his home should not have the benefits of the program. Therefore, the rule expressly allows both the cost of labor and material to qualify.

The same rationale applies to the purchase of an existing house which the participant will remodel and make his principal residence.

The rule provides that in order to qualify as an amount "used exclusively in connection with the first purchase of a principal residence," the amount withdrawn must be made payable to the person or entity from whom the property is being purchased. Thus, in order to claim the exemption for a withdrawal, it must be made so payable. This provision is based on the statutory requirement that the trust agreement contain a provision that, subject to certain exceptions, the trustee will either withhold tax or make the withdrawal payable to the mortgagor, construction

contractor, or other vendor of the property purchased. See clause (b)(5) of the Act. Since the trust agreement is equally binding on the trustee and the participant, it is reasonable to require, by rule, that the participant have any withdrawal made so payable.

The rule takes a liberal position and allows a withdrawal to be made payable jointly with such person or entity and the participant.

When a participant uses money withdrawn from an IHA for earnest money in connection with the purchase of his first principal residence, it is treated as "used exclusively in connection with the first purchase of a principal residence," even if the deal falls through and no purchase results. However, if the earnest money is not forfeited but returned to the participant, then the participant must redeposit the money in the IHA. This is a reasonable and practical interpretation. If the money was forfeited, it nevertheless was used in the attempt to purchase the participant's first principal residence. If the money was not forfeited but immediately redeposited in the IHA, it seems unreasonable to penalize the participant for his attempt, when no other use was made of the money.

In accordance with this treatment, the rule expressly provides that the trustee is not required to withhold tax on a withdrawal that the participant verifies will be used as earnest money in connection with the purchase of the participant's first principal residence.

3. The statutory framework gives a tax benefit when a withdrawal from an IHA is used for the purchase of a first principal residence. It would be a tremendous administrative burden to trace the amount withdrawn from one transaction to another until it is ultimately used for the first purchase of a principal residence. Therefore, it is provided in the rule that the amount be used for a principal residence within a reasonable time after the withdrawal and that the withdrawal shall not be used for any other purpose in the interim. This seems to be in keeping with the statutory framework, especially the requirement that the withdrawal be made payable to the seller of the property, which evidences a legislative intent along similar lines.
4. An IHA may be used only to purchase a first principal residence for the particular participant of that IHA. It cannot be used to purchase a residence for someone else. Although the statute does provide this, the rule does so with more clarity and emphasis.
5. This provision of the rule expresses a concept similar to that explained in Part D.3, above. The other provision dealt with double deductions, while this provision deals with double exemptions.
6. This provision makes it clear that even though the residence was purchased with tax free dollars, the basis of the residence need not be adjusted. In other words, the IHA provisions create a permanent exemption, rather than merely a deferral of tax.
7. This provision makes it clear that when a withdrawal is used for the first purchase of a principal residence, it is not only exempt from income tax, but it is also not included in computing

the low income alternative tax, etc. The rationale is that there is no provision in the law which specifically includes these amounts for computing the particular items.

8. The authority for this provision is found in clause (e) of the Act. Justification for the verification form was discussed above. The closing statement contains much of the information required on the verification form. In case that the verification form looks suspicious or that there are other matters that need investigation, the Commissioner may request additional information.

F. Tax Treatment of Distributions Not Used For a First Principal Residence.

1. The rule seeks to simplify and clarify the difficult and complex language of the statute. Consequently, much paraphrase of the statute is used. The first paragraph represents the general rule that withdrawals not used for a first principal residence are includible in gross income and subject to the 10 percent additional tax.

2. The second paragraph is an exception to the general rule. This provision of the rule rewords the statutory language found in the third paragraph of clause (c) of the Act.

3. The exception contained in paragraph 3 is taken from clause (d) of the Act.

4. The rule makes it clear that whenever an amount is required to be included in gross income because it was not used for a first principal residence, it is ordinary income to the participant. It cannot be treated as a capital gain.

The rule provides that the 10 percent additional tax is not to be offset by any nonrefundable tax credits. It seems quite

apparent that the legislature intended the 10 percent additional tax to constitute a penalty for not using the withdrawal in the intended manner. To allow a penalty to be offset by any excess nonrefundable credits destroys the effect of the penalty.

5. The 10 percent additional tax is only applicable when a withdrawal is required to be included in gross income. The withdrawal of an excess contribution is not required to be included in gross income if the withdrawal was made within the time for filing an income tax return for the taxable year in which the excess contribution was made. This is found in clause (c)(2) of the Act.

6. If the trust agreement so provided, the agreement does not take effect and the IHA is not established for seven days after the date of the trust agreement. The purpose for allowing such a "revocation period" is explained earlier at Parts B.5 and C.1.f. During the seven day period, the prospective participant may revoke the agreement and receive back his money without the 10 percent additional tax and without the trustee withholding any tax. This is so because the penalty and withholding provisions apply only to withdrawals from an IHA. Not until after the seven day period does the arrangement constitute an IHA.

7. The trustee is required by clause (b)(4) of the Act to distribute the entire amount in the IHA to the participant within 10 years after the date of the first contribution to the account. There is nothing in the statute that would exempt this distribution from the requirement that it be included in gross income and subject to the 10 percent additional tax. Moreover, it would seem that it should be subject to such treatment since the

account was not used for the purchase of a first principal residence, which was the objective of the statute, yet the participant was allowed tax deductions with respect to the account.

G. Excess Contributions.

1. The first paragraph is a paraphrase of the statutory requirements regarding "excess contributions" and is made for purposes of introduction, clarity and continuity.

2. The second paragraph makes it clear in what taxable year the six percent additional tax is due. It also clarifies and emphasizes that this additional tax is due in <u>each</u> taxable year that an excess contribution remains in the account, not just in the taxable year in which the excess contribution was made. This interpretation is based on the language in the second paragraph of clause (f) of the Act where it is said that there "is imposed for each taxable year, a tax not to exceed six percent . . . ."

3. Excess contributions are defined in clause (f) of the Act as "the amount by which the amount contributed for the taxable year to the account exceeds the amount allowable as a contribution under clause (b)(1) for the taxable year." Since clause (b)(1) provides that the amount allowable as a contribution is any amount that does not exceed $2,500 during a taxable year or that does not exceed $10,000 for all taxable years, the rule so states. The second sentence of clause (f) of the Act excepts from the definition of excess contributions any contribution which was distributed out of an individual housing account to which clause (c)(2) applies. The rule incorporates the provisions of clause (c)(2) and provides that an amount shall not be considered an excess contribution if it, plus the interest earned

on it, is withdrawn from the account by the date that the tax return is due for the taxable year in which it was made. The rule also points out that even though in such circumstances the interest withdrawn is not includible in gross income under the IHA provisions, it is still subject to tax under other provisions. Unlike the interest, the withdrawn contribution was probably already taxed. The rule provides, however, that to the extent the contribution was not already taxed, it must be included in gross income.

4. This paragraph points out the statutory provisions found at clause (c)(3) of the Act.

5. It is reasonable to assume that if there are excess contributions in the account and the individual withdraws an amount from the account, that he would intend to withdraw the excess contribution. After all, by reducing the amount of excess contributions, he is reducing the amount of additional tax that he would have to pay. The rule adopts such an assumption.

6. There is no express provision in the statute to allow an excess contribution made in one taxable year from being used as a deductible contribution in a subsequent taxable year. On the other hand, there is no express provision prohibiting such treatment. It seems reasonable, however, that if an individual makes an excess contribution in one taxable year and in the next taxable year does not contribute enough to utilize the maximum deduction allowed, the individual should be allowed to reduce the amount of his excess contributions in the account and use it as a deductible contribution. After all, he could do so indirectly, by withdrawing the excess contribution before

the close of the taxable year and redepositing it in the IHA. On the other hand, it would be going too far to allow the taxpayer to carry the excess contribution back to a preceding year. The preceding taxable year is already closed and the taxpayer obviously could not meet the six month deposit requirement. See clause (a) of the Act.

H. Special Rules.

1. Disability or death. For purposes of clarity and continuity the rule points out that a participant who is disabled is not subject to the 10 percent additional tax for not using an IHA for the purchase of a first principal residence. This exception to the 10 percent additional tax is found in the middle of clause (d) of the Act. In order not to mislead people, it is pointed out in the rule that even though a disabled participant is not subject to the 10 percent additional tax, any withdrawal from an IHA is still includible in the participant's gross income for the year of the withdrawal under the same rules as for any other participant. There is also no exception to the six percent additional tax on excess contributions for a disabled participant and the rule so provides.

Clause (d) of the Act provides that "an individual shall not be considered to be disabled unless he furnishes proof of the disability in the form and manner as the commissioner of revenue may require." It is upon this basis that the rule requires a disabled participant to furnish a signed declaration of disability to the trustee at the time of a withdrawal. The items required in the disability statement are taken from the definition of the term

"disabled" in Minn. Stat. 290A.03, Subd. 10, which is also the definition for IHAs, since it is incorporated by reference in clause (d) of the Act.

Only upon audit when there is some question whether the participant's disability is within the meaning of Minn. Stat. 290A.03, Subd. 10 will the participant have to produce any further information about the disability. This is certainly more reasonable and less onerous than requiring every participant claiming disability to furnish all of the detailed information.

The rule repeats the statutory requirements that upon the death of a participant, the amount in the account shall be payable to the estate of the participant. This is done for purposes of introduction, emphasis and continuity. The statute provides an exception only to the 10 percent additional tax where the participant has died. The rule emphasizes this and states that upon the death of the participant, the amount in the account is still includible in gross income. The rule makes it clear that it must be included in the decedent's final income tax return, rather than on the estate's fiduciary return. The statute is silent on this point but the rule's position is reasonable in light of the statutory scheme. The deduction was allowed only to help save for a first residence. Since the taxpayer died, the purpose for the deduction is lost. It cannot be used for a residence, which is the only time a withdrawal is not included in income. And it was the decedent that got the deduction so it should be the decedent's final return that includes the income. Moreover, since

the income does not accrue after the participant's death, it is not proper to include the income in the fiduciary return.

The statute provides an exception where the account was held jointly by the decedent and a spouse of the decedent. In such a case the account shall remain as the individual housing account of the surviving spouse and does not become payable to the estate of the deceased participant. Since the statute provides that the account shall continue as an IHA for the benefit of the surviving spouse, all of the limitations and restrictions contained in the law are still applicable to the surviving spouse. The rule so provides.

It would be very difficult to determine, administratively, whether or not a particular withdrawal was "attributable" to the death of a participant. Consequently, the rule takes a liberal position and provides that any withdrawal made within 60 days after the death is automatically attributable to the death. This seems to be more than reasonable since even after the 60 days a particular withdrawal could still be shown to be attributable to a death.

2. The concept of a "transfer" of an IHA to a different financial institution is similar to the concept of a "rollover" with respect to Individual Retirement Accounts (IRAs). The term "transfer" was used, rather than the term "rollover" in order to distinguish a transfer from a rollover, since the rules and restrictions are somewhat different.

The primary difference is that a "rollover" of an IRA is paid directly to the participant, while a transfer of an IHA must be

made payable to the transferee institution. Moreover, a rollover need not be paid into another IRA for 60 days thereafter, while an IHA must be promptly transferred to the new account and not used for any other purpose in the interim. See IRC Sec. 408(d)(3) and IRS Proposed Reg. 1.408-1(b)(2).

The stricter requirements for IHA transfers arise from the fact that transfers of IHAs are not expressly authorized by statute (although they are also not expressly prohibited). The rule seeks to allow as much freedom with respect to the IHA as it can within the framework of the statutory provisions. However, there is no 60 day period authorized by the statute, as there is for IRAs. And use of an IHA for any purpose other than the purchase of a first principal residence subjects the participant to both tax and penalty. Therefore, the additional restrictions on transfers of IHAs are essential if transfers are to be allowed at all.

It seems reasonable to allow an individual to transfer his account from one institution to another as long as he continues to meet all of the statutory requirements regarding the IHA. And since he is merely transferring the account from one institution to another, it seems reasonable to treat it as such and not treat it as a withdrawal or deposit. The transfer provisions apply only when the IHA is transferred from one financial institution to another, i.e., when the trustee is changed. If the IHA is only transferred within one institution, e.g., transferred from one branch to another branch, there will be no tax consequences since the trustee remains the same. The transfer provisions in the

rule, in effect, treat the transfer as a mere substitution of trustees. It is for this reason that the transfer is treated as not being a withdrawal from the first account and a deposit in the second account. It is also for this reason that the participant is required to transfer the entire amount in the first IHA and to close and terminate that account.

Obviously, if the amount to be transferred is used for any purpose while it is being transferred, it cannot be considered a mere substitution of trustees. Then it must be treated as an actual "withdrawal" and subject to the consequences thereof.

Since both accounts are IHAs, both of them must meet all of the requirements of the rule. A participant should not be able to get around the 10 year limit on the life of an IHA by simply transferring it. Therefore, the rule provides that the receiving account shall terminate 10 years from the date that the original IHA account was established. The trustee of the receiving account will probably not know the date that the original account was established. Therefore, the rule provides that the trust agreement covering the receiving account shall provide that that account will terminate 10 years from the date that the original account was established. This will force the participant to tell the new trustee that it is a transfer and the date that it must terminate. The new trustee must then terminate the account on such date and so notify the participant.

Since the transfer is not treated as a withdrawal, the transferor trustee is not subject to the withholding requirements. The rule so provides as long as the transferor trustee receives notice of the transfer from the participant. To assure that the account is actually transferred and the transfer provisions are not used merely to circumvent the withholding requirement, the rule provides that the original trustee must make the instrument of payment payable to the new trustee.

The requirement that the participant furnish to the trustee a written declaration of his intention to transfer an IHA gives the trustee protection from the withholding requirements. Since the trustee is personally liable for any tax required to be withheld, obviously the trustee would be reluctant to honor an oral request. The requirement that the trustee file the statement within 10 days with the Commissioner of Revenue allows the Commissioner to closely monitor such transfers.

3. The rule provides that an individual who is not a resident of Minnesota may establish an IHA in Minnesota. This is based on an implication from Section 6 of the Act, which provides that withdrawals and penalties from an IHA are assignable to Minnesota even though the participant is not a resident of Minnesota. The rule also paraphrases Section 6 of the Act in order to avoid any misunderstandings and because Section 6 is codified in a different part of Chapter 290, specifically, Minn. Stat. 290.17, Subd. 2(5).
4. Married Individuals. For married individuals, clause (b) of the Act requires an IHA to be for the exclusive benefit of the individual and his spouse jointly. Part D.6 of the rule provides

that married individuals are allowed no more than one $1,500 maximum deduction between them.

A question immediately arises on the treatment to be accorded to two individuals who each have their own IHA and who marry.

It seems clear that prior to the marriage, each individual may deduct up to $1,500 for any taxable year and up to $10,000 in total for all taxable years. It also seems clear that after the marriage the two married individuals do not each get to deduct up to the $1,500 and $10,000 limitations, but rather, the married couple as a unit, is allowed only one deduction up to the $1,500 and $10,000 limitations, to divide between them. This interpretation is reasonable because prior to the marriage, the treatment is consistent with the treatment accorded other non-married individuals; after the marriage, the treatment is consistent with the treatment accorded other married individuals.

In the taxable year of the marriage, the couple is allowed only one deduction not to exceed the $1,500 and $10,000 limitations, even if each individual had deposited $1,500 in his or her own IHA prior to the marriage. This is because both the deduction and the marital status is determined as of the close of the taxable year. The date of the deposit is relevant only as to whether the six month deposit requirement has been met.

There is a more difficult problem with respect to the $10,000 maximum limitations on the total deductions that may be claimed

and total contributions that may be made for all taxable years. What treatment should be accorded to two married individuals who each had an IHA prior to marriage with respect to which they had contributed and deducted a combined total of more than $10,000 prior to the year of the marriage, even though neither of them had individually exceeded the $10,000 maximum limitations?

To be consistent with the treatment accorded other married individuals, the couple should not be allowed to contribute any more to the IHA after the marriage. But should the marriage, itself, apart from any contributions in the year of the marriage or thereafter, result in the application of the six percent additional tax for excess contributions, since the total contributions to the account exceed the $10,000 maximum allowed to a married couple?

The Department did not feel that the penalty should be applicable, and the rule so provides. The basis for our position is that at the time the contributions were made (or more correctly, at the end of the taxable year in which the contributions were made), they were allowable contributions. Therefore, in subsequent years they remain allowable contributions. The marriage itself, does not render a contribution made in a prior year an excess contribution.

Since there is a 10 year limitation on the existence of an IHA, and after the marriage the two individual accounts are treated as one joint account, it must terminate 10 years from the date

of the first deposit to account first established. The rule so provides.

The trustee is required to terminate an IHA upon expiration of the 10 year limitation. Yet for two participants who marry and whose individual accounts are treated as one joint account, the trustee will only know the date that the account he is administering was established. In the situation being discussed, the trustee will probably not even know of the marriage, much less whether the spouse's account was established before the account the trustee is administering. In order to protect a trustee in this situation, the rule provides that the treatment of the accounts of two participants who marry as one joint account shall extend only to the participants themselves. The trustee may continue to administer the two accounts as if the individuals had not married.

5. Termination of the Account. The obvious legislative intent of the IHA program is to assist individuals or married couples in saving for the purchase of their first principal residence. Once the participant owns his own residence, the purpose of the program is lost. Consequently, the rule provides that an IHA shall terminate whenever it is used to purchase the participant's first principal residence. This is consistent with the prohibition on the establishment of an IHA by an individual who owns (or did own) his own residence.

The rule summarizes and clarifies the treatment of an IHA upon the expiration of the 10 year limitation on its existence. These

provisions have been previously discussed at Parts C.1.d, C.1.e, and F.7.

6. Marriage Dissolution Transfers. The general treatment of marriage dissolution transfers is provided in clause (c)(4) of the Act. The rule paraphrases the statutory provision for purposes of introduction and clarity. The rule then provides that the limitations and restrictions on the IHA apply to the transferee as if he or she had made all prior deposits and withdrawals. This seems to be the legislative intent, since it did not provide a different treatment for the money in the account that is transferred. There is certainly nothing in the Act to indicate that a former spouse that receives an IHA as part of a marriage dissolution should have higher deduction or contribution limitations than anyone else or that the IHA should last longer than 10 years.

I. Exhibits.

The requirements for the written trust agreement are provided in Part B.4 of the rule. The requirements for the written disclosure statement are provided in Part B.5 of the rule. The exhibits in Part I. of the rule are meant only as examples of particular documents which are in compliance with the rule. There is no requirement that the particular documents provided in the exhibits actually be used to set up an IHA. The financial institution and a prospective participant may use other trust agreements or disclosure statements as long as the documents meet the requirements of this rule.

Use of the prototypes provided in the rule does have an advantage. The prototypes will be treated as being in compliance with the requirements of the rule. By using the prototypes, the trustee need

not worry that trust agreement or disclosure statement will be found deficient in some respect which could cause the participant to lose the deductions provided in the Act. The trustee may so assure the participant.

The trustee may add provisions to the prototype trust agreement or disclosure statement as long as the added provisions are not in conflict with any provisions of the prototypes or in conflict with any provisions of the rule or the statute.

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EXHIBIT A

BANCO®

NORTHWEST BANCORPORATION
Northwestern Bank Building
Minneapolis, Minnesota 55480
612/372 8123

December 12, 1980

Mr. Gary Mesna
Attorney
Income Tax Division
Minnesota Department of Revenue
Centennial Office Building
St. Paul, Minnesota 55145

Dear Mr. Mesna:

RE: Draft Rules for Individual Housing Accounts

We have reviewed the draft rules forwarded to us for comment. We have some concerns about the general statuatory framework, which may be beyond the scope of the rules, but will take this opportunity to comment on those matters as well as the draft rules themselves.

Our first concern is the requirement that a contribution must be made six months prior to year end in order to be deductible in that year. Bank records are kept on an annual basis. This requirement will cause a great deal of hand posting and manual recordkeeping. Reporting requirements placed on the trustee will be unduly burdensome and expensive as a result of this requirement. Shifting part of the reporting onus to the taxpayer would greatly ease the trustee's burden and expense. It would not be unduly burdensome for the taxpayer to maintain records of the dates and amounts of contributions and to report this information to the state. The trustee could provide the taxpayer with the amount of interest earned in the calendar year and the amount in the account at the end of the calendar year. Present systems would not have to be modified to provide such reports.

The statute permits a trustee to commingle funds held in IHA accounts for purposes of investment. The regulation permits commingling in a common trust fund or common investment fund. The only authority for commingling investments by a bank trustee in a common trust fund is that contained in Regulation 9, §9.18 of the Comptroller of the Currency. Minnesota Statutes §48.84 incorporates the applicable regulation for national banks (Regulation 9) as the governing rule for commingling of investments by state banks and trust companies. Both the IHA regulation and statute limit investments to certificates of deposit or savings or time deposits. Regulation 9, §9.18 specifically prohibits investment in a bank trustee's own accounts. Income tax and securities law questions would also be raised by common trust fund investments not

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complying with Regulation 9. See §584 of the Internal Revenue Code, §3(a)(2) of the Securities Act of 1933 and Minnesota statutes §290.281 sub.1 and §80A.15(j). We recommend that commingling in a common trust fund not be permitted.

Since the investment provisions do not limit a trustee to investments in its own savings deposits, there is a question of whether a national bank which does not have trust powers can act as trustee. We have raised this question with the Regional Office of the Comptroller of the Currency but do not anticipate an answer before year end. We recommend that the regulations specifically limit a trustee's investment authority to its own savings deposits and not to savings deposits generally. Minnesota statutes §48.159 covering IRA accounts has such restriction.

The proposed rule requires that the trustee prepare a rather intricate disclosure which must include the tax consequences of this type of account. The statue does not require a disclosure statement. We, therefore, question the requirement that the trustee prepare a detailed disclosure not required by the statute. The draft rule contains over 15 pages of technical explanation. We would suggest that the taxpayer be provided with a copy of the rule in its final form in lieu of a disclosure or that the state prepare a standard disclosure of the tax consequences, both state and federal, of the account.

The rule provides that the trustee will not accept deposits to an IHA from an individual who currently owns or formerly owned a principal residence. We believe that this provision should be amended to authorize the trustee to rely upon the certification of the taxpayer that he or she does not presently own or has not owned a principal residence. The rule as proposed would require the trustee to make some type of inquiry which we believe is unwarranted. The onus should be put on the taxpayer, the person with knowledge.

The statute is silent on the question of fees or compensation. A bank will incur considerable expense in acting as an IHA trustee. We suggest that the rule and the trust agreement specifically provide that the trustee be entitled to reasonable compensation for its services. See Minnesota Statutes §48.80 covering trustees and trust companies generally.

The rules use the term "beneficiary" and the proposed trust agreement uses "grantor." Grantor more accurately describes the relationship. We would recommend that grantor be used throughout the rules in place of beneficiary.

In our opinion, the prototype trust agreement should be revised to accomplish the changes and comments outlined above. We would recommend that Article II be completely redrafted to put the onus on the taxpayer to state that he or she does not now and has not owned a principal residence. The recommended change in reporting requirements would likewise necessitate modifications in the trust agreement. The taxpayer should also acknowledge the contribution limitations and agree to abide by them.

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We are in the process of developing a trust agreement for use by our banks and will forward a copy to you under separate cover.

We appreciate the opportunity to comment on these draft rules and sincerely hope that the rules can be modified and amended to greatly simplify the reporting requirements for trustees.

Sincerely,

Robert A. Krane
Executive Vice President

RAK:meb

In the Matter of the Proposed Adoption of Rules of the State Department of Revenue Governing Individual Housing Accounts (13 MCAR Section 1.6016)

STATEMENT OF COMPLIANCE WITH RULEMAKING PROCEDURES

I, Gary P. Mesna, Attorney for the Income Tax Division, do hereby declare that I have examined the rules and all related documents and that, based on my examination and my personal familiarity with the applicable procedures, the Administrative Procedure Act, the rules of the Office of Administrative Hearings, and the rules of the Attorney General have been followed. Any exceptions are noted below.

Gary P. Mesna

Gary P. Mesna
Attorney, Income Tax Division
Minnesota Department of Revenue

Dated: 4-13-81

(13)

STATE OF MINNESOTA

DEPARTMENT OF REVENUE

In the Matter of the Proposed Adoption of Rules of the State Department of Revenue Governing Individual Housing Accounts (13 MCAR Section 1.6016)

NOTICE OF SUBMISSION TO THE ATTORNEY GENERAL

Pursuant to your request and in accordance with Minnesota Statutes, section 15.0412:

PLEASE TAKE NOTICE that the above-captioned rules have been submitted to the Office of the Attorney General on this date, April 13, 1981, for review as to form and legality. Pursuant to 1 MCAR section 1.206 B., the Attorney General will not approve the rules for at least eight calendar days after receipt to allow any person or association time to comment on the legality of the rules, after which that Office will complete its review. If you desire to comment on the legality of the above-captioned rules, you should direct your comments to the Office of the Attorney General, G-25 State Administration Building, 50 Sherburne Avenue, Saint Paul, Minnesota 55155, telephone (612) 296-7030. Please note that the above-cited rule of the Attorney General also provides that a copy of any written comments submitted to the Attorney General must be submitted simultaneously to this agency.

There were no changes made in the proposed rules after publication and before submission to the Attorney General.

Clyde E. Allen, Jr.
Commissioner of Revenue

In the Matter of the Proposed Adoption of Rules of the State Department of Revenue Governing Individual Housing Accounts (13 MCAR Section 1.6016)

AFFIDAVIT OF MAILING NOTICE OF SUBMISSION TO THE ATTORNEY GENERAL

STATE OF MINNESOTA)
) ss.
COUNTY OF RAMSEY)

Mary Lacho, being first duly sworn, deposes and says:

That on the 13Th day of April, 1981, in the City of St. Paul, County of Ramsey, State of Minnesota, she served the attached Notice of Submission to the Attorney General by depositing in the United States mail at said City of St. Paul, a copy thereof, properly enveloped, with postage prepaid, on all persons and associations who requested notice that the rules in the above-entitled matter have been submitted to the Attorney General.

Mary Lacho

Subscribed and sworn to before me this 13th day of April, 1981.

Kathryn A. Kenney

KATHRYN A. KENNEY
Notary Public, Ramsey County, Minn.
My Commission Expires
Sept. 23, 1981