

## Employer Assistance for Home Purchase Tax Expenditures

This memo covers two tax expenditures that are available when an employer establishes a savings account for an employee and makes contributions to this account for the employee to purchase a primary residence—the Employer Assistance for Home Purchase Credit [Section 39-22-558, C.R.S.] and the Employer Assistance for Home Purchase Employee Deduction [Section 39-22-104(4)(bb), C.R.S.]. Both tax expenditures were created in 2023 by House Bill 23-1189 and are available for Tax Years 2024 to 2026. Neither tax expenditure has been substantively changed since its creation. Statute requires the Office of the State Auditor (OSA) to issue an evaluation prior to the legislative session before a tax expenditure expires [Section 39-21-305(1)(d), C.R.S.]. At this time, data is not available from the Department of Revenue (Department) to evaluate either tax expenditure. Therefore, this memo summarizes how the tax expenditures work, discusses the data limitations, and provides a few policy considerations for the General Assembly to consider.

**The Employer Assistance for Home Purchase Credit (Employer Credit) allows an employer to claim an income tax credit equal to 5 percent of the employer’s contribution to the employee’s home savings account.** In each tax year, the amount of the credit is limited to \$5,000 per employee for any given employer, and employers may not claim more than \$500,000 in total credits for home savings account contributions to all employees. The credit is not refundable but can be carried forward for 5 years if the credit exceeds the employer’s tax liability. In order to be eligible for the credit, employers must establish a savings account where the contributed funds can be deposited, along with policies on how the employer contributions will be made and how employees can make their own contributions and withdrawals. Under statute, eligible expenses are defined as “a down payment and any closing costs included on a real estate settlement statement, including but not limited to appraisal fees, mortgage origination fees, and inspection fees” [Section 39-22-558(2)(b), C.R.S.]. Eligible property must be purchased by an employee as a primary residence. If the employee ends their employment with the employer that established the home savings account on their behalf or the employee uses the funds they contributed to the home savings account for any purpose other than an eligible expense, then the employer must remit to the employee the remaining amount of the employee’s contributions to the account plus interest earned on that amount. The employee also forfeits any of the unexpended employer contributions to the account, and the employer must repay any credit they previously claimed as employer contributions to that account by increasing their tax liability for the tax year in which the remittance to the employee occurs.

Statute says the purpose of the Employer Credit is “to induce certain designated behavior by taxpayers to encourage home ownership by providing tax relief to employers who contribute money to an employee for a down payment and related closing costs on a home purchase” [Section 39-22-558(1)(a), C.R.S.]. Additionally, during committee hearings for House Bill 23-1189, the bill sponsors stated that one of the main purposes of the credit is for employers to use it for recruitment and retention of employees.

Statute provides that the OSA should measure the effectiveness of the credit in achieving its purpose based on records maintained by an employer that show (1) the number of employees for which the employer made

employer contributions in the tax year, (2) the amount the employer contributed to each employee's home purchase savings account in the tax year as employer contributions, (3) the number of employees who expended money from a savings account on eligible expenses for a home purchase in the tax year, and (4) the total amount of any employer contributions made by the employer for use by the employee for eligible expenses in connection with a qualifying home purchase that an employee has forfeited in the tax year. However, statute does not explicitly require the Department to collect this information from employers, and Department staff verified that they do not collect any of this information from employers during the income tax return filing process. Therefore, we are unable to measure the effectiveness of the Employer Credit using these metrics. Additionally, Department data on claims of the Employer Credit for Tax Year 2024 will not be available until January 2027, so we are unable to determine the extent to which the credit has been used or its revenue impact to the State at this time. We spoke with stakeholders from two trade organizations that operate in the state that had testified in support of the creation of this credit in 2023. They reported that they were not aware of any businesses that had used this credit and thought that awareness of the credit was likely low, at least partly because no state agencies were promoting it to employers.

**The Employer Assistance for Home Purchase Employee Deduction (Employee Deduction) allows an employee to deduct any employer contributions to a home savings account when calculating their Colorado taxable income.** According to Department guidance on the Employee Deduction, the Department only allows employees to claim the deduction to the extent that these contributions are included in the employee's federal taxable income, but that requirement is not explicitly included in statute. Employees may also make contributions to the account, but their own contributions are not eligible to be deducted. If the employee ends their employment with the contributing employer or uses their own contributions to the home savings account for any purpose other than expenses associated with the purchase of a primary residence, the employee must add back any amounts previously claimed under this deduction to their federal taxable income when calculating their Colorado taxable income.

Statute does not establish a purpose for the Employee Deduction. Based on legislative testimony from the bill sponsors for House Bill 23-1189, we inferred that the purpose was to avoid imposing state income tax on employees for the amount contributed by their employers to the employees' home savings accounts because they wanted to make the employer contributions to these accounts a non-taxable benefit for employees. In the Policy Considerations section, we discuss several issues with the timing of the Employee Deduction that the General Assembly might want to address.

Statute also does not provide performance measures for the Employee Deduction. Department data on claims of the Employee Deduction for Tax Year 2024 will not be available until January 2027, so we are unable to determine the extent to which the deduction has been used or the revenue impact to the State at this time.

We did not identify any states that currently offer a similar tax expenditure to the Employer Credit or Employee Deduction. The Connecticut and Florida legislatures considered bills in 2024 and 2026, respectively, to create employer credits similar to Colorado's credit, but the bills did not pass.

We did not identify any other tax expenditures or programs in the state that provide employers with a financial benefit for helping their employees purchase a primary residence. There are several other programs available in the state that help people purchase a home. For example, the Colorado Housing and Financing

Authority (CHFA) offers down payment assistance grants and loans to eligible applicants. Metro Down Payment Assistance (metroDPA) is a program sponsored by the City and County of Denver that provides qualifying applicants with down payment assistance to purchase homes in certain Front Range cities.

## Policy Considerations

**Due to uncertainty about whether employees claim the Employee Deduction when their employer makes the contribution or when the employee withdraws the money from the account, the General Assembly might want to consider extending the tax years that employees can claim the Employee Deduction so it is available in future tax years when employees withdraw funds from their home savings accounts.** Based on the statutory language and discussions with Department staff, we were unable to definitively determine whether the employer contributions should be included in the employee's federal income when the contributions are made or later when the employee withdraws the money to pay for an eligible expense. The Department has interpreted statute to require the contribution to be included in the employee's federal income in order to claim the deduction. Therefore, the timing of when employer contributions are included in the employee's federal income tax has implications for when the employee might claim the Employee Deduction as well as when the employee might need to addback a previously claimed deduction. Extending the Employee Deduction does not mean the General Assembly would also need to extend the Employer Credit. The Employer Credit could still be allowed to expire at the end of Tax Year 2026 with employees allowed to claim the Employee Deduction in subsequent tax years.

If the employer owns and controls the home savings account until the employee uses the funds for an eligible purchase, it is unlikely that employer contributions are included in employees' federal income at the time the contributions are made. This is because the employees are not likely considered to have received the contributions as income for federal income tax purposes. Federal regulations [26 CFR § 1.451-2(a)] consider a taxpayer to have received income when "Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. **However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions**" (emphasis added).

Statute requires that the employer establish the account and establish policies and procedures regarding contributions to and withdrawals from the account [Section 39-22-558(3)(b)(I) and (II), C.R.S.], which suggests that the employer retains ownership and control of the account until an employee withdraws funds to pay for eligible expenses. This likely means that the employee is not considered to have received (for federal income tax purposes) the employer contributions to the account until they withdraw the funds for an eligible purpose and, therefore, employer contributions would not be included in employees' federal taxable income until the year in which funds are withdrawn to pay for eligible expenses. In this scenario, an employee would not use the Employee Deduction until they withdraw the funds from the account.

The Department seems to agree with this interpretation of federal law and statute. Department staff told us, "...we think it likely that the employer contribution is not recognized by the employee as income at the time the employer makes the contribution because the employee is likely not in constructive receipt of an

employer's contributions prior to withdrawal...Consequently, we believe employees generally will not be able to claim a subtraction for an employer contribution made to their account." However, it is likely that when the employee makes a withdrawal from the account to pay for an eligible expense related to a home purchase that the employee will be considered to have received income for federal income tax purposes, and thus have some amount of the employer contributions included in their federal income. The deduction is currently set to expire January 1, 2027, which means that employer contributions made between Tax Years 2024 and 2026 could be taxable to the employee if the employee withdraws the funds for an eligible expense after the end of 2026. In this case, the employee could have a large and unexpected state tax liability depending on the amount of the contributions included in their federal taxable income at the time of the withdrawal. For example, if an employer contributed \$5,000 to an employee's home savings account each year in 2024, 2025, and 2026, and the employee used the \$15,000 for eligible expenses related to purchasing a primary residence in 2027, in this scenario, the employee would be unable to claim the Employee Deduction in 2027 because it expired, and the employee would owe \$660 in Colorado income taxes on the \$15,000 in employer contributions (assuming a 2027 Colorado tax rate of 4.4 percent). It is unclear whether that was the intention of the General Assembly.

On the other hand, extending the Employee Deduction might cause an additional administrative burden on the Department for relatively few taxpayers. As discussed previously, we do not know how many taxpayers have claimed the deduction or how many might potentially be eligible in the future because their employer contributed to their home savings account. However, the Department reported that several taxpayers have incorrectly tried to claim the Employee Deduction. Department staff reported to us that of the claims of the deduction that the Department has reviewed so far, the majority of the claims by employees are incorrect. Additionally, Department staff stated that when taxpayers (employees) called the Department to ask questions about the Employee Deduction, they often stated that they claimed their Health Savings Account (HSA) amount on the line for the Employee Deduction on their tax returns. Department staff were not certain why this occurred, but thought it could be due to a knowledge gap or lack of proper guidance on software vendor platforms when individuals were filing their 2024 tax returns. Therefore, the deduction might be providing relatively little benefit to taxpayers relative to the cost and time for the Department to administer the deduction.

**If the General Assembly decides to extend the Employer Credit and Employee Deduction, it could clarify whether the employer or the employee owns and controls the home savings account prior to the employee using the funds for eligible expenses.** As discussed above, clarifying this could make the federal tax treatment of these contributions and accounts clearer regarding when the employee can claim the Employee Deduction. Alternatively, the General Assembly could clarify in statute that the employee is eligible to take the Employee Deduction in the tax year their employer makes the contribution to their account, regardless of whether the funds were included in federal income in that year. This would mean some employees would receive the state deduction in a prior year to when it is included in their federal income, but would help ensure the Employer Credit and Employee Deduction are taken in the same tax year and would eliminate the need to have a longer expiration date for the Employee Deduction.

**If the General Assembly decides to extend the Employer Credit and Employee Deduction, it could consider directing the Department to collect the information from employers outlined in statute.** As discussed above, we encountered significant data constraints that made it impossible for the OSA to evaluate the Employer Credit and Employee Deduction using the performance measures that the General Assembly

created. Specifically, statute provides that the OSA should measure the effectiveness of the Employer Credit in achieving its purpose based on records maintained by an employer that show (1) the number of employees for which the employer made employer contributions in the tax year, (2) the amount the employer contributed to each employee's home purchase savings account in the tax year as employer contributions, (3) the number of employees who expended money from a savings account on eligible expenses for a home purchase in the tax year, and (4) the total amount of any employer contributions made by the employer for use by the employee for eligible expenses in connection with a qualifying home purchase that an employee has forfeited in the tax year. These performance measures are not usable because the Department is not explicitly required to and does not collect the relevant information from employers, even though employers are required under statute to maintain records of the information. If the General Assembly extends the credit and wants the OSA to conduct an evaluation using these performance measures, it should specifically direct employers to maintain the information, the Department to collect the information from employers, and the Department to provide it to our office upon request.

## Office of the State Auditor

State Auditor	<b>Kerri L. Hunter, CPA, CFE</b>
Deputy State Auditor	<b>Michelle Colin, JD</b>
Evaluation Manager	<b>James Taurman, MPA</b>
Evaluation Team	<b>Jacquelyn Combellick</b> <b>Kim Tinnell, MBA, MS, MA</b>



OFFICE OF THE STATE AUDITOR

C O L O R A D O

Working to improve government for the people of Colorado.