



# FIRST-TIME HOME BUYER SAVINGS ACCOUNT DEDUCTION

EVALUATION SUMMARY | JULY 2022 | 2022-TE32

TAX TYPE	Income	REVENUE IMPACT	\$1,942
YEAR ENACTED	2016	(TAX YEAR 2018)	
REPEAL/EXPIRATION DATE	None	NUMBER OF TAXPAYERS	4

**KEY CONCLUSION:** The First-Time Home Buyer Savings Account Income Tax Deduction is not meeting its purpose of encouraging savings for the first-time purchase of a home because it has been used by few taxpayers and provides a small tax benefit.

## WHAT DOES THE TAX EXPENDITURE DO?

The First-Time Home Buyer Savings Account Deduction [Sections 39-22-4704 and 104(4)(w)(I), C.R.S.] allows taxpayers who set up a savings account to set aside money for a down payment and/or closing costs of a home to deduct the interest earned on that account from their income. Taxpayers are limited to contributing \$14,000 per year as individuals or \$28,000 per year for account holders who file taxes jointly, up to a maximum total contribution of \$50,000. The account can earn interest, tax free, up to the point when there is a total of \$150,000 in the account; once the account reaches \$150,000, it can continue to earn interest, but any interest earned is not deductible.

## WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-22-4702, C.R.S.] provides that “the purpose for allowing taxable income to be reduced by earnings from a first-time home buyer savings account is to encourage first-time home ownership through incentivizing saving for a down payment and closing costs because of the significant financial and civic benefits home ownership provides for our state.”

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to:

- Review the extent to which the deduction is meeting its purpose and consider repealing it or making changes to increase its usage.
- Establish performance measures for the deduction.



# FIRST-TIME HOME BUYER SAVINGS ACCOUNT DEDUCTION

## EVALUATION RESULTS

### WHAT IS THE TAX EXPENDITURE?

The First-Time Home Buyer Savings Account Deduction [Section 39-22-4704, and 104(4)(w)(I), C.R.S.] (First-Time Home Buyer Deduction) allows taxpayers who set up and designate a savings account to set aside money for a down payment and/or closing costs for the purchase of a first home to deduct the interest earned on that account from their income when calculating their Colorado taxable income. Taxpayers are limited to contributing \$14,000 as individuals or \$28,000 for account holders who file their taxes jointly per year. According to statute [Section 39-22-4704(3)(a)(II), C.R.S.], “The maximum amount of all contributions for all taxable years to a first-time home buyer savings account is fifty thousand dollars.” The account can earn interest, tax free, up to a total of \$150,000; once the account reaches \$150,000 it can continue to earn interest but any interest earned on the first-time home buyer savings account is not deductible. House Bill 16-1467 created this income tax deduction in 2016, and it became available to taxpayers beginning January 1, 2017. The operation of this deduction has remained unchanged since its creation.

To qualify for the First-Time Home Buyer Deduction, individuals must have never owned a home before or, as a result of a dissolution of marriage, not been listed on the title of a property title for at least 3 consecutive years. Individuals must also set up an account and designate the account as a First-Time Home Buyer Savings Account. According to Department of Revenue (Department) staff, because the deduction is limited to qualifying savings accounts, the money cannot be saved in investment accounts, such as mutual funds.

For example, if a couple puts the \$28,000 annual limit into a savings account that earns 1 percent interest and designates it as a First-Time Home Buyer Savings Account, the couple will earn \$280 on their savings during the year, which they can deduct from their taxable income. In the next year, if the couple adds \$22,000 to reach the statutory maximum contribution of \$50,000 in principal, the account would total \$50,280 and earn about \$503 in interest over the year, which they could then deduct from their taxable income. The total tax savings as a result of the deduction during the 2 years would be about \$36.

The First-Time Home Buyer Deduction is not available to taxpayers who withdraw the money to pay for a home before 1 full year has elapsed or use it to purchase a manufactured or mobile home that is not taxed as real property. Further, if the taxpayer uses the money for something other than the down payment or closing costs on a primary residence, the deducted interest or other income is subject to recapture, meaning that the taxpayer would owe the tax for the deducted interest back to the State. Additionally, statute imposes a penalty of 5 percent of the tax recapture if the taxpayer withdraws the money to pay an ineligible expense 10 or fewer years after the first deposit and 10 percent of the recapture if more than 10 years have elapsed since the first deposit. For example, if a couple withdrew the \$28,000 they put into the home savings account to pay for an ineligible expense, such as a car, after 1 year, they would owe the \$12.74 they should have paid in tax plus 5 percent of the \$12.74, or an additional \$0.64, for a total of \$13.38. However, if the taxpayer uses the money for the purchase of a primary residence in another state or if the primary beneficiary dies without naming a new beneficiary prior to their death, there is no penalty.

Individuals claim the First-Time Home Buyer Deduction on Line 17 of the Subtractions from Income Schedule (Form DR 0104AD), which they must attach to their Colorado Individual Income Tax Return (Form DR 0104). Taxpayers must also attach the First-time Home Buyer Savings Account Interest Deduction form (Form DR 0350), which includes information about the eligible savings account, to their return.

### WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly state the intended beneficiaries of the First-Time Home Buyer Deduction. Based on our review of the statute and the operation of the deduction, we inferred that the intended beneficiaries are Coloradans who have never owned homes and are saving to purchase a home. Additionally, statute mentions that homeownership provides, “significant financial and civic benefits...[to the] state” [Section 39-22-4702, C.R.S.]. Therefore, indirect beneficiaries could be the residents of the State and the State itself, since homeowners pay property tax and income tax, and may actively participate in the communities in which they live.

### WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-22-4702, C.R.S.] provides that “the purpose for allowing taxable income to be reduced by earnings from a first-time home buyer savings account is to encourage first-time home ownership through incentivizing saving for a down payment and closing costs because of the significant financial and civic benefits home ownership provides for our state.”

### IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We found that the First-Time Home Buyer Deduction is likely not meeting its purpose because it has been used by only a few taxpayers, and some of those claims were improper claims. Additionally, the tax benefit the deduction provides is extremely small relative to the typical down payment for a home and the median price of a home in Colorado, likely providing little to no incentive for a potential home buyer to increase their savings and restrict their money in a first-time home buyer’s savings account.

Statute does not explicitly provide performance measures for this deduction. Therefore, we created and applied the following

performance measure to determine if the expenditure is meeting its purpose:

**PERFORMANCE MEASURE:** *To what extent are eligible taxpayers using the First-Time Home Buyer Deduction and does it provide an incentive for saving for a personal residence?*

**RESULT:** Based on Department data, we found that only four taxpayers claimed the First-Time Home Buyer Deduction in Tax Year 2018, which was the most recent year of data available. Furthermore, according to Department staff, taxpayers who claim the credit often do so improperly with most sending a statement indicating they are deducting their mortgage interest rather than interest from an eligible first-time home buyer savings account, in which case the Department disallows the deduction. The Department confirmed that at least one of the four claimants in Tax Year 2018 claimed the deduction in error; we lacked data to determine whether the other three claims were legitimate claims of the deduction.

We also spoke to two stakeholders, one in banking and another in real estate. Both reported that they did not think many Coloradans know about the deduction. The banker reported that with interest on savings being so low over the last few years, the tax benefit may not outweigh the risk to taxpayers who are not certain that they are going to purchase a home. The real estate professional told us that people confuse this tax deduction with the federal mortgage interest tax deduction and so do not take steps to use this deduction. However, he also said that a real estate stakeholder group had plans to start promoting this deduction to increase general knowledge of it and better encourage its use.

Additionally, the deduction appears to provide a relatively small benefit in comparison to the cost of a down payment on a home. For example, as previously discussed, if a married couple filing a joint tax return maxed out the principal in their eligible savings account in the second year with a total of \$50,000, assuming a 1 percent interest rate, by the second year they would have earned just under \$800 in interest, which would result in a tax savings of about \$36 across both years. If, however, a taxpayer was only able to put \$2,000 each year into the

account, the account would grow to \$4,060 at 1 percent interest, or a gain of \$60, over 2 years. The taxpayer would save \$3 in taxes on that interest income across both years. For comparison, according to data published by the National Association of Realtors, the median down payment on a home was 12 percent nationally in 2019 and, according to the Colorado Association of Realtors, the median home price in Colorado in April 2022 was about \$600,000—though prices were higher in metro areas such as Denver (\$660,000), meaning that, statewide, a typical down payment would be about \$72,000. Therefore, in comparison to the median down payment and home prices in Colorado, the tax savings provided by the First-Time Home Buyer Deduction is likely insufficient to act as an incentive for a potential home buyer to increase their savings or restrict their money in a first-time home buyers savings account.

#### WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

According to Department data, the First-Time Home Buyer Deduction resulted in four taxpayers claiming a total of \$1,942 in income tax deductions in Tax Year 2018, or an average of \$486 per taxpayer. However, as discussed previously, at least one of the taxpayers claimed the deduction improperly and we lacked data to determine whether the other taxpayers qualified. Due to this limited usage, it appears that the deduction has had no significant economic impact or encouraged increased overall home ownership in the state.

#### WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If this deduction was eliminated, individuals saving for their home down payments and closing costs who use the deduction would see a relatively small increase in their state income tax liability. For example, an individual with \$50,000 in a qualifying savings account earning 1 percent interest would see an annual tax increase of about \$23. As discussed, the deduction appears too small to have a substantial impact on taxpayer saving decisions. However, for taxpayers who save over a long period and put the maximum amount of principal in their

accounts, the interest deduction and tax savings would be somewhat higher. Further, the deduction could become more significant if interest rates for typical savings accounts increase in the future.

#### ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified 13 other states with similar deductions for first-time home buyers. Of these states, two limit the deduction to the interest earned on savings similar to Colorado. The other 11 states provide a more substantial benefit by offering the deduction for both the contribution to the account and the interest income. Exhibit 1 outlines the policies in each state.

**EXHIBIT 1. OTHER STATES WITH FIRST-TIME HOME BUYER  
SAVINGS ACCOUNT INCOME TAX DEDUCTIONS  
AS OF APRIL 2022**

State	Eligible Principal Contribution Amount Per Year (Individual/Couple)	Maximum Principal Contribution (Individual/Couple)	Maximum Principal and Interest Eligible for Deduction (Individual/Couple)	What Can Be Deducted?
Alabama	No limit	\$25,000/\$50,000	\$25,000/\$50,000	Up to \$5,000/\$10,000 contribution per year for 5 years is deductible.
Idaho	\$15,000/\$30,000	\$100,000	\$100,000	Contributions and interest income are deductible.
Iowa	\$2,000/\$4,000	Ten times the annual eligible deduction limit of the beneficiary.	\$20,000/\$40,000 Eligible for 10 years.	\$2,000/\$4,000 contribution per year is deductible. Contribution limits increase based on inflation.
Kansas	\$3,000/\$6,000	\$24,000/\$48,000	\$50,000	Contributions and interest income are tax deductible indefinitely.
Maryland	\$5,000	\$50,000	Principal and interest earned in a 10-year period.	Account can earn interest for 10 years. Both contributions and interest income are deductible.
Michigan <sup>1</sup>	\$5,000/\$10,000	\$50,000	No limit	Contributions up to \$5,000 per individual and interest are deductible.
Minnesota	\$14,000/\$28,000	\$50,000/\$100,000	\$150,000	Interest income and dividends are deductible.
Mississippi	\$2,500/\$5,000	No maximum	No limit	Contributions up to \$2,500/\$5,000 are deductible.
Missouri	\$1,600/\$3,200	No maximum	No limit	50% of the contribution and all interest income are deductible.
Montana	\$3,000	No maximum	No limit	Up to \$3,000 per year and interest income are deductible.
Oklahoma	\$5,000/\$10,000	\$50,000	\$50,000	Contributions and interest income up to \$50,000 are deductible.
Oregon <sup>2</sup>	\$5,000/\$10,000	\$50,000	\$50,000	Contribution and interest income up to \$50,000 are deductible.
Virginia	No maximum	\$50,000	\$150,000	Interest income and capital gains are deductible.

SOURCE: Office of the State Auditor analysis of other state first-time homebuyer income tax deductions.

<sup>1</sup> Michigan's deduction is available through 2026.

<sup>2</sup> Contributions must be made into a first-time home buyer savings account opened before January 1, 2027 to qualify.



### ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

We did not identify any Colorado tax expenditures that are similar to the First-Time Home Buyer Deduction.

The Colorado Housing and Finance Authority (CHFA)—whose mission is “...to increase the availability of affordable, decent, and accessible housing for lower income Coloradans...”—offers down payment assistance grants to Coloradans based on income and location within the state. For first mortgages, CHFA offers down payment or closing cost assistance grants of up to 3 percent of the mortgage. The maximum loan amount is up to \$647,200, meaning that some individuals could qualify for a little over \$19,000 in down payment assistance.

### WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

We did not identify any data constraints during our evaluation of this deduction.

### WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EXTENT TO WHICH THE FIRST-TIME HOME BUYER DEDUCTION IS MEETING ITS PURPOSE AND COULD CONSIDER REPEALING IT OR MAKING CHANGES TO STATUTE TO INCREASE ITS USE. As discussed, we found that due to its limited usage and small tax benefit, this deduction has not met its purpose of encouraging saving for first-time home purchases. Moreover, the Department reported that the deduction is confusing to taxpayers, who often mistake it for a mortgage interest tax deduction and claim it improperly, and, additionally, that it is difficult to enforce the terms of the deduction. In Tax Year 2018, which was the only year of data available, only four taxpayers claimed the deduction, and at least one of those claims was an improper claim. Additionally, the deduction provides only a small tax savings to taxpayers, about \$36 over a 2-year period for couples that save \$50,000, the highest dollar amount allowed by statute. Furthermore, many individuals seeking to purchase a home

for the first time are likely to save less than the statutory maximum so the potential benefit they could receive from the deduction would also be less. Therefore, the General Assembly may want to review the deduction and could consider repealing it if it is not meeting its purpose to the extent intended.

Alternatively, the General Assembly could make changes to address the deduction's low usage and increase the benefit it provides. For example, we found that 11 of the 13 other states with a similar deduction allow eligible taxpayers to deduct the contributions they make to first-time home buyer savings accounts, not just the interest earned on the accounts. This type of change would significantly increase the deduction's benefit and its revenue impact to the State. For example, if an individual contributed \$14,000 to an account and could deduct the full contribution, they could receive a \$637 reduction in Colorado tax liability. By comparison, under the current deduction, a taxpayer would receive about a \$6 reduction in tax liability for a \$14,000 savings account that earns 1 percent interest over a 1-year period. However, Department staff reported that most taxpayers currently claim this deduction improperly; therefore, there is a risk that without additional oversight or controls over eligibility, an expansion of the credit could result in more taxpayers claiming it improperly.

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE DEDUCTION, IT MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH PERFORMANCE MEASURES FOR IT. Statute [Section 39-22-4702, C.R.S.] states that the purpose of this deduction is to "...encourage first-time home ownership through incentivizing saving for a down payment and closing costs..." However, statute does not provide performance measures for evaluating the effectiveness of the deduction. Therefore, based on the purpose outlined above, we developed a performance measure to assess the extent to which the deduction is meeting its purpose. However, if the General Assembly does not repeal the deduction, it may want to clarify its intent by providing performance measure(s) in statute. This would eliminate potential uncertainty regarding the deduction's effectiveness and allow our office to more definitively assess the extent to which it is accomplishing its intended goals.