Tax Expenditure Evaluations for Review by the Legislative Oversight Committee Concerning Tax Policy

July 2024

OSA

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Tax Expenditure Evaluations and Memos

OSA

Film Incentive Tax Credit Memo

During the 2023 legislative session, the General Assembly passed House Bill 23-1309 authorizing an income tax credit for film production companies for in-state production activities. The income tax credit replaced the State's cash rebate program available to production companies for their in-state production activities and is only effective for Tax Year 2024. The credit's purpose is to "incentivize production companies to film in Colorado and attract more film projects, in particular high-budget film projects, that will employ more Coloradans." The tax credit will expire unless the General Assembly takes action during the 2024 legislative session to extend it. Statute requires us to issue an evaluation prior to the legislative session before a tax expenditure expires [Section 39-21-305(1)(d), C.R.S.]. However, because Tax Year 2024 is the first year the credit is available, there are no data to perform a complete evaluation of the credit prior to the 2024 legislative session. Therefore, we are issuing this memo to provide a summary of the credit.

The credit is available to production companies that employ a workforce made up of at least 50 percent Colorado residents and the credit amount is based on the production's "qualified local expenditures." These are defined as payments made by the production company to a person or business in Colorado as part of the production, and can include, but are not limited to, payments for set construction, wardrobe, and accessories; the cost of renting facilities and equipment, including leasing vehicles and providing food and lodging to people working on the production; and payments for wages and salaries for employees or contractors when Colorado income taxes are withheld.

Production companies can qualify for a credit of up to 20 percent of their qualified local expenditures if:

- The production company is Colorado-based and spends a minimum of $100,000 on qualified local expenditures, or

- The production company is an out-of-state company that is producing a commercial or video game and spends a minimum of $250,000 in qualified local expenditures.

If the production is filmed in a rural community or a marginalized urban center—or if the production used local infrastructure when filming—the production company can receive a 22 percent tax credit. Additionally, the director of the Office of Economic Development and International Trade (OEDIT) may approve a tax credit that exceeds 20 or 22 percent for a production company.

The Colorado Office of Film, Television, and Media (OFTM) in OEDIT and the Economic Development Commission (EDC) are charged with reviewing and approving applications for the tax credit. Production companies must first apply to OFTM for conditional approval for the tax credit before beginning production activities in Colorado. The OFTM and the EDC may grant conditional approval for tax credits for a project, based on the project's expected qualified local expenditures. The OFTM and EDC can approve up to $5 million in credits across all projects, if the State revenue surplus for Fiscal Year 2024 is at least $50 million. If the state revenue surplus does not exceed $50 million, OFTM cannot issue any tax credits unless the General Assembly passes a bill that specifies an amount of tax credits available for that tax year. Once a production company has completed its production activities in Colorado, it must have a Colorado-based CPA certify that it met the workforce and qualified local expenditures requirements. Once the OFTM has approved the CPA's report, the OFTM issues a tax credit certificate to the production company. If a production company's project has credits that exceed its income tax liabilities for the year, the amount of excess credits will be refunded to the company. Statute also requires that OEDIT and the OFTM review the credit's effectiveness and report the results of their review no later than February 4, 2025.

Policy Consideration

The General Assembly may want to consider specifying a maximum amount of aggregate tax credits available for the 2024 Tax Year during the 2024 legislative session. Section 39-22-559(5), C.R.S., makes the $5 million in credits available only if the state revenue surplus is at least $50 million. However, the certification process that will determine if state revenue for Fiscal Year 2024 meets this requirement does not occur until September 2024. Therefore, the OFTM cannot provide any production companies with credits until September 2024 at the earliest. Alternatively, the General Assembly could change statute to specify a maximum amount of aggregate tax credits allowed for 2024. Statute allows the General Assembly to authorize a maximum amount of tax credits for the year if the State's revenue surplus is less than $50 million, so it could use a similar process to allow OFTM to approve and issue credits earlier in the year.

The General Assembly may want to consider clarifying whether out-of-state production companies producing a film or television show are eligible for the credit, and if so, the minimum amount of qualified local expenditures they must meet to qualify for a tax credit. While statute defines "production activities" as "the shooting of a film, support activities related to such shooting, and any preshooting or postshooting activities," [Section 39-22-559(2)(g), C.R.S.], statute allows the credit for "Twenty percent of the total amount of the production company's qualified local expenditures if the total of such expenditures equals or exceeds two hundred fifty thousand dollars for a production company that produces *a television commercial or video game* [emphasis added] and that does not originate production activities in Colorado…" [Section 39-22-559(3)(b), C.R.S.]. Therefore, statute appears to limit the credit for out-of-state companies to only those working on television commercials or video games. Because part of the purpose of the tax expenditure is to "attract more film projects, in particular high-budget film projects" the General Assembly may want to consider specifying whether out-of-state production companies that are producing a television show or film are eligible for the tax credit as well and, if so, the required minimum amount of local expenditures. The cash rebate program, which is similar to the credit, requires out-of-state film productions to have a minimum of $1,000,000 in qualified local expenditures to receive a cash rebate [Section 24-48.5-116(1)(b)(I), C.R.S.].

Child Care Expenses Income Tax Credits

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The Child Care Expenses Credits allow taxpayers to claim a refundable income tax credit for their expenses incurred for child care for children under age 13. Taxpayers must have an Adjusted Gross Income (AGI) of $60,000 or less and must incur the child care expenses to allow the taxpayer to work or look for work. The credits, and qualifying expenses, are based on the federal Child and Dependent Care Expenses Credit (federal credit) that taxpayers can claim on their federal income tax return.

There are two state credits that are available to make child care more affordable for working families:

- The Child Care Expenses Credit for taxpayers that have an Adjusted Gross Income (AGI) of $60,000 or less, for both joint and single filers, and claim the federal Child and Dependent Care Credit on their federal income taxes or,
- The Low-Income Child Care Expenses Credit for taxpayers that have an AGI of $25,000 or less, for both joint and single filers, and are eligible for the federal credit, but do not have sufficient federal tax liability to claim the federal credit.

Overall, we found that both credits are likely underutilized and the Low-Income Child Care Expenses Credit does not ensure that all individuals without a federal tax liability can claim a credit for their child care expenses. Additionally, the credit amounts are likely too small to help taxpayers afford child care to allow them to work or look for work given the current costs of child care. Specifically, we found:

- Only about 14 percent (19,200 returns) of potentially eligible Colorado households claimed the Child Care Expenses credits in Tax Year 2020.
- Changes to federal tax laws, such as increases to the standard deduction amounts, have reduced the number of taxpayers who claim the credits and caused some taxpayers with child care expenses to become ineligible for the credits.
- Credit amounts, averaging less than $300, offset some child care expenses, but are likely too small to make child care more affordable in order for parents to work or look for work.
- AGI limits and allowable expense amounts have not been adjusted for inflation, eroding the relative financial benefit of the credits.

Policy Considerations

- The General Assembly could consider decoupling the state Child Care Expenses Credits from the federal credit.
- The General Assembly could consider adjusting the income limits for the state credits to account for inflation and changes to the standard deduction amount.
- The General Assembly could consider adding the Child Care Expenses Credits to the state requirements that employers notify employees of the availability of certain tax credits [Section 39-22-604(6)(c), C.R.S.].

	Child Care Expenses Credit	Low-Income Child Care Expenses Credit
Tax Type:	**Income**	**Income**
Expenditure Type:	**Credit**	**Credit**
Statutory Citation:	**39-22-119, C.R.S.**	**39-22-119.5, C.R.S.**
Year Enacted:	**1996**	**2014**
Repeal/Expiration Date:	**None**	**December 31, 2028**
Revenue Impact:	**$5.1 million (2020)**	
Purpose given in statute or enacting legislation? **Yes**		

Child Care Expenses Credits

Background

The Child Care Expenses Credits allow taxpayers to claim a refundable income tax credit for expenses they incur for child care for children under age 13.

There are two state credits:

- The Child Care Expenses Credit for taxpayers that have an Adjusted Gross Income (AGI) of $60,000 or less, for both joint and single filers, and claim the federal Child and Dependent Care Credit (federal credit) on their federal income taxes.

- The Low-Income Child Care Expenses Credit for taxpayers that have an AGI of $25,000 or less, for both joint and single filers, and are eligible for the federal credit, but do not have sufficient federal tax liability to claim it.

Eligibility for the two state credits, and qualifying expenses, are based on the federal credit, which requires that taxpayers, and their spouse if married:

- Incur the expenses to care for a dependent in order to work or attend school, or look for work.

- Have earned income for the year (e.g., income from wages, salaries, or tips, but not income from a pension, interest and dividends, or child support payments). If the taxpayer is a full-time student, or one spouse is a full-time student, they are treated as having earned income.

- Have a federal tax liability to apply the credits to.

The federal credit amount is calculated as a percentage of a taxpayer's eligible child care expenses, up to $3,000 in expenses for one dependent or up to $6,000 for two or more dependents. The percentage declines from a maximum of 35 percent of expenses to 20 percent of expenses, as taxpayers' AGI increases. For example, a taxpayer with an AGI under $15,000 can receive a federal income tax credit of 35 percent of their

Technical Note:

IRS Publication 503 defines eligible child care expenses as expenses that "allow you (and your spouse if filing jointly) to work or look for work" and are for "a qualifying person's care."

For the federal credit, qualifying persons are considered to be a dependent under the age of 13, or in some instances a spouse or other dependent, 13 years or older, who could not care for themselves.

Expenses may include daycare, before or after school care, and expenses for summer camps, provided they meet the other conditions. Expenses for education for grades kindergarten and above do not qualify since they are not considered for the "well-being and protection" of the child.

child care expenses, and a taxpayer with an AGI of $43,000 or more can receive a federal income tax credit of 20 percent of their child care expenses.

Child Care Expenses Credit. The state Child Care Expenses Credit was enacted in 1996 and in order for Colorado taxpayers to claim the credit, it requires them to:

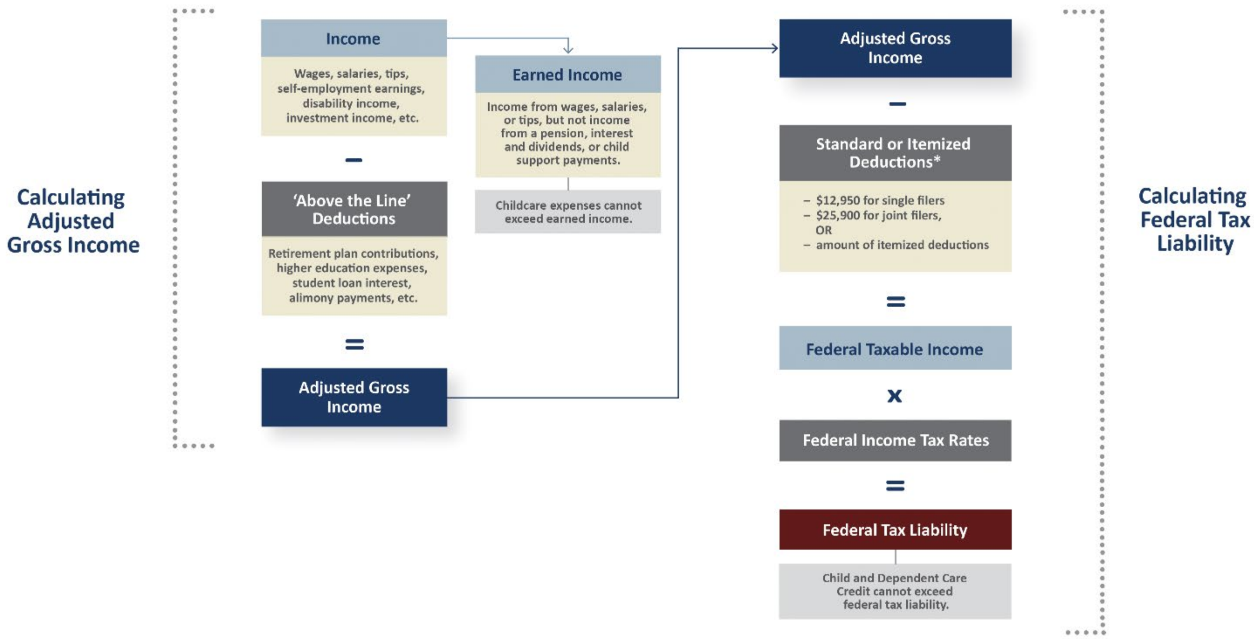
- Claim the federal credit,
- Have an AGI of $60,000 or less,
- Only claim expenses for a dependent under the age of 13 (i.e., the state credits do not apply to some of the federally qualified dependents, such as dependent adults).

Since 2018, the state Child Care Expenses credit allows taxpayers to claim 50 percent of the amount of their federal credit on their state income taxes, up to a maximum of $525 for one dependent or $1,050 for two or more dependents. Prior to this legislative change, the percentage of credits allowed ranged from 50 percent of the taxpayer's federal credit to 10 percent, decreasing as AGI increased.

The purpose of the Child Care Expenses Credit is to "make child care more affordable for working families." The state credit allows taxpayers who are eligible for the federal credit to claim an additional credit on their state income taxes. Therefore, the state credit is limited by the requirements of the federal credit, including the taxpayer's AGI, earned income, their federal tax liability amount, and the federal credit amounts.

There are two main factors when calculating federal income taxes that limit the credit for taxpayers. First, taxpayers cannot claim child care expenses that exceed their earned income, unless they are a student. Second, taxpayers cannot claim a credit that exceeds their federal tax liability. Taxpayers reduce their income by certain deductions to arrive at AGI, which determines 1.) the percentage of their child care expenses they can claim for the federal credit, and 2.) whether they are eligible for the state credits. Taxpayers then reduce their AGI by the standard, or itemized deductions, in order to determine their federal tax liability. Taxpayers with an AGI at or below the standard deduction amount do not have a tax liability and, therefore, cannot claim a federal credit. Exhibit 1 shows how AGI, earned income, and federal tax liability are calculated to determine the amount of federal credits a taxpayer is eligible to claim.

Exhibit 1
Calculation of AGI, Earned Income, Taxable Income, and Federal Tax Liability that Determine Eligibility for the State Child Care Expenses Credits



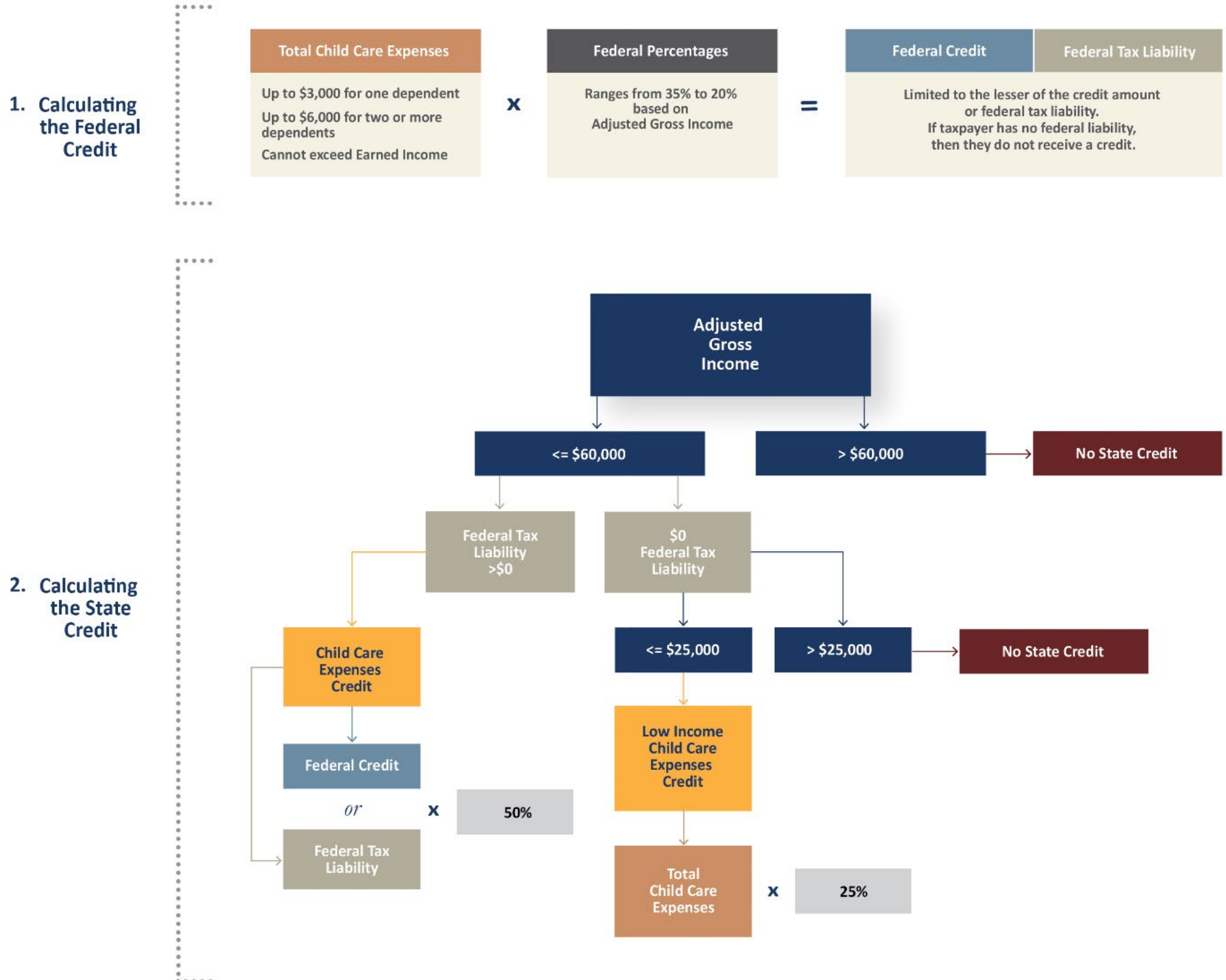
Source: Office of the State Auditor analysis of federal income tax calculation steps.
*Standard Deduction amounts listed are for Tax Year 2022. Itemized deductions include amounts paid for state and local income or sales taxes, real property taxes, personal property taxes, mortgage interest, disaster losses, gifts to charities, and part of the amount paid for medical and dental expenses.

Low-Income Child Care Expenses Credit. Although taxpayers with lower incomes may meet all of the eligibility requirements for the federal credit, many do not have a federal tax liability and, therefore, cannot claim a federal credit. As a result, until 2014, these taxpayers were also not eligible to claim the State's Child Care Expenses Credit. In order to correct this issue, in 2014, the Legislature created the Low-Income Child Care Expenses Credit that allows taxpayers with an AGI of $25,000 or less, who are eligible for the federal credit but do not have sufficient tax liability, to still claim a state credit for their child care expenses. Instead of a percentage of their federal credit, taxpayers can claim a credit for up to 25 percent of their qualified child care expenses, up to a maximum of $500 for one dependent or $1,000 for two or more dependents.

The purpose of the Low-Income Credit is "to fix the [Child Care Expenses Credit] so that all low-income working families are able to claim the [Child Care Expenses Credit] regardless of the amount of their federal child care expenses credit."

Exhibit 2 shows how the federal credit and two state Child Care Expenses Credits are calculated.

Exhibit 2
Calculation of the Federal Child and Dependent Care Expenses Credit and the State Child Care Expenses Credit and Low-Income Child Care Expenses Credit



Source: Office of the State Auditor analysis of the calculation of the federal Child and Dependent Care Expenses Credit and how it impacts the calculation of the State's standard Child Care Expenses Credit and Low-Income Child Care Expenses Credit.

While there are not data providing the exact number of Colorado taxpayers who are eligible for the Child Care Expenses Credits, according to U.S. Census Bureau data, in 2021, there were approximately 141,000 households in Colorado with an annual income of $60,000 or less and at least one child under the age of 13. Of those 141,000 households, there were approximately 42,700 households with an annual income under $25,000.

Research from several nonpartisan economic and policy centers shows that the affordability of child care has a disproportionate effect on low-income earning women and women of color, causing parents to leave the workforce to care for children or for children to go without child care when child care is unaffordable. According to the Colorado Health Institute, much like "access to health care, healthy food, and safe and affordable housing, access to affordable child care affects a family's quality of life and ability to thrive." In addition, subsidies for child care are associated with higher quality child care, which supports child development. The Child Care Expenses Credits are one of several programs in Colorado to financially assist families with the cost of children. In addition to the Child Care Expenses Credits, Colorado has:

- The Child Tax Credit (CTC), which is a refundable credit for taxpayers with children under the age of 6 who also qualify for the federal Child Tax Credit. This credit does not require taxpayers to work or look for work in order to qualify, but is limited to taxpayers with an AGI of up to $75,000 for single filers or up to $85,000 for joint filers, adjusted for inflation. Because the CTC was not funded until 2022, data is not yet available on the use or revenue impact of the credit.

- The Colorado Child Care Assistance Program (CCCAP), which provides financial assistance to low-income families to pay for child care. Using federal block grant funds and state funds, the Department of Early Childhood (CDEC) administers CCCAP with Colorado counties; each Colorado county sets their own eligibility requirements, but families cannot have an income over 85 percent of the state median income, or about $74,500 between 2018 and 2022. In federal fiscal year 2020, CCCAP funding was able to serve about 10,300 families and about 17,000 children. Families may qualify for CCCAP and the state Child Care Expenses Credits, but may not use their CCCAP benefits as qualifying expenses for the credits.

- The Colorado Universal Preschool Program (UPK) to provide free part-time preschool for 3- and 4-year olds. This program began in 2023, therefore some families may have reduced child care expenses if their child attends part-time preschool funded through the UPK program.

In addition to Colorado, 24 other states plus the District of Columbia, offer an income tax credit for child care expenses so that taxpayers may work or look for work.

Statute does not provide performance measures to evaluate whether these credits are meeting their purpose; therefore, we developed the following performance measures to evaluate the credits.

- The extent to which the Child Care Expenses Credits are being claimed by eligible taxpayers.

- The extent to which the Low-Income Child Care Expenses Credit has allowed taxpayers without a federal tax liability to still claim a state tax credit for their child care expenses.

- Whether the Child Care Expenses Credits are making child care more affordable so parents can work or look for work.

Evaluation Results

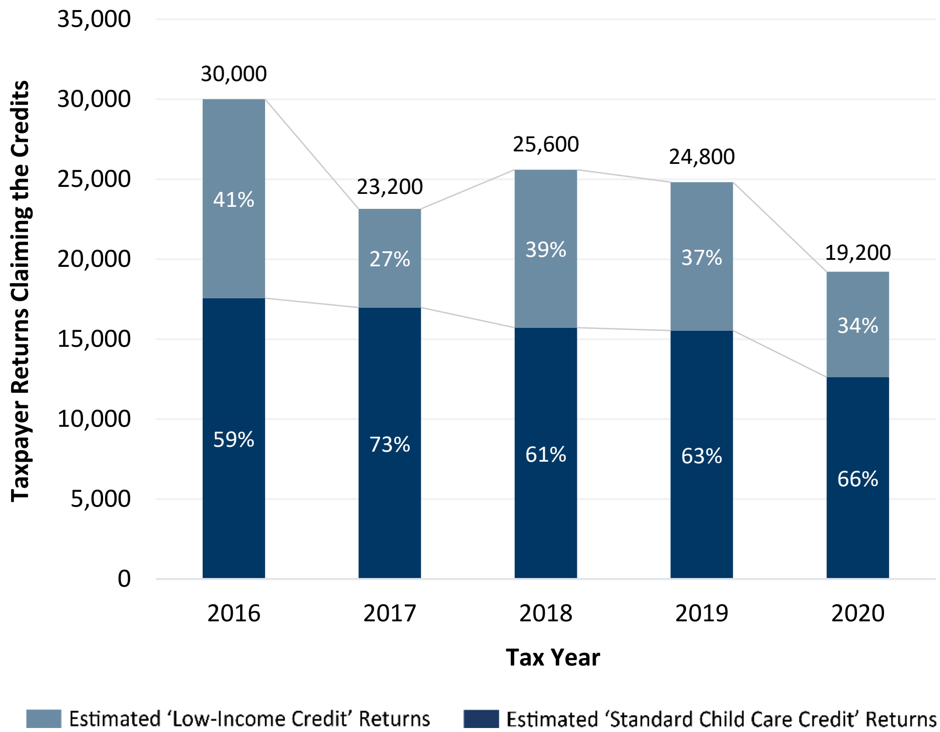
We found that both credits are likely underutilized and the Low-Income Child Care Expenses Credit does not ensure that all individuals without a federal tax liability can claim a credit for their child care expenses. Additionally, the credit amounts are likely too small to help taxpayers afford child care to allow them to work or look for work given the current costs of child care.

Only a small portion of intended beneficiaries have claimed the credits. Based on U.S. Census Bureau estimates, 141,000 Colorado households have at least one child under the age of 13 and have an income of $60,000 or less. We found that only about 14 percent of these households (about 19,200 taxpayer returns) claimed the Child Care Expenses Credits in Tax Year 2020, the most recent year of Department of Revenue (Department) data available. Of the 141,000 households with qualifying children and income levels, there were about 42,700 households with an annual income under $25,000 who may qualify for the Low-Income Child Care Expenses Credit. However, because the Department does not separate out returns claiming the Low-Income Child Care Expenses Credit from the standard Child Care Expenses Credit, we could not determine the extent to which taxpayers claimed each credit. However, based on taxpayer AGI, we estimated that about 15.5 percent (about 6,600 taxpayer returns) of the eligible 42,700 households with an income below $25,000 used the Low-Income Child Care Expenses Credit.

While some of the 141,000 households may be ineligible for the credits because they do not have qualifying child care expenses, or one spouse does not have earned income, it is likely that many qualifying households do not claim the credits. This aligns with research on use of the federal credit. Specifically, a 2021 Congressional Research Service report, *Child and Dependent Care Tax Benefits: How They Work and Who Receives Them*, reported that in 2018, nationwide, about 12 percent of taxpayers with children claimed the federal tax credit.

While state legislative efforts in 2018 to expand the standard Child Care Expenses Credit by increasing the percentage of the federal credit that could be claimed may have temporarily boosted the use of the credit, Exhibit 3 shows that the total number of returns claiming the credits has declined by about 36 percent, dropping from roughly 30,000 in 2016 to 19,200 in 2020.

Exhibit 3
Number of Returns Claiming the Child Care Expenses Credits[1] for Tax Years 2016 through 2020.



Source: Office of the State Auditor analysis of Department of Revenue Statistics of Income and Tax Profile and Expenditure data for taxpayers claiming the Child Care Expenses Tax Credits for Tax Years 2016 through 2020.
[1] The Department of Revenue data for the Low-Income Credit and the standard Child Care Credit is aggregated together as the Child Care Expenses Credits. Therefore the percentage of returns claiming the Low-Income Credit and the Standard Child Care Credit are OSA estimates based on taxpayers' AGI.

The number of claims in 2020 might be particularly low due to the COVID-19 pandemic, which created massive shifts in the child care industry and workforce. It is possible that some of the decrease in use of the credits in 2020 could be attributed to child care facilities being closed, taxpayers relying on informal networks of care, or taxpayers choosing to leave the workforce to care for their children, or losing their job.

While there is not a clear reason why the use of the Child Care Expenses Tax Credits is a low proportion of the potentially eligible population, there are some factors that may be creating barriers to the use of the credits. Research on other similar tax credits, such as the Earned Income Tax Credit and the Child Tax Credit also show that at lower income levels, many taxpayers who are eligible for tax credits do not claim them because they are not legally required to file a tax return. This may be because the small benefit of a tax credit does not outweigh the time and cost of filing a tax return. Among eligible taxpayers that do file, lack of awareness might also be a cause for some taxpayers not claiming the credits. According to stakeholders in the early childhood industry, a lack of awareness could be due to a lack of access to the internet and tax preparation assistance, a lack of community outreach addressing this credit, or informational materials that are not multi-lingual or accessible to taxpayers.

Additionally, a Congressional Research Service report on the federal credit indicates that the lowest-income families tend to have child care expenses well below the $3,000 and $6,000 maximum expense amounts allowed, so they would not receive the maximum state credit either. Lower out-of-pocket child care expenses do not necessarily mean that lower-income populations do not have child care needs; rather, they may indicate that these needs are met informally—such as having a neighbor or relative watch a child during the workday. These informal arrangements may not result in formal out-of-pocket child care payments that allow taxpayers to qualify for the credit.

Technical Note:

As part of the American Rescue Plan Act, for 2021, the federal tax credit expense limits were increased, the percentage of allowable expenses was increased to 50 percent for taxpayers with an AGI of less than $125,000, and the tax credit became refundable.

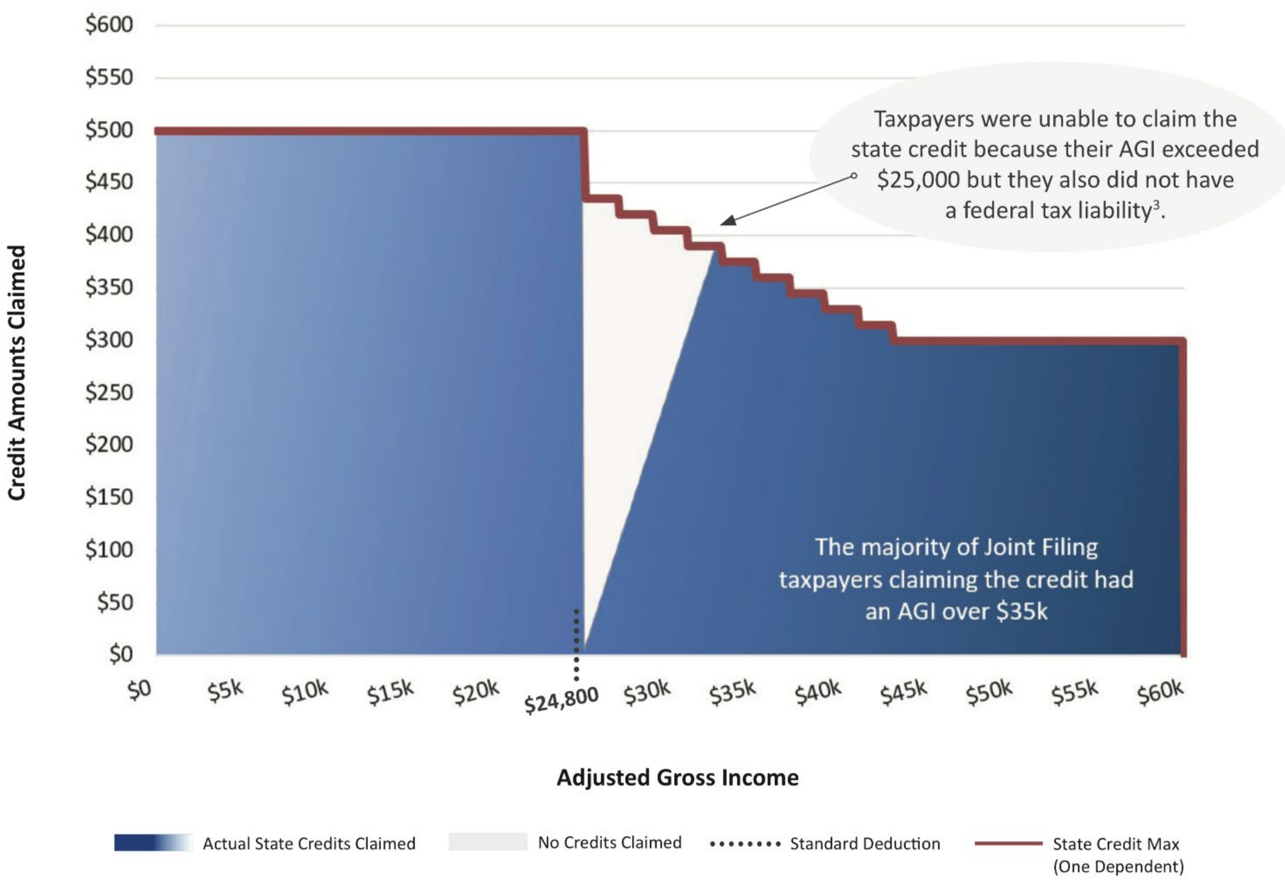
Because of this federal change, the state tax credit amounts will likely increase for Tax Year 2021 since taxpayers could claim a larger percentage of their child care expenses and were not limited to a credit by their federal tax liability.

However, the Department does not have data available for Tax Year 2021 to analyze the impact of the American Rescue Plan Act's temporary changes.

Finally, according to the 2022 Colorado Health Access Survey conducted by the Colorado Health Institute, "about 17% of parents/guardians living at or below 100% of the federal poverty level ($27,750 per year for a family of four in 2022) needed but couldn't find child care in the past year." Therefore, some taxpayers who would otherwise use the credits may have been unable to do so because they could not find child care.

Changes to federal tax laws have reduced the number of taxpayers who can claim the Child Care Expense Credits and caused uneven treatment for certain taxpayers. In 2014, when the Low-Income Child Care Expenses Tax Credit was passed, the standard deduction was $12,400 for joint filers. However, since the passage of the federal Tax Cuts and Jobs Act (TCJA) in 2017, the standard deduction was nearly doubled and the Child Tax Credit was increased, reducing the tax liability of low-income earners, and reducing the number of taxpayers who could claim the federal credit. For example, in 2018 research from the Tax Policy Center estimated that the share of taxpayers with incomes between $20,000 and $40,000 benefiting from the federal credit would fall more than any other income group. If taxpayers at these income levels are not able to claim the federal credit because the standard deduction and other federal tax credits have reduced their tax liability, then they are not able to claim the State's Child Care Expenses Credit. In addition, if these taxpayers who no longer receive a federal credit have an AGI of more than $25,000 they are also ineligible for the State's Low-Income Child Care Expenses Credit. The taxpayers most impacted by these changes are joint filers whose AGI is at, or near, the standard deduction amount. Exhibit 4 shows the impact of the federal changes on taxpayers who are married and filing jointly at an AGI level near $25,000 in Tax Year 2020. As shown, the standard deduction amount in 2020 was $24,800, meaning that taxpayers at or below this amount would not have had taxable income or a federal tax liability and would not be eligible to claim the federal credit, but could still claim the state Low-Income Child Care Expenses Credit. However, taxpayers with an AGI between $25,000 and $33,000 saw their federal tax liability reduced to minimal amounts, or $0, meaning their state credits were limited to 50 percent of their federal tax liability or they were no longer eligible for a state tax credit, shown by the gap in the actual credits claimed in 2020. As taxpayers' AGI increases there was a gradual phase-in of the credit, until taxpayers' federal tax liability exceeded their federal credit amount and they could begin claiming the maximum credit amount.

Exhibit 4
Tax Year 2020[1] Child Care Expenses Credits Claimed[2] for Joint Filing Taxpayers and Maximum Allowable State Tax Credits for One Dependent.



Source: Office of the State Auditor analysis of Department of Revenue data for married filing jointly taxpayers claiming the Child Care Expenses Tax Credits for Tax Year 2020.

[1] In Tax Year 2020, the federal standard deduction reduced taxpayers' federal tax liability and resulted in a gap in eligibility for jointly filing taxpayers to claim the Child Care Expenses Credits. This graph does not show taxpayers with an AGI of less than $0. These taxpayers on average claimed credits of about $550, but accounted for less than 1 percent of the total revenue impact.

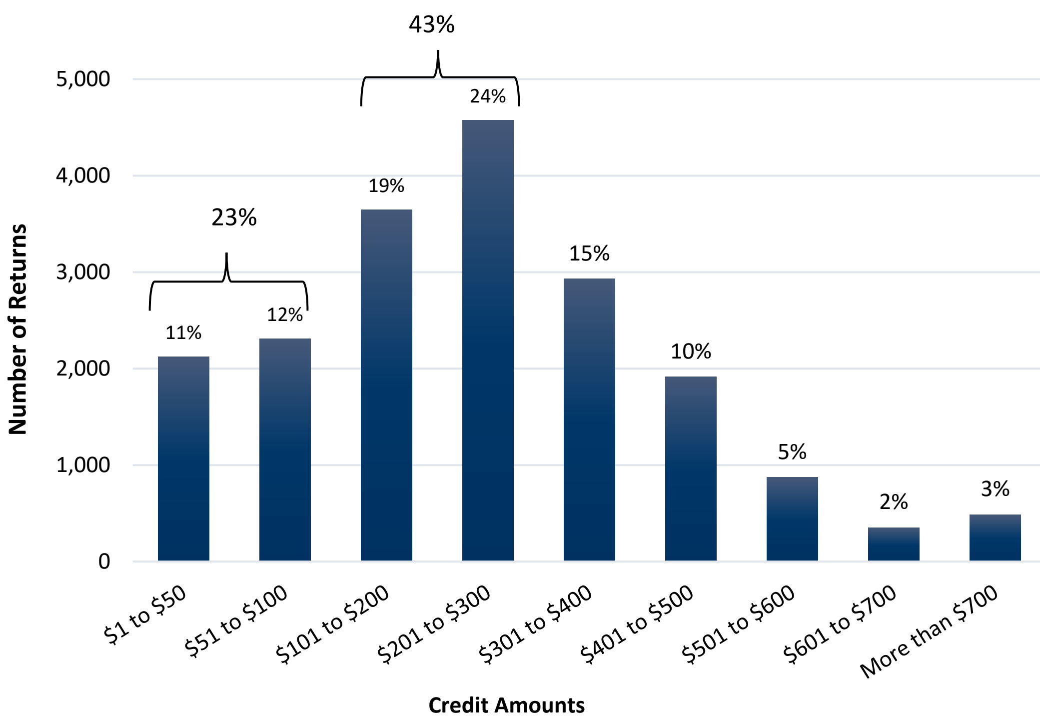
[2] This graph shows the range of credits claimed in 2020, not all taxpayers claimed the maximum amount of the credit. Credits ranged from $1 to $500.

[3] The gap in taxpayers claiming the state credits ranges from an AGI of $24,801 to $32,700 where, based on taxpayers claiming the standard deduction of $24,800 in Tax Year 2020, no other adjustments to income, and an effective tax rate of 10 percent, the taxpayers' federal tax liability exceeds the amount of the tax credit that a taxpayer is eligible to claim.

While the Tax Cuts and Jobs Act provisions are set to expire in 2025, any federal changes that limit taxpayers' tax liabilities could potentially prevent taxpayers from claiming the federal and state credits. For example, the 2023 standard deduction for joint filers is $27,700, which is over the AGI limit for taxpayers with no federal tax liability to claim the state Low-Income Child Care Expenses Credit. As a result, taxpayers who file jointly, claim the standard deduction, and have an AGI between $25,001 and $27,700 will not be able to claim either the state credit or the federal credit in Tax Year 2023. Taxpayers with an AGI just over the standard deduction amount will see their credits reduced because they will have little to no federal tax liability. This gap will continue to grow to the extent that the standard deduction amount increases.

Credit amounts offset some child care expenses, but the credits are likely too small to make child care more affordable. According to Department data, the average amount claimed for both credits was $266 in Tax Year 2020, up from about $100 in Tax Year 2017 due to 2018 legislation that increased the credit amounts. As shown in Exhibit 5, of the 19,200 returns that claimed the credit in 2020, about a quarter of them claimed $100 or less, and nearly half claimed between $101 to $300. Overall the revenue impact of the credits in Tax Year 2020 was about $5.1 million.

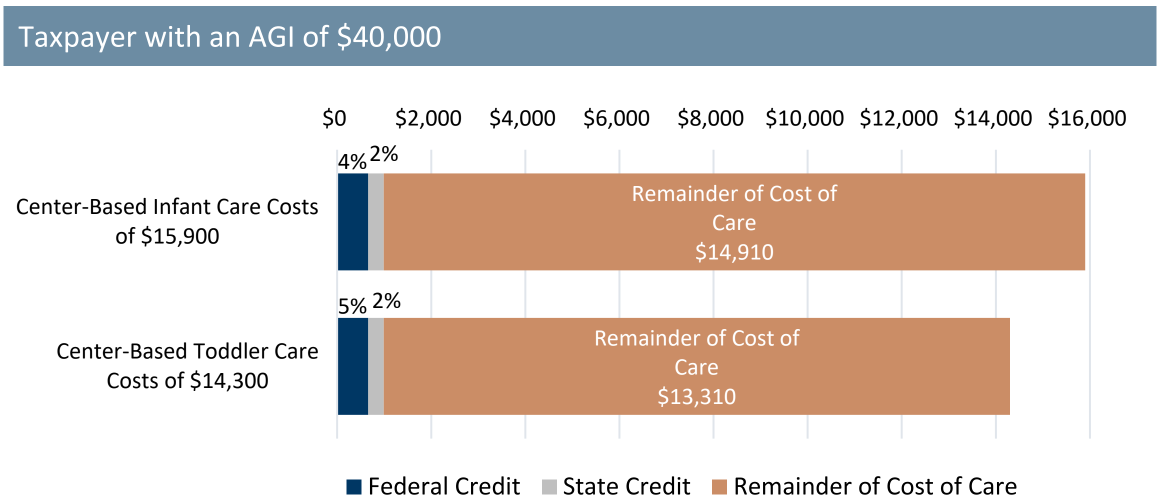
Exhibit 5
Frequency of Dollar Amounts Claimed for Tax Year 2020

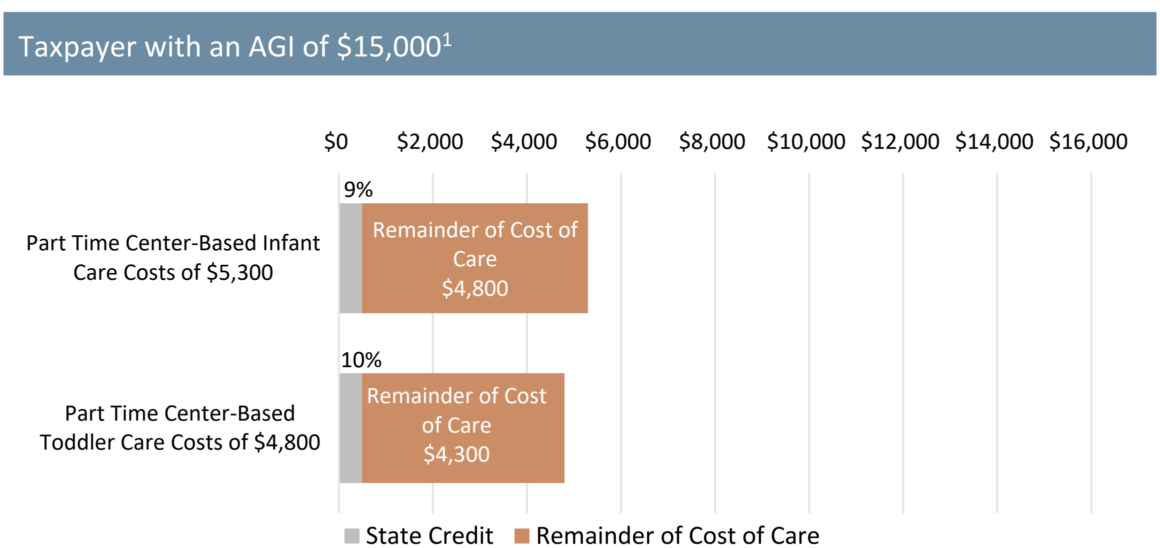


Source: Office of the State Auditor analysis of Department of Revenue data for taxpayers claiming the Child Care Expenses Tax Credits for Tax Year 2020. This data includes taxpayers who had expenses for one dependent (maximum credit of $525) or two or more dependents (maximum credit of $1,050).

While taxpayers may also claim a federal credit if they have a federal tax liability, offsetting some additional child care costs, the overall impact of the credits is relatively low in relation to the costs. Exhibit 6 shows a hypothetical example of the costs covered by state and federal tax credits depending on the median child care costs in Colorado for two different types of center-based care, infant care and toddler care, by taxpayer AGI. In 2020, the median annual cost of center-based infant care was about $15,900 a year, and the median costs for center-based toddler care was about $14,300.

Exhibit 6
Portion of Child Care Expenses Covered by State and Federal Credits





Source: Office of the State Auditor analysis of the percent of child care expenses covered for infant care and toddler care for taxpayers claiming the standard Child Care Expenses Credit and the federal credit or the Low-Income Child Care Expenses Credit.

[1] While taxpayers with an AGI of $15,000 or less are eligible for a federal tax credit of 35 percent of their expenses, because they generally do not have a federal tax liability they are unlikely to be able to claim a federal credit and instead would only receive the state Low-Income Child Care Expenses Credit.

While data on the actual expenses incurred for child care compared to the credit is not available, the U.S. Department of Health and Human Services considers child care 'affordable' for families that are low-income and qualify for assistance when it accounts for 7 percent or less of a family's income. In Colorado, families spend an average of between 16 and 27 percent of household income on child care; in the hypothetical example taxpayers receiving the maximum amount of credits would still spend between 29 and 37 percent of their income on child care. Given the relatively small amounts of the state credits, they are unlikely to make childcare significantly more affordable for most families.

Policy Considerations

The General Assembly could consider decoupling the state Child Care Expenses Credits from the federal credit. As discussed above, changes to the federal tax code have had unintended consequences on the eligibility of taxpayers for the Child Care Expenses Credits. As a result, some taxpayers currently do not qualify for a state-level credit or get a smaller credit than appears to have been intended by the General Assembly. Additionally, the relative value of the federal credits has declined because the expense caps used to calculate the federal credit have not been changed since 2001. According to a report from Congressional Research Service, "if the [federal] credit as enacted in 1976 had been adjusted annually for inflation, the $800 maximum credit amount for two or more children in 1976 would have equaled more than $3,500 in 2018. Hence, inflation has eroded a substantial amount of the credit's value." Currently the maximum federal credit for two or more children is $2,100. Additionally, actual expenses for child care have outpaced the maximum allowable expenses. Because the state Child Care Expense Credits are tied to the allowable federal expenses, their relative value has also eroded over time.

The General Assembly could address these issues by amending statutes to base the calculation of the Child Care Expenses Credit on the expenses taxpayers incur, rather than their federal credit. Unlinking the state credit from the federal credit would also allow the State to set its own expense limits and credit rates based on taxpayer AGI. However, this could potentially increase the administrative burden on taxpayers since they would have to calculate a second state credit rather than basing their calculation on their federal credit amount. Additionally, decoupling the credit could create an additional administrative burden for the Department, since coupling the state credit with the federal credit allows the State to benefit from federal oversight and fraud detection. These changes could also have a revenue impact to the State, depending on the requirements the General Assembly sets for calculating the credit amount, but we did not have data to quantify the potential impacts.

Four other states—Hawaii, New Mexico, Oregon, and South Carolina—have their own state child care expenses tax credits that are not linked to the amount of the taxpayer's federal credit; instead these states provide taxpayers a credit based on a percentage of the taxpayer's expenses for child care. Three other states—California, Iowa, and New York—calculate the allowable credit amount based on the taxpayer's federal credit, but allow a state credit regardless of the taxpayer's federal tax liability, similar to how the Low-Income Child Care Expenses Credit operates.

In our previous evaluation in 2019, we also included a policy consideration to decouple the state Child Care Expenses Tax Credit from the federal credit to avoid federal changes that reduce the credit's stability and effectiveness. The General Assembly has not taken action on this policy consideration. However, in the 2023 Legislative Session, the General Assembly did pass House Bill 23-1112, which expanded the benefits of two similar credits that are based on federal credits, the Earned Income Tax Credit, and the Child Tax Credit. This expansion also included restructuring the Child Tax Credit as a flat rate based on taxpayer AGI to allow all taxpayers to claim a credit regardless of the amount of their federal Child Tax Credit.

The General Assembly could consider adjusting the income limits for the state credits to account for inflation and changes to the standard deduction amount. The Child Care Expenses Credits' AGI limits are not adjusted for inflation, and the AGI limit of $60,000 is the same since the credit was created in 1996. According to inflation adjustments from the U.S. Bureau of Labor and Statistics, $60,000 in 1996 is equivalent to about $116,300 in 2023, almost double the original AGI level cut off. Additionally, as discussed, the Low-Income Child Care Expense Credit's AGI limit was set at $25,000 with the intention of allowing taxpayers who did not qualify for a federal credit due to having insufficient income to still qualify for a state credit. Because the federal standard deduction amount has increased substantially, some taxpayers are no longer able to qualify for any state credit or are substantially limited in the amount they can claim due to having insufficient tax liabilities. Therefore, the credits may not be providing the same benefits as originally intended and the General Assembly may want to consider increasing the AGI limit for the Low-Income Child Care Expenses Credit if the credits remain coupled to the federal tax credit.

These changes would likely increase the revenue impact to the State, as more taxpayers would become eligible for the credit and some may be able to claim larger credits, but we did not have data to assess the extent to which the revenue impact would increase.

The General Assembly could consider adding the Child Care Expenses Credits to the state requirements that employers notify employees of the availability of certain tax credits. As discussed, it appears that the credits are underutilized by eligible taxpayers and this could be, at least in part, due to a lack of awareness. In 2023, the General Assembly passed House Bill 23-1006, which requires employers to provide employees with written notice of the availability of other state tax credits, such as the Earned Income Tax Credit and the Child Tax Credit, in English and other languages the employer uses to communicate with their employees. Adding the Child Care Expenses tax credits to the employer requirements could help increase awareness of the credit for taxpayers who may not currently know about the credits and could be eligible for them.

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Deduction of Wages and Salaries Due to IRC 280C

Tax Expenditure Evaluation • February 2024 • 2024-TE1

OFFICE OF THE STATE AUDITOR
COLORADO

The Deduction for Wages and Salaries Due to Internal Revenue Code Section 280C (IRC 280C Deduction) allows businesses that cannot deduct wage and salary expenses for federal tax purposes due to IRC 280C to deduct these wage and salary expenses from their state taxable income. IRC 280C prevents taxpayers from deducting expenses that they use to qualify for several federal tax credits from federal taxable income so that they will not receive a double benefit at the federal level. Colorado uses federal taxable income as the basis for determining Colorado taxable income, but does not offer similar credits, so businesses that cannot deduct expenses under IRC 280C have a higher state tax liability if the expenses are not deductible at the state level.

We were unable to assess the extent to which eligible businesses claim the deduction because data is not available. According to Colorado Department of Revenue (Department) guidance, taxpayers claim the IRC 280C Deduction under the "Other Subtractions" line on the appropriate business type tax form, which is aggregated with several other types of deductions, so data specific to the deduction were not available for our analysis. However, Colorado CPA's we contacted indicated that they are aware of the deduction and have clients that use it.

Some types of businesses are not able to claim the deduction, even though they can claim a federal tax credit. The IRC 280C Deduction may only be claimed by C- and S-corporations, so some business types qualify for federal tax credits referenced by IRC 280C but are not allowed to claim Colorado's deduction.

The IRC 280C Deduction allows businesses to deduct some, but not all, of the expenses for which they receive a federal credit. Since the enactment of the state IRC 280C Deduction, IRC 280C now references additional federal tax credits that cover additional expenses besides wages and salaries. As a result, there are expenses for which businesses can claim credits that they may not deduct from their federal taxable income, but are also not deductible from their state taxable income.

Policy Considerations

The General Assembly could consider expanding the IRC 280C Deduction to more business entities that qualify for federal tax credits and including more types of expenses that are associated with federal tax credits referenced by IRC 280C in addition to wages and salaries.

Tax Type:	**Income**	Year Enacted:	**1979**
Expenditure Type:	**Deduction**	Repeal/Expiration Date:	**None**
Statutory Citation:	**Section 39-22-304(3)(i), C.R.S.**	Revenue Impact (2020):	**Unknown**

Purpose given in statute or enacting legislation? **No**

Deduction of Wages and Salaries Due to IRC 280C

Background

Businesses typically deduct expenses when filing their federal income taxes; however, businesses that incur expenses that qualify for federal tax credits referenced by IRC 280C [26 USC 280C] may not deduct those same expenses from their federal taxable income because they are receiving a credit instead. Colorado uses federal taxable income as the basis for determining Colorado taxable income, so businesses that claim federal credits cannot deduct these same expenses, and therefore will have a higher state taxable income if the expenses are not deductible at the state level.

The Deduction for Wages and Salaries Due to Internal Revenue Code Section 280C (IRC 280C Deduction) [Section 39-22-304(3)(i), C.R.S.] allows businesses that cannot deduct wage and salary expenses for federal tax purposes due to IRC 280C to deduct these wage and salary expenses from their state taxable income.

The enactment of IRC 280C in 1977 unintentionally led to an increase in Colorado tax liability for businesses receiving federal tax credits. This occurred because IRC 280C restricts businesses from deducting expenses they use to claim certain federal credits from their federal taxable income in order to prevent taxpayers from receiving a double benefit at the federal level (i.e., a credit and a deduction). Similar credits are not available at the state level, but Colorado uses federal taxable income as the starting point for calculating Colorado taxable income—in effect transferring the federal restriction on deductions to Colorado. As a result, businesses that claimed federal credits referenced by IRC 280C to decrease their federal tax liability had an increased Colorado taxable income and tax liability, with no offsetting state level deduction or credit. In 1979, the General Assembly created the IRC 280C Deduction to address this issue and allow businesses to deduct wage and salary expenses from their state taxable income that were disallowed from being deducted when calculating federal taxable income.

The IRC 280C Deduction may be claimed by C-corporations and S-corporations. C-corporations are subject to federal and state income taxes at the entity level. S-corporations are also subject to income tax, with income passing through to each shareholder's pro rata share ownership of the company. Individuals, estates, and certain trusts may be shareholders in an S-corporation. For federal tax purposes, Limited Liability Companies (LLCs) may elect to be either a C- or S-corporation and therefore claim the IRC 280C Deduction.

We inferred that the purpose of the IRC 280C Deduction is to offset businesses' higher state tax liability due to expenses which are normally deductible not being deductible because the business claimed federal credits. We inferred this purpose after reviewing federal Internal Revenue Code, state statutes, the legislative history of the deduction, and similar policies in other states. This is a common structural provision of states that use federal taxable income as the basis for determining state taxable income. Statute does not provide performance measures, so we developed the following performance measures to evaluate the deduction:

- To what extent is the deduction being claimed by eligible businesses receiving federal tax credits?
- To what extent are businesses that receive the applicable federal credits able to deduct expenses for state tax purposes that are not deductible at the federal level under IRC 280C?

Evaluation Results

We were unable to assess the extent to which eligible businesses claim the deduction because data is not available; however, stakeholders appear to be aware of and using the deduction. According to Department of Revenue (Department) guidance, taxpayers claim the IRC 280C Deduction under "Other Subtractions" on the appropriate business type tax form and aggregate the amount claimed for the IRC 280C Deduction with several other types of deductions. As a result, the amount claimed for the IRC 280C Deduction cannot be separated from other deductions claimed on the same line. For example, C-corporations claimed a total of $44.4 million in Other Subtractions in 2020, but we were unable to determine what portion was due to the IRC 280C Deduction. S-corporations that file their taxes at the entity level, or that pass through their income to their shareholders, also report the subtraction under the aggregated subtractions line on the appropriate Department tax forms. Additionally, while the U.S. Department of the Treasury reports on the use of the credits referenced under IRC 280C, it does not break them out by state, so we could not estimate the amount of credits that would potentially be eligible for the Deduction at the state level. Instead, we surveyed members of the Colorado Society of CPAs to determine whether eligible businesses are claiming the Deduction. We received responses from seven CPAs who all said they were familiar with the Deduction and have clients that use it.

Some types of businesses are not able to claim the deduction, even though they can claim a federal tax credit and are not allowed to deduct those related expenses from their federal taxable income. The IRC 280C Deduction may only be claimed by C- and S-corporations, so some business types qualify for federal tax credits referenced by IRC 280C but are not allowed to claim Colorado's deduction. The types of businesses that may qualify for federal tax credits referenced by IRC 280C varies depending on the credit. For instance, cooperatives and partnerships may claim the federal Work Opportunity Credit for salaries and wages, which is a credit referenced by IRC 280C, but are not eligible to claim the state level IRC 280C Deduction. As a result, some businesses, such as C- and S-corporations would be able to take the deduction, but others would have to pay state income tax on the salaries and wages they could not deduct on their federal taxes because they claimed a federal credit and the state deduction is not available to them.

The IRC 280C Deduction allows businesses to deduct some, but not all, of the expenses for which they receive a federal credit. When the deduction was created, the applicable federal credits only covered wage and salary expenses; so at the time, the state deduction—which is limited to wage and salary expenses—would have covered all of the expenses that were not deductible from federal taxable income under IRC 280C. However, since the enactment of the state IRC 280C Deduction, IRC 280C has been amended several times and now references additional federal tax credits that cover expenses besides wages and salaries. As a result, there are expenses that businesses can claim credits for that they may not deduct from their federal taxable income, but are also not deductible from their state taxable income. Exhibit 1 shows all federal tax credits referenced in IRC 280C and whether the credits allow qualifying expenses that are deductible for state tax purposes provided by the IRC 280C Deduction. As shown, not all credits cover salary and wage expenses, and some credits allow expenses that include wages and salaries, as well as additional expenses that the IRC 280C Deduction does not allow. Since the IRC 280C Deduction only allows the deduction of wage and salary expenses, businesses receiving tax credits that allow other expenses would have a higher state tax liability because they cannot deduct those expenses.

Exhibit 1
Colorado Allowance of Deduction of Expenses for Federal Tax Credits Referenced by IRC 280C

All expenses that qualify for the Credit are for wages and salaries, which are deductible at the state level. This includes:
Employer Wage Credit for Employees Who Are Active Duty Members of the Uniformed Services[1]
Employer Credit for Paid Family and Medical Leave[2]
Empowerment Zone Employment Credit[3]
Work Opportunity Credit[4]
Some expenses that qualify for the Credit are not wages and salaries, and are not deductible at the state level. This includes:
Qualified Clinical Testing Expenses for Certain Drugs Credit[5] Supplies and computers used in clinical testing are not deductible.
Credit for Increasing Research Activities[6] Supplies and computers used in conducting research are not deductible.
No expenses that qualify for the Credit are deductible at the state level. This includes:
Credit for Employee Health Insurance Expenses of Small Employers[7] Non-elective contribution amounts made on behalf of employees for premiums for qualified health plans are not deductible.

Source: Colorado Office of the State Auditor analysis of federal statutes [26 USC 280C] and:
[1] 26 USC 45P | [2] 26 USC 45S | [3] 26 USC 1396 | [4] 26 USC 51 | [5] 26 USC 45C | [6] 26 USC 41 | [7] 26 USC 45R

Policy Considerations

In our previous evaluation on the IRC 280C Deduction, published in April 2019, we included two policy considerations, which we repeat in this report. To better align the IRC 280C Deduction with the credits currently referenced by IRC 280C, the General Assembly can consider two policy changes.

The General Assembly could consider expanding the IRC 280C Deduction to more business entities that qualify for federal tax credits under IRC 280C. Currently, individuals (including those operating as sole proprietorships), estates, trusts, LLCs (not electing to be either a C- or S-corporation), and partnerships cannot claim the deduction despite being able to claim federal tax credits referenced by IRC 280C. The General Assembly could allow specific entities that are not currently eligible for the deduction to modify their federal taxable income under the corporate income tax statutes, which includes this deduction, similar to how S-corporations are allowed to according to statute [Sections 39-22-322 and 323, C.R.S.]. Alternatively, potential statutory language could allow all entities that claim federal tax credits referenced by IRC 280C to receive the IRC 280C Deduction specifically.

Expanding the types of businesses entities could have two effects. On one hand, it would help all entities that receive federal credits referenced by IRC 280C mitigate the impact of increased state tax liability as a result of not being allowed to deduct expenses as allowed ordinarily. On the other hand, allowing more businesses entities to deduct these expenses may increase the total state revenue impact associated with the IRC 280C Deduction. However, because there is no state data on the current use of the federal credits and the IRC 280C Deduction, we could not estimate the impact this would have on state revenue or businesses.

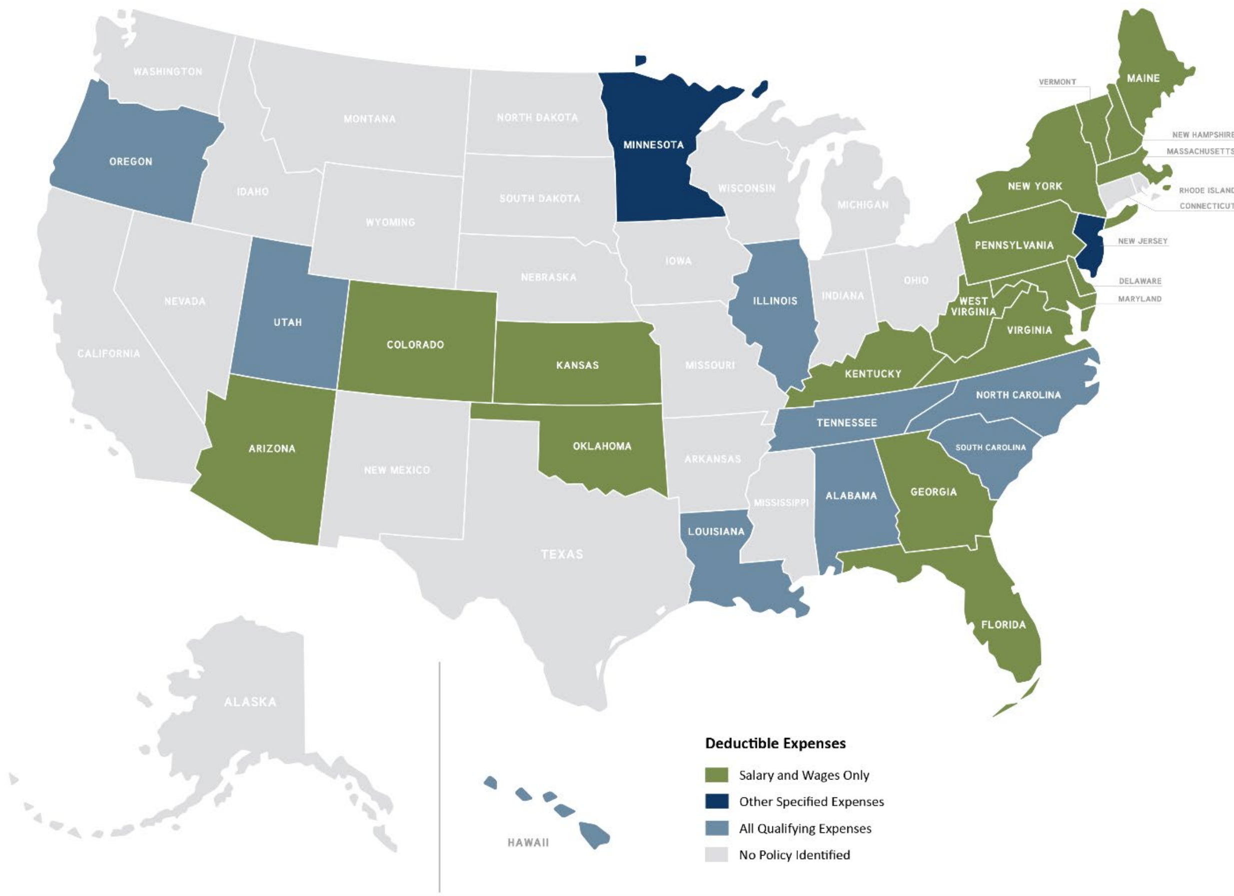
The General Assembly could consider including more types of expenses that are associated with federal tax credits referenced by IRC 280C in addition to wages and salaries. As shown above in Exhibit 1, the IRC 280C Deduction only reduces state tax liability to companies receiving federal tax credits for wage and salary expenses. However, all expenses associated with federal tax credits referenced by the section are disallowed from being deducted on a businesses' federal tax returns. For example, that means that a company receiving the Credit for Increasing Research Activities could only deduct wage and salary expenses used to qualify for the credit for state tax purposes and not the other expenses that they used for the federal credit, such as supplies or computers used in research activities. For any credit that a business claims with expenses other than wages and salaries, the effect would be a higher state tax liability.

Research into other states' policies shows there are other approaches the General Assembly could take if it desires to offset higher state tax liability for all federal credits referenced by IRC 280C. Exhibit 2 shows 16 states have policies similar to Colorado and allow businesses to deduct wage and salary expenses only. However, other states offer two alternative policy approaches:

- **Allow expenses associated with specific credits to be deductible**: A state may target specific federal credits and allow their associated expenses which are not deductible to become deductible when determining state taxable income. For instance, two states, Minnesota and New Jersey allow expenses associated with the Credit for Increasing Research Activities to be deducted.

- **Allow all expenses to be deductible**. IRC 280C references seven different tax credits with various expenses required to calculate the amount of credit a business can receive. In recognition that the expenses used to calculate this amount are "ordinary and necessary," and thus typically deductible, a total of nine states have allowed all qualifying expenses to be deductible for state tax purposes. North Carolina is an example of a state with this policy and allows a deduction for an ordinary and necessary business expense if the expense was required to be reduced or was not allowed under the Internal Revenue Code because the corporation claimed a federal tax credit in lieu of a deduction. [N.C. Gen. Stat. 105-130.5(b)(11)].

Exhibit 2
State That Have Policies Allowing C-Corporations to Deduct Certain Expenses due to IRC 280C



Source: State Auditor analysis of relevant state statutes and Bloomberg Tax Research.

Either one of these policy approaches would expand the types of expenses that can be deducted for state tax purposes, but would also increase the state revenue impact of the IRC 280C Deduction. However, we could not analyze the impact these state policies would have on state revenue or businesses because there is no state data on the current use of the federal credits and the IRC 280C Deduction. We did review publicly available data from other states' tax expenditure evaluations to see comparable revenue impacts and found that most states are like Colorado and report their equivalent deduction on a non-itemized line. We found that three states—Minnesota, New York, and West Virginia—report their deduction on itemized lines. Minnesota allows businesses to deduct expenses related to research and development (instead of wages and salaries) and reported a total fiscal impact of $4.2 million in Fiscal Year 2022. New York showed a fiscal impact for wage and salary deductions of $7 million as of Fiscal Year 2017. Finally, West Virginia also allows businesses to deduct wage and salary expenses for the Work Opportunity Credit, but only gave an estimated fiscal impact value of $400,000 annually.

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Tax-Exempt Organization Insurance Premium Tax Deduction

Tax Expenditure Evaluation • February 2024 • 2024-TE3

OFFICE OF THE STATE AUDITOR
COLORADO

Colorado generally imposes a 2 percent premium tax on insurance companies' premiums written in the state. **The Tax-Exempt Organization Insurance Premium Tax Deduction (Tax-Exempt Organization Deduction) allows insurers to deduct any premiums collected for policies purchased by tax-exempt organizations from their taxable premiums.** This deduction was originally enacted in 1969, and is likely intended to reduce the costs of tax-exempt organizations' insurance policies for their employees by allowing insurers to reduce premium costs on policies that they do not pay premium tax on.

Although some insurers are aware of and claiming the deduction, we could not determine the number of insurers claiming it or the amount claimed, and it is possible some eligible insurers might not be claiming it. Additionally, we could not determine the extent to which the deduction results in reduced premium costs for tax-exempt organizations.

- According to Division of Insurance (Division) data, between Tax Years 2018 and 2022, at least 20 insurance companies claimed the deduction. However, because the Division's premium tax filing forms do not include instructions or guidance on the types of premiums that qualify for the deduction or where to claim them, we could not determine if all of the insurers who claimed the deduction were eligible, or if there were insurers who could have been eligible for the deduction but did not claim it.
- Insurers who claimed the deduction reported that any cost savings that they incur is factored into the premium amounts for policies sold to tax-exempt organizations. However, there are many factors that go into insurance policy pricing, and insurers could not provide data on the actual cost savings they may have passed on to the tax-exempt organizations.

Policy Consideration

The Division could consider providing written instructions for insurers on its tax filing forms, along with guidance on the types of premiums that are tax exempt and how they should be claimed. We included the same policy consideration in our previous evaluation of this expenditure in 2019.

Tax Type:	**Insurance Premium Tax**	Year Enacted:	**1969**
Expenditure Type:	**Deduction**	Repeal/Expiration Date:	**None**
Statutory Citation:	**10-3-209(1)(d)(IV), C.R.S.**	Revenue Impact:	**Estimated between $4 million to $10 million**

Purpose given in statute or enacting legislation? **No**

Tax-Exempt Organization Insurance Premium Tax Deduction

Background

Colorado generally imposes a 2 percent premium tax on insurance companies' taxable premiums written in the state. **The Tax-Exempt Organization Insurance Premium Tax Deduction (Tax-Exempt Organization Deduction) allows insurers to deduct premiums collected for policies purchased by tax-exempt organizations for their employees from their taxable premiums**.

In order for the premiums to qualify for the deduction, the employer purchasing the policy or contract must be the State, a political subdivision of the State, or exempt from state income tax under Section 39-22-112, C.R.S., which includes charitable organizations, religious organizations, private foundations, and other non-profits. Only insurance products that are subject to premium tax qualify for this deduction. Therefore, some insurance coverage purchased by tax-exempt organizations, such as self-insurance, premiums purchased through non-profit insurers, or premiums purchased through Health Maintenance Organizations, would not qualify under this deduction.

This deduction was originally enacted in 1969, at a time when the General Assembly was passing other bills related to expanding access to insurance benefits. At the time, no purpose was included in the legislation; therefore, it is unclear whether the deduction was originally intended to increase access to insurance by reducing premium costs for tax-exempt organizations, or as a way to apply the same type of tax treatment to organizations that are not normally taxed (i.e., similar to the sales tax exemption for charitable organizations).

Technical Note

Employers who self-insure pay some or all of employees' claims from their own funds, although they often still contract with an insurer to act as a "third-party administrator." Self -insurance is not classified as an insurance product in Colorado and is not subject to premium tax.

Many larger public sector employers, such as the State and local governments, self-insure for various types of employee insurance coverage.

While the original purpose is unclear, based on its current operation and feedback from stakeholders, **the deduction is likely intended to reduce the costs of tax-exempt organizations' insurance policies for their employees by allowing insurers to reduce premium costs on policies for which they do not pay premium tax.**

Insurers directly claim the tax deduction on any eligible premiums they write. Tax-exempt organizations do not directly benefit from the deduction; however, if the insurer pays less in premium taxes, they could pass that cost savings onto the tax-exempt organizations by reducing the cost of their premiums.

We developed the following performance measures to evaluate the deduction:

- The extent to which insurers are aware of and applying the deduction.

- The extent to which the deduction reduces the cost of insurance that the State, political subdivisions of the State, and other tax-exempt organizations purchase for their employees.

Evaluation Results

Although some insurers are aware of and claiming the Tax-Exempt Organization Deduction, we could not determine the number of insurers claiming it or the amount claimed, and it is possible some eligible insurers might not be claiming it. Overall, according to Division of Insurance (Division) data, between Tax Years 2018 and 2022, at least 20 insurance companies claimed the deduction. Of these, 19 insurers made up about 30 percent of the total life, health, and accident premiums sold in Colorado between 2018 and 2022, and one insurer made up about 5 percent of total property and casualty premiums during the same time period. However, there could have been more insurers that were eligible for the deduction but were not aware of it because the Division's tax filing forms do not provide guidance on the types of premiums that qualify for the deduction. Additionally, the Division's tax forms have several allowable deductions listed, but there are no instructions for insurers on what premiums to include under each deduction. Specifically, the Division has a deduction labelled "Political Subdivisions" and one labelled "Other Deductions" with no additional instructions on what premiums qualify for each deduction. Division staff reported that they were unsure where insurers should claim their qualified premiums, but thought they might be claimed under Other Deductions. We reviewed Division data for Tax Years 2018 through 2022 and found that insurers were inconsistent in how they reported their qualified premiums. For example, 15 of the insurers reported their premiums under the Political Subdivisions column of the form, three insurers claimed non-profit premiums under the Political Subdivisions column and the Other Deductions column, and another insurer claimed their state and municipal agency premiums under Other Deductions. Additionally, several other insurers did not separate out their premiums that are not taxable due to other deductions—such as premiums for Medicare, Federal Employee Health Benefits, or tax-exempt annuities—or did not specify which deduction they were using. Because of these inconsistencies in reporting, we could not determine the total value of premiums sold to tax-exempt organizations, the breakdown of premiums written for political subdivisions versus non-profits, or the type of insurance that was sold. Additionally, in 2022, the Division modified its form to include instructions for insurers on where to report premiums for taxable and nontaxable annuities, which are not specific to tax-exempt organizations, but the form had an error that instructs insurers to claim their non-taxable annuities under the Political Subdivisions line. We identified at least one insurer that listed its taxable annuity premiums under the Political Subdivisions deduction, and may have erroneously deducted premiums that should have been taxed. The Division has since removed this error from the forms.

Based on the 20 insurers that explicitly claimed the Political Subdivisions deduction and/or only listed "non-profit" or "state and municipal agency" and did not list the premiums as "annuities," we calculated an average minimum revenue impact to the State for the deduction of about $4 million annually during 2018 to 2022, representing an average of $204 million annually in premiums written to tax-exempt organizations. When including premiums for tax-exempt organizations that were aggregated with other tax-exempt premiums—and premiums where the insurer did not specify the "Other" deduction they were using—the maximum revenue impact was an average of about $10 million annually during 2018 to 2022, representing an average of $504 million in premiums written.

While it appears that insurers are aware of and applying this deduction, we could not determine whether there are insurers who write eligible premiums but are not aware of and, as a result, have not used the deduction. We contacted all 20 insurers who claimed the deduction, as well as a life insurance advocacy member organization, to determine whether insurers are consistently using the deduction. One insurer, representing about 19 percent of the premiums deducted, responded that they consistently use the deduction and did not have any trouble claiming it. Additionally, the advocacy organization responded that the industry is aware of the deduction, so most insurers are probably claiming it; however, the organization stated that their members are not consistent about where they claim it on the tax filing form. We also contacted three non-profit organizations that purchase eligible coverage for their employees, and determined that their insurers claimed the deduction. However, because the Division's tax filing forms do not include any guidance on the deduction or explanation of the premiums that qualify for the deduction, it is possible there are some insurers that write premiums for tax-exempt organizations that are not claiming the deduction.

We researched policies in other states and only two states, Kentucky and New York, have a deduction similar to Colorado's, so it is not necessarily a common practice that insurers would be aware of. There are 12 other states and the District of Columbia that have a similar, but more narrow tax deduction, such as limiting the tax deduction to premiums covering public employees; many do not have a tax deduction for premiums sold to non-profit or other tax-exempt organizations.

We could not determine the extent to which the deduction results in reduced premium costs for tax-exempt organizations. Price setting for premiums involves actuarial analyses, and generally, insurers will set benchmark rates for policies based on groupings of clients that share similar risks. Because tax-exempt organizations may or may not share similar risks as private companies, we contacted the 20 insurers who claimed the deduction and a life insurance advocacy member organization to determine the extent to which the premium tax deduction influences insurers' premium pricing. We received responses from four insurers and the advocacy organization, all of which reported that the deduction helps the insurer lower the price of premiums sold to tax-exempt organizations. One stakeholder reported that if the tax-exempt organization makes the insurer aware of the deduction during the RFP, the insurance company will factor the cost-savings into the organization's premium pricing. However, none of the insurers were able to provide us a cost comparison of a policy that is subject to premium tax versus one that is not, or an overall cost savings provided to tax-exempt organizations as a result of the deduction. Therefore, we could not determine the extent to which the 2 percent premium tax savings is passed on in the form of a reduction in premium pricing for tax-exempt organizations.

Policy Consideration

Due to inconsistencies in taxpayer reporting of the Tax-Exempt Organization Deduction, the Division could consider providing written instructions for insurers on its tax filing forms and guidance on the types of premiums that are tax-exempt and how they should be claimed. We included the same policy consideration in our 2019 evaluation of the deduction. In 2019, the Division reported that it was developing updated instructions for its tax filing forms and provided draft guidance that it had prepared; however, as of 2024 the forms had not been updated and the guidance had not been issued. In 2024, Division staff reported that they anticipate that the replacement of their legacy filing system will allow for clearer filing data fields for insurers. Updating the tax filing forms and issuing the guidance would help ensure that any insurers that are eligible for the deduction are aware of it, and are therefore, more likely to claim it. This would also help ensure that insurers claim the appropriate premiums as a deduction, so the General Assembly and the Division have accurate data on the use and revenue impact of this expenditure.

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Credit for Insolvency Assessments Paid

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Tax Expenditure Evaluation • August 2023 • 2023-TE12

When an insurer with policies written in Colorado is declared insolvent, the Colorado Life & Health Insurance Protection Association (Association) requires other insurers to pay an assessment to cover the claims of policyholders who previously purchased policies from the insolvent insurer. Life and annuity insurers are then allowed to claim a credit, spread evenly over a 5-year period, against their premium taxes owed for the amount of these assessments paid. We considered the purpose of the credit to be to reimburse life and annuity insurers for costs incurred for assessments paid to the Association and to promote stability within the insurance industry.

The credit is meeting its purpose because insurers are generally aware of the credit and most of the available credit amount has been claimed. Additionally, the credit effectively reimburses life and annuity insurers to cover costs associated with assessments paid to the Association.

- According to Division of Insurance staff, the Association, and stakeholders, the credit is commonly known about and used across the industry, providing an important reimbursement for the costs of assessments levied by the Association.

- The credit appears to sufficiently reimburse insurers to cover assessment costs, thereby reducing the risk of instability across insurers in the industry.

- The credit may also prevent the costs of assessments from being passed on to future policyholders in the form of increased policy rates.

Policy Considerations

We did not identify any policy considerations in this evaluation.

Tax Type:	**Insurance Premiums**	Year Enacted:	**1991**
Expenditure Type:	**Credit**	Repeal/Expiration Date:	**None**
Statutory Citation:	**Section 10-20-113(1)(a), C.R.S.**	Revenue Impact (2018 to 2022):	**$305,000**

Purpose given in statute or enacting legislation? **No**

Credit for Insolvency Assessments Paid

Background

The Colorado Division of Insurance (Division) is responsible for monitoring and regulating state insurance activity to provide a financially stable insurance market and to protect policyholders if insurance companies no longer have the capital to provide coverage for future claims and benefits of policyholders. The Division determines when an insurance company is in financial distress and should be declared insolvent, at which point the Division assumes control of the company's assets and liabilities and pays the company's outstanding claims.

However, insolvent insurers do not always have the funds necessary to cover outstanding claims and other liabilities. In these cases, the Colorado Life & Health Insurance Protection Association (Association), which was created under Section 10-20-106 and 108, C.R.S, requires its member insurers to pay an assessment to cover the claims of policyholders who previously purchased policies from the insurer that became insolvent. These assessments are called class B assessments (assessments) and they are assessed against all life, annuity, or health insurers that are members of the Association in an amount sufficient to cover the insolvent insurer's outstanding claims. The assessment each insurer pays is proportionate to their market share of premiums collected in the state, capped at 2 percent of each insurance company's average premiums from the most recent 3 years. While health insurers and HMOs may raise policy rates to cover the assessment cost, life and annuity insurers are allowed a premium tax credit to offset the assessment cost.

Technical Note:

Statute defines a member insurer as any insurer that is licensed or holds a certificate of authority in the state to write any kind of insurance [Section 10-20-103(8), C.R.S]. House Bill 23-1303 added health maintenance organizations (HMOs) as member insurers.

The Credit for Insolvency Assessments Paid allows life and annuity insurers to claim a premium tax credit, divided evenly over a 5-year period (i.e., insurers claim 20 percent of their assessment amount paid against their premium taxes each year) following the payment of the assessment to the Association.

Following an assessment, the Association provides insurers with a Credit for Contribution Certificate that outlines the amount of credits they are eligible to claim against their premium tax liability, which insurers submit to the Division when filing their premium tax return.

If a member insurer does not have sufficient tax liability to use the credit, the insurer may carry the credit forward to future years. Additionally, the total combined credit amount that all member insurers can claim is capped at $4 million annually, with excess amounts carried forward; however, based on discussions with the Association, the total amount certified has not exceeded the statutory cap.

While statute does not state a purpose for the Credit for Insolvency Assessments Paid, **we considered the purpose to be to reimburse life and annuity insurers for costs incurred for assessments paid to the Association and to promote stability within the insurance industry.** Specifically, based on our review of legislative audio from the credit's enactment, the General Assembly created the Association, along with assessments, to cover policies that were already purchased to ensure that policyholders were protected during an insolvency. However, there was concern that assessments for life and annuity insurers, who sell fixed premiums and cannot quickly cover additional expenses with a policy rate change, could create additional financial hardships for these types of insurers and lead to instability in the industry and additional insolvencies. Therefore, the General Assembly created the credit to offset the cost of assessments that life and annuity insurers have to absorb. This approach is similar to the policies of other states. All 50 states, including the District of Columbia, have an Association that is part of the National Organization of Life and Health Insurance Guaranty Associations, and 43 states plus the District of Columbia provide a tax credit for insolvency assessments paid by life and annuity insurers. Because health insurers sell policies on a more short-term basis, statute instead allows them to recoup assessment costs through policy rate increases and they are not eligible for the credit.

We considered the intended beneficiaries of the Credit for Insolvency Assessments Paid to be life and annuity insurance companies that can claim the credit to recoup their assessment costs, as well as future policyholders who are likely protected from rate increases due to insurers recouping, rather than passing on, some of the assessment costs.

We developed the following performance measures to evaluate the tax expenditure:

- Are insurers aware of and using the Credit for Insolvency Assessments Paid?

- Does the Credit for Insolvency Assessments Paid effectively reimburse life and annuity insurers to cover costs incurred from assessments paid to the Association, reduce the risk of instability in the industry, and help protect policyholders?

Evaluation Results

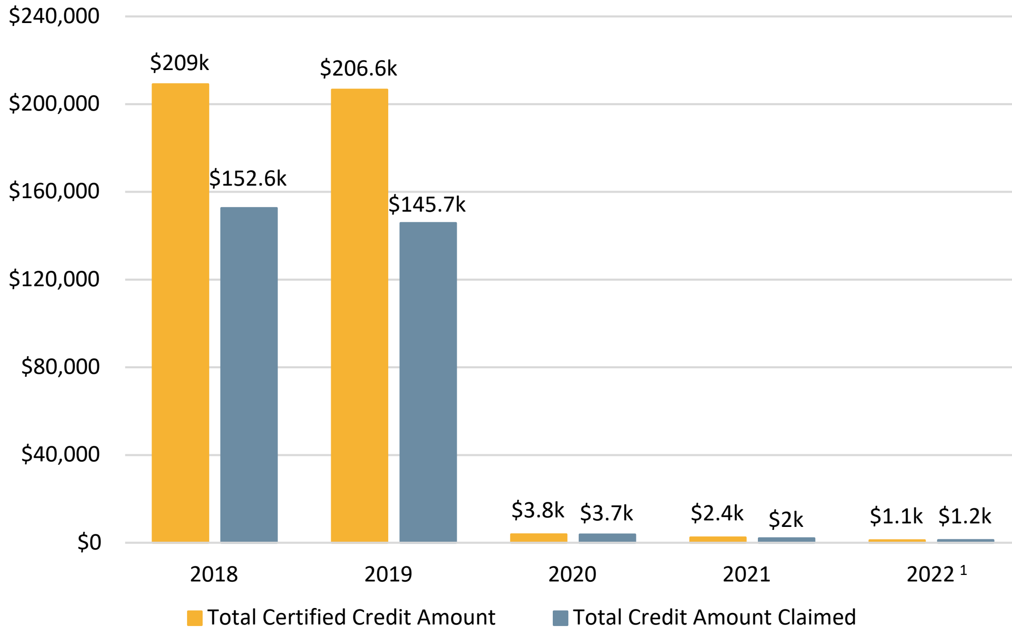
The Credit for Insolvency Assessments Paid is meeting its purpose because insurers are generally aware of the credit and most of the available credit amount has been claimed.

Additionally, the credit effectively reimburses life and annuity insurers to cover costs associated with assessments paid to the Association.

Life and annuity insurers are aware of and claiming the credit. Based on our discussions with Division staff, the Association, and stakeholders, we found that the credit is commonly known and used across the insurance industry. For example, discussions with the Association, member insurers, and trade associations indicated that insurance companies are aware of the credit and the credit provides an important reimbursement for the costs of assessments levied by the Association. In addition, because similar credits are available in most states, insurers that operate in multiple states are likely to be familiar with the credits.

Most insurers claimed the credits they were eligible to claim in recent years. Based on data provided by the Division and the Association, we found that insurers claimed about $305,000 of the nearly $423,000 in credits certified by the Association from Tax Year 2018 through 2022, with a single insurer accounting for nearly 95 percent of the total unclaimed amount. Other insurers' unclaimed amounts were relatively small, ranging from less than $1 to about $5,000 per year. In our discussions with Division staff, they did not know why certain insurers did not claim the full amount of tax credits they were eligible to claim. Exhibit 1 compares the amount of credits insurers claimed and the amount they were certified to claim from Tax Years 2018 through 2022 for a large assessment levied in 2014 and a smaller assessment levied in 2017, which led to higher credit certifications in 2018 and 2019 and lower amounts in subsequent years. As discussed above, insurers are allowed to claim 20 percent of their assessment amount paid as a credit against their premium taxes each year for 5 years. This means that in 2018 and 2019, insurers were able to claim their credits from the larger assessment amount from 2014 and the smaller 2017 assessment.

Exhibit 1
Credits Claimed and Credits Certified for Tax Years 2018 through 2022



Source: Colorado Office of the State Auditor analysis of data provided by the Colorado Division of Insurance (Division) and the Colorado Life & Health Insurance Protection Asssociation.
[1]The amount claimed in Tax Year 2022 is slightly higher than the amount certified, however, the Division did not provide a response to why this occurred.

The Credit provides life and annuity insurers with a sufficient reimbursement to cover assessment costs to reduce the risk of instability in the industry.

Stakeholders indicated that the credit is generally sufficient to cover insurers payments and reduce the financial risks that could occur in the industry as a result of assessments levied against member insurers. Due to the credit being paid over 5 years and inflation reducing the value of money over time, insurers do not receive the full value of the assessments they pay, but the credit covers almost all of it. For example, based on a hypothetical $100 assessment levied against an insurance company, assuming a 2 percent discount rate based on the Federal Reserve Board's target inflation rate, the credit offsets about 94 percent the insurer's assessment costs. However, because assessments in recent years have been relatively small, it is unlikely that they would have had a significant impact on the insurance industry regardless of the credit. For example, the most recent assessment occurred in 2017, with payments from insurers ranging from $2.80 to $852, with a median of $76. While such a small cost is unlikely to have created financial instability for insurers, if more substantial insolvencies resulting in greater assessments levied on member insurers occurred in future years, this would increase the importance of the credit in mitigating insurers' solvency risks.

In addition to meeting its purpose, we also determined that the credit may prevent future policyholders from covering the cost of the assessment through increased policy rates. The credit may also benefit insurance consumers by allowing insurance companies to avoid passing the cost of assessments on to policyholders in the form of higher premiums, although it is unclear the extent to which this would occur in the absence of the credit. Generally, life and annuity insurers are limited in their ability to pass costs on to current policyholders because they cannot raise fixed policy premium rates. However, life and annuity insurers could pass the cost of the assessment on to future policyholders by charging higher life and annuity policy rates. Economic research suggests that consumers' demand for life and annuity insurance is less responsive to price changes, indicating that life and annuity insurers would likely pass on most of the increased cost of assessments in the form of future policy rate increases if they did not receive a reimbursement through the tax credit. Additionally, based on discussions with stakeholders, the credit could be important to smaller domestic insurers in Colorado that receive a relatively larger portion of their premium revenue from Colorado policyholders. Because these insurers have less premium revenue from other states, an assessment in Colorado may be more difficult for them to absorb, as compared to larger insurers for which Colorado policies may make up a small portion of their total premium revenue.

Policy Considerations

We did not identify any policy considerations.

OFFICE OF THE STATE AUDITOR

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C O L O R A D O

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Alternative Transportation Options Credit for Employers Memo

The Alternative Transportation Options Credit allows employers to claim an income tax credit for amounts they spend to provide alternative transportation options to their employees. Statute requires us to issue an evaluation prior to the legislative session before a tax expenditure expires [Section 39-21-305(1)(d), C.R.S.]. The credit is only available for Tax Years 2023 and 2024, so data on taxpayer use of the credit will not be available before the General Assembly would need to take legislative action during the 2024 legislative session if it would like to extend the credit. Therefore, we are issuing this memo to provide a summary of the credit, preliminary data on the use of the credit, and some issues that we noted in speaking with stakeholders and the Department of Revenue (Department) about the credit.

The General Assembly created the Alternative Transportation Options Credit for Employers in 2022 "to increase the use of alternative transportation options by employees in going to and returning from their places of employment by providing an incentive to employers to provide alternative transportation options to employees." Statute defines alternative transportation options as "free or partially subsidized generally accepted transportation demand management strategies provided to employees working in Colorado" such as mass transit passes; provision of ridesharing vans, bicycles, and electric bicycles; and shared micromobility options such as bikesharing and electric scooter sharing programs. Additionally, the employer may only claim the credit for alternative transportation options that are available to all of its Colorado employees regardless of their job position, whether they are full- or part-time, and whether they are salaried, paid hourly, or tipped. If it is not feasible to offer a particular alternative transportation option to certain employees, an employer may offer a substantially equivalent alternative transportation option to those employees.

The credit, which is refundable, is equal to 50 percent of the amount spent by the employers to provide alternative transportation options to its employees, and the maximum credit that may be claimed by an employer is $125,000 per tax year. Additionally, the maximum amount spent in any tax year for any one employee for which an employer may claim a credit is $2,000. The credit is available to most types of employers, as long as they have at least three employees in Colorado. This includes for-profit businesses, such as corporations, partnerships, and limited liability companies, as well as nonprofit organizations and certain local governments; since the credit is refundable, tax exempt entities can benefit from the credit if they meet its requirements and file a corporate return with the Department to claim the credit.

Before making qualifying expenditures and claiming the credit, the employer has to provide the Department with a copy of its plan (Form DR 1323) for notifying its employees about the availability of the alternative transportation options that it offers and information on what steps the employer plans to take to encourage employees to use the options. Statute also requires that employers report to the Department information on its alternative transportation options program, including the specific alternative transportation options offered, the number of employees offered an alternative transportation option, and, to the extent feasible, the number of employees actually using the options and the number of trips taken by employees using the options; this information is reported on Form DR 1323. Employers then claim the credit on their income tax returns.

Department staff indicated that, as of September 2023, they have received plans (Form DR 1323) from three employers. According to Department staff, this indicates that three employers have established their intent to develop a program to offer alternative transportation options to their employees that would qualify for the credit. However, until these taxpayers file their income tax returns for Tax Year 2023 in Calendar Year 2024, the Department will not know whether any of these taxpayers have completed the investments that qualify for the credit and, subsequently, claim the credit. The Department reports that complete data about the credit for Tax Year 2023 will be included within its Fiscal Year 2025 Annual Report, published in January 2026.

Policy Considerations

If the General Assembly decides to extend the credit beyond 2024, it could consider clarifying four potential issues in statute. We identified four potential issues based on our research, conversations with stakeholders in the industry, and discussions with Department staff. The Department has commenced rulemaking on this credit and indicated to us that it was considering whether to address some of these issues through rulemaking. However, the Department indicated that it would be helpful if the General Assembly clarifies these issues in statute. The issues identified include:

Whether expenses incurred for providing alternative transportation options to volunteers are eligible for the credit. Statute [Section 39-22-509(3)(a), C.R.S.] provides, "…there is allowed a credit to each employer in an amount equal to fifty percent of the amount spent by the employer to provide alternative transportation options to its employees…" Statute does not define "employee" for purposes of the credit, but volunteers are not typically employed by organizations so it is unclear whether expenses paid to offer alternative transportation options to volunteers qualify for the credit. Since this credit is refundable and available to nonprofit organizations and local governments, it may be beneficial for the General Assembly to clarify whether expenses incurred by employers to offer alternative transportation options to volunteers qualify for the credit.

Whether the "substantially equivalent" requirement applies to the mode of transportation or can be interpreted more broadly. Statute [Section 39-22-509(3)(d), C.R.S.] provides, "An employer may claim a credit only for amounts spent by the employer for alternative transportation options that it makes available to all of its employees who are employed in Colorado; except that, if it is not feasible to offer a particular alternative transportation option to certain employees, an employer may offer a *substantially equivalent* [emphasis added] alternative transportation option to such employees. The requirement that an alternative transportation option be offered to all employees who are employed in Colorado applies regardless of the position that an employee holds, whether the employee is employed on a full-time or part-time basis, or whether an employee is salaried, compensated in whole or in part through commissions or tips, or paid on an hourly basis."

It is unclear whether the "substantially equivalent" requirement applies to the transportation mode or could be interpreted more broadly. For example, it is unclear if a company offers electric bike passes in the Denver area whether it must offer something similar to an electric bike pass to all employees, regardless of where in the state they are located, or if employees in rural areas of the state where electric bike share programs are not available or practical could be offered the option to work remotely to satisfy that requirement. Therefore, the General Assembly could consider clarifying how the substantially equivalent provision applies in the case of employers who have employees throughout the state.

How the per-employee cap applies in cases in which the employer purchases a capital asset (e.g., a van or fleet of electric bicycles). Statute provides limitations for the maximum amount spent in any income tax year for which an employer may claim a credit [Section 39-22-509(3)(a), C.R.S.]. The maximum for the company is $250,000 annually, and there is also a per-employee maximum amount spent of $2,000. When a company purchases a capital asset, such as a van or a fleet of electric bikes, it is unclear how the per-employee cap should be calculated. For example, if a company with 100 total employees purchases a van with a capacity of 20 people for $50,000 but only 15 employees use the van regularly for commuting, it is unclear how the company should determine the per-employee cap (e.g., $50,000/100; $50,000/20; or $50,000/15). Therefore, the General Assembly could consider clarifying how it intends for the per-employee cap to be applied when an employer is purchasing a capital asset.

When an employer purchases a capital asset, whether the employer can claim the credit for the cash out amount or the depreciation expense. When an employer purchases a capital asset it is unclear whether the employer may claim the credit for the actual cash amount spent (e.g., $50,000 for a van) or the depreciation expense for the tax year. If the credit can be claimed only for the depreciation expense for the tax year for an asset that is depreciated beyond 2024, which is when the credit is currently set to expire, there is a question of whether the employer can continue to claim the credit beyond 2024 for the remaining depreciation expense.

Business Personal Property Tax Income Tax Credit

Tax Expenditure Evaluation • June 2024 • 2024-TE5

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The Business Personal Property Tax Income Tax Credit allows taxpayers who paid local business personal property taxes in the state during the income tax year to claim a refundable income tax credit for a portion of those taxes. Statute provides that the purpose of the credit is "to minimize the negative impact of the business personal property tax on businesses."

We found that the credit has only provided a small reduction to the overall tax burden of business personal property taxpayers in the state because relatively few eligible businesses claim it and the benefit it provides varies substantially depending on the total value of taxable business personal property. Additionally, many taxpayers attempt to claim it when they are not eligible or miscalculate their credit amount when they are eligible.

Policy Consideration

The General Assembly may want to consider repealing the Business Personal Property Credit. If the General Assembly repeals the credit but would like to provide property tax relief to business personal property taxpayers impacted by the credit's repeal, it could consider making changes to the Business Personal Property Tax Exemption to target who benefits. Specifically, it could consider exempting the first $52,000 (or another amount) of business personal property actual value rather than only exempting businesses with that amount or less in actual value of business personal property.

Tax Type:	**Income**	Year Enacted:	**2019**
Expenditure Type:	**Credit**	Repeal/Expiration Date:	**None**
Statutory Citation:	**Section 39-22-537.5, C.R.S.**	Revenue Impact (2021):	**$169,818**

Purpose given in statute or enacting legislation? **Yes**

Business Personal Property Tax Income Tax Credit

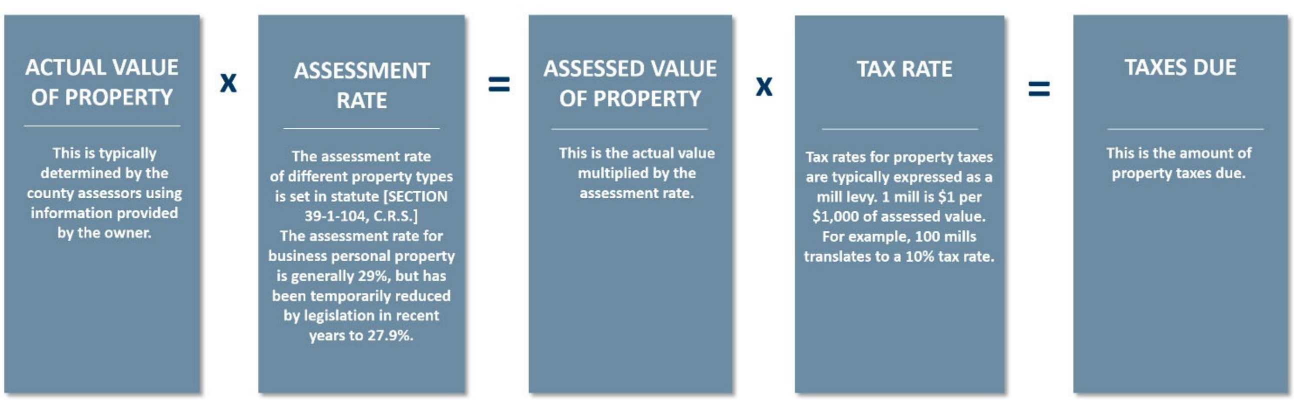
Background

The Business Personal Property Tax Income Tax Credit (Business Personal Property Credit) [Section 39-22-537.5, C.R.S.] allows taxpayers who paid local business personal property taxes during the income tax year to claim a refundable income tax credit for a portion of those taxes.

Business Personal Property Tax and Exemption

The Colorado Constitution imposes property tax, which is paid annually, on the value of business personal property located in the state [Article X, Section 3]. Business personal property is property that is used in a business, such as equipment, machinery, security systems, and furnishings, and is not real property, such as land and commercial buildings. Business personal property taxes are local taxes and do not provide tax revenue for the State. Property taxes are based on the property's value, which is generally determined by local county assessors using information provided by businesses on a Personal Property Declaration Schedule that they file each year—though some personal property, such as public utility property like gas lines and wind farms, is valued by the state (referred to as "State assessed" property). After the property value has been determined each year, the property taxes to be assessed are then calculated as shown in Exhibit 1. Property taxes are calculated during the valuation year and paid in the next year. For example, property taxes for Property Tax Year 2023 will be paid during Calendar Year 2024.

Exhibit 1
How Business Personal Property Tax is Calculated



Source: Office of the State Auditor analysis of Section 39-1-104, C.R.S., and Art. X, Sec. 3 Colorado Constitution.

For example, if a business owner has business personal property worth $100,000 in a location with a combined tax rate of 85 mills, their business personal property taxes would be calculated as shown in Exhibit 2.

Exhibit 2
Example of Business Personal Property Taxes Due on $100,000 of Property

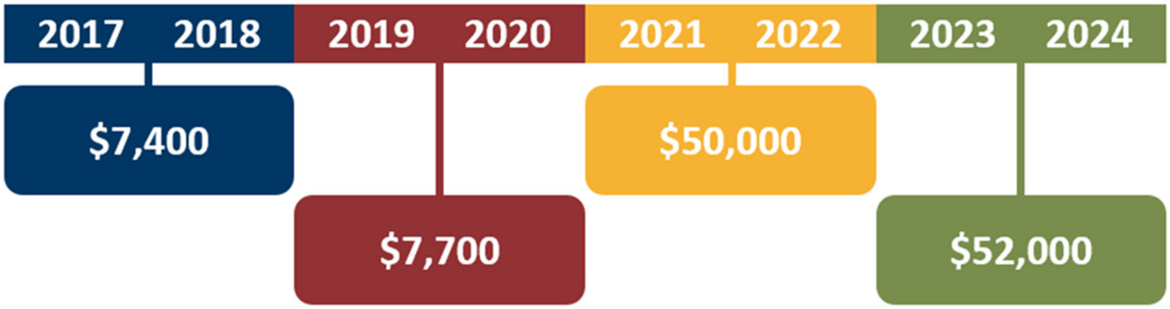
ACTUAL VALUE OF PROPERTY		ASSESSMENT RATE		ASSESSED VALUE OF PROPERTY		TAX RATE		TAXES DUE
$100,000	x	29%	=	$29,000	x	85/1,000 = 0.085 = 8.5%	=	$2,465

Source: Office of the State Auditor analysis of Section 39-1-104, C.R.S., Art. X, Sec. 3 Colorado Constitution, and Division of Property Taxation mill levy data.

Statute provides an exemption from filing the Personal Property Declaration Schedule and paying the business personal property tax for businesses with an actual value of business personal property located in a county that is under a certain amount [Section 39-3-119.5, C.R.S.]. This Business Personal Property Exemption applies at the county level and is a threshold, meaning that businesses with property values above the exemption amount in a county owe business personal property tax on the entire value of their business personal property, not on the difference between the exemption amount and their total value of business personal property in the county. Exemption thresholds are common in states with business personal property taxes. There are 36 states in addition to Colorado that impose business personal property tax, and 12 of those states (as well as Colorado) provide a business personal property tax exemption. Of the 12 states with a business personal property tax exemption, 5 structure their local business personal property tax exemptions as a threshold.

Prior to 2021, the exemption amount was periodically adjusted either by the General Assembly or per statute to account for inflation. In 2021, the General Assembly passed House Bill 21-1312, which significantly increased the exemption amount from $7,700 to $50,000. Beginning in Property Tax Year 2023, the $50,000 exemption amount will be automatically adjusted biennially to account for inflation and rounded per statute, and the new exemption amount will be published online by the Division of Property Taxation, which is within the Department of Local Affairs. For example, for Property Tax Years 2023 and 2024, the exemption amount increased to $52,000. Exhibit 3 shows the exemption amount for recent years.

Exhibit 3
Business Personal Property Exemption Amounts from 2017-2024



Source: Office of the State Auditor analysis of Section 39-3-119.5(2), C.R.S.

Beginning in Property Tax Year 2021, which was the first year that the larger exemption amount went into effect, the State is required by statute to reimburse local governments for the annual revenue lost due to the increased exemption amount [Section 39-3-119.5(3)(d) and (e), C.R.S.]. In 2022, the State reimbursed local governments for $16.7 million in lost revenue due to the larger exemption amount (for 2021 taxes payable in 2022), and in 2023, the State reimbursed local governments for $16.6 million (for 2022 taxes payable in 2023).

Business Personal Property Tax Income Tax Credit

Statute allows taxpayers to claim an annual refundable income tax credit for the business personal property taxes they paid on up to $18,000 of the actual value of the taxpayer's business personal property. Since the Business Personal Property Exemption was increased to $50,000 (or higher) beginning in 2021, all taxpayers who claim the credit will have $18,000 in actual value of business personal property on which to calculate their Business Personal Property Credit, although their credit amounts will vary based on the mill levy at the property's location. To determine the credit amount, the taxpayer multiplies the business personal property taxes paid by $18,000 divided by the taxpayer's total actual value of taxable business personal property in the state. For example, a business with $100,000 in total actual value of business personal property that owes $2,465 in business personal property taxes would have a Business Personal Property Credit of $444, calculated as shown in Exhibit 4.

Exhibit 4
Example Calculation of the Business Personal Property Credit

Source: Office of the State Auditor analysis of Sections 39-1-104 and 39-22-537.5, C.R.S.; Art. X, Sec. 3 Colorado Constitution; and Division of Property Taxation mill levy data.
[1] Assumes a mill levy of 85, which was the statewide county total average mill levy in 2022, and a 29 percent assessment rate.

To claim the credit, taxpayers report the credit amount on the designated line of their Colorado income tax returns and must also attach a copy of their property tax statement from the county assessor showing the business personal property taxes paid.

The Business Personal Property Credit was created in 2017 by Senate Bill 17-267 and was first available in Income Tax Year 2019. The Business Personal Property Credit replaced a similar income tax credit that was available from Tax Years 2015 to 2018. We did not identify any other states that offer both a business personal property tax exemption and a broad income tax credit for business personal property taxes paid. We only identified one state (West Virginia) with a credit that is relatively similar to Colorado's credit. In West Virginia, businesses that have $1 million or less in actual value of all property in the state are allowed to claim a refundable income tax credit for 50 percent of the property taxes paid on personal property, so small businesses in West Virginia get back about half of the business personal property taxes they paid.

Technical Note

The credit is not available for the graduated annual specific ownership taxes imposed on motor vehicles, wheeled trailers, semi-trailers, trailer coaches, and mobile and self-propelled construction equipment, or the property taxes imposed on public utilities that are State assessed; public utilities are entities that are doing business in the state as railroad companies, airline companies, electric companies, small or low impact hydroelectric energy facilities, geothermal energy facilities, biomass energy facilities, wind energy facilities, solar energy facilities, energy storage systems, clean energy resources, rural electric companies, telephone companies, telegraph companies, gas companies, gas pipeline carrier companies, domestic water companies selling at retail except nonprofit domestic water companies, pipeline companies, coal slurry pipelines, or private car line companies.

Statute provides that the credit's purpose is "to minimize the negative impact of the business personal property tax on businesses" [Section 39-22-537.5(1), C.R.S.].

Statute does not provide performance measures for the Business Personal Property Credit nor does it explain what is specifically meant by "negative impact" of the business personal property tax.

When organizations critique business personal property taxes, in general, their critiques focus on two aspects of the tax: (1) the financial burden of paying tax on depreciable assets used in a business, and (2) compliance costs, since businesses typically must track all or most of their personal property and report that information to local governments by filing or updating forms annually. Since the credit was not designed in a way to address the compliance costs associated with filing business personal property taxes, we developed the following performance measure to evaluate the credit based on the first factor listed related to financial burden: To what extent does the Business Personal Property Credit reduce the financial burden of businesses that pay business personal property tax?

Evaluation Results

The Business Personal Property Credit has only provided a small reduction to the overall tax burden of business personal property taxpayers in the state because relatively few eligible businesses claim it and the benefit it provides varies substantially depending on the total value of taxable business personal property.

The Business Personal Property Credit does not appear to be claimed by most eligible taxpayers and many taxpayers claim it incorrectly. In Income Tax Year 2021—the most recent year for which we have data—425 taxpayers claimed the Business Personal Property Credit for a total of about $170,000, according to Department of Revenue (Department) data. We estimate that this is less than 1 percent of business personal property taxpayers in the state.

To estimate the proportion of eligible taxpayers who used the credit, we compared the number of credits claimed with the number of personal property declaration schedules businesses filed with counties to report their taxable business personal property, which we used as a proxy for business personal property taxpayers (i.e., potentially eligible credit claimants). Of the 425 taxpayers who claimed the credit, the majority (373) were individuals, many of whom likely received the credit from a pass-through entity, such as a partnership, so the number of businesses that benefited from the credit is likely less than 425. According to Division of Property Taxation data, in Property Tax Year 2020, businesses filed about 150,700 personal property declaration schedules statewide. However, this data may include personal property declaration schedules filed by public utilities that are State assessed and are not eligible for the credit. Additionally, businesses are required to file the personal property declaration on a county basis, so a business operating in multiple counties would file a personal property declaration schedule in each county in which they have taxable business personal property even though they are considered one taxpayer for income tax purposes. For those reasons, the 150,700 figure likely represents fewer than 150,700 businesses and, thus, may overestimate the number of businesses eligible for the credit. We compared credits claimed in Income Tax Year 2021 to declaration schedules filed in Property Tax Year 2020 because (1) property taxes are paid in arrears so 2020 property taxes were paid in 2021, and (2) the credit is allowed for property taxes *paid* during the income tax year; therefore, Business Personal Property Credits claimed in 2021 are based on 2020 property taxes. Although we encountered several data limitations in conducting this analysis, the data indicate that the credit may be under-utilized by potentially eligible taxpayers.

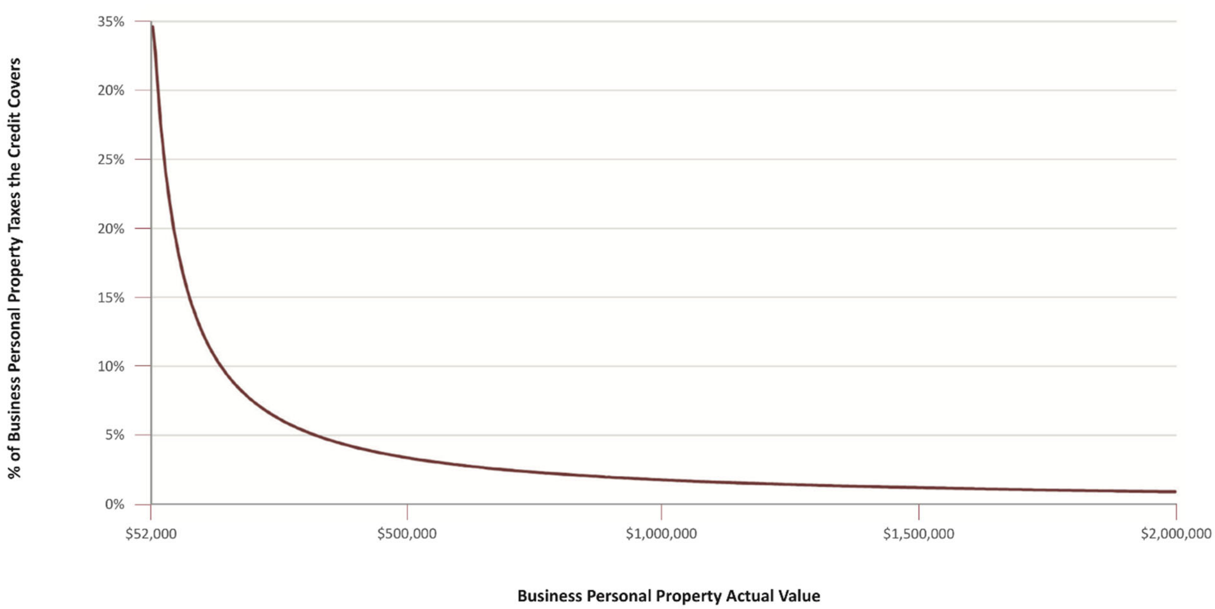
We found that few eligible taxpayers may have claimed the credit because many taxpayers and CPAs do not appear to be aware of the credit. We spoke with three trade organizations that represent businesses in the state, and they reported that businesses are likely not aware of the credit, and they suggested speaking with CPAs since many businesses use CPAs to file their taxes. We surveyed CPAs who are members of the Colorado Society of Certified Public Accountants (COCPA) and prepare Colorado tax returns for businesses. Of the 20 CPAs who answered the survey question "Are you aware of the business personal property credit in 39-22-537.5, C.R.S.?", 12 (60 percent) responded that they were not aware of the credit. In the survey, we also asked CPAs "Do your clients ever ask you about the business personal property credit or mention it to you?" Seventeen CPAs responded to this question and all of them said no.

Additionally, it is possible that many of the taxpayers who claimed the credit claimed it incorrectly. Department staff reported that taxpayers commonly make errors in claiming this credit, but they do not have any data available on how frequently errors occur. Staff said that errors can only be determined through a tax examiner manually reviewing the claim. Since the Department is aware that errors are common for this credit, it reported that staff place some emphasis on reviewing Business Personal Property Credit claims, but due to resource limitations, they are not able to manually review every claim for the Business Personal Property Credit. We reviewed 20 Business Personal Property Credit claims filed in Tax Year 2020 in GenTax, the State's accounting system; all of these credits were over $1,000 and collectively represented almost 40 percent of the credit's total revenue impact in 2020. Based on our review, it appears that many of these credits were claimed erroneously or miscalculated. For example, it appears that several taxpayers attempted to claim the credit for real property rather than business personal property, and several taxpayers attempted to claim the credit for the property tax paid on the first $18,000 of actual value of multiple properties rather than the first $18,000 of their total actual value of all business personal property in the state. If the Department reviews these credits and determines taxpayers made errors, it could result in even fewer taxpayers receiving the credit.

The Department provides information about the Business Personal Property Credit in its tax return instruction booklets for all taxpayer types but it has not published any taxpayer guidance documents on its website, such as an FYI, Income Tax Topic, or Income Tax Guide, or promulgated formal rules about this credit specifically. Trade organizations that we spoke with stated that having a premade pamphlet about the credit that they could distribute to their members may help increase awareness. It is also possible that having this kind of information available may help reduce erroneous claims.

For businesses that claim it, the Business Personal Property Credit reduces the financial impact of the business personal property tax to some extent, but the relative benefit from the credit varies substantially depending on the total value of business personal property that a business owns. Since the Business Personal Property Credit is refundable, it effectively reimburses businesses that do not qualify for the Business Personal Property Exemption (in Section 39-3-119.5, C.R.S.) for the business personal property taxes they paid on $18,000 of actual value of their business personal property. We estimated how much the credit reimburses businesses as a percentage of the total business personal property taxes they paid as total business personal property value increases. For purposes of our example, we used the 2022 statewide total average county mill levy of 85 mills. As shown in Exhibit 5, businesses with just over the Business Personal Property Exemption threshold amount of $52,000 receive the highest percentage (about 35 percent) of their business personal property taxes back through the Business Personal Property Credit, with the amount diminishing substantially as businesses' value of personal property increases; in our example, businesses with over $1.9 million in actual value of business personal property receive less than 1 percent of their business personal property taxes back through the Business Personal Property Credit.

Exhibit 5
Business Personal Property Credit Decreases as Total Business Personal Property Values Increase



Source: Office of the State Auditor analysis.

As mentioned earlier, a credit for taxes paid on $18,000 of business personal property in a location with a mill levy of 85 mills would generate a credit of around $450. This is compared to business personal property taxes of about $1,300 if they have just over the exemption amount ($52,001) or about $24,700 if they have $1 million worth of business personal property. Additionally, because of the credit's design, businesses with the same value of business personal property in different areas of the state with different mill levies receive a proportionate reimbursement of their business personal property taxes through the credit. For example, a business with $52,001 in a location with a total mill levy of 20 mills and a business with $52,001 in a location with a total mill levy of 150 mills each receive about 35 percent of their business personal property taxes back through the Business Personal Property Tax Credit—though the nominal value of the credit will be higher for the taxpayer with property in the higher taxing jurisdiction. On average, mill levies are lower in rural areas than in urban and front range areas, so, generally, businesses in rural areas may receive smaller credits than businesses in front range and urban areas.

Further, the degree to which the credit minimizes the negative impact of the business personal property tax for a business likely depends on how capital-intensive a business is relative to its profit margins. For example, we spoke with trade organizations that represent different types of businesses in the state, and several mentioned that restaurants tend to have a lot of high-value equipment but low profit margins and, therefore, the credit may be helpful in particular to those types of businesses since they often do not qualify for the Business Personal Property Tax Exemption because the value of their equipment exceeds the exemption threshold amount. CPAs that we surveyed also mentioned that restaurants tend to have high value of property and low profit margins, along with several other industries, including construction, manufacturing, breweries, and agriculture processing facilities. One trade organization that we spoke with as well as a CPA who responded to our survey mentioned that the age of the business may also impact whether they qualify for the Business Personal Tax Property Exemption, which also impacts whether they need/qualify for the Business Personal Property Credit. For example, older businesses may have depreciated most of their business personal property and qualify for the Business Personal Property Tax Exemption (and thus not need the credit) whereas startups or new business locations may have high values of business personal property and not qualify for the exemption and thus be able to use the Business Personal Property Credit to recoup some of the property taxes they paid.

In addition to the credit, businesses can deduct property taxes as ordinary and necessary business expenses on their federal income tax returns. The State does not require businesses to add back the property taxes deducted at the federal level when calculating Colorado taxable income; therefore, since Colorado uses federal taxable income as the starting point for calculating Colorado taxable income, businesses receive a deduction at the state level for property taxes deducted at the federal level. We did not account for the benefit taxpayers receive from deducting their property taxes in the analysis above, but receiving both a credit for a portion of the property taxes paid as well as a deduction for all property taxes paid increases the overall benefit businesses receive from the State.

CPAs reported administrative issues with claiming the credit. Some CPAs who we surveyed reported several administrative issues with the credit, including that the instructions are insufficient for claiming the credit on the return, the Department is inconsistent with what documentation it requires taxpayers to provide in order to claim the credit, and the Department disallows the credits despite proper documentation being provided. One trade organization that we spoke with as well as two CPAs who responded to our survey also reported that the value of the credit often is not worth the time to claim it.

Policy Consideration

The General Assembly may want to consider repealing the Business Personal Property Credit. As discussed, we found several issues with the credit. First, the credit does not appear to be used by most eligible taxpayers, likely due to the lack of awareness by businesses and CPAs. Second, for many taxpayers, the benefit the credit provides is very small relative to the total business personal property taxes they paid. Finally, many taxpayers attempt to claim it when they are not eligible or miscalculate their credit amount when they are eligible. Consequently, the Department must spend time reviewing the credit claims since taxpayers commonly make errors in claiming it; however, the Department stated that it has limited resources and cannot review every claim.

Additionally, the larger Business Personal Property Exemption amount may be minimizing the negative impact of the business personal property tax for many taxpayers, so the credit may no longer be necessary to achieve that purpose. As discussed, the Business Personal Property Credit provided about $170,000 in benefits to taxpayers in Tax Year 2021, compared to at least $16.7 million in tax benefits provided by the Business Personal Property Exemption. When the General Assembly created the current Business Personal Property Credit in 2017 (to go into effect beginning in Tax Year 2019), the Business Personal Property Tax Exemption amount was $7,400. When the General Assembly passed the credit in 2017, they discussed that creating the credit was a better option at the time than increasing the Business Personal Property Exemption because if they increased the exemption, there was a downstream impact on the Gallagher Amendment formula, which required the taxable value of property in the state to be balanced at 45 percent residential and 55 percent commercial, including business personal property; it maintained that ratio by adjusting the residential assessment rate while holding the nonresidential (commercial) rate constant at 29 percent for most types of property. In 2020, Coloradans voted to repeal the Gallagher Amendment, so the Gallagher Amendment formula is no longer a factor that needs to be considered. When the General Assembly increased the exemption threshold from $7,700 in 2020 to $50,000 in 2021, there was a decrease of about 44,400 (29 percent) personal property declarations schedules filed statewide, with the largest decreases in San Juan County (99 percent decrease), Logan County (85 percent decrease), Chaffee County (80 percent decrease), Park County (75 percent decrease), and Fremont County (71 percent decrease); 21 counties had at least a 50 percent reduction in business personal property schedules filed between 2020 and 2021. It is possible that some of the reduction in schedules filed was due to other causes besides the increased exemption amount, such as businesses closing (particularly due to the COVID-19 pandemic) or moving outside the taxing jurisdiction, but Division of Property Taxation staff reported that most of the decrease could be attributable to the larger exemption amount.

However, if the General Assembly repeals the Business Personal Property Credit, business personal property taxpayers with property valued over the exemption amount will no longer receive relief since they are not eligible for the exemption. The extent to which this would impact businesses depends on how much they currently benefit from the credit. As shown in Exhibit 5, businesses with total actual value of business personal property worth just over the exemption threshold amount currently receive the largest relative benefit from the credit, whereas businesses with higher amounts of business personal property receive a credit that is small relative to the total property taxes they pay.

If the General Assembly repeals the credit but would like to provide property tax relief to business personal property taxpayers impacted by the credit's repeal, it could consider making changes to the Business Personal Property Tax Exemption to target who benefits. Specifically, it could consider exempting the *first* $52,000 (or another amount) of business personal property actual value rather than only exempting businesses with that amount or less in actual value of business personal property. As discussed, we found that 7 of the 12 states we identified with a business personal tax exemption structure their exemptions in this way. Depending on the amount exempted, this policy could have a substantial impact on local government revenue but would ensure that all business personal property taxpayers receive some property tax relief. Based on 2022 business personal property declaration schedules filed and 2022 total average county mill levies, we estimated that providing the $52,000 exemption to all businesses could reduce local government revenues by about $127.4 million annually (in addition to the approximately $17 million the State already annually reimburses local governments for the increased exemption amount), and the General Assembly would need to consider whether the State should backfill this amount as it currently does for the higher exemption amount.

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Contaminated Land Redevelopment Credit

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Tax Expenditure Evaluation • November 2023 • 2023-TE15

The Contaminated Land Redevelopment Credit (Brownfields Credit) allows property owners to claim an income tax credit for voluntary cleanup of contaminated land—known as brownfields—located in Colorado. The credit's purpose is "to encourage voluntary environmental remediation of contaminated sites by providing a financial incentive to move forward with costly remediation projects." Our office issued an evaluation of the Brownfields Credit in 2022. Statute requires our office to "review a tax expenditure with a statutory repeal date so that the evaluation report for such tax expenditure is available during the legislative session held in the calendar year before the tax expenditure is scheduled to repeal" [Section 39-21-305(1)(d), C.R.S.]. The credit is scheduled to expire at the end of 2024. Since we evaluated the Brownfields Credit recently, this follow-up evaluation focuses on evaluating the substantive changes made to the credit by House Bill 22-1392, which include a higher cap on credits that may be certified and reserving a certain amount of the cap for projects in rural communities, a larger credit for remediation projects that occur in rural communities, and an expanded definition of "qualified entities."

We found:

- As noted in our 2022 evaluation of the Brownfields Credit, the credit likely provides a relatively modest additional incentive to remediate contaminated land, but other factors are often more important to property owners when deciding whether to go forward with projects.

- In this evaluation, we found that other factors besides the credit, particularly unfavorable market conditions, have been impacting the number of brownfield sites that are being remediated, including in rural communities.

- Additional qualified entities, such as urban renewal authorities and school districts, appear to be benefitting from the Brownfields Credit with the expanded definition from House Bill 22-1392.

Policy Considerations

We did not identify any policy considerations for this evaluation.

Tax Type:	**Income tax**	Year Enacted:	**2014**
Expenditure Type:	**Credit**	Repeal/Expiration date:	**Dec. 31, 2024**
Statutory Citation:	**Section 39-22-526, C.R.S.**	Credits Certified (2022):	**$2,554,836**

Purpose given in statute or enacting legislation? **Yes**

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Contaminated Land Redevelopment Credit

Background

The Contaminated Land Redevelopment Credit (Brownfields Credit) allows property owners to claim an income tax credit for voluntary cleanup of contaminated land—known as brownfields—located in Colorado. The credit is set to expire at the end of Calendar Year 2024.

Technical Note:

There is no formal process for sites to be designated as brownfields. CDPHE considers brownfields to be abandoned, idled, or under-utilized properties where redevelopment is complicated by the presence of a hazardous substance, pollutant, or contaminant. Some examples of brownfield sites are former gas stations, dry cleaning shops, mining operations, power plants, and agricultural processing facilities.

The Brownfields Credit is calculated as 40 percent of the first $750,000 spent on approved remediation plus 30 percent of the next $750,000. No credit is allowed for expenditures that exceed $1.5 million. Therefore, the maximum credit allowed is $525,000. For tax years beginning on or after January 1, 2022, if the approved remediation site is located in a rural community, the credit amount is increased to 50 percent of the first $750,000 spent plus 40 percent of the next $750,000, for a total maximum credit of $675,000. For the purposes of the credit, a rural community is a municipality or an unincorporated part of any county with a population of less than 50,000 people that is not located in the Denver metropolitan area. Statute allows the Colorado Department of Public Health and Environment (CDPHE) to certify up to $5 million in credits each year; $2 million of the $5 million is reserved for projects in rural communities [Section 39-22-526(3), C.R.S.].

The credit is not refundable, but may be carried forward for 5 years if the taxpayer does not have sufficient tax liability to use all of the credit in the year in which it was generated. Alternatively, the taxpayer or a qualified entity (defined below) can transfer the credit to a taxpayer who can use it; transferring the credit typically involves the taxpayer or qualified entity that completed the remediation project selling the credit at a discount to another taxpayer who can use the credit to offset their income tax liability. According to a Colorado-based tax credit broker, credits are typically sold at 85 percent of their value (e.g., a $100,000 credit sells for $85,000). According to CDPHE staff, in 2021 and 2022, all Brownfields Credits were transferred from the taxpayer or qualified entity that earned the credit to another taxpayer.

For purposes of the credit, qualified entities are nontaxable entities such as nonprofit organizations and local governments. They are defined in statute to include counties, municipalities, school districts and charter schools, state institutions of higher education, public improvement districts (including urban renewal authorities and downtown development authorities), conservation and irrigation districts, public corporations organized pursuant to law, and private nonprofit entities that are exempt from Colorado income tax [Section 39-22-526(2)(d), C.R.S.]. Since qualified entities are not typically income tax paying entities, these entities will often transfer (sell) their credits, which allows them to receive a financial benefit from the credit. For qualified entities, the credit is referred to as a "transferable expense amount." Throughout this report, we refer to credits and transferable expense amounts collectively as "credits."

Nine other states offer tax expenditures that are similar to Colorado's Brownfields Credit, although there is variation in how the tax expenditures operate. Three states offer transferable credits and in two states, the credits are refundable (in one of these the credit is only refundable if the entity is a 501(c)(3) nonprofit organization). Two states allow the credits to be earned by nontaxable entities; in Florida, municipalities and counties are eligible for the credit and in Iowa, 501(c)(3) nonprofit entities may earn a credit. Several states also allow for a larger credit if certain requirements are met. For example, Maryland and New Jersey allow a larger credit if the brownfield site is located in a designated area, such as an enterprise zone or distressed area. Other states allow for an enhanced credit based on property use, such as manufacturing in New York and affordable housing or health care facilities in Florida.

In order to be eligible for the credit, which the General Assembly created in 2014, a qualified entity or taxpayer must submit an application to the Voluntary Clean-up Program within CDPHE. In 1994, the General Assembly created the Voluntary Clean-Up Program to provide guidance and financial assistance for remediating contaminated lands [Section 25-16-301 et seq., C.R.S.]. Sites eligible for the Voluntary Clean-Up Program are brownfields that are not under federal or state environmental regulations, often because the contamination occurred prior to such regulations. Statute excludes the following types of sites from the Voluntary Clean-Up Program—sites designated as "superfund" sites and placed on the National Priorities List by the U.S. Environmental Protection Agency (EPA); sites subject to the federal Resource Conservation and Recovery Act or the State Hazardous Waste Disposal Site program run by CDPHE; and sites subject to CDPHE's Water Quality Division enforcement actions or the Underground Storage Tank program administered by the Colorado Department of Labor and Employment [Section 25-16-303(3)(b), C.R.S.]. Entities participating in the Voluntary Clean-Up Program may also apply for a loan through the Colorado Brownfields Revolving Loan Fund. This program offers low-cost financing at reduced interest rates and flexible terms. The loan is administered by CDPHE, the Colorado Housing and Finance Authority, and the loan fund's Board of Directors, which approves loans. Entities may receive both a loan and a Brownfields Credit. According to CDPHE staff, one project in the last 3 years has applied for both the loan program and the tax credit.

CDPHE is responsible for determining whether a property is eligible for the Voluntary Clean-Up Program. In order to qualify, Section 25-16-304, C.R.S. requires the property owner to submit a plan that provides:

- An environmental assessment that describes the property's contamination and its risk to public health and the environment.

- A plan for remediation of the contaminated land that either has or could release contamination that poses an "unacceptable" risk to public health and the environment. The plan needs to consider the site's present and future use, and a timetable to implement the plan and monitor the site after completion of the remediation.

- A description of state standards that apply to the soil, surface water, or groundwater—or if no standards exist, a description of the plan's proposed clean-up levels and existing risks to public health and the environment.

In order to be certified for the credit by CDPHE, property owners must complete the following steps:

- Submit a Voluntary Clean-Up Program plan to CDPHE for approval and pay a fee of $2,000 to compensate CDPHE for the time it spends reviewing the plan. Voluntary Clean-Up Program plans include the applicant's estimated costs of remediation and the projected tax credit based on those costs.

- Complete the remediation described in the plan.

- Receive a No Action Determination letter from CDPHE, which confirms that the remediation is complete and, generally, that neither CDPHE nor the federal government will require additional remediation.

- Submit documentation to CDPHE on the actual remediation costs, such as invoices detailing payments for remediation.

- Receive a certification letter for the credit from CDPHE that shows the credit amount based on actual remediation costs.

- Claim the credit on their income tax return or transfer the credit. If the credit is transferred, the transferor and transferee must jointly file a copy of the written transfer agreement with CDPHE within 30 days after the transfer.

Statute provides that the specific legislative purpose of the Brownfields Credit is "to encourage voluntary environmental remediation of contaminated sites by providing a

financial incentive to move forward with costly remediation projects" [Section 39-22-526(3.5)(b), C.R.S.]. Additionally, statute provides that the general purposes of the credit are to "induce certain designated behavior by taxpayers" and "provide tax relief for certain businesses or individuals" [Section 39-22-526(3.5)(a)(I) and (II), C.R.S.].

Our office issued a Brownfields Credit evaluation in January 2022. In that evaluation, we found that the credit provides a relatively modest additional incentive to clean up contaminated land and appears to have encouraged some property owners to go forward with remediation projects. However, it is likely more effective for properties that are located in marginal redevelopment markets and for property owners with less funding available for remediation and redevelopment, whereas well-funded redevelopment projects in strong redevelopment markets may already have strong incentives to complete remediation. In our 2022 evaluation, we also had several policy considerations for the General Assembly, including (1) amending statute to allow entities such as school districts, urban renewal authorities, and business improvement districts to qualify, (2) reviewing the annual aggregate cap on credits, and (3) reviewing the effectiveness of the credit and whether it is meeting its purpose to the extent intended.

The Brownfields Credit was originally set to expire December 31, 2022. In 2022, with House Bill 22-1392, the General Assembly extended the expiration date to December 31, 2024. In addition to extending the credit through the end of 2024, House Bill 22-1392 made other substantive changes to the credit, including providing a larger credit amount for remediation projects located in rural communities; increasing the overall cap for credits that can be issued annually from $3 million to $5 million, while providing that $2 million must be reserved for projects in rural communities; and expanding the list of qualified entities eligible to receive a transferable expense amount for completing remediation projects. These changes went into effect in 2022. Statute requires our office to "review a tax expenditure with a statutory repeal date so that the evaluation report for such tax expenditure is available during the legislative session held in the calendar year before the tax expenditure is scheduled to repeal" [Section 39-21-305(1)(d), C.R.S.]. Since we evaluated the Brownfields Credit recently, this follow-up evaluation focuses on evaluating the substantive changes made to the credit by House Bill 22-1392, some of which addressed the policy considerations we included in our 2022 evaluation. We used the following performance measures to assess the changes:

- To what extent has the Brownfields Credit, as amended in House Bill 22-1392, encouraged remediation of additional brownfield sites, particularly those in rural communities?

- To what extent are public entities that were previously excluded from the credit now able to benefit from it due to the changes from House Bill 22-1392?

Evaluation Results

In our 2022 evaluation of the Brownfields Credit, we found that the credit likely provides a relatively modest additional incentive to remediate contaminated land and may encourage some remediation projects, though other factors are often more important to property owners when deciding whether to go forward with projects.

In this evaluation, we found that other factors besides the credit, particularly unfavorable market conditions, have been impacting the number of brownfields sites that are being remediated, including in rural communities. In Calendar Year 2022, CDPHE certified Brownfields Credits for eight projects, for a total amount of $2.55 million in credits. Two of those projects, with total credits of $1 million for both combined, were in rural communities. We previously found that from 2015 to 2020, CDPHE certified about $2.63 million in credits for about 10 projects each year and about 23 percent (14 of the 62 projects) were outside of Denver, but we cannot say whether all of these projects would have been classified as rural projects by CDPHE since that was before the statutory change by House Bill 22-1392. Based on the number of applications CDPHE has received in 2022 and 2023, it does not seem like the number of projects and percent that are in rural areas will increase significantly in coming years. In Calendar Year 2023, 12 projects completed applications for the Voluntary Clean-Up Program and Brownfields Credit (one of which is in a rural community), but as of November 2023, no credits have been issued for 2023. For 2024, seven projects have applied for the credit, one of which is in a rural community. However, figures for 2023 and 2024 are preliminary since additional entities may file their paperwork to receive the credit or apply for the credit for 2024.

CDPHE staff reported that many remediation projects that submitted applications in recent years have put those projects on hold because construction loan interest rates have increased substantially. For example, three additional projects completed an application for the credit in 2022, but those projects were later put on hold. Other stakeholders, including an environmental lawyer and an environmental consultant who works with brownfields developers, also reported that construction financing has been an issue for brownfields, including high interest rates, lenders' willingness to lend, and high property values. Rising costs might have also impacted the number of developers that have started brownfields projects and, therefore, applied for the credit.

If market conditions improve in the future, developers might apply for and receive more in credits. In 2021, the amount of credits reserved was close to the credit cap of $3 million. Credits reserved for 2022 and 2023 were around $4 million, so were above the old cap but have not approached the new cap of $5 million. However, the amount reserved so far for 2024 is much less, which may also be due to recent and current market conditions. CDPHE staff reported they have spoken with additional developers who are interested in applying for the tax credit for 2024, but they have not yet applied. We spoke with a tax credit broker who works with Brownfields Credit recipients to sell their credits and an environmental consultant that works with developers, and they reported that the increased credit for projects in rural communities has been helpful for the entities that they work with because remediation work is more expensive in those areas since they do not have access to local contractors, which adds travel and hotel expenses for contractors to work in rural communities. Therefore, when market conditions improve, more developers in rural areas might apply for the credit and receive the credit since $2 million of the credits must be allocated to rural areas by statute.

Additional qualified entities appear to be benefitting from the Brownfields Credit with the expanded definition from House Bill 22-1392. Prior to the passage of House Bill 22-1392, the only qualified entities listed in statute eligible for a transferable expense amount were counties, home rule counties, cities, towns, home rule cities, home rule cities and counties, and private nonprofit entities exempt from Colorado income tax. In our 2022 evaluation of the Brownfields Credit, we included a policy consideration for the General Assembly to consider expanding the definition of qualified entities that are eligible for the credit because we found that CDPHE, after consulting with the Attorney General's Office, interpreted "qualified entities" to exclude entities not explicitly mentioned in statute such as school districts, urban renewal authorities, and business improvement districts. It was not clear whether the General Assembly had intended to exclude those entities from accessing the credit. House Bill 22-1392 expanded the list to include school districts, charter schools, special districts, districts authorized by Article 20 of Title 30 (county public improvement districts, such as local improvement districts and county public improvement districts), Article 25 of Title 31 (municipal public improvement districts, such as urban renewal authorities and downtown development authorities), and Articles 41 to 50 of Title 37 (conservation and irrigation districts), state institutions of higher education, quasi-governmental entities, and municipal, quasi-municipal, or public corporations organized pursuant to law.

CDPHE staff reported that they believe the legislative changes from House Bill 22-1392 addressed the issue regarding qualified entities and have not had any issues with ineligible public entities attempting to access the credit but not being included in the expanded definition. We also asked an environmental lawyer, who we also spoke with during the last evaluation, and a tax credit broker whether this has remedied the issue and they said they believe the definition now sufficiently includes all local government entities. According to CDPHE staff, it had two projects from newly eligible qualified entities that were certified credits in 2022—an urban renewal authority and a school district.

Policy Consideration

We did not identify any policy considerations for this evaluation. As discussed above, the General Assembly addressed the policy considerations from our previous evaluation of this credit in House Bill 22-1392.

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State Income Tax Refund Deductions

Tax Expenditure Evaluation • February 2024 • 2024-TE4

OFFICE OF THE STATE AUDITOR
COLORADO

The State Income Tax Refund Deductions allow taxpayers—including individuals, estates, trusts, and corporations—to deduct state income tax refunds that are included in their federal taxable income when calculating their Colorado taxable income.

Taxpayers who itemize deductions on their federal income tax returns can deduct the amount they paid in state income taxes during the year. When they file their state income tax return, a taxpayer will receive a state income tax refund if they overpaid state taxes during the year. As a result, they will have paid less in state income taxes than what they reported on their federal return as a deduction and will have underpaid their federal income taxes. When this happens, taxpayers are required to include their state income tax refund as income on their federal tax return the following year. Since Colorado uses federal taxable income as the basis for Colorado taxable income, the purpose of the deductions is to avoid taxing the state refund by allowing taxpayers to deduct it on their state tax return.

We found the deductions are meeting their purpose because eligible taxpayers are aware of the deductions and are claiming them. We also found that changes to federal law have reduced the number of individual taxpayers who have claimed the State Income Tax Refund Deduction in recent years.

- Data from the Internal Revenue Service and Department of Revenue show that in Tax Year 2020 nearly all eligible individual taxpayers took the deduction.
- The Tax Cuts and Jobs Act decreased the number of individual taxpayers who itemized deductions on their federal return, which decreased the number of Colorado taxpayers who would need to claim the deduction. In the first year the Act went into effect the number of claims decreased by approximately 310,000 taxpayers with a revenue impact decrease of $23.5 million.

Policy Considerations

We did not identify any new policy considerations for the deduction.

	State Income Tax Refund Deduction: **Individuals**	State Income Tax Refund Deduction: **Estates and Trusts**	State Income Tax Refund Deduction: **C-corporations**
Tax Type:	**Income**	**Income**	**Income**
Expenditure Type:	**Deduction**	**Deduction**	**Deduction**
Statutory Citation:	**Sections 39-22-104(4)(e), C.R.S.**	**Sections 39-22-104(4)(e), C.R.S.**	**Section 39-22-304(3)(f), C.R.S.**
Year Enacted:	**1964**	**1964**	**1964**
Repeal/Expiration Date:	**None**	**None**	**None**
Revenue Impact:	**$4.7 million (2020)**	**Could Not Determine (2020)**	**Could Not Determine (2020)**
Purpose given in statute or enacting legislation? **No**			

State Income Tax Refund Deductions

Background

The State Income Tax Refund Deductions allow taxpayers—including individuals, estates, trusts, and corporations—to deduct state income tax refunds that are included in their federal taxable income when calculating their Colorado taxable income.

State tax refunds can be included in federal taxable income for a taxpayer under the following scenario:

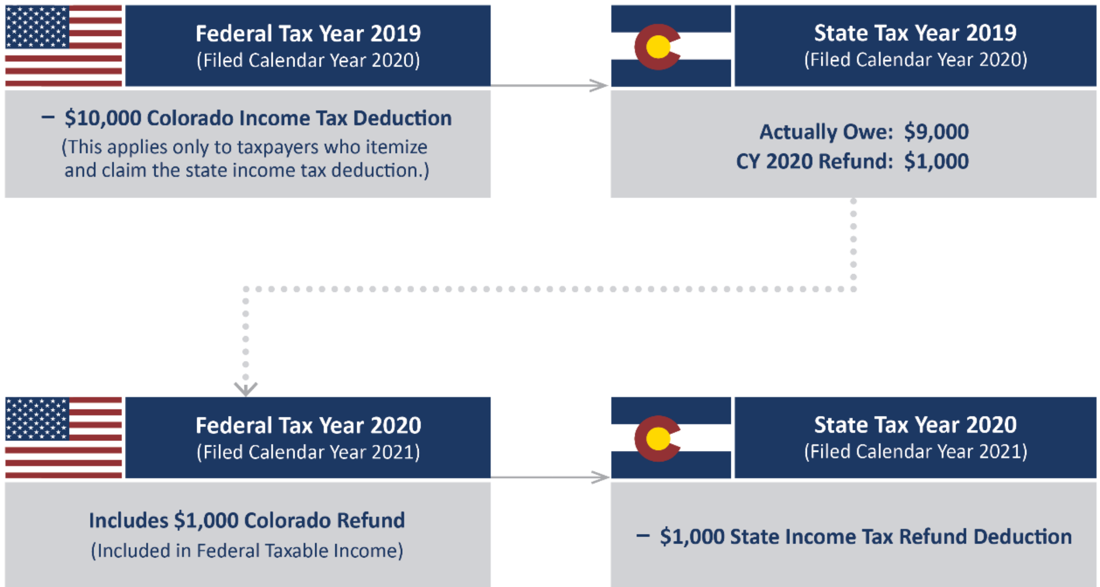
- First, the taxpayer chooses to itemize deductions instead of taking the standard deduction on their federal income tax return, and claims a federal deduction for state income taxes paid. Currently, individuals can deduct the amount they paid in state income taxes during the year up to $10,000.

- Second, the taxpayer files their state income tax return and receives a refund of all or a portion of the state taxes they paid, which occurs if they overpaid state taxes during the year.

- Third, because of the state tax refund the taxpayer will have paid less in state income taxes than what they reported on their federal return as a deduction, which effectively means they underpaid their federal income taxes. When this happens, taxpayers are required to report their state tax refund as federal taxable income on their federal tax return the following year to the extent that deducting it in the prior year decreased their federal taxable income to at or above what it would have been had the taxpayer claimed the standard deduction.

Since Colorado uses federal taxable income as the basis for calculating Colorado taxable income, the State Income Tax Refund Deductions are necessary to avoid applying state income tax to the refund the State provided the taxpayer in the prior year. Exhibit 1 demonstrates how the deductions are applied to prevent the prior year state tax refund from being taxed by the State.

Exhibit 1
How the Exemptions Prevent Additional Tax on State Income Tax Refunds



Source: Office of the State Auditor analysis of federal tax law [26 USC 61-63, 111, & 164] and state statutes [Sections 39-22-104(1.7)(b), (2), & (4)(e) and 304(1)(a) & (b) & (3)(f), C.R.S.]

In order to claim this deduction, individuals complete the Subtractions from Income Schedule form, noting the amount of the state income tax refund that was included in their federal income. Estates, trusts, and corporations put their state income tax refund on the line for "Other Subtractions." S-corporations have the option to file a composite return on behalf of their shareholders or pass the liability through to the shareholders, who report the income on their personal tax returns.

Of the 40 other states and the District of Columbia with a standard income tax, 38 have a similar tax expenditure that either excludes state income tax refunds from the calculation of state taxable income or allows a deduction similar to Colorado's.

These deductions were created in 1964 by the same legislation [House Bill 64-1003] that transitioned Colorado from calculating its own state income tax base to using the federal income tax base as the starting point for determining Colorado taxable income and they have remained largely unchanged since their creation. Based on our review of federal and state statutes, legislative history, Department of Revenue (Department) taxpayer guidance documents, and discussions with certified public accountants (CPAs), we inferred that **the purpose of these deductions is to prevent state income tax refunds for overpayments of tax from being taxed by the State the following year.**

Evaluation Results

We found that the deductions are meeting their purpose because eligible taxpayers are aware of them and claiming them. In order to determine the proportion of eligible taxpayers who are using these deductions, we examined the Internal Revenue Service's (IRS) Statistics of Income for individual taxpayers from Colorado, along with Department data, on the usage of the deductions for Tax Year 2020. The IRS Statistics of Income report estimates that about 114,000 Colorado taxpayers received a state income tax refund in Calendar Year 2020 for Tax Year 2019 and included it in their federal income for Tax Year 2020; these taxpayers should have generally been eligible for the State Income Tax Refund Deductions. In comparison, Department data showed about 114,000 individual taxpayers claimed the deductions in Tax Year 2020, indicating that nearly all eligible individual taxpayers are aware of the deduction and using it. Additionally, information on the deductions is widely available; information on the deductions is clearly provided on the Department's tax forms and instructions and by Turbo Tax, a tax return preparation software that is widely used; and CPAs we spoke with were also aware of it.

We lacked data for estates, trusts, and businesses to complete a similar analysis for those entities. To assess the awareness and use of these deductions among these entities, we surveyed CPAs from the Colorado Society of Certified Public Accountants for their feedback on the deductions. We received 8 responses from our survey, 7 of which indicated that CPAs as a whole are aware of these deductions and apply them to individual, estates/trusts, or corporations. These results are consistent with the feedback we received in our previous evaluation of the deductions. CPAs noted that corporations are unlikely to use the deduction as frequently as individuals because they often use accrual basis accounting and accrue the exact amount of taxes they owe on an ongoing basis. For corporations that use cash basis accounting, an overpayment and, thus, refund may occur, in which case CPAs report that these corporations will claim the deduction.

Department data indicate that the deduction had a revenue impact of $4.7 million for individual taxpayers in Tax Year 2020. Since the line of the tax return forms that estates, trusts, and C-corporations use to report the deduction is labeled "Other Subtractions" and is used to report multiple other deductions, it is not possible for us to determine the State Tax Refund Deductions' revenue impact for those types of taxpayers. The data provided by the Department show the total amount of all the subtractions taken on that line by estates and trusts totaled $6.9 million, and $44.4 million for corporations. However, based on the feedback we received from CPAs and an examination of the other deductions that are reported on this line, we believe that the State Tax Refund Deductions account for a small percentage of the deductions reported.

We also found that changes in federal law decreased the number of individual taxpayers who claim the State Income Tax Refund Deductions. Department data show that the use of the deduction by individuals decreased substantially from Tax Year 2018 to 2020, from 424,000 individuals claiming the deduction for a total of $28.2 million in Tax Year 2018 to 114,000 individuals claiming it for a total of $4.7 million in Tax Year 2020. This decrease appears to have been caused by the federal Tax Cuts and Jobs Act (TCJA), which significantly increased the federal standard deduction (from $6,500 to $12,000 for single filers and from $13,000 to $24,000 for joint filers to be adjusted annually) and placed a $10,000 cap on the total state and local taxes that can be deducted by individuals for Tax Years 2018 to 2025. As a result, it is likely fewer individual taxpayers itemized their deductions on their federal return, which is required in order for individual taxpayers to need to use the State Income Tax Refund Deduction.

Further, academic research indicated that the federal tax savings of the TCJA—which came from the increase in federal standard deductions and the elimination of federal personal exemptions—did not translate to lower Colorado income tax liabilities for taxpayers because it did not reduce their federal taxable income, which Colorado bases its income taxes on. Thus, some taxpayers ended up paying more state taxes and did not receive a state income tax refund, so had no need for these deductions. Since the increase of the federal standard deduction is set to expire after 2025, unless it is extended, it is likely that itemized filings at the federal level will return to levels seen prior to the implementation of the TCJA and the number of Coloradans claiming the State Income Tax Refund Deductions will increase as well.

Policy Consideration

We did not identify any new policy considerations for the deduction. Our previous evaluation suggested that the General Assembly review the State Income Tax Add-back Provision for Individuals, Estates, and Trusts for Tax Years 2018 to 2025 to clarify the order in which deducted state taxes are added back to Colorado taxable income. Since then, the Department has released guidance on its website indicating how a taxpayer is to calculate their addback amount, so we do not have any further policy considerations.

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Credit for Unsalable Alcohol

Tax Expenditure Evaluation • November 2023 • 2023-TE16

OFFICE OF THE STATE AUDITOR
COLORADO

Colorado levies an excise tax on alcoholic beverages that are meant for sale or consumption in the state. Alcohol excise taxes are due from the seller the first time alcoholic beverages are sold, transferred, or otherwise disposed of within Colorado, which typically occurs when a manufacturer sells Colorado-made alcoholic beverages to a distributor or when a distributor sells alcoholic beverages shipped from outside the state to a Colorado wholesaler or retailer. **The Credit for Unsalable Alcohol allows taxpayers to claim a refund or credit for the amount of excise taxes paid on alcoholic beverages sold in Colorado when, after payment of the excise tax, the alcoholic beverages are rendered unsalable due to destruction or damage.** The credit was likely intended to provide taxpayers with a credit or refund for paying a tax that can no longer be passed on to the consumer since the alcohol has been rendered unsalable due to damage or destruction.

We found:

- Taxpayers appear to use the credit for large volume losses when they occur; in 2021, 88 percent of the total credits were for claims of over $1,000, which is at least 18,000 bottles of wine, 2,210 bottles of spirituous liquor, or 133,300 bottles of beer.
- The amount claimed by alcohol type is not proportionate to the amount of excise taxes paid by alcohol type. The Department of Revenue does not know why this occurred.
- Industry representatives reported that the credit is important, but some taxpayers reported not being aware of the credit.

Policy Considerations

We did not identify any new policy considerations for this evaluation.

Tax Type:	**Liquor excise tax**	Year Enacted:	**1953**
Expenditure Type:	**Credit**	Repeal/Expiration date:	**None**
Statutory Citation:	**Section 44-3-503(9), C.R.S.**	Revenue Impact (2021):	**$230,589**

Purpose given in statute or enacting legislation? **No**

Credit for Unsalable Alcohol

Background

Colorado levies an excise tax on alcoholic beverages that are meant for sale or consumption in the state. Alcohol excise taxes are due from the seller the first time alcoholic beverages are sold, transferred, or otherwise disposed of within Colorado, which typically occurs when a manufacturer sells Colorado-made alcoholic beverages to a distributor or when a distributor sells alcoholic beverages shipped from outside the state to a Colorado wholesaler or retailer. However, for administrative convenience, some manufacturers and distributors pay the excise tax prior to the sale of the alcoholic beverages. The tax is typically passed on to final consumers of the alcohol in the form of higher prices. Colorado imposes the following excise taxes on alcohol:

Exhibit 1
Colorado Alcohol Excise Tax Rates

Alcohol Type	Tax Rate
Malt Liquor and Hard Cider	$0.08 per gallon
Vinous Liquor (Excluding Hard Cider)	$0.0733 per liter
Spirituous Liquor	$0.6026 per liter

Source: Colorado Office of the State Auditor analysis of Section 44-3-503(1)(a), C.R.S.

The Credit for Unsalable Alcohol allows taxpayers to claim a refund or credit for the amount of excise taxes paid on alcoholic beverages sold in Colorado when, after payment of the excise tax, the alcoholic beverages are rendered unsalable due to destruction or damage. The credit is not available for alcoholic beverages that are unsalable due to spoilage. Taxpayers are required to report and remit the alcohol excise taxes to the Department of Revenue (Department) on a monthly basis using the Monthly Report of Excise Tax for Alcohol Beverages (Form DR 0442). To claim the credit, taxpayers record the amount of alcohol destroyed or damaged on their monthly form, effectively offsetting their current tax liability by the amount of excise tax they previously paid on the alcoholic beverages (that were later damaged or destroyed). Alternatively, taxpayers may claim the credit as a refund using the Claim for Refund Form (Form DR 0137E). To qualify for the credit or refund, taxpayers must also submit evidence to the Department showing that the tax was paid and provide an affidavit (Form DR 0444) itemizing the products damaged or destroyed, along with the destruction date and an authorized agent's signature from the business that is filing the form. In cases where taxpayers plan the destruction in advance, Department guidance directs taxpayers to notify the Department of their intention to destroy the unsalable beverages at least 4 weeks in advance; a Department representative may attend to witness the destruction, but, according to Department staff, rarely does so in practice.

The credit was likely intended to provide taxpayers with a credit or refund for paying a tax that can no longer be passed onto the consumer since the alcohol has been rendered unsalable due to damage or destruction. This type of credit also exists at the federal level [26 USC 5064] and is common among other states. However, the federal credit is restricted to losses where the excise tax paid totals $250 or more, except when the President has declared a major disaster area. The $250 minimum means taxpayers must have lost at least 18,000 bottles of wine or 5,000 bottles of beer to be able to claim the credit. Additionally, there are 32 other states with a similar expenditure for unsaleable alcohol. All of the other states provide a refund or credit for damaged products, but eligibility varies based on alcohol types and whether products lost due to theft, spoilage, or major disaster are eligible.

To determine whether the credit is meeting its purpose, we assessed the extent to which eligible taxpayers are aware of and using the credit.

Evaluation Results

In 2021, 122 taxpayers claimed $230,589 in credits. This is a relatively small amount (less than 0.5 percent) of the $53.3 million in alcohol excise taxes collected that year. We lacked data on how many manufacturers or distributers in the state had damaged or destroyed alcohol, so we were unable to determine the proportion of eligible beneficiaries that claimed the credit. Most of the credit amounts were for large losses of product. In 2021, 88 percent of the total credits were for claims greater than $1,000. As shown in Exhibit 2, this translates into a loss of more than 18,000 bottles of wine or 133,000 bottles of beer.

Exhibit 2
Number of Bottles of Alcohol Required to be Damaged for Credits of $100, $500, and $1000

	Vinous Liquor (750 ml Bottles)	Spirituous Liquor (750 ml Bottles)	Malt Liquor and Beer (12 oz Bottles)
Greater than $100 Credit	> 1,800 bottles	> 220 bottles	> 13,300 bottles
Greater than $500 Credit	> 9,000 bottles	> 1,100 bottles	> 66,600 bottles
Greater than $1,000 Credit	> 18,000 bottles	> 2,210 bottles	> 133,300 bottles

Source: Office of the State Auditor analysis of Section 44-3-503(1)(a), C.R.S.

Most taxpayers claimed the credit three times or less in 2021, but 16 of the 122 taxpayers (13 percent) filed for the credit every month of 2021 and claimed $166,000—or about 73 percent of all unsalable alcohol credits for that year. Most of these 16 taxpayers claimed relatively small amounts, about $65 per month on average, but a few of them claimed, on average, more than $4,400 per month, which translates into a monthly loss of nearly 80,000 bottles of wine or 589,000 bottles of beer. The Department reported that without conducting an audit of these taxpayers—which it has not done—it does not have information or data to explain why these taxpayers claimed the credits each month. It noted that tax is collected largely on a voluntary compliance basis and it only audits a small portion of returns, especially when the risk to state revenue is low, such as with liquor excise taxes.

The amount claimed by alcohol type is not proportionate to the amount of excise taxes paid by alcohol type. As shown in Exhibit 3, credit claims related to malt liquor, which includes beer, accounted for 80 percent of the total claims in 2021, but malt liquor only accounts for 19 percent of the liquor tax revenue. In contrast, spirits made up more than 70 percent of the excise tax revenue, but only accounts for 15 percent of the unsaleable alcohol credit claims. The Department reported that it does not know why the amount of credits by alcohol type is not proportional to the amount of excise taxes paid.

Exhibit 3
Percentage of Excise Taxes Paid and Credits Claimed in 2021 by Alcohol Type

Alcohol Type	Percent of Credits Claimed	Percent of Excise Taxes
Spirituous Liquor	15	71
Malt Liquor (includes beer)	80	19
Vinous Liquor (includes wine)	5	10
Hard Cider	< 1	< 1

Source: Office of the State Auditor analysis of Department of Revenue excise tax and credit claim data.

Industry representatives reported the Credit for Unsalable Alcohol is important, but some taxpayers reported not being aware of the credit. Between our previous evaluation and this one, we spoke with eight liquor production industry professionals, and many expressed the importance of the Credit for Unsalable Alcohol to their business. Multiple industry professionals said the credit is especially useful to businesses when there is a large quantity of product damaged or destroyed. According to industry stakeholders, insurance typically would not cover the costs of the excise tax paid on damaged or destroyed alcohol, so the credit allows the business to recover some of that loss. For example, one stakeholder reported that their company had lost half of a pallet of liquor during the transfer of product while the product was still in their possession. Their business was able to file for the Credit for Unsalable Alcohol to recover some of that loss. However, two industry professionals reported that they were unaware that the Credit for Unsalable Alcohol existed and stated that they did not believe that other industry associates were aware of the tax credit either, so some taxpayers might not be claiming the credit when they have significant losses.

Policy Consideration

We did not identify any new policy considerations for the credit. In our previous evaluation of the Credit for Unsalable Alcohol, released in July 2019, we included a policy consideration for the General Assembly to consider clarifying whether it intended for taxpayers to be allowed to claim the credit for excise taxes paid on spoiled alcohol, which the Department has declared through rulemaking is not eligible. The General Assembly has not taken any legislative action in response to the policy consideration included in our 2019 evaluation.

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Fuel Excise Tax Expenditures

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COLORADO

Tax Expenditure Evaluation • June 2024 • 2024-TE6

Colorado levies an excise tax on fuel at a rate of 20.5 cents per gallon for special fuel, 22 cents per gallon for gasoline and gasoline/ethanol fuel blends, 6 cents per gallon for aviation gasoline, and 4 cents per gallon for jet fuel. This evaluation covers three tax expenditures—Two Percent Loss Allowance, Bad Debts and Administration Allowance, and Lost or Destroyed Fuel Credit, referred to collectively in this report as the Fuel Excise Tax Expenditures. These expenditures compensate taxpayers for taxes paid on fuel that does not reach the final consumer, fuel the taxpayer is not paid for after paying the excise tax, and for the cost of calculating and remitting fuel excise taxes.

We found that all of the evaluated expenditures are meeting their purposes. Specifically:

- The Two Percent Loss and Bad Debt and Administrative Allowances are automatically applied by the Department of Revenue so taxpayers consistently receive them.
- The 2 percent rate for the Two Percent Loss Allowance was in line with current tax policies in similarly situated states. We found that 10 of the 15 states that we reviewed that border Colorado and/or have similar winter climates have a transfer loss allowance similar to Colorado.
- Despite the infrequency of its use, beneficiaries are aware of the Lost and Destroyed Fuel Credit and appear to claim it when they are eligible.

Policy Considerations

We did not identify any new policy considerations for these tax expenditures.

	Two Percent Loss Allowance	Bad Debt & Admin Allowance	Lost and Destroyed Fuel Credit
Tax Type:	**Excise - Fuel**	**Excise - Fuel**	**Excise - Fuel**
Expenditure Type:	**Allowance**	**Allowance**	**Credit**
Statutory Citation:	**Section 39-27-102(1)(b)(I), C.R.S.**	**Section 39-27-105(2)(b), C.R.S.**	**Section 39-27-103(1), C.R.S.**
Year Enacted:	**1929**	**1969**	**1929**
Repeal/Expiration Date:	**None**	**None**	**None**
Revenue Impact:	**$13.1 million (2021)**	**$3.2 million (2021)**	**$0 (2021)**
Purpose given in statute or enacting legislation? **Yes**			

Fuel Excise Tax Expenditures

Background

Colorado levies an excise tax on fuel at a rate of 20.5 cents per gallon for special fuel, 22 cents per gallon for gasoline and gasoline/ethanol fuel blends, 6 cents per gallon for aviation gasoline, and 4 cents per gallon for jet fuel. Statute requires the first entity that removes the fuel from the "terminal," defined as a fuel storage and distribution facility, to pay the excise tax. This is most often a distributor, but could also be a supplier or retailer depending on the situation. While a distributor typically pays the excise tax, the cost of the tax is intended to be passed on through the distribution chain in the form of higher prices, so that the final consumer of the fuel bears the cost of the tax. Fuel excise taxes are remitted to the State monthly. The revenue generated by motor vehicle gasoline and special fuel excise taxes are used for the management of Colorado's public highways and the costs of administration of the taxes. Excise taxes collected on aviation fuel are used exclusively for aviation purposes.

This evaluation covers three structural tax expenditures that define the tax base for the State's fuel excise tax, referred to collectively in this report as the Fuel Excise Tax Expenditures.

The Two Percent Loss Allowance [Section 39-27-102(1)(b)(I), C.R.S.] was established in 1929 and its purpose is to allow taxpayers to deduct two percent of the taxable gallons removed from the terminal in order to account for fuel that is lost in transit, typically due to volumetric shift (see technical note), evaporation, or other losses in the transfer process. The Department of Revenue (Department) automatically applies the allowance each month when the distributor reports and pays their excise taxes. House Bill 21-1322 removed the requirement that taxpayers allot half of this allowance to retailers, which was done through a one percent reduction in price.

The Washington Joint Legislative Audit and Review Committee released a review of the State of Washington's fuel loss allowance which found, in conjunction with EPA research, that the combined loss of fuel in transfer, evaporation, and volumetric shift was less than one percent of total fuel. We looked at tax policies in 15 states that either border Colorado and/or have similar winter climates. Of those, 10 states had some form of transfer loss allowance ranging from 0.5 to 2.5 percent with the average being 1.5 percent.

Technical Note

Volumetric shift is the industry term for the increase or decrease in volume of a fluid that occurs due to temperature changes. As the fluid gets cooler, the volume decreases; inversely, as the fluid gets warmer, the volume increases. This means that 100 gallons of gasoline put into a tanker truck at 60 degrees would reduce in volume as the temperature decreases during winter transport. If the weather was at 0 degrees, the amount of volume would decrease 4 percent leaving the tanker only containing about 96 gallons of a more viscous gasoline. However, once the fuel has warmed back up to 60 degrees, the volume will return to its original viscosity and volume of 100 gallons.

The Bad Debts and Administrative Allowance [Section 39-27-105(2)(b), C.R.S.] was established in 1969 and provides taxpayers with a 0.5 percent reduction in net fuel excise taxes owed (calculated after the two percent deduction has been applied). Its purpose is two-fold. First, it covers taxes that taxpayers paid on fuel that customers requested be removed from the terminal but were later unable to pay for (i.e. bad debts). The purpose of this part of the allowance appears to be to allow taxpayers to recoup taxes paid on bad debt fuel since the cost of the tax was not passed on to the customer. The second purpose of the allowance is to compensate taxpayers for expenses associated with the calcuation and payment of fuel taxes. The Department automatically applies the allowance when the taxpayer reports and pays their excise taxes. Taxpayers are not extended this allowance for any filing period in which their report and/or payment are posted after the defined due date; therefore, the allowance also provides an incentive to encourage timely filing and payment.

Of the 15 states we looked at, seven have some form of refund or credit for fuel excise taxes paid in bad debt situations and nine have some form of allowance intended to assist or cover administrative costs associated with paying the excise taxes. Of those nine administrative allowances, seven are stand-alone provisions, rather than being combined with another allowance, such as an allowance for bad debts. On average, the seven states we reviewed with stand-alone adminstrative allowances allowed taxpayers to retain 1.2 percent of the taxes owed.

The Lost or Destroyed Fuel Credit [Section 39-27-103(1), C.R.S.] was established in 1929 and allows a distributor, transporter, or retailer to receive a credit in the amount of the excise taxes paid for fuel that was lost or destroyed and never reaches the consumer. The credit can only be taken when the loss or destruction of 100 gallons or more of fuel occurred under circumstances that were outside the control of distributors, transporters, and retailers—i.e. “fire, lightning, flood, windstorm, explosion, accident, or other cause beyond the control of the distributor or transporter of such gasoline or special fuel.” House Bill 21-1322 clarified that the person in control of the fuel at the time of the incident is the party entitled to receive this credit regardless if they were the one to pay the excise tax because, assumedly, the tax was already passed on to them in the form of higher prices. The purpose of the credit is to offset taxpayers’ tax liability on fuel for which the excise tax cannot be passed on to the final consumer.

To claim the Lost and Destroyed Credit, eligible distributors, transporters, and retailers must submit the Excise, Fee and Fuel Claim for Refund form (DR137E) to the Department within 30 days of the incident occuring, along with supporting evidence, such as a police report. In addition, a qualified taxpayer claiming the credit must have a fuel tax refund permit from the Department, which they acquired by submitting the Gasoline/Special Fuel Tax Refund Permit Application (DR 7189). Of the 15 states we looked at, thirteen have either a refund or a credit for taxes paid on fuel that was lost or destroyed and have similar restrictions on when it can be claimed to those in Colorado.

There are no performance measures for any of the Fuel Excise Tax Expenditures included in statute. In order to determine if these expenditures are meeting their purposes, we assessed whether the intended beneficiaries were aware of and taking the allowances and credit when eligible.

Evaluation Results

We found that the Two Percent Loss and Bad Debt and Administrative Allowances are meeting their purposes because they are regularly received by the intended beneficiaries. The Department automatically applies these two allowances when the taxpayers file their excise tax return. Therefore, all eligible taxpayers should be receiving these allowances. The revenue impact for these expenditures totalled $16.3 million for Calendar Year 2021, the most recent year with information available, with the Two Percent Loss Allowance accounting for 80 percent (about $13.1 million) and the Bad Debt and Administrative Allowance accounting for the other 20 percent (about $3.2 million). An industry representative we spoke with said that eligible taxpayers are aware of the allowances and receive them regularly as calculated by RevenueOnline, the online tax-payment platform operated by the Department. They also explained that although bad debts are not common outside of a recession, the Bad Debt and Administrative Allowance does assist greatly in the administrative burdens associated with paying the excise tax. They noted that paying the excise tax can be complex and time-consuming because tracking and applying the many tax exemptions related to fuel, such as fuel for governmental entities, aviation fuel used in commercial aircraft, and dyed special fuels, requires substantial documentation from customers prior to calculating and submitting their monthly returns.

Additionally the Department confirmed that the current design of the allowance is administratively convienient for both the Department and the taxpayers because it does not require any documentation or review; it is simply calculated as a percentage of the tax.

We found that, despite the infrequency of its use, beneficiaries are aware of the Lost and Destroyed Fuel Credit and appear to claim it when they are eligible. In our previous evaluation, published in July 2019, we found that between Tax Years 2011 and 2017 the credit had been claimed by 8 taxpayers for a total of $12,000. According to Department staff, there have been no claims for the Lost and Destroyed Fuel Credit in 2017, 2019, and 2021, which are the only recent years for which data is available. It should be noted, however, that while the types of situtations that would make a taxpayer eligible for this credit—wildfire, electrical storm, accident outside the control of the operator, etc.—are fairly common occurances, fuel loss or destruction resulting from such an event is far more rare. Although this credit is not used very often, it still serves an important structural purpose in ensuring that fuel which does not reach the consumer and is not used on public roads is not taxed in the event that a qualifying incident does occur. We spoke with a representative from a fuel distributors trade organization and they reported being aware of the credit, and stated that taxpayers are also aware of the credit, but that they are not aware of any qualifying events in recent years.

To determine whether there were any potentially-eligible taxpayers who lost fuel in the state but did not claim the credit, we researched fuel spills that occurred in the state between 2015 and 2021. We used the Environmental Protection Agency's On-Scene Coordinator Response Sites database to identify three potentially-eligible fuel spills in Colorado; however, upon further review, in all cases the drivers were responsible in some way for the accidents that resulted in fuel loss and, thus, the taxpayers were not eligible for the credit.

Policy Considerations

We did not identify any new policy considerations for these tax expenditures. Our previous evaluation did not identify any policy considerations for these tax expenditures either.

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Agricultural Sales Tax Exemptions

Tax Expenditure Evaluation • August 2023 • 2023-TE13

OFFICE OF THE STATE AUDITOR
COLORADO

The Agricultural Exemptions eliminate the state sales and use tax on most farming and ranching inputs—such as livestock and agricultural compounds—along with farm equipment and special fuel used in farm vehicles.

Based on data from the U.S. Department of Agriculture, the U.S. Energy Information Administration, and the Department of Revenue, we estimate the revenue impact of the exemptions was more than $200 million in 2021.

The exemptions are meeting their purposes because eligible Colorado farmers and ranchers are aware of them and the exemptions appear to be applied to eligible sales; however, the financial benefits from the exemptions vary based on local sales tax policies.

Policy Considerations

We did not identify any policy considerations in this evaluation.

	Agricultural Inputs	Farm Equipment & Parts	Special Fuel for Use in Farm Vehicles
Tax Type:	**Sales and Use**	**Sales and Use**	**Sales and Use**
Expenditure Type:	**Exemption**	**Exemption**	**Exemption**
Statutory Citation:	**Sections 39-26-102(9) and (19)(c)-(f), 39-26-104(1)(a), and 39-26-716(4)(a)-(c), C.R.S.**	**Section 39-26-716(4)(e) and (f), C.R.S.**	**Section 39-26-716(4)(d), C.R.S.**
Year Enacted:	**1943 - 2019**	**1999**	**1977**
Repeal/Expiration Date:	**None**	**None**	**None**
Revenue Impact:	**$249.5 million (2021)**	**$16.8 million (2021)**	**$1.9 million (2021)**
Purpose given in statute or enacting legislation? **No**			

Agricultural Sales Tax Exemptions

Background

This evaluation covers several sales and use tax exemptions that apply to the agricultural industry, referred to collectively in this report as Agricultural Exemptions. These exemptions can be categorized into three groups:

- **The Agricultural Inputs Exemptions—exempt most inputs to agricultural operations from state sales and use tax, including the following:**
  - Livestock
  - Feed for livestock
  - Agricultural compounds used in caring for livestock
  - Semen for agricultural or ranching purposes
  - Fish for stocking purposes *(We have included "aquaculture"—the process of raising fish for commercial sale—within our use of the term "agriculture" in this tax evaluation.)*
  - Fertilizer for use in the production of agricultural commodities
  - Spray adjuvants used in caring for livestock or in the production of agricultural commodities
  - Pesticides registered by the commissioner of agriculture for use in the production of agricultural and livestock products
  - Seeds
  - Orchard trees

  Most of these exemptions were created between 1943 and 1999; in 2019 the General Assembly created the exemption for fertilizers used in the production of agricultural commodities.

- **The Farm Equipment and Parts Exemption—exempts sales and purchases of farm and dairy equipment from state sales and use tax.** To qualify for the exemption, the equipment must be used directly and primarily for a farm, ranch, or livestock production operation. Additionally, dairy equipment must be used at a farm dairy in connection with the production of raw milk and not at a commercial dairy or in connection with the production of pasteurized, separated milk products for retail sale. Examples of equipment that qualify include tractors, irrigation equipment with a purchase price of at least $1,000, baling wire, cow identification systems, transponders, and milk containment tanks. Qualifying farm equipment also includes parts that are used in the repair or maintenance of farm equipment, regardless of purchase price. The exemption also covers farm equipment under lease or contract if the fair market value is at least $1,000. Equipment, materials, and supplies used on the farm but not directly in the farm operations (e.g., office supplies or equipment used in the sale or distribution of farm products) are not included in the exemption.

The exemption was created in 1999 and expanded in 2000 and 2001 to include parts used to repair and maintain equipment and dairy equipment and parts to the list of eligible items. In 2019, with House Bill 19-1162, the General Assembly expanded the exemption to include farm equipment and systems to identify or track food animals, such as ear tags and ear tag scanners. Identification and tracking equipment and systems were already exempt for dairy cows, but House Bill 19-1162 extended the exemption to include equipment and systems, specifically electronic and non-electronic ear tags and ear tag scanners, used by non-dairy farms like beef and pork producers to track and identify food animals (such as cattle and pigs) and animals used in the production of food. The purpose of this extension was to provide Colorado's non-dairy animal farmers the same tax benefits as its dairy farmers.

- **The Special Fuel for Use in Farm Equipment Exemption—exempts from state sales and use tax sales of special fuel used for the operation of vehicles used on farms and ranches**. Special fuel means diesel engine fuel, kerosene, liquefied petroleum gas, and natural gas, but does not include gasoline. The exemption was created in 1977 and has remained substantively unchanged since that time.

The Agricultural Exemptions are typically applied at the point of sale. When selling or leasing farm equipment, the vendor is responsible for obtaining a signed affidavit (Form DR 0511) from the person buying or renting the equipment affirming that they will use the equipment primarily and directly in a farm operation. Vendors report exempt sales on the Department of Revenue's (Department) Retail Sales Tax Return (Form DR 0100).

We considered the beneficiaries of the Agricultural Exemptions to be ranchers, farmers, and people who raise fish for commercial sale. According to the U.S. Department of Agriculture (USDA) data, in 2022, there were 39,000 farms and ranches in Colorado with an average size of 815 acres. In 2018, which is the most recent year of aquaculture data available, there were 17 aquaculture farms.

While statute does not state a purpose for the Agricultural Exemptions, based on our review of their operation and legislative history, we considered the exemptions to have several potential purposes, as follows:

- **Ensure that sales and use tax is only levied on consumers making purchases of finished agricultural products instead of agricultural producers who may not be able to absorb the additional tax.** A general principle of sales and use tax is for the consumer of the final product to pay the tax and, therefore, not apply sales and use tax to earlier steps in a product's supply and distribution chain. Agricultural producers are typically "price takers" because the price of most agricultural products is set by national and international markets and individual producers are typically unable to increase the sales price they receive beyond established market rates. Therefore, if the State's sales and use tax were levied at multiple points in an agricultural product's supply and distribution chain or on equipment necessary for agricultural operations, Colorado's agricultural producers would likely have to absorb most of the increased taxes, effectively decreasing their after-tax income. Most farms and ranches operate on small profit margins so absorbing these additional taxes would potentially cause farmers and ranchers significant financial distress. According to the USDA, in 2021, 71 percent of farms in the United States had a profit margin of below 10 percent and were thus high-risk for financial problems.

The Agricultural Exemptions are similar to exemptions the State offers for other industries, like manufacturing, that ensure sales and use tax is only paid when a product is sold to the final consumer. For example, statute [Section 39-26-102(20)(a), C.R.S.] exempts manufacturing inputs, such as raw materials that will become part of a product that will be sold to consumers, from sales and use tax. Statute [Section 39-26-709(1)(a)(II), C.R.S.] also exempts machinery used in manufacturing from sales and use tax because it is necessary for the production of the final product that will be sold to a consumer. Finally, statute [Section 39-26-102(21)(a), C.R.S.] also exempts energy and fuel used in manufacturing from sales and use tax because it is also a necessary component of the manufacturing process.

- **Prevent what is known as "tax pyramiding," which occurs when each transaction in a product's supply and distribution chain is subject to tax.** Tax pyramiding can cause economic distortions, since less tax is paid for products with shorter supply and distribution chains, and can raise the price end consumers pay to the extent that the businesses in a product's production and distribution chain pass the cost of sales tax on to the next business in the distribution chain by increasing their prices. Tax pyramiding also decreases the transparency of the tax system, since final consumers generally are not able to determine how much of the sales price they pay is due to taxes levied during the production and distribution of the product. Therefore, in addition to farmers and ranchers, consumers of agricultural products could benefit from the Agricultural Exemptions because they are not paying for taxes previously levied on the product and can more easily determine the sales tax rate on their purchases.

- **Maintain consistency with other exemptions for food.** Additionally, the General Assembly has exempted many food items from sales tax through the Food for Home Consumption Exemption [Sections 39-26-707(1)(e) and (2)(d) and 714(2), C.R.S.] and the Food Ingredients Exemption [Sections 39-26-102(20)(b)(I) and 39-26-713(2)(b) and (e), C.R.S.], among others. If the State levied sales tax on inputs, machinery, or fuel used to produce food items, consumers could pay some portion of the tax through higher prices, which would undermine the purpose of the exemptions for food items.

To determine whether the Agricultural Exemptions are meeting their purposes, we assessed the extent to which eligible taxpayers are aware of and using the exemptions.

Evaluation Results

We found that, overall, the Agricultural Exemptions are meeting their purposes because Colorado's farmers and ranchers are aware of and applying them. In our previous report on the Agricultural Inputs Exemptions, published in January 2019, we found that they were meeting their purpose after speaking to 18 stakeholders and concluding that Colorado's agricultural industry was generally aware of and applying the exemptions. In our previous report on the Farm Equipment and Parts Exemption, published in January 2022, we found that this exemption was meeting its purpose after reaching out to 18 stakeholders and interviewing three of them—all of whom were aware of and using the exemption.

For this report, we reached out to six of those stakeholders and interviewed three—all of whom confirmed that they still used the exemptions. We also contacted an additional seven stakeholders and spoke with two about the exemptions that have been amended or enacted since 2019—Special Fuel for Farm Vehicles, Farm Equipment and Parts, and Fertilizers—to determine whether they are aware of and applying the exemptions. All of the stakeholders with whom we spoke were aware of the new or modified exemptions.

The financial benefits from the Agricultural Exemptions vary based on local sales tax policies. Although all purchases of eligible items are exempt from state sales taxes, only some local governments apply the exemptions. Specifically, all of the State's statutory cities and counties (which have their local sales taxes collected by the State on their behalf) must adopt all of the Agricultural Inputs and Special Fuel for Farm Vehicles Exemptions. In contrast, under Section 29-2-105(1)(d)(I)(F), C.R.S., statutory cities and counties may opt into the Farm Equipment and Parts Exemption by enacting a local ordinance. Additionally, statutory cities and counties that opted into the Farm Equipment and Parts Exemption prior to August 2, 2019 have the option to enact an additional local ordinance to exempt identification and tracking equipment and systems for food-producing animals, which the General Assembly included under the statutory definition of "farm equipment" in 2019. Conversely, statutory cities and counties that opt to exempt farm equipment and parts on or after August 2, 2019 must also exempt these equipment and systems. According to the Department, 23 of the 52 statutory counties and 15 of the 160 statutory cities that levy a sales tax have opted to exempt farm equipment and parts.

These varying tax policies can result in significant differences in the tax savings provided by the exemptions, as our example tractor purchase scenario illustrates in Exhibit 1. As shown, a farmer purchasing a new $80,000 tractor in Fruita would save $4,000 in city and county taxes because both the city of Fruita (with a 3 percent sales tax) and the county of Mesa (with a 2 percent sales tax) exempt farm equipment from sales taxes. These savings would be in addition to the $2,320 in state sales taxes saved due to the Farm Equipment and Parts Exemption, which would exempt the purchase from the 2.9 percent state sales tax. In sum, the farmer would have a savings of 7.9 percent. Meanwhile, a farmer buying the same $80,000 tractor in Granada would not have any savings in city or county taxes, as neither the city of Granada nor the county of Prowers exempt farm equipment from sales taxes. However, the farmer would save the same $2,320 in state sales taxes as the farmer in Fruita. Overall, this farmer would have a savings of 2.9 percent.

Exhibit 1
Comparison of Hypothetical Sale of a Tractor in Two Jurisdictions with Different Local Sales Tax Treatment of Farm Equipment

	Farmer in Fruita	Farmer in Granada	
New Tractor Purchase	$80,000	$80,000	New Tractor Purchase
Savings from State Sales Tax Exemption for Farm Equipment and Parts (2.9%)	– $2,320	– $2,320	Savings from State Sales Tax Exemption for Farm Equipment and Parts (2.9%)
Additional Savings from City of Fruita (3%) and County of Mesa (2%) Farm Equipment and Parts Exemption	– $4,000	– $0	Additional Savings from City of Granada (0%) and County of Prowers (0%) Farm Equipment and Parts Exemption
Total for New Tractor	**$73,680**	**$77,680**	**Total for New Tractor**
Total Tax Savings	**7.9%**	**2.9%**	**Total Tax Savings**

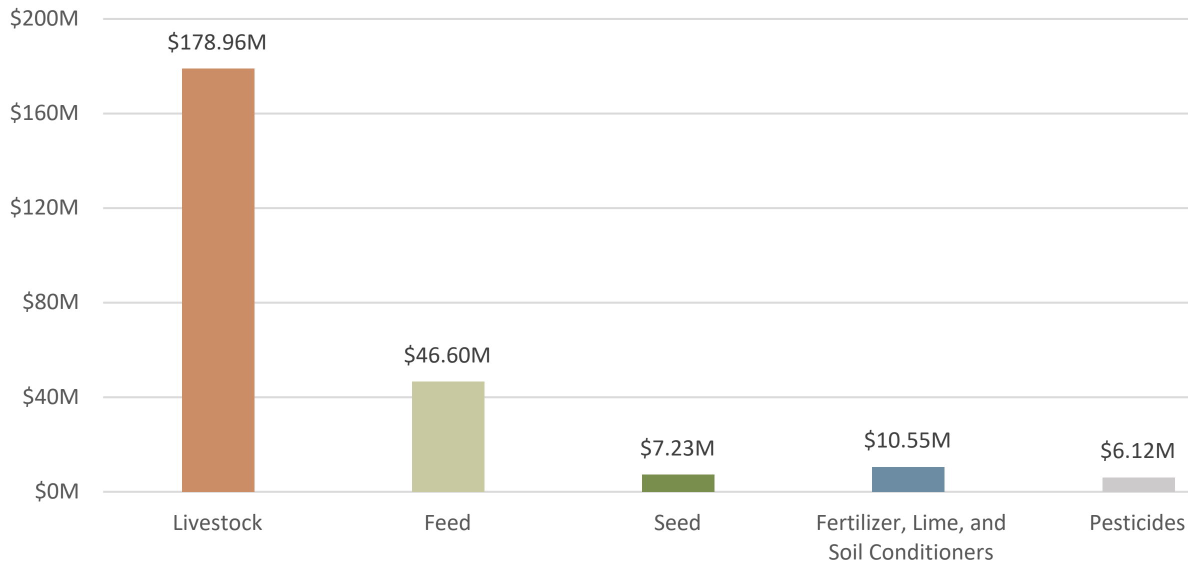
Source: Office of the State Auditor analysis of state and local government tax rates.

Additionally, Colorado's home rule cities and counties, established under Article XX of the Colorado Constitution, that collect their own sales taxes are *not* required to conform to any of the State's tax policies, including the Agricultural Exemptions. We looked at home rule cities in Colorado's 20 counties with the most farm land, and found they vary greatly in terms of which of the Agricultural Exemptions they offer. For example, Craig, Sterling, and Windsor have adopted all of the Agricultural Exemptions, whereas many larger Front Range cities, including Colorado Springs, Greeley, and Thornton, have adopted few, if any, of the exemptions.

We estimate that the Agricultural Sales Tax Exemptions provide more than $200 million in annual tax savings to Colorado's agricultural producers.

- **Agricultural Inputs Exemptions**—We estimate that agricultural producers received at least $249.5 million in tax savings from the exemptions in 2021. Exhibit 2 shows the estimated revenue impact by agricultural input type.

Exhibit 2
Estimated Revenue Impact of Agricultural Inputs Exemptions in Tax Year 2021



Source: Office of the State Auditor analysis of USDA data.

We used USDA statistical reports for our estimate, which provide estimated expenses for inputs purchased by Colorado farmers and the value of livestock sales by Colorado producers. However, these data have several limitations that likely impact the accuracy of our estimate. First, the USDA data set that we used does not include data for all the agricultural inputs exempt from Colorado sales tax, so it is possible that the actual revenue impact to the State and corresponding tax savings to agricultural producers is greater than $249.5 million. Specifically, the USDA data do not include data on agricultural compounds, semen for agricultural or ranching purposes, fish for stocking, or orchard trees. Second, we used USDA data on cash receipts for meat animals sold by Colorado producers in our estimate for the livestock exemption, which likely includes some sales made to out-of-state purchasers who would not be subject to sales tax regardless of the exemptions. We attempted to account for livestock sales to out-of-state consumers by subtracting exports of live farm animals from Colorado producers' cash receipts of meat animals; however, it is possible this does not account for all sales of livestock to out-of-state consumers. It is also possible that our revenue impact estimate of the Livestock Exemption (based on USDA data) double counts some transactions and thus overestimates the revenue impact. This is because we included in our estimate both expenses reported by Colorado producers who purchased livestock as well as cash receipts from sales of livestock by Colorado producers. To the extent that a Colorado producer purchased livestock from another Colorado producer, that transaction would be reflected in both the expenses of the purchaser and the cash receipts of the seller. However, we lacked data on how many transactions were between in-state sellers.

When we evaluated the Agricultural Inputs Exemptions in 2019, these exemptions were not itemized on the Retail Sales Tax Return. At that time, we estimated the revenue impact using USDA data, and found that it was likely around $231.2 million in 2017. In 2020, the Department amended its Retail Sales Tax Return so that the Agricultural Inputs Exemptions are reported on their own line on the return, and the Department is now able to extract that data from the returns. Most of the Agricultural Input Exemptions are reported in aggregate on a line for "Exempt agricultural sales, not including farm and dairy equipment" (Schedule A, Line 10). According to Department data, the State revenue impact of the Agricultural Inputs Exemptions was $20.9 million in 2021 based on amounts reported on the Retail Sales Tax Returns; this amount also includes the Farm Closeout Sales Exemption, which we reported on in May 2023, but we think that it is a relatively small portion of the total amount. However, it is likely that the Department's data significantly underreports the actual revenue impact to the State and corresponding tax savings to agricultural producers of the Agricultural Inputs Exemption. Our estimates for 2017 and 2021 are much higher than the revenue impact reported by the Department for 2021 due to several factors: (1) since the reporting line for the exemptions on the Retail Sales Tax Return changed in 2020, some retailers may not have realized the return was changed and may still be reporting the Agricultural Inputs Exemptions on the "Other Exemptions" line of the return; (2) if a vendor only makes exempt sales of commodities, they are not required to file a sales tax return and therefore, those exempt sales would not be reported to the Department on any forms; and (3) the agricultural items in the USDA data do not align exactly with the items covered by Colorado's exemptions.

- **Farm and Equipment and Parts Exemption**—According to Department data, the State revenue impact of the Farm Equipment and Parts Exemption was about $16.8 million in 2021 based on amounts reported on the Retail Sales Tax Returns. Exempt sales of farm and dairy equipment are reported on a separate line of the Retail Sales Tax Return (Schedule B, Line 4).

- **Special Fuel for Farm Vehicles Exemption**—According to data from the U.S. Energy Information Administration (EIA), in 2020, Colorado farmers spent approximately $66.7 million on diesel fuel, which translates into a state revenue loss and corresponding savings by farmers of approximately $1.9 million. Although this exemption is reported on the Retail Sales Tax Return as well ("Sales of gasoline, dyed diesel, and other exempt fuels," Schedule A, Line 5), we based our estimate on EIA data because the exemption is reported on the same line of the return with three other fuel exemptions—gasoline, special fuel used on State highways, and aviation gasoline—and we were unable to determine the amount reported just for the Special Fuel for Farm Vehicles Exemption. In 2021, the total State revenue impact for all the exemptions reported on that line was about $370.4 million. However, it is likely that the majority of that amount is attributable to the other exemptions reported on that line.

The Agricultural Exemptions might help keep Colorado farmers competitive with farmers in other states. All 44 other states that impose a retail sales or similar tax provide exemptions for items used by the agricultural sector, although the types of items exempted and their administration vary. We reviewed the specific exemptions available in neighboring states and Texas, which we included in our analysis because stakeholders with whom we spoke indicated that many agricultural goods used or produced in Colorado are purchased from or sold to Texas. Exhibit 3 illustrates that while there are some differences between these states regarding the exemption of some items, most agricultural inputs are not subject to sales tax in most of the states we reviewed. Like Colorado, most of these states have additional requirements for claiming the exemptions, such as requiring the purchaser to meet the definition of "farmer" and use the items purchased for an agricultural purpose.

Exhibit 3
Agricultural Sales & Use Tax Exemptions of Colorado's Neighbor States with National Agricultural Sales Ranking

Exemption	Colorado[1]	Nebraska (#3)	Texas (#4)	Kansas (#7)	Oklahoma (#22)	Arizona (#31)	New Mexico (#34)	Utah (#37)	Wyoming (#38)
Agricultural Machinery & Equipment	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Livestock	Exempt	Exempt	Exempt	Exempt	In certain circumstances	Exempt	Exempt	Exempt	Nontaxable
Poultry	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Nontaxable
Livestock Bedding	Exempt	Taxable	Exempt	Taxable	Exempt	Taxable	Taxable	Exempt	Exempt
Animal Feed	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Nontaxable
Antibiotics, Medicines & Vaccines	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	In certain circumstances	Exempt	Taxable
Growth Promotants	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	In certain circumstances	Taxable
Semen	Exempt	Exempt	Exempt	Exempt	Exempt	No guidance	Exempt	No guidance	Taxable
Fertilizers	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt
Pesticides	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	In certain circumstances	Exempt
Energy & Fuel	Exempt	Nontaxable	Exempt	Exempt	Exempt	Taxable	Taxable	Exempt	Exempt

Source: Office of the State Auditor analysis of Bloomberg Industry Group data on U.S. state tax policies and U.S. Department of Agriculture data on agricultural commodity cash receipts.
[1] Colorado ranks 20th in agricultural sales among states.

Policy Considerations

We did not identify any policy considerations for the Agricultural Exemptions. In our previous evaluation of the Agricultural Inputs Exemptions released January 2019, we included the policy consideration that the General Assembly may want to review and clarify statutes specifying which agricultural inputs are exempt. Specifically, we stated that the General Assembly may consider clarifying whether the following agricultural inputs were intended to be exempt from sales and use tax: 1) fertilizers; 2) soil conditioners, plant amendments, plant growth regulators, mulches, compost, and manure; 3) fish for non-stocking purposes (as opposed to fish sold for stocking purposes, which are explicitly exempted); and 4) embryos/fish eggs. In 2019, with House Bill 19-1329, the General Assembly added explicit exemptions for fertilizer and spray adjuvants for use in agricultural commodity production. The General Assembly did not take any legislative action to clarify whether the other three agricultural inputs are exempt from sales and use taxes.

OFFICE OF THE STATE AUDITOR

Residential Energy Storage Credit Memo

Statute allows an income tax credit for the purchase of a system for retaining, storing, and delivering energy that will be installed in a Colorado residence [Section 39-22-546, C.R.S.]. The residential energy storage system must be commercially available and consist of batteries or batteries paired with on-site generation, such as solar panels or a fuel-powered generator. The credit's purpose is to incentivize "the purchase and installation of residential energy storage systems" and "contribute to the state's effort to achieve its climate goals." The credit is only available for Tax Years 2023 and 2024, and will expire unless the General Assembly takes action to extend it during the 2024 legislative session. Statute requires us to issue an evaluation prior to the legislative session before a tax expenditure expires [Section 39-21-305(1)(d), C.R.S.]. However, because Tax Year 2023 is the first year the credit has been available—and taxpayers who claim the credit on their 2023 individual returns will generally file during Calendar Year 2024—we lacked sufficient data to perform a complete evaluation of the credit prior to the 2024 legislative session. Therefore, we are issuing this memo to provide a summary of the credit.

The credit is available to homeowners or lessees who have the landlord's permission who install an energy storage system in 2023 or 2024. The credit must be taken in the same year the storage system is purchased. The credit is for 10 percent of the cost to purchase the system, which includes charges for sales tax and freight, but not assembly, installation, or permit fees. Homeowners and lessees can claim the income tax credit by submitting a credit form (Form DR 1307) to the Department of Revenue (Department) when they file their income tax return. The credits claimed by the homeowner or lessee are not refundable and cannot be carried forward, so they will only receive their credit's full value if they have sufficient income tax liability in the year they purchase the energy storage system. As discussed, the Department will not start to receive credit forms from homeowners and lessees until they file their Tax Year 2023 income tax returns in 2024, so no data is available on the number of homeowners or lessees who might claim the credit for 2023.

Alternatively, homeowners or lessees can assign the credit to the seller of the system. If a homeowner or lessee assigns the credit, the seller must discount the cost to purchase the system by the credit amount and submit the credit form to the Department within 30 days of the purchase. Therefore, homeowners and lessees can get the credit's full value even if they would not otherwise have the tax liability to claim it. Credits assigned to sellers are fully refundable, so sellers who have more in credits than their income tax liability for the tax year will still receive the full value of their credit(s). The fiscal note for Senate Bill 22-051, which created the credit, estimated 110 systems at a cost of $11,500 per system would be installed in 2023, which would result in about $126,500 in credits. The Department was not able to provide any preliminary data on the use of the credit, so we are unable to provide an updated estimate of the cost for this memo.

Senate Bill 22-051 also created a sales and use tax exemption for energy storage systems. The sales tax exemption is also available starting in 2023, but will be available through 2032 [Section 39-26-733, C.R.S.]. We will publish an evaluation of the sales tax exemption—but not the income tax credit, unless it is extended—in 2027.

Organ Donor Employer Credit

Tax Expenditure Evaluation • December 2023 • 2023-TE18

OFFICE OF THE STATE AUDITOR
COLORADO

The Organ Donor Employer Credit is available to Colorado employers that provide an employee with a paid leave of absence for purposes of organ donation. The credit is equal to 35 percent of the employer's expenses incurred for paying the employee for up to 10 working days during their leave of absence and for the cost of any temporary replacement help. Statute states that the purpose of the credit is "to support living donors and the companies that employ them" [Section 39-22-540(1)(b), C.R.S.].

As of Tax Year 2020, the Organ Donor Employer Credit did not support living donors or their employers because the credit was not being used. If the current version of the credit is extended beyond Tax Year 2024, it may provide some support to a small number of living donors and employers, but it is unlikely to make a significant impact because they may not be aware of the credit, and donors and employers must meet a number of specific requirements in order for the employer to qualify for the credit.

Specifically, we found:

- For those who are aware of the credit, statutory requirements likely significantly reduce the number of living donors and employers whose situations would qualify for the credit.
- The restriction on taking annual leave or sick days in order to donate may cause confusion for employers about whether they qualify for the credit.
- There may be other, more cost-effective options available to living donors and their employers.

Policy Considerations

If the General Assembly decides to extend the Organ Donor Employer Credit beyond its current expiration date of December 31, 2024, the General Assembly could assess whether the credit is available to the intended population of donors and, if necessary, consider making changes to statute.

Tax Type:	**Income**	Year Enacted:	**2018**
Expenditure Type:	**Credit**	Repeal/Expiration date:	**December 31, 2024**
Statutory Citation:	**Section 39-22-540, C.R.S.**	Revenue Impact (2020):	**$0**

Purpose given in statute or enacting legislation? **Yes**

Organ Donor Employer Credit

Background

The Organ Donor Employer Credit (Organ Donor Credit) is available to Colorado employers that provide an employee with a paid leave of absence for purposes of organ donation. The credit amount is equal to 35 percent of the employer's expenses incurred for paying the employee for up to 10 working days during their leave of absence and, if applicable, for the cost of any temporary replacement help during this period. For example, an employer who pays an employee $2,000 over the course of 10 days while they are taking a leave of absence for organ donation would receive a $700 credit.

In order for the employer's expenses to qualify, the employee's wages and benefits must be less than $80,000 during the income tax year in which the leave of absence is taken. The credit is not refundable but can be carried forward for up to 5 tax years after the first year in which the credit is claimed. The credit is available for Tax Years 2020 through 2024.

Technical Note:

Statute [Section 39-22-540(2)(b), C.R.S.] provides that the credit is not available for any period of time "during which [the organ donor] employee utilizes any annual leave or sick days that the employee has been given by the employer."

Statute states that the purpose of the credit is "to support living donors and the companies that employ them" [Section 39-22-540(1)(b), C.R.S.]. Between 2013 and 2022—the most recent 10-year period for which data is available from the Organ Procurement and Transplantation Network—an average of 136 Coloradans per year became living donors. The need for donated organs in the United States exceeds the number of organs available from deceased donors. For example, in 2022, a total of 167 Coloradans were removed from the national transplant waiting list because they died before receiving an organ or became too sick for an organ transplant to be successful. Organ donation from living donors can help address this need, and transplanted organs from living donors often work longer when compared to organs from deceased donors.

Under the National Organ Transplant Act of 1984, it is illegal to accept compensation or other items of value, like gifts or vacations, in exchange for donating an organ, although donors are permitted to receive reimbursement for some expenses related to their donation. The organ recipient's health insurance typically covers the medical expenses for the living donor, like medical testing, surgery, and post-operative care, but other expenses for organ donation may not be covered, such as lost wages, travel, lodging, and dependent care. Donors may be able to receive financial assistance for some of these costs from national programs; the transplant recipient or their family; the transplant hospital; or charities.

In order to determine whether the credit is meeting its purpose, we assessed the extent to which the credit is being used by employers with employees who have donated organs.

Evaluation Results

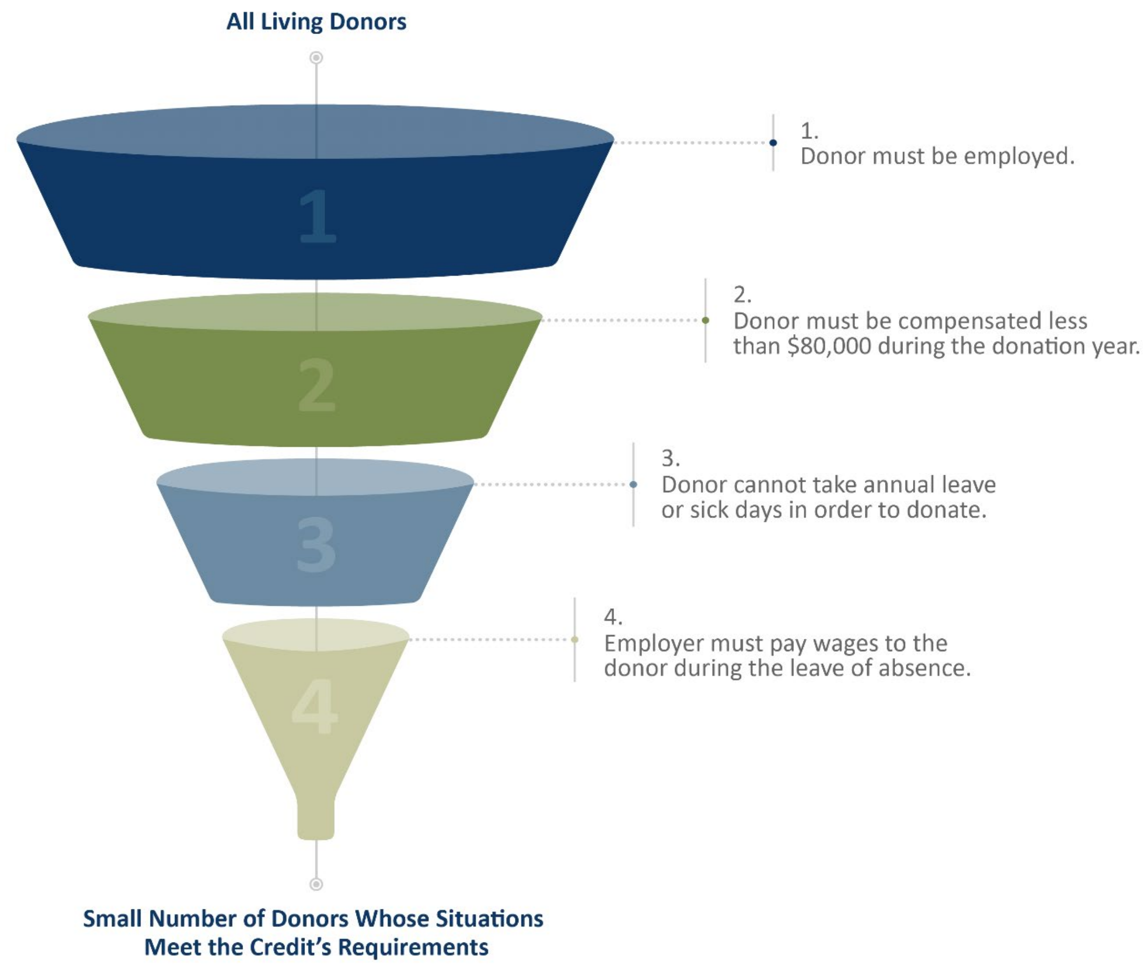
As of Tax Year 2020, the Organ Donor Credit did not support living donors or their employers because the credit was not being used. If the current version of the credit is extended beyond Tax Year 2024, it may provide some support to a small number of living donors and employers, but it is unlikely to make a significant impact because they may not be aware of the credit, and donors and employers must meet a number of specific requirements in order for the employer to qualify for the credit.

In Tax Year 2020—the only year for which data is available from the Department of Revenue—no employers claimed the credit for wages paid to living organ donors, despite the fact that 118 Coloradans became living donors that year. Although we were unable to determine definitively why none of the employers of these living donors claimed the credit, we identified a number of factors that may have contributed to the credit's low use.

Living donors and their employers may not be aware of the credit. We spoke to four Colorado professionals who work with living donors, and only one of them was aware of the credit. Since these individuals work with living donors on a regular basis and are aware of the challenges facing donors, including the need for time off from employment and the financial difficulties of forgoing wages, the fact that most of them are not aware of the credit suggests that the credit is not well known.

For those who are aware of the credit, statutory requirements likely significantly reduce the number of living donors and employers whose situations would qualify for the credit. The credit's requirements are summarized in Exhibit 1. As shown, the living donor must be employed; must be compensated less than $80,000 in the year of their donation; cannot take annual leave or sick days in order to donate; and must receive wages from their employer during their leave of absence.

Exhibit 1
Statutory Requirements Reduce the Number of Credit-Eligible Employers



Source: Office of the State Auditor analysis of Section 39-22-540(2)(b), (3)(a), and (4), C.R.S.

Although we were unable to determine the extent to which these requirements reduce the number of donors whose situations would qualify for the credit, each requirement is likely to prevent some donors from qualifying. For example, if employment patterns among organ donors are consistent with statewide employment patterns, only about 67 percent of the 160 Coloradans who donated an organ in 2022, or about 107 donors, would have been employed during the year. We do not know how many donors qualified under the credit's $80,000 compensation limit. Based on wage data from the U.S. Bureau of Labor Statistics, over half of the employed donors in 2022 may have earned less than $80,000 in wages. However, since the credit's compensation limit includes both wages and benefits, some of these donors may have received a total compensation of $80,000 or more and thus would not have met the credit's compensation requirement.

Finally, the third and fourth requirements may be particularly restrictive because employed donors are likely to fall into at least one of the following categories, none of which would be eligible for the credit:

- The employer provides paid leave to employees as a matter of standard policy. Examples may include sick days, annual leave, vacation time, or paid time off (PTO). If the living donor takes sick days or annual leave, their employer would not be eligible for the credit and, as discussed below, it is unclear whether other types of paid leave would qualify for the credit.

- The employer does not provide paid leave to employees but is subject to the Family Medical Leave Act (FMLA), which requires employers with at least 50 employees to provide job-protected time off for up to 12 work weeks. Since FMLA leave is unpaid, the living donor's employer would not be eligible for the credit.

- The living donor works for an employer that does not provide paid leave and is not subject to FMLA requirements. If the employer chooses to provide paid leave to the donor as a one-time benefit, this may qualify for the credit. However, the employer may also choose to hire someone else in the donor's position in order to avoid lost productivity. This category can also include living donors who are self-employed.

The restriction on taking annual leave or sick days in order to donate may cause confusion for employers about whether they qualify for the credit. Specifically, statute allows the credit under circumstances in which the employer "provides a paid leave of absence to an employee for the purpose of organ donation" but specifies that this "does not include a period during which [the] employee utilizes any annual leave or sick days that the employee has been given by the employer" [Section 39-22-540(2)(b), C.R.S.]. Notably, statute does not define the terms "annual leave" or "sick days" for purposes of the credit, and employers may use a variety of terms for and provide a number of different types of paid leave to employees for the employees' personal use, such as vacation time or PTO. As a result, employers may be confused about whether an employee can take only certain types of paid leave or, indeed, any type of paid leave that the employer provides to employees as a matter of standard policy. Additionally, employers that do not offer any type of standard paid leave to employees may not be clear as to whether a period of paid leave provided under a special arrangement for purposes of organ donation would be considered "sick days" under current statute. We did not have data to estimate what percentage of employees who donate an organ have one or more of the above types of leave. However, all of the stakeholders that we talked to about the requirement that the organ donor not take annual leave or sick days either expressed confusion about the requirement or thought that this requirement was likely too restrictive for the credit to apply to most donors' situations.

There may be other, more cost-effective options available to living donors and their employers. There are several national programs that provide reimbursement for lost wages and other donation-related expenses to living donors, including the National Living Donor Assistance

Center (NLDAC), which covers expenses up to $6,000, and Donor Shield, which is available through the National Kidney Registry and covers expenses up to $18,000. These programs have different eligibility requirements, but both reimburse living donors for all of the donor's lost wages and other expenses, including dependent care and travel expenses. In contrast, the credit only affects the donor's wages and does not account for any donation expenses; it also reimburses employers for their expenses rather than reimbursing donors. Additionally, these two reimbursement programs are both available for longer leaves of absence—up to 4 weeks and up to 6 weeks, respectively—than the credit, which is only available to employers for 10 working days, or 2 standard work weeks. Exhibit 2 shows the estimated amount of recovery time needed for living donors to return to normal activities after undergoing surgery to donate a kidney or part of a liver, which are the two organs that are typically donated by living donors. As shown, living donors may require a longer recovery period before returning to work than what the credit covers, depending on how physical their job is.

Exhibit 2
Estimated Amount of Time for Living Organ Donors to Return to Pre-Donation Activities

	Kidney Donors	Liver Donors
Return home from surgery and inpatient recovery	2-3 days	5 days
Drive a car	2 weeks	2-4 weeks
Lift heavy items	6-12 weeks	8-12 weeks

Source: Adapted from information provided by the Organ Procurement and Transplantation Network.

Employers may also have more cost-effective options than paying a donating employee's wages and claiming the credit. For example, large employers that are subject to FMLA could elect to provide the living donor with unpaid leave rather than paid leave, which would reduce the cost of the donor's leave of absence from 65 percent of the wages paid (with the credit) to $0. The living donor may also be able to receive short-term disability benefits during their leave of absence, which would provide them with a specified percentage of the unpaid wages without additional cost to the employer. Finally, depending on how quickly they can fill the donor's position, employers may also choose to let go of the donor and hire someone else instead.

Policy Consideration

If the General Assembly decides to extend the Organ Donor Credit beyond its current expiration date of December 31, 2024, the General Assembly could assess whether the credit is available to the intended population of living donors and, if necessary, consider making changes to statute. As discussed above, the credit had not been claimed by any employers as of Tax Year 2020, and we identified a number of factors that likely significantly reduce the number of living donors and employers whose situations would qualify for the credit, including the statutory employment, compensation, and paid leave requirements. Additionally, living donors and their employers may be confused about the credit's requirements regarding which types of paid leave are and are not eligible. The General Assembly may want to address one or more of these issues in order to improve the credit's effectiveness if it chooses to extend the credit to additional tax years.

The General Assembly could also consider providing a credit or deduction to living donors instead of to their employers. We identified 24 other states that offer a tax expenditure for expenses related to living organ donation. Of these, four states, similar to Colorado, allow a credit or deduction to employers of living donors, generally based on the wages paid to donors during the time spent away from work as a result of the donation. Additionally, 22 states provide a credit or deduction to living donors themselves, generally based on unreimbursed expenses related to the organ donation, such as lost wages, travel expenses, and lodging expenses. Most of these states allow for a deduction for up to $10,000 in unreimbursed expenses. However, a tax incentive provided directly to individuals may not provide timely financial support to living donors. Several stakeholders indicated that many potential donors do not have the savings necessary to pay their living expenses for several weeks while not making money, so a credit or deduction that they only receive once they file their taxes, which might be several months or even a year after their donation, might not address their immediate financial needs.

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Dyed Special Fuels and Off-Road Fuel Use Tax Expenditures

Tax Expenditure Evaluation • February 2024 • 2024-TE2

OFFICE OF THE STATE AUDITOR
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The Dyed Special Fuels Exemption and Off-Road Fuel Use Refund are available to individuals or businesses who purchase gasoline or special fuels and use them for off-road purposes, as well as to government entities. The Dyed Special Fuels Exemption fully exempts diesel and kerosene fuels that have been dyed from the State's special fuel excise tax. Dyed diesel fuel can be used for any nontaxable purposes that are permitted by federal law, such as for fueling farm or construction equipment, off-road business vehicles and equipment, and stationary machines, such as generators and compressors. The Off-Road Fuel Use Refund is available to taxpayers and government entities who use gasoline or undyed special fuel for specified off-road purposes, which include operating a stationary gas engine, motor boats, and certain agricultural, commercial, and industrial uses.

These tax expenditures are likely intended to prevent individuals or businesses from having to pay the State's fuel excise tax on gasoline or special fuel when the fuel is used for off-road purposes since off-road uses of fuel do not affect the condition of or benefit from public roads. **The Dyed Special Fuels Exemption and Off-Road Fuel Use Refund are likely meeting their purpose because stakeholders appear to be aware of and using the tax expenditures. Additionally, based on information provided by stakeholders, the sales price of dyed diesel appears to reflect the tax savings from the Dyed Special Fuels Exemption.**

Policy Considerations

We did not identify any policy considerations for these tax expenditures.

	Dyed Special Fuels Exemption	Off-Road Fuel Use Refund
Tax Type:	**Fuel excise**	**Fuel excise**
Expenditure Type:	**Exemption**	**Refund**
Statutory Citation:	**Section 39-27-102.5(1.5) and (2)(a), C.R.S.**	**Section 39-27-103(2.7)(a-c), (e-h), and (3)(a), C.R.S.**
Year Enacted:	**1979**	**1931**
Repeal/Expiration Date:	**None**	**None**
Revenue Impact:	**$43.1 million (2021)**	**$4.4 million (2019)**
Purpose given in statute or enacting legislation? **No**		

Dyed Special Fuels and Off-Road Fuel Use Tax Expenditures

Background

Colorado levies excise taxes on gasoline and special fuels based on the number of gallons acquired, sold, or offered for sale in the state. Revenue from these taxes is allocated to Colorado's Highway Users Tax Fund, which is used for the construction and maintenance of public roads in Colorado [Sections 43-4-203 and 204, C.R.S.]. The current fuel excise tax rates are $0.22 per gallon on gasoline and $0.205 per gallon on special fuels.

This evaluation covers two fuel excise tax exemptions for purchases of fuel that is used for off-road purposes—the Dyed Diesel and Kerosene Fuel Excise Tax Exemption (Dyed Special Fuels Exemption) and the Off-Road Fuel Use Excise Tax Refund (Off-Road Fuel Use Refund).

We inferred that the purpose of these fuel excise tax expenditures is to prevent individuals or businesses from having to pay the State's fuel excise tax on gasoline or special fuel when the fuel is used for off-road purposes since off-road uses of fuel do not affect the condition of or benefit from public roads.

Technical Note

Statute [Section 39-27-101(12) and (29), C.R.S.] defines the following:

- **Gasoline** means any flammable liquid used primarily as a fuel for the propulsion of motor vehicles, motor boats, or aircraft. Even though the definition of gasoline includes aviation fuels, these fuels are subject to their own excise tax in lieu of the gasoline excise tax. Therefore, this report does not include topics related to aviation fuels. We will cover the aviation fuel tax expenditures in other reports.
- **Special fuel** means diesel engine fuel, kerosene, liquefied petroleum gas, and natural gas used for the generation of power to propel a motor vehicle on public roads.

The Dyed Special Fuels Exemption exempts diesel and kerosene fuels that have been dyed from the State's special fuel excise tax. Fuel in the United States is dyed in accordance with federal law to indicate that the fuel can be used for purposes that are exempt from the federal special fuel excise tax. Exempt purposes include fueling farm or construction equipment, off-road business vehicles and equipment, and stationary machines, such as generators and compressors. According to the Internal Revenue Service (IRS), Publication 510, dyed diesel fuel and dyed kerosene fuel are exempt from the federal special fuel excise tax when the fuels are (1) permanently dyed according to federal rules and regulations and (2) used for nontaxable purposes. If dyed diesel fuel or dyed kerosene fuel is used for taxable purposes, like in a motor vehicle on public roads, violators can be fined the greater of $10 per gallon or $1,000 by the IRS for the first violation.

Technical Note

In the past, the U.S. Environmental Protection Agency (EPA) regulations required fuel distributors to add dye to high-sulfur diesel fuel in order to distinguish it from low-sulfur diesel. Beginning in 1993, the dyed high-sulfur fuel was restricted to off-road use, and by 2012, the EPA required all diesel to meet the lower sulfur content standards regardless of use. Today, IRS regulations require that distributors add dye to diesel solely for the purpose of distinguishing tax-exempt (dyed) fuel from taxable (undyed) fuel. The EPA still requires heating oils like kerosene to be dyed.

Although both dyed diesel fuel and kerosene are covered by the State's exemption, according to data from the U.S. Energy Information Administration (EIA), in 2020, a total of 100,000 gallons of kerosene fuel was sold in Colorado compared to 709 million gallons of diesel fuel. This suggests that the Dyed Special Fuels Exemption is primarily applied to purchases of dyed diesel fuel.

In additional to the nontaxable purposes that are permitted for dyed fuel under federal law, Colorado statute also specifically allows the exemption for construction companies using dyed diesel to work on Colorado public road construction projects, farmers or ranchers using dyed diesel in agriculture, and government entities. Since these uses are already permitted nontaxable uses of dyed diesel under federal law, which also qualify for Colorado's exemption, this provision in Colorado statute does not create additional tax benefits. Exhibit 1 shows some typical uses of diesel fuel, categorized by taxability.

Exhibit 1
Taxable and Nontaxable Uses of Diesel Fuel for Federal and Colorado Fuel Excise Taxes

Tax Status	Use
Taxable	Diesel engines in vehicles operated by non-governmental personnel on public roads
Nontaxable	Farm/construction equipment; off-road business uses; stationary machines, such as generators and compressors; government use both on- and off-road; U.S. military tanks/trucks

Source: Office of the State Auditor analysis of U.S. Energy Information Administration fuel definitions, Internal Revenue Service Publication 510: Excise Taxes, and Section 39-27-102.5(2)(b)(II), C.R.S.

The Off-Road Fuel Use Refund is available to taxpayers and government entities who use gasoline or undyed special fuel for any of the following off-road purposes:

- Operating a stationary gas engine
- Operating a motor vehicle on or over fixed rails
- Operating a tractor, truck, or other farm implement or machine for agricultural purposes on a farm or ranch
- Operating a motor boat
- Cleaning or dyeing fuel

- Any commercial use other than the operation of a motor vehicle on Colorado's public roads
- Any other use that is nontaxable under federal law

Individuals, businesses, and government entities, which for simplicity we will refer to collectively as taxpayers, who purchase and use gasoline or undyed special fuel for these purposes are eligible to claim a refund from the Department of Revenue (Department) for the state fuel excise taxes that were paid on that gasoline or special fuel by applying for a Gasoline/Special Fuel Tax Refund Permit and submitting a Fuel Tax Refund Claim form. Taxpayers may file refund claims as frequently as once per quarter, and the quantities of gasoline or undyed special fuel purchased must generally be at least 20 gallons within the previous 12 months at the time that the claim is being filed.

For businesses, the Department calculates the amount of the taxpayer's refund by multiplying the total amount of fuel purchased by a specific percentage that the Department assigns to the taxpayer's industry, then multiplying this by the fuel excise tax rate. The assigned percentage is an estimate of the amount of fuel that the taxpayer used for off-road purposes, which the Department may determine based on the historical average of how much gasoline or undyed special fuels are used for off-road purposes by the taxpayer's industry or on an alternative data source, such as data provided by an industry association. Exhibit 2 shows the average assigned percentages for major industry groups.

Exhibit 2
Average Assigned Percentages for the Off-Road Fuel Use Refund by Industry Group

Industry Group	Average Assigned Percentage (Gasoline)	Average Assigned Percentage (Special Fuel)
Commercial	71%	62%
Agriculture	71%	71%
Construction	46%	79%
Transportation	77%	33%
Mining	57%	73%

Source: Office of the State Auditor analysis of Department of Revenue industry-assigned percentages used for calculating the amounts of taxpayers' Off-Road Fuel Use Refunds.

The average assigned percentage is 64 percent across all industries. Although the assigned percentages might not precisely reflect an individual taxpayer's use of fuel for off-road purposes, Department staff stated that the intention is for the administrative ease of filing for the refund to outweigh the imprecision. Gasoline/Special Fuel Tax Refund Permit holders also have the option of appealing the assigned percentage by providing documents that support a different percentage to the Department. Exhibit 3 provides two examples of how the Off-Road Fuel Use Refund is calculated.

Exhibit 3
Example Calculations of the Off-Road Fuel Use Refund for a Mining Business

Fuel Type (Colorado Excise Tax Rate)	Fuel Purchased	Industry Percentage Assigned by the Department	Estimated Amount of Fuel Used for Off-Road Purposes (Based on Industry Percentage)	Refund of Excise Tax Paid on Fuel Used for Off-Road Purposes
undyed diesel ($0.205 per gallon)	150 gallons	73%	150 gallons x 73% = 109.5 gallons	109.5 gallons x $0.205 per gallon = $22.45
gasoline ($0.22 per gallon)	200 gallons	57%	200 gallons x 57% = 114 gallons	114 gallons x $0.22 per gallon = $25.08

Source: Office of the State Auditor analysis of statute [Sections 39-27-102(1)(a)(II) and 39-27-103(3)(a), C.R.S.] and Department of Revenue data.

In addition to Colorado's Off-Road Fuel Use Refund, taxpayers can also submit a refund form to the IRS for federal fuel excise taxes paid on gasoline or undyed special fuels used for nontaxable purposes. As in Colorado, the federal refund is available for farming use and off-highway business use, but it can also be claimed for some uses that are not specifically allowed for purposes of Colorado's refund, such as use by local buses, blood collector organizations, and in foreign trade. The IRS does not require a refund permit like Colorado does. The current federal fuel excise tax rates are $0.184 per gallon on gasoline and $0.244 per gallon on special fuels, including diesel and kerosene.

According to data from Bloomberg law, 29 other states have provisions that are similar to Colorado's Dyed Special Fuels Exemption because they have a broad exemption for dyed special fuel or dyed diesel and/or they exempt diesel fuel when it is used for road construction projects or for agricultural purposes. In addition, 34 other states offer a refund that is similar to Colorado's Off-Road Fuel Use Refund. Although each state has its own definitions and methods of administering the refund, the allowable off-road and nontaxable purposes are similar in other states to Colorado.

We used the following performance measures to determine whether these tax expenditures are meeting their purpose of preventing individuals or businesses from having to pay the State's fuel excise tax on gasoline or special fuel when the fuel is used for exempt purposes:

- To what extent are farmers, ranchers, construction companies that are performing public road construction projects, and businesses in Colorado aware of the Dyed Special Fuels Exemption and Off-Road Fuel Use Refund?

- To what extent are fuel distributors reducing the price of dyed special fuels to account for the Dyed Special Fuels Exemption?

Evaluation Results

The Dyed Special Fuels Exemption and Off-Road Fuel Use Refund are likely meeting their purpose because stakeholders appear to be aware of and using the tax expenditures. Additionally, based on information provided by stakeholders, the sales price of dyed diesel appears to reflect the tax savings from the Dyed Special Fuels Exemption.

Farmers, ranchers, construction companies that are performing public road construction projects, and businesses are likely aware of the tax expenditures. We found that the tax expenditures are applied to a substantial amount of fuel purchases in the state, which indicates that the intended beneficiaries are likely aware of and using the tax expenditures. Specifically, based on Department data, the Dyed Special Fuels Exemption had a revenue impact to the State of $43.1 million and was applied to about 210 million gallons of fuel purchases in Tax Year 2021. In comparison, about 709 million gallons of diesel fuel—both exempt and non-exempt—were sold in the state in Calendar Year 2020, the most recent year for which EIA data was available. Additionally, we contacted 10 stakeholders in regards to Dyed Special Fuels Exemption, but we only received a response from one stakeholder who works with the construction industry. They mentioned that these exemptions make sense to them because the State's fuel excise tax revenue funds the Highway Users Tax Fund, and therefore, it would not be fair for them or others to pay fuel excise tax on gasoline or special fuel when the fuel is used for off-road purposes. In the previous Dyed Diesel Fuel Excise Tax Exemption report, published in 2019, stakeholders mentioned the importance of dyed diesel fuel and how widely the fuel is used for off-highway or government use nationwide.

In addition, we found that the Off-Road Fuel Use Refund was used substantially, reducing state revenue by $4.4 million in 2019, the most recent year for which data was available. We used this revenue impact and other Department data to estimate that the taxpayers who claimed the refund used about 21 million gallons of fuel for off-road purposes. We contacted 26 stakeholders from different industries listed on the Department's Gasoline/Special Fuel Tax Refund Permit Application for feedback on the Off-Road Fuel Use Refund. The two stakeholders who responded mentioned the importance of keeping this tax expenditure, which is consistent with what stakeholders told us during our previous evaluation of the Off-Road Fuel Use Excise Tax Exemptions, published in 2019. We were unable to determine what portion of the refunds went to private businesses and what portion went to government entities.

Distributors appear to be reducing the price of dyed diesel fuel by amounts that are roughly equivalent to the sum of the State and federal fuel excise tax rates. We were unable to obtain Colorado market price data necessary to compare the price of dyed special fuels, which should be less expensive if the exemption is being passed on to consumers, to the price of undyed special fuels.

However, fuel distributors reported that the sales price of dyed diesel engine fuel is about 20 cents (reported by three out-of-state distributors that sell diesel fuel in Colorado) to 50 cents (reported by one in-state distributor and one in-state operating fueling station) less per gallon than the sales price of undyed diesel fuel. Another stakeholder stated that the price difference was a result of the nontaxable status of dyed diesel fuel and its intended off-road use. Fuel distributors also mentioned other factors that affect the price of fuel, including the diesel fuel quantity, delivery date and delivery location, and whether the storage tanks are owned or leased. Therefore, price differences between dyed and undyed fuel may depend on other factors in addition to the tax exemption. We were unable to get price information for dyed or undyed kerosene because most fuel distributors do not offer kerosene fuel for direct purchase, so we do not know if distributors are discounting the price for dyed kerosene to account for the tax exemption.

Policy Considerations

We did not identify any new policy considerations for the Dyed Special Fuels Exemption or the Off-Road Fuel Use Refund, nor were there any policy considerations in the previous evaluations of these tax expenditures, both published in 2019.

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Fraternal Society Exemption

Tax Expenditure Evaluation • November 2023 • 2023-TE17

OFFICE OF THE STATE AUDITOR
COLORADO

Colorado levies a 2 percent insurance premium tax on the amount of premiums that insurers collect from policyholders in the state. Fraternal societies are organizations of people with a common tie or objective that provide benefits, such as life insurance, to their members and engage in charitable and/or community initiatives. The Fraternal Society Exemption allows these societies to issue insurance policies to their members without paying insurance premium taxes on the premiums paid by members. The exemption was likely intended to avoid imposing a tax burden on fraternal societies due to the societal benefits they provide.

The Fraternal Society Exemption is applied to all premiums collected by fraternal societies on policies issued to members.

- All 36 fraternal societies that were licensed in Colorado in 2022 received the exemption on premiums reported to the Division of Insurance.

- Representatives of the fraternal society sector reported that the sector is very aware of the exemption and that the exemption allows them to expand their charitable and fraternal activities in their communities.

Policy Considerations

We did not identify any new policy considerations for the exemption.

Tax Type:	**Insurance premium tax**	Year Enacted:	**1883**
Expenditure Type:	**Exemption**	Repeal/Expiration date:	**None**
Statutory Citation:	**Sections 10-3-209(1)(d)(I) and 10-14-504, C.R.S.**	Revenue Impact (2022):	**$3.3 million**

Purpose given in statute or enacting legislation? **No**

Fraternal Society Exemption

Background

Colorado levies a 2 percent insurance premium tax on the amount of premiums that insurers collect from policyholders in the state. **The Fraternal Society Exemption allows fraternal benefit societies to issue insurance policies to their members without paying insurance premium taxes on the premiums paid by members.**

Fraternal benefit societies (fraternal societies) are organizations of people in which membership is based on a common tie or objective. They provide benefits to their members and may also engage in charitable, educational, or community initiatives. Fraternal societies were most popular in the late 19th and early 20th centuries, when they issued roughly half of all life insurance policies in the United States. The total number of fraternal societies operating in the United States has declined slowly since the 1920s. The American Fraternal Alliance (AFA) estimates that there were about 109,000 Coloradans who belonged to fraternal societies in 2022, and about 91,000 (83 percent) of these members held a life insurance policy or certificate issued by their fraternal society.

Technical Note:

In order to qualify for the exemption, statutes require a fraternal society to:

- Be governed by a board or assembly of delegates that are elected by the society's members.
- Conduct its business via local chapters that meet at least once per month.
- Provide social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic, or religious benefits to its members.
- Provide members and their dependents with contractual benefits, which may include annuities or death, disability, or medical benefits, among others.
- Not issue stock or be conducted for profit.

The exemption was likely intended to avoid imposing a tax burden on fraternal societies due to the societal benefits they provide. Since the exemption was enacted at the same time as the insurance premium tax in 1883, it appears that the exemption was not intended to provide a new benefit for fraternal societies but rather to define which types of insurers would be subject to the newly imposed premium tax. Additionally, statute states that fraternal societies are "charitable and benevolent institution[s]" and exempts them from most state and local taxes [Section 10-14-504, C.R.S.]. Representatives of the fraternal society sector reported that the exemption is helpful for their operations because it allows them to expand their charitable and fraternal activities in their communities. The AFA reports that Colorado fraternal members spent over 750,000 hours volunteering and provided more than $9 million in financial contributions to communities in 2021. All other states and the District of Columbia exempt fraternal societies from their respective insurance premium taxes.

In order to determine whether the exemption is meeting its purpose, we assessed the extent to which the exemption is applied to premiums paid for insurance policies issued by fraternal societies.

Evaluation Results

The Fraternal Society Exemption is applied to all premiums that fraternal societies collect from Colorado policyholders.

In 2022, there were 36 licensed fraternal societies in Colorado. Based on information from the Division of Insurance (Division), fraternal societies that are licensed with the State are receiving the exemption for all premiums collected from their members on Colorado policies. Like other types of insurers, fraternal societies are required to file annual statements with the National Association of Insurance Commissioners (NAIC) and complete the same annual insurance premium tax filing process with the Division in Colorado. Division staff reported that their tax system recognizes filings from fraternal societies based on each society's NAIC number and automatically exempts the society's reported premiums from the insurance premium tax. Therefore, any premiums reported by insurers that are registered as fraternal societies with the NAIC and are licensed with the Division are exempt from Colorado's insurance premium tax. Finally, fraternal society sector representatives reported that the sector is very aware of the exemption, and no new fraternal societies have been created in several decades, so most likely, every fraternal society is correctly registered with the NAIC and is receiving Colorado's exemption.

Based on NAIC data, fraternal societies collected about $166 million in exempt premiums in Tax Year 2022, so the exemption reduced the State's insurance premium tax revenue by about $3.3 million. Notably, Colorado statute also exempts premiums paid for certain types of annuities from the insurance premium tax, and premiums paid for annuities accounted for about $71 million (43 percent) of the premiums paid to fraternal societies; however, we were unable to determine what percentage of these premiums would have also qualified for the exemption for annuities.

Policy Consideration

We did not identify any new policy considerations for the exemption. In our previous evaluation of the exemption, released in January 2019, we included a policy consideration that the General Assembly may want to assess whether the exemption continues to serve a valid purpose because of its age and the large changes in both the role of fraternal societies and the insurance industry since the exemption was created. Two interim legislative committees (the Tax Expenditure Evaluation Interim Study Committee in 2019 and the Legislative Oversight Committee Concerning Tax Policy in 2022) reviewed this policy consideration and elected not to take any legislative action.

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Wholesales Sales Tax Exemption

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Tax Expenditure Evaluation • August 2023 • 2023-TE14

The Wholesales Sales Tax Exemption is available to any purchaser with a sales tax license who is making a purchase of goods in Colorado for resale. The exemption was likely intended to ensure that the sales tax is only applied to purchases made by consumers and to promote a transparent tax system. Exempting wholesale sales from sales tax avoids levying the tax on each transaction made between different businesses that handle a product during its distribution chain, which would result in "tax pyramiding"—when a single product is taxed multiple times before it is sold to the consumer. This would compound the tax, making the actual taxes paid higher than the set rate and driving up the price before the item reaches the consumer. In this way, tax pyramiding also reduces the transparency of the tax system by hiding the true amount of sales tax paid by the consumer.

We found that the Wholesales Exemption is effective because it is frequently used by qualifying businesses.

- Taken together, the revenue impact for all types of wholesales exemptions in 2021 was $3 billion. We could not determine what portion of this amount was specifically attributable to exempted wholesales purchased for resale.

- This exemption was established in 1935 as part of the legislation that created the Colorado retail sales tax, so it is well-established within Colorado's sales tax system.

- This type of wholesale exemption is common in other states as well, so retailers who operate in other states in addition to Colorado are probably familiar with similar exemptions in those states.

Policy Consideration

We did not identify any policy considerations for the exemption.

Tax Type:	**Sales and use tax**	Year Enacted:	**1935**
Expenditure Type:	**Exemption**	Repeal/Expiration Date:	**None**
Statutory Citation:	**Sections 39-26-102(9), (19)(a), and 39-26-104(1)(a), C.R.S.**	Revenue Impact:	**Could not determine**

Purpose given in statute or enacting legislation? **No**

Wholesales Sales Tax Exemption

Background

The Wholesales Sales Tax Exemption (Wholesales Exemption) is available to any purchaser with a sales tax license who is making a purchase of goods in Colorado for resale. The exemption is applied at the point of sale by vendors who then report all exempted sales to the Department of Revenue (Department). Wholesale purchasers present their sales tax license to the vendor at the point of sale, and the vendor applies the exemption by not collecting the State's 2.9 percent sales tax on the sale. If a vendor has reason to believe that the item purchased is not intended for resale and are unable to verify otherwise, they may apply the sales tax. If the purchaser feels that sales tax has been applied in error, they may file a Claim for Refund form with the Department. We issued our prior evaluation of this exemption in September 2018.

The Wholesales Exemption covers purchases made specifically for resale. Our evaluations of exemptions for other wholesale purchases that are not made for resale but are exempted from sales tax under statute, such as agricultural inputs, ingredients and component parts used in manufacturing, and newsprint and printers' ink, are contained in separate reports.

Although not given in statute, we believe the purpose of the exemption is to ensure that the sales tax is only applied to purchases made by consumers and to promote a transparent tax system. Exempting wholesale sales from sales tax avoids levying the tax on each transaction made between different businesses that handle a product during its distribution chain, which would result in "tax pyramiding"—when a single product is taxed multiple times before it is sold to the consumer. Tax pyramiding can increase the sales tax paid by consumers if businesses in the distribution chain pass on the taxes they pay to subsequent purchasers in the form of higher prices. Exhibit 1 provides an example of how tax pyramiding can occur in the absence of an exemption for resales.

Exhibit 1
Hypothetical Example[1] of the Sale of Shoes without the Wholesales Exemption

Source: Office of the State Auditor analysis of state and local government tax rates.
[1]We added Estes Park's total local tax rate of 5%, Larimer County's 0.8% tax rate, and the Colorado state sales tax rate of 2.9% to calculate a combined state and local sales tax rate of 8.7%. We chose a hypothetical shoe price for illustration purposes and did not account for any markup that vendors may add to the amount they pay for the shoes in order to make a profit. Our calculations are based on the assumption that each vendor passes on the entire amount of sales tax they pay to the next purchaser.

As shown in Exhibit 1, tax pyramiding compounds the tax each time a product is sold from one business to the next, making the actual taxes paid higher than the set rate and driving up the price before the item reaches the consumer. In this way, tax pyramiding also reduces the transparency of the tax system by hiding the true amount of sales tax paid by the consumer. For sales of items that have been identified in statute as tax-exempt for the consumer—such as food for home consumption and hygiene products—the sale to the consumer would not be subject to sales tax, but the final price may still be higher due to the cost of sales taxes charged at earlier stages of distribution being passed on to the consumer.

Tax pyramiding can also harm businesses that sell products with longer distribution chains. Since these less integrated businesses must make more sales transactions to purchase and distribute the product before it is sold to a consumer, it may be more difficult for businesses with this structure to compete with businesses with a more integrated distribution system. Using the manufacturer in Exhibit 1 above as an example, if another shoe manufacturer operated its own distribution system and retail stores, its shoe would only be taxed once (when sold at retail), allowing the seller to offer the shoe at a substantially lower price to consumers (e.g., $54.35 compared to $64.22). In this situation, a business with a longer distribution chain may choose to absorb all or a portion of the additional tax caused by tax pyramiding to offer a lower price and remain competitive. However, this would reduce profitability and may not be sustainable depending on the profit margin of the product being sold. Since the Wholesales Exemption avoids compounding the tax that must be paid by either the consumer or by businesses that distribute and sell goods, we considered both the businesses that claim the exemption and consumers to be the exemption's intended beneficiaries.

Evaluation Results

We found that the Wholesales Exemption is effective because it is frequently used by qualifying businesses.

According to Department data, in 2021, the State forwent about $3 billion in sales and use tax revenue due to all types of wholesale exemptions. Although we could not quantify the portion of this amount specifically attributable to the Wholesales Exemption, a substantial portion of the revenue impact is likely attributable to this exemption due to the commonality of sales for resale. Additionally, the exemption is likely well-known by the businesses that qualify for it because it is a common structural provision in nearly every state with a sales tax (44 of 45 other states with a sales tax, including the District of Columbia, have a similar exemption) and has been part of Colorado's sales tax code since 1935, when the State's sales tax was established.

The exemption also applies to some local sales taxes in the state. Statute requires local governments that have their local sales taxes collected by the State on their behalf to apply most of the State's sales tax exemptions, including the Wholesales Exemption. Additionally, home rule municipalities, which have the authority to set their own sales tax policies independent from the State's, also generally exempt wholesales for resale from their local sales tax. The top 12 most populous cities in Colorado are home rule jurisdictions that collect their own taxes, and all 12 exempt wholesales for resale.

We did not receive any feedback from stakeholders to indicate that they had any issues with the exemption. We contacted 30 organizations via email and telephone to discuss their awareness of the exemption and whether they had any issues using it. None of the stakeholders we reached out to followed up or offered their feedback on the exemption.

Policy Consideration

We did not identify any policy considerations for the exemption, nor were there any policy considerations in the previous evaluation.

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Memo to the Committee

OFFICE OF THE STATE AUDITOR

KERRI L. HUNTER, CPA, CFE • STATE AUDITOR

MEMORANDUM

Date: 7/23/2024
To: Members of the Legislative Oversight Committee Concerning Tax Policy
From: James Taurman, Manager, Legislative Tax Expenditure Evaluation Team
Re: Information related to HB 24-1053

House Bill 24-1053 made several changes to the scope of the Office of the State Auditor's work on tax policy. Specifically, the bill:

1. Gave our office discretion in deciding whether to reevaluate a tax expenditure after it has been reviewed once and the timing of the subsequent review. The OSA must still review new expenditures and issue reports on expiring expenditures prior to the legislative session before they are scheduled to expire.

2. Allows the Tax Policy Committee to select 3 additional expenditures for our office to review before June 30 of the following year.

3. Allows the Tax Policy Committee to select 3 specific, discrete topics related to existing tax policy for the OSA to report on before June 30 of the following year.

4. Requires that we annually report on the impact of using federal taxable income as the basis for Colorado taxable income including any changes that may significantly impact the State's tax base.

On the following pages, we provide information related to each of these topics.

1. Expenditures OSA Will Review by June 30, 2025

We plan to review the following expenditures by June 30, 2025.

Expenditure	Reason for Review
ABLE Savings Account Contribution Deduction	First available in Tax Year 2022 and expires after Tax Year 2025. We will publish this report prior to the 2025 Session so the General Assembly can take action on the expenditure if it would like to.
Early Childhood Educator Credit	First available in Tax Year 2022 and expires after Tax Year 2025. We will publish this report prior to the 2025 Session so the General Assembly can take action on the expenditure if it would like to.
Senior Housing Credit	First available for 1 year in Tax Year 2022. Reinstated by the General Assembly for 2024. We will review the 2022 version, so the General Assembly will have information on its effectiveness if it would like to reinstate the credit again in future years.
Rural Jump Start Tax Expenditures	The General Assembly extended the expenditures until 2031. However, the Rural Jump Start grants, which were created since our last review, were only extended until 2025. We will publish this report prior to the 2025 Session so the General Assembly can take action on the grants if it would like to.
Regional Home Office Rate Reduction	The General Assembly changed the criteria to receive the reduction since our last review.
Medical Supplies Exemption	The General Assembly exempted feminine hygiene products and diapers since our last review. We will focus on the additional exemptions.
Oil and Gas Severance Tax Netback Expenses Deductions	The General Assembly changed which taxpayers can claim these deductions since our last review.
Annuities and Pension Premium Tax Exemptions	Statute now requires annuities to be in a retirement account to qualify. We will also review the Pension Premium Tax Exemption.
Agricultural Aviation Fuel Refund	We will complete this review, which we started prior to the passage of HB 24-1053.
Manufacturing Sales Tax Exemptions	We will complete this review, which we started prior to the passage of HB 24-1053.

2. Additional Expenditures

Statute [Section 39-21-403(2)(c)(I)(B), C.R.S.] allows the Committee to request in writing that we evaluate up to 3 additional specific tax expenditures. These reports will be published by June 30, 2025.

To help the Committee members identify specific expenditures for us to review, we have provided a table (see attached Excel file) of all of the State's current tax expenditures and key information about each, such as cost to the State and whether previous reports contained policy considerations. If we have already issued a report on an expenditure, we have discretion on whether to conduct subsequent reviews of the same tax expenditure. Prior to each new fiscal year, we will determine whether to re-review expenditures that we reviewed 5 years prior. We anticipate taking the following factors into account when making this determination – time since our last review, policy considerations in our previous report, cost of the expenditure, significant legislative changes to the expenditures since our last review, and significant changes to the taxpayers or industry since our last review. In addition, statute requires us to issue at least one report prior to the legislative session before an expenditure is scheduled to expire so we will plan to review any expenditures with a repeal date, regardless of whether we have reviewed the expenditure previously.

In the table, we have included columns on the Potential Review Year, whether it is a Statutorily Required or Discretionary Review, and, if discretionary, whether we have Selected for Discretionary Review. These columns indicate which expenditures we have to review and, if so, by when and the expenditures we might review and when we plan to make that determination. For example, the ABLE Account Contribution Deduction (line 9 in the table) will expire in 2026, so the review year is 2025 and it is a new expenditure so we are required to review it, which is indicated in the Review Notes column. In contrast, we reviewed the Newspaper Exemption expenditure (line 185 in the table) in 2023, so have discretion on whether to issue another evaluation in the future. We will determine whether to re-evaluate the expenditure as part of our work for 2028.

If there is any additional information that it would be helpful for the Committee to have, please let us know.

3. Tax Topic Reports

Statute [Section 39-21-403(2)(c)(I)(C), C.R.S.] allows the Committee to request in writing that the Office of the State Auditor prepare up to two reports annually on specific, discrete topics related to existing tax policy. We must then provide the Committee Chair with a written proposed scope of work for the requests within 30 days. The Committee Chair will review and approve the scope of work and we will issue the reports by June 30, 2025.

The following are some potential topics the Committee could consider requesting:

1. A thematic report covering several tax expenditures. For example, we could compare effective severance tax rates and available expenditures by mineral type - coal, oil and gas, metallic minerals, and molybdenum. Or, we could look at the tax expenditures available to a specific group, such as low-income individuals, and compare them to best practices. We could also look at the incentives related to a specific industry, such as aviation.

2. A report that estimates the amount attributable to each tax expenditure that is claimed on a common line on the Department of Revenue's forms, for which revenue impact estimates are not currently available. For example, the tax return for individual taxpayers has them claim 10 different deductions on the Other Subtractions line. Individual taxpayers claimed over $27 million in deductions on this line in Tax Year 2020. We could try to review a sample of the returns of these taxpayers to determine which deductions they were claiming and the relative dollar amount.

3. A report on an emerging tax issue. For example, we could look at the impact of remote work on income and sales tax revenue and tax incentives other states have used to attract remote workers.

4. Federal Income Tax Report

We are in the planning stage for a report on the impact of using Federal Taxable Income as the basis for Colorado Taxable Income, including changes at the federal level that might have a significant impact on the State's tax base or taxable income within the state. At this point we plan to include:

1. Background information on how Federal Taxable Income is calculated, including information on the most common federal deductions and subtractions.

2. Background information on Colorado deductions and additions to Federal Taxable Income to arrive at Colorado Taxable Income.

3. Summary of recent federal changes that had a significant impact on Colorado Taxable Income.

4. Potential future federal changes that could have a significant impact on Colorado Taxable Income. For example, provisions of the Tax Cuts and Jobs Act of 2017 that are set to expire after 2025.