



BIOTECHNOLOGY SALES AND USE TAX REFUND

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE9

TAX TYPE	Sales and use	REVENUE IMPACT	\$478,000
YEAR ENACTED	1999	(TAX YEAR 2015, RECENT YEARS NOT REPORTABLE)	
REPEAL/EXPIRATION DATE	None	NUMBER OF TAXPAYERS	Could not determine

KEY CONCLUSION: The Biotechnology Sales and Use Tax Refund only provides financial incentives to a small number of qualified biotechnology taxpayers. Stakeholders reported a general lack of awareness of the refund within Colorado biotechnology businesses when compared to awareness of other financial incentives offered by the State.

WHAT DOES THE TAX EXPENDITURE DO?

The Biotechnology Sales and Use Tax Refund (Biotechnology Refund) [Section 39-26-402(1), C.R.S.] allows qualified biotechnology taxpayers to claim a refund for state sales and use taxes paid on the sale, storage, use, or consumption of tangible personal property to be used in Colorado directly and predominately in research and development of certain biotechnology applications.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

The title of the enacting legislation of the Biotechnology Refund (House Bill 99-1335) states that the purpose of the refund is to create “financial incentives for the development of biotechnological activity in Colorado.”

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing performance measures for the Biotechnology Refund.
- Reviewing its effectiveness and whether it should be designed as a refund rather than a sales tax exemption applied at the time of the sale.



BIOTECHNOLOGY SALES AND USE TAX REFUND

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Biotechnology Sales and Use Tax Refund (Biotechnology Refund) [Section 39-26-402(1), C.R.S.] allows qualified biotechnology taxpayers to claim a refund of state sales and use taxes paid on purchases of specified personal property. Qualified biotechnology taxpayers are defined in statute as C corporations, partnerships, limited liability companies (LLCs), S corporations, or sole proprietorships that purchase, store, use, or consume tangible personal property to be used in Colorado directly and predominately in research and development of biotechnology [Section 39-26-401(4), C.R.S.]. Biotechnology, as defined in statute, “means . . . the application of technologies to produce or modify products, to develop microorganisms for specific uses, to identify targets for small pharmaceutical development, or to transform biological systems into useful processes or products; and . . . the potential endpoints of the resulting products, processes, microorganisms, or targets [that] are for improving human or animal health care outcomes” [Section 39-26-401(1), C.R.S.]. Biotechnological processes that are used to manufacture chemicals, develop and produce sustainable fuels and materials, and improve crop yields and resiliency are not included in the statutory definition of biotechnology for purposes of the refund. Further, statute does not provide for taxpayers to claim the Biotechnology Refund for any local sales taxes paid.

House Bill 99-1335 created the Biotechnology Refund in 1999. The refund has not undergone any substantive changes since its enactment. To claim the refund, qualified biotechnology taxpayers are required to submit the Department of Revenue Claim for Refund of Tax Paid to Vendors (Form DR 0137B) with relevant documentation of the eligible purchases included.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the beneficiaries of the Biotechnology Refund. Based on our review of the statutory language and feedback from stakeholders, we considered the intended beneficiaries to be companies in Colorado that are engaged in biotechnology research and development for the purposes of improving human or animal health care outcomes, which includes, but is not limited to, pharmaceutical drug and vaccine development, gene therapy, and rapid disease detection.

Based on U.S. Bureau of Labor Statistics data, we identified 166 biotechnology research and development businesses operating in Colorado in 2020. These businesses employed 1,670 people within the state. Over half of these businesses were located in Adams, Boulder, and Denver counties, and approximately 3 quarters of people employed in this industry were employed in Boulder County.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

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

We determined that the Biotechnology Refund is meeting its purpose, but only to a limited extent, because it provides financial incentives for the development of biotechnological activity in Colorado to only a small number of eligible taxpayers. It also appears that many biotechnology companies may not be aware of the Biotechnology Refund.

Statute does not provide quantifiable performance measures for this expenditure. Therefore, we created and applied the following performance measure to determine whether the refund is meeting its purpose:

PERFORMANCE MEASURE: To what extent has the Biotechnology Refund provided incentives for the development of biotechnological activity in Colorado?

RESULT: We found that while the Biotechnology Refund provides financial incentives to qualified biotechnology taxpayers, there were very few claims for the Biotechnology Refund in recent years, according to data from the Department of Revenue (Department). We cannot specify the number of claimants due to taxpayer confidentiality requirements.

A representative from an industry group informed us that Colorado biotechnology companies were generally not aware of the Biotechnology Refund. This could partially be due to the fact that the Department does not have any published guidance for taxpayers to consult regarding the Biotechnology Refund. The lack of awareness is likely inhibiting the State's ability to provide financial incentives to taxpayers that are eligible for them.

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

The Biotechnology Refund resulted in a revenue impact to the State of \$478,000 in Calendar Year 2015. In subsequent years, the annual revenue impact has remained below that amount, and in some years has been substantially less, but we cannot report the amounts due to taxpayer confidentiality requirements. Based on its limited use, it appears that the refund has likely not had a significant impact on the State's biotechnology industry, although it may provide some support to the few taxpayers who have claimed it.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If this expenditure were eliminated, many companies engaged in biotechnology research and development would likely not see any changes in their practices due to the low awareness and usage of the Biotechnology Refund. Furthermore, eliminating this expenditure may not significantly impact expansion of the industry in Colorado. The bioscience industry in Colorado, which includes biotechnology but is a broader industry sector, saw 34 percent job growth between 2010 and 2019 without widespread use of the Refund. Stakeholders told us that, while financial incentives are important, other factors contribute to the growth of the biotechnology industry in Colorado, such as proximity to research institutions, quality of life, and the State's workforce.

Nevertheless, if the expenditure were eliminated, those companies that use it would no longer be able to access its financial benefits. According to industry group representatives, biotechnology research and development is a very capital-intensive and lengthy endeavor. The cost of tangible personal property used by a qualified biotechnology taxpayer for research and development can range from \$85,000 to \$250,000 annually per project and projects take an average of 12 years to complete and go to market. Incentives, including but not limited to the Biotechnology Refund, can help qualified biotechnology taxpayers manage these factors. First, incentives can help them secure funding by reducing the perceived risk of investing in the research and development of biotechnology products, which historically have a high rate of failure. Second, incentives can help them continue to operate during the research and development period, which is often characterized by low revenue.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We examined the tax laws of the 44 other states (excluding Colorado) with a sales tax and identified at least 32 that have exemptions for equipment purchased to use in research and development, although most of these exemptions are not specifically targeted at biotechnology.

Of these 32 states, Connecticut, Maine, Missouri, and Wisconsin all have exemptions specifically for biotechnology research and development equipment. California has a reduced sales and use tax rate for purchases of tangible personal property used in biotechnology research and development. Colorado is the only state that administers a tax expenditure for tangible personal property used in biotechnology research and development as a refund that a taxpayer must apply for, rather than an exemption applied at the point of sale or use.

Some states have additional tax incentives to promote the biotechnology industry, such as biotechnology and/or bioscience industry investment income tax credits in Arizona, Maryland, Kansas, and Virginia. Additionally, some states offer grants to bioscience companies, including grants that match the federal Small Business Innovation Research Grant.

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

We identified the following tax expenditures and programs that may also support businesses engaged in the development of biotechnology and that can likely be claimed by businesses that claim the Biotechnology Refund:

ENTERPRISE ZONE RESEARCH AND EXPERIMENTAL ACTIVITIES INCOME TAX CREDIT [SECTION 39-30-105.5, C.R.S.]—If eligible, a taxpayer can claim an income tax credit of 3 percent of their research and development costs above the total average cost of the taxpayer’s research and development costs from the past 2 years. To qualify, a taxpayer must have expenditures in research and experimental activities (as defined in 26 USC 174) conducted in an enterprise zone for the purpose of carrying out a trade or business. Qualified biotechnology taxpayers that are located within enterprise zones would likely be eligible to claim the Enterprise Zone Research and Experimental Activities Income Tax Credit.

ADVANCED INDUSTRY GRANTS AND CREDIT—We identified several grant programs and a credit administered by the Office of Economic Development and International Trade (OEDIT) that biotechnology companies can likely use. Specifically, companies that are industry sponsors of bioscience research and development at recognized research institutions are eligible to receive up to \$150,000 for said research via the Advanced Industries Proof of Concept Grant. In Fiscal Year 2020, OEDIT awarded 34 of these grants, totaling \$2.8 million. When bioscience businesses in Colorado move beyond the research and development phase, they would likely be eligible for other Advanced Industry grants. These include the Collaborative Infrastructure Grant, which awards up to \$500,000 for large-scale advanced industry projects; the Early Stage Capital and Retention Grant, which awards up to \$250,000 to Colorado advanced industry businesses to develop and commercialize new technologies; and the Export Grant, which provides up to \$15,000 and 50 percent of approved expenses to small and medium-sized advanced industry companies that want to export or are currently exporting their products abroad. These three grants awarded a total of \$12.4 million to Colorado advanced industry businesses in Fiscal Year 2020. Companies that are eligible for the Biotechnology Refund may also receive investments from investors that can take advantage of the Advanced Industries Investment Tax Credit, which gives investors in small Colorado advanced industry businesses a state income tax credit equal to 25 percent of their investment, up to \$50,000 in credits for each small business in which they invest. The Advanced Industries Investment Tax Credit is scheduled to expire at the end of 2022.

FEDERAL QUALIFIED SMALL BUSINESS PAYROLL TAX CREDIT FOR INCREASING RESEARCH ACTIVITIES [26 USC 3111(f)(1), 26 USC 41(a) AND (h)]—Some qualified biotechnology taxpayers in Colorado would likely be eligible for the federal Qualified Small Business Payroll Tax Credit for Increasing Research Activities. This credit is available to small businesses that have qualified research expenses, have less than \$5 million in gross receipts in the tax year in which the credit is claimed, and had no gross receipts before the 5-year period ending with the year

in which the tax credit is claimed. Qualified research expenses are defined as wages paid to employees and money spent on supplies or computer equipment used to conduct research. If eligible, a startup can claim up to \$250,000 against their federal payroll taxes.

FEDERAL SMALL BUSINESS INNOVATION RESEARCH GRANT AND SMALL BUSINESS TECHNOLOGY TRANSFER GRANT—Some biotechnology companies in Colorado may be eligible for the Small Business Innovation Research Grant (SBIR) and the Small Business Technology Transfer Grant (SBTT), both of which are offered by the Federal Small Business Administration. The SBIR awards funding to small businesses to engage in research and development that has the potential for commercialization. The SBTT awards funding to promote public/private partnerships (such as that between a small business and a nonprofit research institution). Small business is defined as a business with 500 or fewer employees for the purposes of these two grants.

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

There were no data constraints that impacted our ability to evaluate this tax expenditure.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER ESTABLISHING PERFORMANCE MEASURES FOR THE BIOTECHNOLOGY REFUND. Since statute and the bill that established the Biotechnology Refund do not establish performance measures for this tax expenditure, we developed a performance measure to assess the extent to which the refund is meeting its purpose. However, the General Assembly may want to establish performance measure(s) in statute. This would allow our office to more definitively assess the extent to which the refund is accomplishing its intended purpose.

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REVIEWING THE EFFECTIVENESS OF THE BIOTECHNOLOGY REFUND AND POTENTIALLY AMENDING STATUTE TO APPLY IT AT THE TIME OF SALE. When this tax expenditure was first proposed as legislation, it appears that it may have been intended to be a mechanism by which the State would refund excess revenue under the Taxpayer's Bill of Rights (TABOR). Specifically, the title for House Bill 99-1335, which established the refund, indicated that it would refund revenues in excess of the constitutional limitation on state fiscal year spending. TABOR imposes restrictions on state revenue and spending, requiring the State to issue refunds of surplus revenue to taxpayers in fiscal years where revenue exceeds the TABOR spending cap if voters have not authorized the State to retain the excess revenue (see the *Tax Expenditures Overview Section of the Office of the State Auditor's Tax Expenditures Compilation Report* for additional details about TABOR). For this reason, it appears that this tax expenditure may have originally been designed as a refund, rather than an exemption applied at the time of sale, in order to prevent taxpayers from claiming it in years when the State is not required to issue TABOR refunds. However, language limiting the Biotechnology Refund to years when the State must issue TABOR refunds was ultimately not included in the final enacted bill. As a result, though statute allows qualified biotechnology taxpayers to claim the refund in any year they have eligible purchases, they must file for a refund with the Department instead of receiving a sales tax exemption from the vendor at the time of sale, which is how the other sales tax exemptions in the state are typically administered.

As discussed, we found that the refund is being claimed by few taxpayers, and stakeholders indicated that many companies may not be aware of the refund. Because the State rarely designs tax expenditures to be administered solely as sales tax refunds, taxpayers may not be aware that it is available. Further, because refunds require additional administrative steps that delay the receipt of the tax benefit, they are likely less beneficial to taxpayers. In addition, other states with similar tax expenditures structure them as sales tax exemptions rather than refunds.

As such, the General Assembly could consider amending statute to change this expenditure to a sales tax exemption, which may make it a more accessible incentive for bioscience companies in Colorado. However, this would also likely lead to a larger revenue impact to the State from the Biotechnology Refund and we lacked the data to estimate the potential revenue impact of this change.