



## Fiscal Note

### Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

## HB 26-1223: MODIFYING CERTAIN TAX EXPENDITURES

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**Prime Sponsors:**

Rep. Woodrow; Boesenecker  
Sen. Ball; Roberts

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**Fiscal note status:** This revised fiscal note reflects the reengrossed bill, as amended by the Senate Finance Committee.

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### Summary Information

**Overview.** The bill makes modifications to certain sales and use tax expenditures and creates an expanded family affordability credit.

**Types of impacts.** The bill is projected to affect the following areas on a continuous basis:

- State Expenditures
- State Revenue
- Local Government

**Appropriations.** For FY 2026-27, the bill requires an appropriation of \$48,326 to the Department of Revenue.

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**Table 1**  
**State Fiscal Impacts**

| Type of Impact          | Budget Year<br>FY 2026-27 | Out Year<br>FY 2027-28 |
|-------------------------|---------------------------|------------------------|
| State Revenue           | \$0                       | \$0                    |
| State Expenditures      | \$48,326                  | \$263,646              |
| Transferred Funds       | \$0                       | \$0                    |
| Change in TABOR Refunds | \$0                       | \$0                    |
| Change in State FTE     | 0.0 FTE                   | 2.7 FTE                |

The bill has offsetting positive and negative impacts on state revenue. See Table 1A and State Revenue section.

**Table 1A  
 State Revenue**

| <b>Fund Source</b>                            | <b>Budget Year<br/>FY 2026-27</b> | <b>Out Year<br/>FY 2027-28</b> |
|---|-----------------------------------|--------------------------------|
| General Fund from Sales Tax Changes           | \$43.6 million                    | \$77.4 million                 |
| General Fund from Family Affordability Credit | -\$43.6 million                   | -\$77.2 million                |
| Housing Development Grant Fund                | Minimal                           | -\$0.2 million                 |
| <b>Total Revenue</b>                          | <b>\$0</b>                        | <b>\$0</b>                     |

**Table 1B  
 State Expenditures**

| <b>Fund Source</b>        | <b>Budget Year<br/>FY 2026-27</b> | <b>Out Year<br/>FY 2027-28</b> |
|---------------------------|-----------------------------------|--------------------------------|
| General Fund              | \$48,326                          | \$208,892                      |
| Cash Funds                | \$0                               | \$0                            |
| Federal Funds             | \$0                               | \$0                            |
| Centrally Appropriated    | \$0                               | \$54,754                       |
| <b>Total Expenditures</b> | <b>\$48,326</b>                   | <b>\$263,646</b>               |
| <b>Total FTE</b>          | <b>0.0 FTE</b>                    | <b>2.7 FTE</b>                 |

## Summary of Legislation

The bill modifies state sales and use tax expenditures and creates a new income tax credit.

### Downloadable Software Exemption

The bill narrows the downloadable software sales and use tax exemption so that only custom software developed for use by a particular user and software governed by a negotiable license agreement is exempt from taxation. Under the bill, all other types of downloadable software are subject to state sales and use tax beginning January 1, 2027. The bill states that counties, municipalities, the Regional Transportation District (RTD) and the Scientific and Cultural Facilities District (SCFD) may only adopt the state’s sales tax base changes in the bill through approval during a local election.

### Retail Food Establishment Sales Tax Deduction for Gas and Electricity

Retailers with prepared food sales are currently allowed the following subtractions from their net sales tax obligations, which are related to energy used to prepare food:

- if prepared food sales exceed 25 percent of the retailer's total sales revenue, 55 percent of the retailer's purchase of energy is exempt from sales tax; and
- if prepared food sales are 25 percent or less of the retailers' total sales revenue, the retailer is allowed a credit against the sales tax it collects in an amount of 0.5 percent of prepared food sales.

The bill codifies and expands these subtractions, allowing for retailers with prepared food sales in excess of 25 percent of total sales revenue to deduct 100 percent of gas and electricity purchases from net taxable sales.

## Sales Tax Deduction for Specific Months

In 2027 and 2028, for July, August, November, and December, certain restaurants, bars, food service contractors, mobile food vendors, and caterers may deduct from state net taxable sales the lesser of state net taxable sales or \$14,000 per site.

## Housing Development Grant Fund Allocations

Beginning January 1, 2027, the bill additionally decreases the percent of sales tax revenue diverted to the Housing Development Grant Fund (HDGF) from 1.655 percent to 1.625 percent of sales tax revenue.

## Expanded Family Affordability Credit

Starting for tax year 2027, the bill creates an expanded family affordability credit (EFAC) for Coloradans who are or would be eligible for the Family Affordability Tax Credit (FATC) available in current law. The credit is refundable, meaning any amount by which the credit exceeds a taxpayer's tax liability is refunded to the taxpayer.

The amount of the EFAC depends on the estimated amount of the state revenue increase that results from the sales tax expenditure changes in the bill. Starting with the December 2027 forecast, Legislative Council Staff is required to determine the maximum dollar amounts of the EFAC so that the projected aggregate total of tax credits claimed is equal to the net amount of revenue gain attributable to the sales tax expenditure changes.

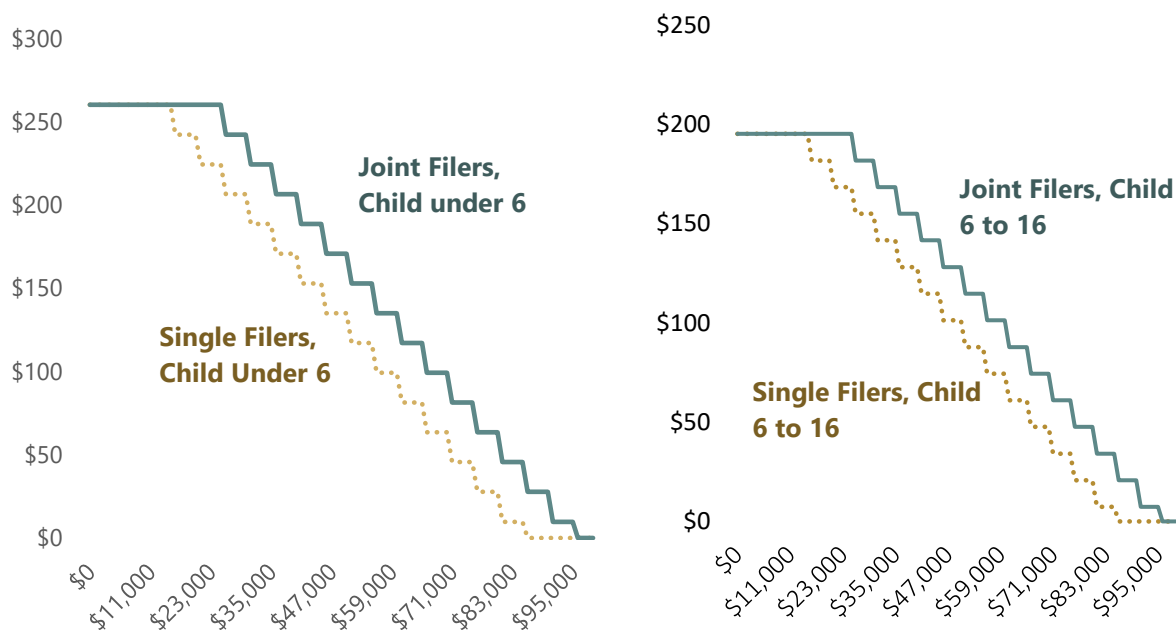
Based on this fiscal note's estimates of the revenue increase from the change to the downloadable software exemption, the projected amount of the EFAC in tax year 2027 is:

- for each child under age 6, \$260 for single filers with AGI of \$16,000 or less, reduced by \$18 (6.875 percent) for every \$5,000 of AGI above \$16,000; and
- for each child ages 6 to 16, \$195 for single filers with AGI of \$16,000 or less (75 percent of the credit for children under age 6), reduced by \$13 (6.875 percent) for every \$5,000 of AGI above \$16,000; or

- for each child under age 6, \$260 for joint filers with AGI of \$27,000 or less, reduced by \$18 (6.875 percent) for every \$5,000 of AGI above \$26,000; and
- for each child ages 6 to 16, \$195 for joint filers with AGI or \$27,000 or less (75 percent of the credit for children under age 6), reduced by \$13 (6.875 percent) for every \$5,000 of AGI above \$26,000.

Figure 1 shows the amount of credit allowed in tax year 2027 for taxpayers for each eligible child, depending on their AGI and the child’s age. Starting with tax year 2028, credit amounts and AGI amounts are adjusted for inflation.

**Figure 1**  
**HB 26-1223 Tax Credit Amounts by Adjusted Gross Income, Filing Status, and Child’s Age**  
**Tax Year 2027**



unavailable for tax year 2026. Under the March 2026 LCS forecast, the FATC is expected to be unavailable in tax years 2027 and 2028.

## Downloadable Software Exemption

Under current law, only software that is prepackaged via a tangible physical medium is subject to the state sales and use tax. Examples of software that are exempt from sales and use tax include:

- software that is used over the internet without being downloaded to the user's computer, such as with "cloud computing";
- software downloaded from the internet to the customer's computer or other electronic device;
- software that is manually installed on a consumer's computer or electronic device by a vendor's representative; and
- custom software developed for use by a particular user.

In 2024, the amount of sales and use tax exemptions reported under the downloadable software exemption totaled \$15.3 million across 47,762 sales tax returns. However, it is probable that some software-as-a-service (SaaS) retailers reported software exemptions under the service exemption rather than the downloadable software exemption, such that the amount of sales reported under the downloadable software exemption is an underestimate of sales that would become subject to sales and use tax under this bill.

## Assumptions

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According to the U.S. Census Bureau, there were \$11.89 billion prepackaged software sales in 2022 in Colorado, up from the \$5.10 billion posted for 2017. Based on that data, it is estimated that there will be \$16.44 billion in Colorado software sales in FY 2026-27, and \$17.67 billion in FY 2027-28, with increasing amounts in future years. The fiscal note assumes that 90 percent of software is downloadable. Since businesses are assumed to account for a significant portion of software sales and software companies likely negotiate contracts with businesses, it is assumed that 20 percent of total downloadable software sales arise from nonnegotiable agreements and would become subject to state sales tax. Because of data constraints, this fiscal note contains high, bidirectional uncertainty. Different estimation methodologies and assumptions produce significantly different estimates. To the extent that more or less software sales are downloadable and nonnegotiable than assumed in the fiscal note, actual revenue increases will respectively be higher or lower than the fiscal note estimate.

## State Revenue

Because the bill requires total funding availability for the tax credit to depend on projected sales and use tax revenue attributable to the sales tax expenditure modifications under this bill, the bill is estimated to have a net \$0 impact on state revenue. Table 2 below presents the state revenue impact by fund.

**Table 2**  
**State Revenue Impact by Fund**

| <b>Fund</b>                                      | <b>FY 2026-27</b> | <b>FY 2027-28</b> |
|--|-------------------|-------------------|
| General Fund Increase from Downloadable Software | \$44.4 million    | \$92.2 million    |
| General Fund Decrease from Restaurant Energy     | -\$0.8 million    | -\$1.7 million    |
| General Fund Decrease from Monthly Deductions    | \$0               | -\$13.3 million   |
| General Fund Decrease from EFAC                  | -\$43.6 million   | -\$77.2 million   |
| Net Change to General Fund                       | Minimal           | \$0.2 million     |
| Net Change to Housing Development Grant Fund     | Minimal           | -\$0.2 million    |
| <b>Net Revenue Change</b>                        | <b>\$0</b>        | <b>\$0</b>        |

### Downloadable Software Sales Tax Exemption

The narrowing of the software sales and use tax exemption combined with the decrease in percent of sales tax revenue allocated to the HDGF is expected to increase General Fund revenue subject to TABOR by \$44.4 million in FY 2026-27 (half-year impact), and \$92.2 million in FY 2027-28 with increasing amounts in future years.

### Retail Food Establishment Sales Tax Deduction for Gas and Electricity

The expansion of the retail food establishment sales tax deduction for gas and electricity is expected to reduce sales and use tax revenue by \$0.8 million in FY 2026-27, and \$1.7 million in FY 2027-28, with similar amounts in future years.

Deductions for calendar year 2026 are claimed on January 2027 sales tax returns, such that expanding the deduction beginning July 1, 2026 results in a half-year impact for FY 2026-27. Deduction claims totaled \$1.4 million in 2021, when 55 percent of energy costs could be deducted from net taxable sales, and are estimated to grow based on inflation in electricity prices and the expansion to 100 percent of energy costs.

### **Special State Sales Tax Deduction**

The special state sales tax deduction for certain food and drink retailers is expected to reduce sales and use tax revenue by \$13.3 million in FY 2027-28 and \$13.4 million in FY 2028-29 only.

Based on the number of retailers that claimed other temporary versions of the state sales tax deduction authorized by [House Bill 20B-1004](#), [House Bill 21-1265](#), and [HB 22-1406](#), the deduction is expected to be claimed by about 8,200 establishments for each month allowed. Under similar temporary deductions, the maximum deduction allowed was \$75,000 per site and deductions per site averaged just over \$51,000 per month. Therefore, the fiscal note assumes establishments will claim the maximum \$14,000 deduction allowed under the bill.

### **Housing Development Grant Fund Allocations**

While sales tax revenue is distributed to the General Fund and the HDGF, the increase in HDGF revenue as a result of the sales tax expenditure changes is expected to be mostly offset by the decrease in HDGF revenue from decreasing the percent of sales tax revenue allocated to the HDGF from 1.655 to 1.625. This results in minimal change to expected sales tax revenue allocated to the HDGF in FY 2026-27, and a \$0.2 million decrease in sales tax revenue allocated to the HDGF in FY 2027-28.

### **Expanded Family Affordability Credit**

The EFAC will decrease General Fund revenue subject to TABOR by \$43.6 million in FY 2026-27, and \$77.2 million in FY 2027-28, with increasing amounts in future years.

### **State Expenditures**

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The bill increases state expenditures in the Department of Revenue by \$48,326 in FY 2026-27 and \$263,646 including 2.7 FTE in FY 2027-28, and \$106,968 including 1.2 FTE per year from FY 2028-29 through FY 2030-31. These costs, paid from the General Fund, are summarized in Table 3 and discussed below. The bill also minimally affects workload in the Legislative Department.

**Table 3  
 State Expenditures  
 Department of Revenue**

| <b>Cost Component</b>            | <b>Budget Year<br/>FY 2026-27</b> | <b>Out Year<br/>FY 2027-28</b> | <b>Out Year<br/>FY 2028-29</b> |
|----------------------------------|-----------------------------------|--------------------------------|--------------------------------|
| Personal Services                | \$0                               | \$167,757                      | \$70,055                       |
| Operating Expenses               | \$0                               | \$3,456                        | \$1,536                        |
| Capital Outlay Costs             | \$0                               | \$14,000                       | \$0                            |
| Software Programming and Testing | \$39,548                          | \$0                            | \$0                            |
| Data Analysis and Reporting      | \$8,778                           | \$8,702                        | \$8,702                        |
| Postage and Form Changes         | \$0                               | \$14,977                       | \$2,759                        |
| Centrally Appropriated Costs     | \$0                               | \$54,754                       | \$23,916                       |
| <b>Total Costs</b>               | <b>\$48,326</b>                   | <b>\$263,646</b>               | <b>\$106,968</b>               |
| <b>Total FTE</b>                 | <b>0.0 FTE</b>                    | <b>2.7 FTE</b>                 | <b>1.2 FTE</b>                 |

**Department of Revenue**

To implement the requirements in the bill, the department will require one-time programming costs in FY 2026-27, ongoing reporting costs beginning in FY 2026-27, and additional staff beginning in FY 2027-28 through FY 2030-31.

**Staff**

The sales tax deduction for specific months for certain food and beverage retailers will require temporary staff to manage taxpayer protests and disputes, process the sales tax remittance claims, conduct audits, and manage increased call center volume. For FY 2026-27 only, staff include tax examiners (2.6 FTE) and a tax conferee (0.1 FTE). For FY 2027-28 through FY 2030-31, staff include tax examiners (1.2 FTE). Workload is expected to be frontloaded as the department supports taxpayer compliance with the new deduction, and are based on an estimated 8,200 retailers per applicable month claiming the deduction.

**Software Programming and Testing**

This bill increases expenditures to program, test, and update database fields in DOR's GenTax software system. Programming costs represent 100 hours of contract programming in FY 2026-27 at a rate of \$244.19 per hour. Costs for testing at the department are estimated to require 246 hours of innovation, strategy, and delivery programming support in FY 2026-27 at a rate of \$41 per hour, and 123 hours of user acceptance testing in FY 2026-27 at a rate of \$41 per hour.

### Data Analysis and Reporting

Expenditures in the Office of Research and Analysis are required for changes in the related GenTax reports so that the department can access and document tax statistics related to the EFAC. These costs represent 231 hours in FY 2027-28 and 229 hours in FY 2028-29 and future years for data management and reporting at \$38 per hour.

### Postage and Form Changes

The DOR will have additional costs for postage to administer the special state sales tax deduction, and must make changes to tax forms to include the deduction and EFAC. Postage costs are estimated at \$5,404 in FY 2027-28 and \$2,759 in FY 2028-29 through FY 2030-31. Form changes require the purchase of services from the Department of Personnel and Administration (DPA), estimated at \$9,573 in FY 2026-27.

### Centrally Appropriated Costs

Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. These costs, which may include employee insurance, supplemental employee retirement payments, indirect cost assessments, and other costs, are shown in Table 3 above.

### Legislative Department

The bill requires the Legislative Council Staff to make determinations related to the revenue impacts of this bill. This work will be accomplished within existing appropriations.

### TABOR Refunds

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While the bill impacts state revenue streams subject to TABOR, the net revenue impact to the state is \$0. As a result, the bill has no impact to the state's TABOR refund obligation.

### Local Government

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The bill will increase sales and use tax revenue for the state-collected local governments that incorporate the software exemption and conform to the state tax base through voter approval during a local election.

## Effective Date

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The bill takes effect upon signature of the Governor, or upon becoming law without his signature. The modification of the downloadable software sales and use tax exemption is effective January 1, 2027. The EFAC in this bill takes effect only if neither [House Bill 26-1221](#) nor [House Bill 26-1222](#) becomes law; otherwise, the EFAC in this bill will be aggregated with the EFAC enacted in one of those bills.

## State Appropriations

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For FY 2026-27, the bill requires a General Fund appropriation of \$48,326 to the Department of Revenue.

## State and Local Government Contacts

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|----------------------------------|------------------------------|
| Counties                         | Revenue                      |
| Local Affairs                    | Special District Association |
| Municipalities                   | State Auditor                |
| Regional Transportation District | Personnel                    |

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The revenue and expenditure impacts in this fiscal note represent changes from current law under the bill for each fiscal year. For additional information about fiscal notes, please visit the [General Assembly website](#).