Office of the State Auditor

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MEMORANDUM

Date: July 16, 2019

To: Tax Expenditure Evaluation Interim Study Committee

From: Colorado Office of the State Auditor

Re: Summary of tax expenditure evaluation policy considerations

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This memo is to provide a summary of the tax expenditure evaluation policy considerations included in the Office of the State Auditor's *2018 Tax Expenditures Compilation Report* and the tax expenditure evaluations issued January, April, and July 2019. The policy considerations have been grouped into the following four categories, based on the nature of the issues raised: (1) Repeal; (2) Clarify Statute; (3) Effectiveness; and (4) Administration.

TAX EXPENDITURE EVALUATIONS
POLICY CONSIDERATIONS INVOLVING:
REPEAL

CROP HAIL INSURANCE PREMIUM TAX EXEMPTION
[SECTION 10-3-209, C.R.S.]

ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No, because it is not being used
SUMMARY	This expenditure exempts a portion of the premiums received on crop hail insurance sold by small-scale, member-owned insurers known as "mutual protective associations" from the premium tax.

POLICY CONSIDERATIONS

(1) The General Assembly could consider either repealing the Crop Hail Exemption or expanding the eligibility requirements for the exemption. Since there are currently no taxpayers who qualify for the exemption and the original purpose of the exemption may be fulfilled by other insurance products, the General Assembly may wish to consider repealing the Crop Hail Exemption.

(2) Alternatively, if the General Assembly would like to make the exemption available to more taxpayers to help reduce the cost of crop hail insurance in the state, it could change the eligibility requirements to include a broader range of beneficiaries, so that the exemption could be used to lower the overall cost of crop hail insurance. Despite the availability of crop hail insurance, Colorado farmers continue to pay significantly higher premium rates than farmers in most other states due to the higher risk of hail damage in Colorado compared to other states, which may reduce the number of insured farmers.

OCCASIONAL SALE OF LIQUOR BY PUBLIC AUCTION EXEMPTION
[SECTION 44-3-106(3)(a), C.R.S.]

ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No
SUMMARY	This expenditure establishes an excise tax exemption for liquor, including beer, wine, and spirits, sold through a public auction that came into the seller's possession under one of the following circumstances: (1) the seller possesses the liquor and the owner has failed to claim the liquor or furnish instructions for its disposition; (2) the seller obtains the liquor as part of the foreclosure of a lien; (3) the liquor has been salvaged or damaged in transit; or (4) the seller operates a charitable organization and receives the liquor as a donation.

POLICY CONSIDERATION

The General Assembly could consider repealing this exemption since it does not appear that taxpayers are using it. However, if applicable sales occur in the future, the exemption may ease the administrative burden on buyers and sellers as intended.

TAX EXPENDITURE EVALUATIONS
POLICY CONSIDERATIONS INVOLVING:
REPEAL

SALES TO RESIDENTS OF BORDERING STATES EXEMPTION
[SECTION 39-26-704(2), C.R.S.]

ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No, because it likely cannot be used
SUMMARY:	This expenditure creates a sales tax exemption at the time of sale for residents of adjoining states that do not impose a retail sales tax.

POLICY CONSIDERATIONS

(1) The General Assembly could consider repealing or amending this exemption since its original purpose no longer applies and statute is unclear regarding whether residents of states that impose taxes that are similar to sales taxes may qualify. Specifically, Wyoming, Nebraska, Kansas, Oklahoma and Utah all currently levy a state retail sales tax that is higher than Colorado's 2.9 percent rate. In addition, Arizona levies a transactional privilege tax on retail sales transactions and New Mexico levies a gross receipts tax. Although the taxes in Arizona and New Mexico are not technically "sales taxes" because the seller, instead of the buyer, is responsible for paying the tax, in practice they operate similarly to a sales tax because sellers typically pass these costs on to buyers and in either case, sellers are typically responsible for remitting the tax to the state. The rates of both of these taxes in Arizona and New Mexico are higher than Colorado's sales tax rate. Therefore, Colorado's sales tax no longer creates a disincentive for any bordering states' residents to make purchases in Colorado. Further, it appears unlikely that any of the states bordering Colorado would choose to abolish their sales tax. Specifically, according to the U.S. Census Bureau's 2014 State Government Tax Collections Summary, which is the most recent year available, sales tax collections, on average, comprise approximately a third of all states' revenue, and specifically sales tax revenue for bordering states ranges from $800 million in Wyoming to $3 billion in Kansas. Compensating for this loss in revenue would be difficult for most states. Furthermore, no state has repealed a retail sales tax (or equivalent tax) once it has been imposed. Therefore, the General Assembly may wish to repeal this expenditure.

(2) Alternatively, if the General Assembly does not choose to repeal this expenditure, it may wish to amend statute to clarify which types of taxes in other states would disqualify their residents from the exemption. Specifically, statute [Section 39-26-704(2), C.R.S.] allows residents of states without a "retail sales tax" to qualify and does not indicate whether this term is intended to include similar taxes, such as Arizona's transactional privilege tax or New Mexico's gross receipts tax. Although it does not appear that, in practice, Colorado retailers are applying the exemption, the statutory language could create confusion for retailers if residents of other states attempt to claim the exemption.

PRE-1987 NET OPERATING LOSS DEDUCTION FOR INDIVIDUALS, ESTATES, AND TRUSTS
[SECTION 39-22-104(4)(d), C.R.S.]

ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No, because it cannot be used
SUMMARY:	This expenditure allows individuals, estates, and trusts to deduct Colorado net operating losses carried forward from tax years beginning prior to January 1, 1987 when computing their Colorado taxable income.

POLICY CONSIDERATION

The General Assembly may want to consider repealing the Pre-1987 Net Operating Loss Deduction since it does not have current or future applicability.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: REPEAL	
PREVIOUSLY TAXED INCOME OR GAIN DEDUCTION FOR C-CORPORATIONS [SECTION 39-22-304(3)(e), C.R.S.]	
ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No, because it is likely not being used
SUMMARY:	This expenditure allows C-corporations to deduct from their federal taxable income any income or gain that was taxed previously by Colorado prior to 1965, to the extent that it is included in the C-corporation's current federal taxable income.
POLICY CONSIDERATION	
The General Assembly may want to consider repealing the Previously Taxed Income or Gain Deduction for C-Corporations since it does not appear likely to have current or future applicability.	

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
FARM CLOSE-OUT SALES TAX EXEMPTION [SECTION 39-26-716(4)(a), C.R.S.]	
ESTIMATED REVENUE IMPACT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure exempts sales of property used for farming or ranching by Colorado agricultural producers who are abandoning operations and holding a farm close-out sale, either by auction or private sale, from state sales tax and some local sales taxes.
POLICY CONSIDERATION	

Because the Farm Close-Out Sales Tax Exemption's exemption of on-road motor vehicles from state and local sales tax is inconsistent with the State's treatment of most other motor vehicle purchases, the General Assembly may wish to review this aspect of the expenditure. Although the language of the exemption does not specifically list motor vehicles as an item exempted from sales tax, it defines the items that can be exempted as "all tangible personal property of a farmer or rancher previously used by him in carrying on his farming or ranching operations." Therefore, if an on-road motor vehicle was used for farming and ranching operations, its sale falls within the exemption.

However, in 1999 when the General Assembly enacted the Farm Equipment Sales Exemption [Section 39-26-716(2)(b), C.R.S.], which is also intended to reduce the sales tax liabilities of farmers and ranchers, it specifically included on-road motor vehicles (i.e., those subject to the State's vehicle registration requirements) "regardless of the purpose for which such vehicles are used" in a list of items that do not qualify as "Farm Equipment" for the purposes of qualifying for the exemption [Section 39-26-716(1)(d), C.R.S.]. Because it is not clear whether the General Assembly intended to include on-road motor vehicles within the items exempted from sales tax when the Farm Close-Out Sales Tax Exemption was enacted in 1945, it may wish to review and, if necessary, amend the language of the exemption to reflect its tax policy preferences. Although we could not quantify the potential revenue impact of this aspect of the exemption during this review, the Department of Revenue reported that in Calendar Year 2018 it plans to begin tracking data related to taxpayers who purchased used vehicles at farm close-out sales who claimed the exemption, so in the future there may be better data regarding the potential revenue impact to the State.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
LONG-TERM LODGING EXEMPTION [SECTION 39-26-704(3), C.R.S.]	
ESTIMATED REVENUE IMPACT	$12.3 million (CALENDAR YEAR 2017)
IS IT MEETING ITS PURPOSE?	Yes, but it may not be applied consistently
SUMMARY:	This expenditure exempts sales of lodgings for stays of 30 consecutive days or more from sales tax.
POLICY CONSIDERATIONS	

(1) The General Assembly could consider clarifying whether the exemption should be available to third-party payers. Statute specifies that the Long-Term Lodging Exemption is for sales that are made "to any occupant who is a permanent resident" of the lodgings [Section 39-26-704(3), C.R.S.]. Statute does not indicate whether this should apply to third-party payer situations, such as when a business pays for a room that is occupied by multiple employees over the length of stay. However, the current Department of Revenue policy is to allow the exemption under such circumstances so long as the lodgings are paid for by the same payer for at least 30 consecutive days, regardless of whether the lodgings are actually occupied by the same person for that length of time. The Department of Revenue's policy likely decreases the administrative burden on lodging providers and taxpayers, but also allows for a broader application of the exemption than may have been intended and likely increases its revenue impact.

(2) The General Assembly could consider clarifying whether home-shares and similar forms of lodging should qualify for the exemption. With the expansion of the home sharing industry, non-traditional temporary lodging options are growing. Although we found that, in practice, some home-share sales are being exempted from sales tax under the Long-Term Lodging Exemption, statute [Section 39-26-704(3), C.R.S.] does not specifically list "home-shares" or "private homes" as an exempted category of lodgings. Such sales could be interpreted as falling under categories that are listed, such as "guesthouse" or "lodging house," though it may not be clear to some taxpayers how to interpret these terms.

More broadly, while Airbnb collects Colorado sales tax on behalf of home-share hosts, hosts operating through other platforms may not be clear about whether or not they are liable for sales tax for any sales, even those under 30 days. Specifically, statute [Section 39-26-102(11), C.R.S.] does not include accommodation sales of "home-shares" or "private homes" in the list of lodging types which are subject to sales tax. Similar to the language in the Long-Term Lodging Exemption, "guesthouse" and "lodging house" are included as applicable lodging types and could be interpreted as including such sales; however, the General Assembly could consider clarifying the types of lodging sales that are subject to sales tax.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
NEWSPAPERS EXEMPTION [SECTION 39-26-102(15), C.R.S.]	
ESTIMATED REVENUE IMPACT	$2.7 million (CALENDAR YEAR 2017)
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure excludes the sale of newspapers from state sales and use tax.
POLICY CONSIDERATION	

The General Assembly could consider clarifying the definition of "newspapers" included in the Newspapers Exemption. Statute [Section 39-26-102(15), C.R.S.] provides that the exemption applies to all "legal newspapers as defined by Section 24-70-102, C.R.S." However, Section 24-70-102, C.R.S., does not explicitly define the term "newspaper," and instead defines the frequency of newspaper publication (e.g., "daily," "weekly") and the requirements for newspapers to serve as a "legal publication." In addition, the newspaper industry has changed substantially in recent years due to the newspaper format evolving to allow distribution to tablets, smartphone applications, PDF replicas and restricted websites, and the growth of digital only news platforms that may meet the definition of newspaper. Further, beginning in 2015, all legal notices required to be published in a newspaper are also required to be published on a statewide website dedicated to public notices that is maintained by a majority of Colorado newspapers. However, statute does not directly state that digital newspapers or other electronic news sources are also exempt from sales and use tax. Although in private letter rulings the Department of Revenue has considered digital newspapers to be included in the Newspapers Exemption, such rulings only apply to the specific taxpayer who requested them, and do not provide guidance on how the Department of Revenue would apply the law to the broader range of publications that could be considered newspapers. It is also unclear whether the federal Internet Tax Freedom Act [47 USC 151 note] would allow the State to tax digital newspapers at a higher rate than hardcopy newspapers. Clarifying the definition could help the newspaper industry better understand whether it needs to collect sales tax.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
BIOGAS PRODUCTION COMPONENTS SALES TAX EXEMPTION [SECTION 39-26-724(1)(c), C.R.S.]	
ESTIMATED REVENUE IMPACT	$1.2 to $2.2 million (BETWEEN MAY 2014 AND JULY 2018)
IS IT MEETING ITS PURPOSE?	Yes, but only to a limited extent
SUMMARY:	This expenditure exempts the sale, storage, and use of components used in biogas production systems from state sales and use tax.
POLICY CONSIDERATIONS	

(1) It is unclear whether on site electricity production from biogas is covered by another tax expenditure, the Alternating Current Exemption authorized in Section 39-26-724(1)(a), C.R.S., which provides that components used in the production of alternating current electricity from a renewable energy source are exempt from sales tax. The General Assembly could consider clarifying whether biogas production systems that are used to produce alternating current electricity, either entirely or partially, are exempt from sales or use tax under the Alternating Current Exemption.

(2) Alternatively, the General Assembly could consider expanding the Biogas Exemption to include electricity and heat produced and consumed on site. Statute [Section 39-26-724(1)(c)(I), C.R.S.] designates three permissible uses for biogas that is produced in order for the biogas production components to be exempt from sales tax: (1) for sale to a power generator, (2) used as a transportation fuel, and (3) turned into renewable natural gas. This list does not include heat and electricity produced on site. However, interviews with stakeholders, as well as additional research into uses of biogas, indicated that on site heat and electricity production is also a common usage of biogas. Therefore, the General Assembly could consider expanding the eligibility requirements for the Biogas Exemption to include biogas systems that are used to generate heat or electricity on site. If implemented, this change would potentially increase the revenue impact of the exemption and may incentivize smaller scale production facilities than what may have been originally intended.

NOTE: This tax expenditure expired as of July 1, 2019.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
AGRICULTURAL INPUTS SALES TAX EXEMPTIONS [SECTIONS 39-26-716(3)(a) AND (4)(a) - (C), 39-26-7-102(9)(a) AND (19)(c) – (d), AND 39-26-104(1)(a), C.R.S.]	
ESTIMATED REVENUE IMPACT	$231.2 million (CALENDAR YEAR 2017 COMBINED)
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure exempts sales of livestock (including poultry), livestock feed, seeds, orchard trees, livestock bedding, pesticides, agricultural compounds, and fish for stocking lakes and ponds from sales and use tax when made by agricultural producers.
POLICY CONSIDERATION	

The General Assembly may want to review and clarify statutes specifying which agricultural inputs are exempt. Specifically, based on our review of statute, we identified several types of inputs that are similar to those that are currently exempted from sales tax by the Agricultural Inputs Exemptions, but for which statute does not clearly state an exemption.

- Fertilizer. Although Section 39-26-102(19)(c) C.R.S., specifies that sales of "agricultural compounds" are wholesale sales, which are not subject to sales and use tax, it does not specifically list fertilizers among a list of items included under the definition of agricultural compounds. Until 2014, Department of Revenue regulations and taxpayer guidance treated fertilizer used for agricultural purposes as exempt and 89 percent of respondents to our 2017-2018 survey of Colorado agricultural producers indicated that they typically do not pay sales tax on fertilizer purchases. However, the Department removed its rules concerning the sales tax treatment of fertilizer in 2014 and as of January 2019, the Department no longer provided taxpayer guidance on applying the Agricultural Compounds and Pesticides Exemption. Thus, it may no longer be clear to taxpayers whether fertilizers are intended to be exempt from sales and use tax and the General Assembly may want to amend statute to clarify this. NOTE: This issue was addressed in House Bill 19-1329.
- Soil conditioners, plant amendments, plant growth regulators, mulches, compost, and manure. These are all commonly-used inputs into farming operations to improve the physical or chemical condition of the soil, preserve or facilitate seed/plant growth, or improve root development and other desirable plant characteristics. Though they appear to have a similar purpose as many agricultural inputs that fall within the Agricultural Inputs Exemptions, they are not included within the definition of any of the covered items and are therefore, not exempt from sales tax. Our review of exemptions in the seven states bordering Colorado, indicates that three directly exempt one or more of these types of inputs from sales or gross receipts tax.
- Aquaculture. Although the Department of Revenue has not issued official guidance, staff told us that their understanding was that the Agricultural Inputs Exemptions for livestock, livestock feed, and agricultural compounds and pesticides (Section 39-26-716(4)(a), C.R.S.) do not apply to sales of fish for non-stocking purposes (as opposed to fish sold for stocking purposes, which are explicitly exempted), since these fish are not explicitly defined as "livestock." However, aquaculture stakeholders that we interviewed indicated that statute could be interpreted to include fish within the statutory definition of livestock, which is defined as "cattle, horses, mules, burros, sheep, lambs, poultry, swine, ostrich, llama, alpaca, and goats, regardless of use, and any other animal which is raised primarily for food, fiber, or hide production" [Section 39-26-102(5.5) C.R.S]. Therefore, the General Assembly may want to clarify whether sales of fish, other than those used for stocking purposes, should be included within the exemption.
- Embryos/fish eggs. Livestock owners looking to pass on the genetics of an animal or grow their livestock numbers may use artificial insemination instead of natural mating. With artificial insemination, livestock owners have the option of conducting embryo transfers, in which semen is artificially inseminated into the ovulating female animal whose genetic stock is desired, then the embryos are flushed out and inserted into surrogate females. Sales of the semen are exempt from sales and use tax under Section 39-26-102(19)(c), C.R.S, but it is not clear if embryo sales are also exempt. Similarly, many aquaculture producers typically purchase fertilized fish eggs as opposed to live fish to use in their operations and it is not clear whether such purchases should be treated as exempt from sales tax.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
EMPLOYEE RETIREMENT PLAN INSURANCE PREMIUM TAX DEDUCTION [SECTION 10-3-209(1)(d)(IV), C.R.S.]	
ESTIMATED REVENUE IMPACT	$186,000 (TAX YEAR 2018)
IS IT MEETING ITS PURPOSE?	Yes, but only to a small extent
SUMMARY:	This expenditure allows insurers to deduct from their taxable premiums any premiums collected after 1968 for policies issued on pensions, profit-sharing, or annuity plans taken out by employers for their employees, if contributions to such plans are deductible from those employers' net income.
POLICY CONSIDERATIONS	

(1) The General Assembly may want to clarify whether premiums from retirement-related insurance policies purchased by partnerships, Limited Liability Companies (LLCs), S-corporations, and other pass-through entities should be included in the Employee Retirement Plan Deduction. According to statute [Section 10-3-209(1)(d)(IV), C.R.S.], to be eligible for the deduction, the premiums must be connected to a retirement plan "established by an employer for employees" and the employer's contributions to the plan must be "deductible by such employer in determining such employer's net income as defined in [S]ection 39-22-304, C.R.S." However, Section 39-22-304, C.R.S., only defines what expenses are deductible from the income of C-corporations and therefore, according to Division of Insurance staff, only premiums for policies and contracts purchased by C-corporations are eligible for the deduction. The Division of Insurance has not established any guidance for insurance companies regarding this requirement and we were unable to determine how insurance companies have interpreted and applied the requirement in practice.

Based on our review of legislative history, it is unclear if the General Assembly intended to limit the deduction to premiums received from C-corporations and exclude the premiums received from partnerships, limited liability companies, or S-corporations. These types of businesses, which are known as "pass-through entities," allow owners to pass income and losses from the business through to their individual tax returns. According to our review of U.S. Census Bureau data, in Calendar Year 2016, 51 percent of Colorado's private sector workforce was employed by a pass-through business. None of the 15 states and the District of Columbia with tax expenditures similar to the deduction appear to limit theirs to C-corporations. If pass-through business entities are included in the deduction, it could increase the revenue impact to the State, although we lacked data to estimate this impact.

(2) The General Assembly may want to consider if insurance premiums issued in connection with other types of employee retirement plans should also be eligible for the Employee Retirement Plan Deduction. When the deduction was created in 1969, most defined contribution retirement plans that are in use today were not yet allowed by the federal tax code. Today, employees often have access to a range of defined contribution retirement plans, such as 401(k) plans, 457 plans for employees of states and local governments, and IRAs. According to the Center for Retirement Research at Boston College, these plans were initially viewed mainly as supplements to employer-funded pension and profit-sharing plans, but are now the primary retirement plan for most employees. Life insurance premiums connected to these plans are typically not eligible for the deduction, which limits eligibility to "pension, profit sharing, or annuity plan[s]." Based on the changes to the retirement plans employers typically offer, the General Assembly may want to consider whether this limitation is consistent with the deduction's purpose. Of the 15 other states and the District of Columbia with tax expenditures similar to the deduction, 14 explicitly allow life insurance products connected to one or more defined contribution plans to also qualify, and one—Nebraska—explicitly allows insurance-related to IRAs to qualify. Making premiums connected to other types of retirement plans eligible for the deduction would likely increase the revenue impact to the State. Although we lacked data to estimate this cost, the impact would be limited to premium taxes collected on insurance policies issued in connection with these plans. For example, if an employer offered life insurance in connection with a 401(k) plan, the premiums for the life insurance could be covered by the deduction and reduce the revenue the State would collect. The amounts the employer contributed to the 401(k) are not insurance and therefore, would not be eligible for the deduction or subject to the insurance premium tax.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
EXCISE TAX CREDIT FOR UNSALABLE ALCOHOLIC BEVERAGES [SECTION 44-3-503(9), C.R.S.]	
ESTIMATED REVENUE IMPACT	$153,000 (CALENDAR YEAR 2017)
IS IT MEETING ITS PURPOSE?	Yes, but it appears to be underutilized
SUMMARY:	This expenditure allows manufacturers and distributors of alcohol that have already paid state excise taxes on alcoholic beverages to receive a credit for the amount of the tax paid attributable to the alcoholic beverages that later become unfit for sale due to damage or destruction.
POLICY CONSIDERATION	

The General Assembly may want to consider amending statute to clarify whether it intended to allow taxpayers to take the credit for alcoholic beverages rendered unsalable due to spoilage. According to statute [Section 44-3-503(9), C.R.S.], the credit applies to alcoholic beverages "rendered unsalable by reason of destruction or damage." However, the terms "destruction" and "damage" are not further defined. Therefore, it is unclear whether the General Assembly intended to include spoiled alcoholic beverages within the meaning of these terms. The Department of Revenue has interpreted statute to disallow taxpayers from claiming the credit for beverages that cannot be sold due to spoilage and has issued clear guidance to taxpayers indicating that they should not claim the credit under these circumstances. However, an industry stakeholder reported that some taxpayers may not make a distinction between different types of losses when claiming the credit and may include losses due to spoilage in the amount they claim. Sixteen of the 20 states (excluding Colorado) and District of Columbia with a similar tax expenditure, include losses for spoilage as eligible for the credit.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: CLARIFY STATUTE	
COLORADO NET OPERATING LOSS DEDUCTION FOR C-CORPORATIONS [SECTION 39-22-304(3)(g), C.R.S.]	
ESTIMATED REVENUE IMPACT	Between $154.8 and $308.2 million (TAX YEAR 2015)
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure allows C-corporations to deduct net operating losses from prior tax years from their Colorado taxable income.
POLICY CONSIDERATIONS	

(1) The General Assembly may want to consider clarifying whether the annual federal net operating loss deduction cap applies in Colorado. Statute [Section 39-22-504(1), C.R.S.] provides, "A net operating loss deduction shall be allowed in the same manner that it is allowed under the internal revenue code except as otherwise provided in this section." However, this statutory language was established prior to the federal 2017 Tax Cuts and Jobs Act, which placed a cap on federal net operating loss deductions at then lesser of the taxpayers aggregate net operating loss carryforward and carrybacks for the year or 80 percent of taxpayers' federal taxable income before the federal net operating loss deduction. For example, a corporation with $200,000 in net operating losses carried forward from prior years and $100,000 in federal taxable income during a tax year would only be able to claim an $80,000 net operating loss deduction (80 percent of its federal taxable income) for federal tax purposes that year, whereas prior to this change it could have claimed a $100,000 deduction (the full amount of its federal taxable income). It is unclear if this provision applies to the state because the federal net operating loss deduction is added back to federal taxable income for state tax purposes when applying the Corporate Net Operating Loss Deduction at the state level. The Department of Revenue has not issued any rules or guidance related to this issue, though its staff have indicated that they are reviewing it. At least one other state (Georgia) has added language to its statute to clarify that the federal 80 percent cap applies for state purposes.

(2) The General Assembly may want to consider whether the State should establish its own net operating loss carryforward period rather than conforming to the federal indefinite carryforward period. At the time the General Assembly established the Corporate Net Operating Loss Deduction, federal law limited the number of years a corporation could carry forward net operation losses. Thus, it is unclear whether the General Assembly intended to allow for indefinite carryforwards when it tied the State's maximum carryforward period to the federal carryforward period. Allowing net operating losses to be carried forward for extended periods, or indefinitely, may impact the State's ability to forecast its revenue and could potentially result in a larger cumulative revenue impact to the extent that some corporations had previously not been able to use all of their net operating losses before they expired. Colorado has historically deviated from one of the federal requirements when in 1983, the General Assembly eliminated the carryback provision. On the other hand, indefinite carryforward periods may help corporations that do not generate income for long periods of time by allowing them to retain their net operating loss deductions indefinitely. In addition, the State's conformance to federal law regarding the carryforward period could make it easier for corporations and the State to administer since doing so avoids the need to maintain a separate calculation for the carryforwards available for state and federal purposes.

(3) The General Assembly may want to consider repealing the provision that allows financial institutions to carry net operating losses forward for 15 years [section 39-22-504(4), C.R.S.]. Statute [Section 39-22-504(4), C.R.S.] provides, "If a financial institution suffers a net operating loss for any taxable year beginning on or after January 1, 1984, the amount of the unused net operating loss may be carried forward to each of the fifteen years following the taxable year of such loss." When this provision was enacted in 1987, for federal income tax purposes, federal law [26 USC 172(b)(1)(F)] provided that financial institutions were only allowed to carry losses forward for five years, as compared to 15 years for other corporations. Since for state tax purposes, statute [Section 39-22-504(3), C.R.S.] provided that "[n]et operating losses of corporations may be carried forward for the same number of years as allowed for a federal net operating loss," the General Assembly likely enacted Section 39-22-504(4), C.R.S. to allow financial institutions to be treated equally to other taxpayers. However, current federal law [26 USC 172] no longer provides different net operating loss carryback or carryforward periods for financial institutions for federal tax purposes.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
AGRICULTURAL LEASE DEDUCTION [SECTION 39-22-304(3)(o), C.R.S.]	
ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No, although it has only been available for 1 year
SUMMARY:	This expenditure allows taxpayers who lease their land or other agricultural assets to beginning farmers or ranchers to receive an income tax deduction equal to 20 percent of the resulting lease payments, up to a maximum of $25,000 per year, for a maximum of 3 years.
POLICY CONSIDERATIONS	

(1) The General Assembly may want to review the tax benefit provided by the Agricultural Lease Deduction to determine whether it provides a sufficient incentive to accomplish its purpose. Specifically, in the four other states with similar tax expenditures, the expenditures were structured to provide a more significant benefit for taxpayers. For example, the four other states have offered similar provisions as tax credits, which provide a direct reduction in income tax liability, as opposed to deductions, which instead reduce taxable income. In addition, they have offered higher caps on the amount each taxpayer can claim, which can also make these provisions more attractive to taxpayers. All four other states have also allowed taxpayers to either carry-forward (i.e., apply the tax benefit to later tax years) or obtain monetary refunds for the expenditures, which provides taxpayers with more flexibility to maximize the benefit they receive.

In at least three of the four states where these provisions are included, it appears that more taxpayers have taken advantage of these expenditures, which has also substantially increased the state revenue impact of the tax expenditures as compared to Colorado. For example, Iowa offers a similar tax expenditure structured as a tax credit that allows each taxpayer to claim up to $50,000 per year, provides for a 10-year carry-forward period, and until this year was capped at $12 million per year in total credits provided by the state. This provision has been widely used in Iowa and may have had some success in keeping program participants in farming and ranching, although it has come at a cost to the state. Specifically, a 2015 study of Iowa's credit program conducted by its Department of Revenue, indicated that new farmers who participated in the program tended to have more of their income come from on-farm revenues (as opposed to work off the farm) and persisted in farming at higher ratios over a 5-year period (95 percent for participants versus 82 percent for non-participants), which indicates that they may have become more established in farming than farmers who did not participate in the program. The report also notes that Iowa issued about $33.5 million in credits and the program had assisted 963 new farmers from 2007 through 2014.

(2) The applications of the statutory requirement that leaseholders submit their federal Schedule F Form in order to qualify for the Agricultural Lease Deduction may make it difficult for many agricultural producers to apply. Specifically, under Section 35-75-107(1)(u), C.R.S., leaseholders are required to submit a copy of their federal Schedule F form along with their application, although statute does not specify whether the form needs to be from the same tax year for which the deduction is claimed. For Calendar Year 2017, the Colorado Agricultural Development Authority required leaseholders to provide the Schedule F form from their 2017 federal tax return (filed in 2018) with the asset owner's application, which was the same year that taxpayers would have been claiming the deduction. This means that leaseholders would have had to file their federal (but not state) income taxes before they or the asset owner could file their application with the Authority, which was due March 31st, to qualify for the deduction. This may have limited the ability of those agricultural producers who normally file for extensions on their federal taxes to qualify, since they would not have completed their Schedule F prior to the March 31st application deadline. The requirement that leaseholders submit their Schedule F form appears to be intended to allow the Authority to verify that the leaseholders are agricultural producers and are not using the leased asset for other purposes. However, the General Assembly may wish to clarify how the Authority should verify that leaseholders are farmers or ranchers to allow more flexibility for farmers and ranchers who are interested in applying for the deduction. For example, the General Assembly could require that the Authority allow leaseholders to submit Schedule F forms from the year prior to the establishment of the lease or allow for alternative forms of documentation to show that they intend to use the leased asset for agricultural purposes. This would allow asset owners and leaseholders to submit applications before the March 31st deadline.

NOTE: This tax expenditure will expire on January 1, 2020.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
HUNGER RELIEF INCOME TAX CREDIT/CROP AND LIVESTOCK CONTRIBUTION CORPORATE INCOME TAX CREDIT [SECTIONS 39-22-536 AND 301(3), C.R.S.]	
ESTIMATED REVENUE IMPACT	Hunger Relief Credit—$71,000 (CALENDAR YEAR 2016) Crop and Livestock Corporate Credit – Minimal (CALENDAR YEARS 2012-2016)
ARE THEY MEETING THEIR PURPOSES?	Hunger Relief Credit—Yes, but the impact is relatively small Crop and Livestock Corporate Credit—No, because it has been used infrequently
SUMMARY:	The Hunger Relief Credit allows a farmer or rancher to claim an income tax credit equivalent to 25 percent of the value of food donations to hunger relief organizations, up to a maximum of $5,000 per year. The Crop and Livestock Corporate Credit allows agricultural C-corporations to claim an income tax credit of 25 percent of the value of food donations, up to a maximum of $1,000 per year.
POLICY CONSIDERATIONS	

(1) Some agricultural producers are unaware of the credits and how to take them. The food banks and the Colorado Farm Bureau both reported that some agricultural producers and the accounting firms they work with may not be aware of the credits and how to claim them. Furthermore, the food banks and Colorado Farm Bureau report that some farmers who have heard of the credit and do occasionally donate food do not know how to apply for the credits and they have a perception that it is "too much work" to do so, even though all that is required is weighing the donation (which food bank staff always do), estimating the donation's value, obtaining a signature from food bank staff, and submitting a form to the Department of Revenue when filing taxes. In addition, of the 28 agricultural producers that we surveyed who responded to the questions, 23 (82 percent) had not heard of the Hunger Relief Credit, and 24 (86 percent) had not heard of the Crop and Livestock Corporate Credit. Although greater public awareness of the credits may increase their impact, it could also lead to larger revenue impacts to the State.

(2) Many agricultural producers' state tax liabilities are too low to benefit from the Hunger Relief Credit. According to a 2015 study from the U.S. Department of Agriculture, 69 percent of all farms in the United States have operating profits that comprise less than 10 percent of their gross farm income, meaning that their federal and state tax liabilities may be low or negative. In addition, the Department of Revenue's most recent data shows that in Tax Year 2013, the average Colorado taxpayer who reported a profit or loss from agricultural operations on their tax return reported a loss of almost $4,600. Although agricultural profits and losses can vary from year-to-year, based on this data, it appears that many agricultural producers in the state may not have any taxable income. Because the Hunger Relief Credit is not refundable, meaning the State will not issue a refund check to the taxpayer if the credit exceeds their state tax liability, individuals only receive a financial benefit from the credit to the extent that they have tax liability to offset.

(3) Federal tax reform could shift the balance of agricultural producers who incorporate as C-corporations, which could impact their eligibility for both the Hunger Relief and Crop and Livestock Corporate Credit. Federal corporate tax rate changes, effective starting in Tax Year 2018, lower the top tax rate for corporations from 35 percent to 21 percent. This may provide an incentive for some agricultural producers who currently file as individuals to incorporate. Though the incentive to incorporate would still be stronger for larger-scale operations, these taxpayers would no longer be able to claim the Hunger Relief Credit and would become eligible for the Crop and Livestock Corporate Credit. This could cause the Crop and Livestock Corporate Credit to be used more often in the future, though these taxpayers would be subject its $1,000 cap.

(4) Some small agricultural producers may not qualify for the Hunger Relief Credit due to federal filing status. Section 39-22-536(1)(e), C.R.S., limits the pool of eligible taxpayers who could claim the hunger relief credit to those who have filed a Schedule F with their federal tax returns, which is required for taxpayers who posted a profit or loss from crop production, animal production, forestry, or logging. Though the intent of this requirement may be to limit the credit to taxpayers who are professional agricultural producers, it may reduce the population of potential beneficiaries. While the Department of Revenue does not have data on how many state taxpayers have filed a Schedule F, food bank staff reported that many small agricultural producers, some of whom donate food, choose not to file the form. None of the relevant statutes and guidance documents that we examined from the other 10 states with similar tax expenditures indicated that donors had to file a Schedule F in order to claim the expenditure.

NOTE: The Hunger Relief Credit is scheduled to expire January 1, 2020.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
SACRAMENTAL WINES EXCISE TAX EXEMPTION [SECTION 44-3-106(1), C.R.S.]	
ESTIMATED REVENUE IMPACT	$2,600 (CALENDAR YEAR 2017)
IS IT MEETING ITS PURPOSE?	Partially, because it is not applied to all sales
SUMMARY:	This expenditure excludes sacramental wines that are used for religious purposes from the liquor excise tax.
POLICY CONSIDERATION	

As currently applied, the Sacramental Wines Exemption may provide a small benefit to some religious organizations while excluding others based on how the wine is purchased. In addition, because the current exemption only applies to wine, it may treat religious organizations that use non-vinous sacramental liquors for ceremonies differently than those that use wine. Further, although the purpose of the exemption was likely to avoid taxing religious organizations, the statutory language does not limit the exemption to only sacramental wine purchased by religious organizations, and individuals who purchase wine for religious purposes, such as ceremonies conducted at home, may also pay the excise tax as part of the purchase price. Although we did not conduct a full legal analysis, this difference in treatment could be problematic under the U.S. and Colorado Constitutions, both of which prohibit the State from enacting laws that give preference to one religious denomination over another, and some U.S. Supreme Court rulings, which under some circumstances, have found that governments should not favor a religious purpose over a secular purpose. On the other hand, it is unclear whether taxpayers who do not benefit from the exemption are experiencing a sufficient burden (i.e., the additional cost of paying the excise tax) to result in a violation of the U.S. or Colorado Constitutions.

To address these issues, the General Assembly could consider amending the Sacramental Wines Exemption to accommodate the different distribution paths sacramental wines take to get to religious organizations and individuals who conduct religious ceremonies using wine. For example, one option could be to allow for rebates of liquor excise taxes paid on sales of sacramental wine made by liquor stores, as is done in several other states. However, because of the small benefit this would provide to consumers (about $.085 per bottle of wine), there may be few potential beneficiaries who would take advantage of a rebate and the cost of administering the rebate program would likely exceed the benefit. In addition, though the use of non-vinous liquors for religious purposes is uncommon, the General Assembly could also consider expanding the exemption to cover the sacramental use of all alcoholic beverages. Alternatively, the General Assembly could ensure equal treatment of all religious groups by eliminating the exemption altogether.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
FRATERNAL SOCIETY EXEMPTION [SECTION 10-3-209(1)(D)(I), C.R.S.]	
ESTIMATED REVENUE IMPACT	$3.8 million (CALENDAR YEAR 2017)
IS IT MEETING ITS PURPOSE?	Yes, but the insurance market has changed significantly since its enactment
SUMMARY:	The expenditure exempts fraternal benefit societies (fraternals), which are social groups organized around a common bond that offer insurance products to their members, from insurance premium tax.
POLICY CONSIDERATION	
The General Assembly may want to consider reviewing the Fraternal Society Exemption due to its age and the large changes in the role of fraternals in society and the insurance industry since it was created to assess whether the exemption continues to serve a valid purpose. As discussed, membership in fraternals has declined significantly and fraternals now provide a much smaller share of the insurance market than they once did during the late 1800's and early 1900's. In addition, there now exist private and public sector safety nets for workers, such as more affordable commercial insurance, employer-provided group insurance, worker's compensation insurance, Social Security, Medicaid, Medicare, and the Supplemental Nutrition Assistance Program that significantly reduce the demand for fraternal insurance. Furthermore, while some studies from the late 19th and early 20th centuries suggest that fraternals offered less expensive insurance at that time, a 1993 Treasury Department study, as well as information provided by industry stakeholders suggests that fraternal insurance policies may currently be priced on par with or be even more expensive than commercial policies. However, because fraternals continue to conduct social and charitable activities, and operate as non-profits, the original purpose of the exemption may still apply to the extent that it was intended to benefit fraternals due to these aspects of their operations.	
INSURANCE PREMIUM TAX EXPENDITURES [SECTION 39-22-112(1), C.R.S.]	
ESTIMATED REVENUE IMPACT	Insurance Premium Income Tax Exemption – $83.6 million (CALENDAR YEAR 2017) Reinsurance, Return Premium, and Early Termination Deductions - Could not determine
ARE THEY MEETING THEIR PURPOSES?	Yes
SUMMARY:	These expenditures essentially define insurers' state premium tax base.
POLICY CONSIDERATION	
The General Assembly may want to consider allowing insurers to deduct from their premium tax base the amount of any licenses, fees, or taxes they pay to local governments. A 1971 Colorado Supreme Court case ruled that the provisions of Section 10-3-209(1)(c), C.R.S., which prohibit Colorado municipalities and counties from levying a per-employee "occupational privilege tax" (sometimes called a "head tax") on insurers, was unconstitutional in relation to home rule jurisdictions seeking to raise revenue. Five Colorado home rule jurisdictions (Aurora, Denver, Glendale, Greenwood Village, and Sheridan) currently levy an occupational privilege tax each month on most businesses and employees, ranging from a total monthly tax of $4 per employee in Aurora and Greenwood Village to $10 in Glendale. Greenwood Village also requires businesses that are liable for the tax to pay a one-time licensing fee of $10. The General Assembly may want to consider allowing insurers to deduct these local taxes and fees when determining their premium tax liabilities, since they were not allowable at the time the expenditures were created. Five states offer a deduction or credit against some or all of these local taxes, licenses, and fees, while six other states expressly cap the amount of these obligations that local governments can impose on insurers. Allowing for such a deduction may also have the added effect of reducing any retaliatory taxes currently levied on Colorado-domiciled insurers, since many state insurance regulators take into account taxes levied by political subdivisions of other states in their own calculations of retaliatory taxes.	

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
CHILD CARE EXPENSE CREDIT [SECTION 39-22-119, C.R.S.]	
ESTIMATED REVENUE IMPACT	$2.73 million (TAX YEAR 2016)
IS IT MEETING ITS PURPOSE?	Yes, to a limited extent
SUMMARY:	This expenditure allows taxpayers with an annual income of up to $60,000 to receive a state income tax credit worth 50 percent of their federal Child and Dependent Care Tax Credit for child care expenses.
POLICY CONSIDERATION	

The General Assembly could consider decoupling the federal credit from the Child Care Credit to increase the stability of the credit and avoid the potential for disparities in the benefit available to eligible taxpayers. Currently, because the Child Care Credit is calculated based on the federal credit amount, changes to federal tax law and regulations can change the amount of Child Care Credit available to taxpayers, which may reduce its stability and effectiveness. Based on the current federal credit, the amount of Child Care Credit taxpayers receive changes whenever any of the following occur: (1) a change to the federal credit itself, (2) a change to the federal standard deduction or exemption amounts, or (3) a change to the federal tax rate or brackets. For example, the 2017 Federal Tax Cuts and Jobs Act substantially increased the standard deduction, eliminated the exemption for dependents, and changed tax rates across income levels, beginning in Tax Year 2018. Because the federal credit is limited to the amount of taxpayers' federal tax liability, these changes had an impact on the amount of the federal credit and subsequently, the amount of Child Care Credit taxpayers can claim. For example, including the changes from House Bill 18-1208, a married taxpayer filing a joint return, with one child and an adjusted gross income of $30,000 and child care expenses of $3,000 would have been able to claim a Child Care Credit of $258 for Tax Year 2019 without the changes to federal law, but will be able to claim a $280 credit in 2019 due to the changes. On the other hand, a taxpayer filing as a head of household, with one child, and an adjusted gross income of $20,000 and child care expenses of $3,000 will receive an $83 credit instead of a $128 credit without the change.

Additionally, directly tying the Child Care Credit to the federal credit can create unintended disparities in the amount of credits taxpayers receive. Because the federal credit is capped at taxpayers' federal tax liability, which can be substantially less than what taxpayers would otherwise be able to claim based on their actual child care expenses, taxpayers with low federal tax liability may also receive less in Child Care Credits. In addition to the potential for disparities across income levels, there are also potential disparities based on taxpayers' filing status (i.e., married filing jointly, single, head of household).

Although the General Assembly could address these issues by amending statutes to base the calculation of the Child Care Credit on child care expenses incurred, regardless of the federal credit available, this would potentially increase the burden on taxpayers filing for the credit, since they would have to perform a separate calculation in order to claim the Child Care Credit. In addition, decoupling the Child Care Credit from the federal credit could increase the revenue impact to the State, though we lacked sufficient data to quantify this potential impact. This change would also make the Low-Income Credit unnecessary since taxpayers would be able to take the Child Care Credit regardless of their federal tax liability.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
ON-DEMAND AIRCRAFT USED OUTSIDE STATE EXEMPTION [SECTION 39-26-711.8(1), C.R.S.]	
ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No, because it has not yet been used
SUMMARY:	This expenditure excludes aircraft typically used for non-scheduled, "on-demand" flights that are primarily outside of Colorado from state sales and use tax.
POLICY CONSIDERATION	

The General Assembly may want to evaluate the eligibility requirements of the On-Demand Aircraft Exemption to determine if they should be expanded to allow more purchasers to take the exemption. Based on our review of the legislative history of House Bill 14-1374 and our discussions with stakeholders, we identified only two companies in Colorado that might qualify for the exemption due to the eligibility requirements. Specifically, although there are about 38 on-demand air carriers based in Colorado, most of them would not qualify for the exemption because their aircraft either only operate in Colorado or if they operate outside the state, they still cannot meet the exemption's requirements limiting the amount of time the aircraft spend in the state.

Revising the exemption to include all aircraft purchased for use by on-demand air carriers, regardless of whether they are used within or outside Colorado, would increase the number of purchasers able to take the exemption. However, it could also lead to a larger revenue impact for the State and we did not evaluate the extent to which such a change would increase economic activity in the aviation industry. House Bill 18-1083, which passed the General Assembly during the 2018 Legislative Session would have made a similar change, but was vetoed by the Governor, who cited a lack of evidence that the bill would have increased aircraft purchases and additional aircraft storage in Colorado. This bill would have broadened the Commercial Airlines Sales and Use Tax Exemption [Section 39-26-711, C.R.S.] to include all aircraft purchased for use by on-demand air carriers, whether they are used within or outside of Colorado, and would have defined what constitutes an "on-demand air carrier." A Colorado Aviation Business Association study of the bill's impact estimated that Colorado on-demand operators would bring in about two additional aircraft per year because of the bill, and Legislative Council estimated its annual revenue impact at $90,000 to $224,000. However, we did not verify the extent to which additional aircraft would have been purchased or brought into the state under the bill.

NOTE: This tax expenditure expired as of July 1, 2019.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
HISTORIC PROPERTY PRESERVATION CREDIT [SECTION 39-22-514, C.R.S.]	
ESTIMATED REVENUE IMPACT	$727,029 (AVERAGE OF TAX YEARS 2013–2016)
IS IT MEETING ITS PURPOSE?	Yes, but to a limited extent
SUMMARY:	This expenditure provides an income tax credit for taxpayers who make rehabilitation expenditures on a historic property.
POLICY CONSIDERATION	

The General Assembly may want to consider harmonizing the historic property credit eligibility requirements with those provided under the 2014 Historic Structures Credit provided under Section 39-22-514.5, C.R.S. The Historic Property Credit has largely been overtaken by the newer 2014 Historic Structures Credit, which provides the same or a larger benefit for most taxpayers. However, some taxpayers may continue to claim the Historic Property Credit because it provides broader eligibility requirements in some areas. For example, in order for commercial properties to qualify for the 2014 Historic Structures Credit, a taxpayer must generally be the owner of the property or have a leasehold interest of 39 years or more, while the Historic Property Credit allows taxpayers to qualify if they have a lease of at least 5 years. Also, for the 2014 Historic Structures Credit, qualified rehabilitation expenditures for commercial properties must exceed $20,000 versus $5,000 for the Historic Property Credit. In addition, residential properties that are income producing or that are not owner-occupied are eligible for the Historic Property Credit, but not the 2014 Historic Structures Credit.

Because of these differences, if the Historic Property Credit is allowed to expire on January 1, 2020, as currently scheduled, some taxpayers who currently only qualify for a Historic Property Credit will not have any credit available. The General Assembly may want to review the purpose of the 2014 Historic Structures Credit to determine whether statute should be amended to allow these taxpayers who currently only qualify for the Historic Property Credit to be eligible for the 2014 Historic Structures Credit. On the other hand, if the General Assembly extends the Historic Property Credit prior to its expiration, it may want to review the benefits this credit provides or its eligibility requirements to determine whether they should be aligned with the 2014 Historic Structures Credit.

NOTE: This tax expenditure is scheduled to expire January 1, 2020.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
DEDUCTION FOR WAGES AND SALARIES DUE TO INTERNAL REVENUE CODE 280C [SECTIONS 39-22-304(3)(i), 322, AND 323, C.R.S.]	
ESTIMATED REVENUE IMPACT	Less than $51.4 million (TAX YEAR 2015)
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure allows C-corporations and individuals with income from S-corporations to modify their federal taxable income for purposes of determining state taxable income by deducting wage and salary expenses that are not deductible for federal tax purposes due to IRC 280C.
POLICY CONSIDERATIONS	

(1) The General Assembly may want to consider whether additional types of taxpayers should also be eligible for the IRC 280C Deduction. Specifically, other than individuals who receive income from an S-corporation, the deduction is not available to taxpayers who file as individuals and receive sole proprietorship, limited liability company, or partnership income even though they are eligible for the federal credits referenced in IRC 280C and are also subject to its limitations on deducting the expenses that are the basis for these credits from federal taxable income. As a result, these taxpayers are currently subject to a higher state tax liability than C-corporations and S-corporations relative to the deduction of the applicable expenses. However, this change would likely increase the state revenue impact of the deduction, although we lacked data to quantify this potential impact.

(2) The General Assembly may want to determine whether the IRC 280C Deduction should be restricted to wage and salary expenses and only amounts that are not deductible due to IRC 280C. In 1979, the year the deduction was created, IRC 280C only restricted taxpayers from deducting "wages or salaries paid or incurred" related to the applicable federal employment credits. Statute [Section 39-22-304(3)(i), C.R.S.] limits the deduction using this same language and ties it to IRC 280C. Therefore, it is unclear if the General Assembly specifically intended to limit the deduction to wages and salaries or included this limitation to conform the language of the deduction with the original language in IRC 280C. However, since that time, the U.S. Congress has expanded IRC 280C to disallow the deduction of all types of expenses (not just wages and salaries) related to several other federal credits. As a result, the IRC 280C Deduction no longer fully addresses taxpayers' increased state tax liability due to IRC 280C, which may mean that it is not fully addressing its original purpose. Of the 27 states with similar deductions, we found that 11 allow taxpayers to deduct all expenses that are disallowed by the applicable credits referenced by IRC 280C.

Similarly, the deduction does not include expenses related to the federal Employer Social Security Credit (also known as the FICA Tip Credit) under Section 26 USC 45B (IRC 45B). This credit is available to all employers (i.e., it is not limited to C- or S-corporations) who pay excess social security tax for tipped employees and, like the credits referenced in IRC 280C, taxpayers are limited from deducting these expenses if they take the federal credit. However, the deduction does not cover these expenses because they are disallowed from deduction at the federal level under IRC 45B, not IRC 280C. Congress established IRC 45B in 1993, after Colorado's IRC 280C Deduction was created, so it is unclear whether the General Assembly would have included expenses not deductible under IRC 45B as qualifying for the deduction if IRC 45B had existed at the time the deduction was established. We identified one state, Arizona, that has a similar deduction that includes IRC 45B in the expenses taxpayers can deduct when calculating state taxable income. Expanding the types of expenses the IRC 280C Deduction applies to would increase its state revenue impact, although we lacked the necessary data to quantify this potential impact.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
STATE INCOME TAX REFUND DEDUCTIONS FOR INDIVIDUALS, ESTATES AND TRUSTS [SECTION 39-22-104(4)(e), C.R.S.]	
ESTIMATED REVENUE IMPACT	$47.7 million for individuals (TAX YEAR 2015); Unable to determine for estates and trusts
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure allows individuals, estates, and trusts to deduct from their federal taxable income refunds or credits for overpayment of state income taxes that were included in their federal gross income when computing their Colorado taxable income.
POLICY CONSIDERATION	

The General Assembly may want to review the state income tax add-back provision for individuals, estates, and trusts [Section 39-22-104(3)(d), C.R.S.] for Tax Years 2018 to 2025 to address changes to federal tax law. Specifically, the 2017 Tax Cuts and Jobs Act [Pub. L. 115-97] established a $10,000 state and local tax deduction limit for individuals, estates, and trusts for Tax Years 2018 to 2025. Prior to Tax Year 2018, there was no limit on the amount of state and local taxes that could be deducted. Federal law [26 USC 164] allows taxpayers to deduct state and local real property taxes, personal property taxes, and income or sales taxes, but does not designate the order in which the deductions must be taken or require that the full amount of taxes incurred be deducted. Colorado statute [Section 39-22-104(3)(d), C.R.S.] requires that only state income taxes taken as a federal deduction be added back to federal taxable income when calculating Colorado taxable income, but does not address how taxpayers should apportion the state and local taxes for the purposes of determining their state tax liability with the federal $10,000 state and local tax deduction limit in place. If a Colorado taxpayer itemized deductions and chose to deduct only property taxes on their federal income tax return and the taxpayer subsequently receives a state income tax refund, the taxpayer would not be required to include the state income tax refund in their federal gross income in the year the refund is received. Consequently, the taxpayer would not need/qualify for the State Income Tax Refund Deduction.

For federal tax purposes, a taxpayer with high property and state income taxes may choose to deduct only property taxes if they have $10,000 or more in property taxes to reach the federal limit. In this case, the taxpayer would have no state income tax add-back and would have a lower state tax liability than, for example, if they chose to deduct their state income taxes on their federal return.

Under current law, taxpayers can minimize their Colorado tax liability by not deducting their state income taxes on their federal return if they have sufficient local property tax liability to reach the $10,000 federal limit on the state and local tax deduction. Therefore, the federal limit creates a relative advantage for taxpayers with high local property taxes, for example taxpayers who own large or multiple properties. These taxpayers would also be less likely to qualify for the State Income Tax Refund Deduction because they would have less in state income taxes deducted from their federal return that could have later been subject to a state income tax refund inclusion on their federal returns. Taxpayers who paid less local property taxes would be at a relative disadvantage because they would need to deduct more in state income taxes to reach the $10,000 federal cap and would then be required to add back more of their federal deduction when calculating their Colorado taxable income. These taxpayers would be more likely to qualify for the State Income Tax Deduction because they are more likely to have deducted state income taxes that were later subject to a state income tax refund inclusion on their federal return.

Because the federal cap on state and local tax deductions was not in place when the General Assembly created the State Income Tax Refund Deduction and the State's current law regarding what federal deductions taxpayers must add back to their federal taxable income to calculate their Colorado taxable income, it may want to consider whether to address the potential difference in Colorado taxable income based on how taxpayers choose to deduct state and local taxes when filing their federal returns. For example, the General Assembly could require that taxpayers add back some portion of the state income taxes they *could have* deducted on their federal return, up to $10,000.

It is important to note that this issue is more likely to impact higher-income taxpayers who itemize their deductions and have more than $10,000 in state and local tax liabilities. Most individuals in Colorado would likely not be impacted because they either use the standard deduction on their federal return or because they have less than $10,000 in state and local taxes to deduct when itemizing their federal deductions. In addition, under current law, the federal state and local tax deduction limit may increase taxpayers' taxable income overall, at both the federal and state level. Therefore, some taxpayers may be likely to pay more in taxes under the current law than they would have prior to the federal deduction limit, regardless of how they choose to structure their state and local tax deduction.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: EFFECTIVENESS	
NON-PROFIT TRANSIT AGENCY FUEL TAX EXEMPTION [SECTION 39-27-102.5(7), C.R.S.]	
ESTIMATED REVENUE IMPACT	None
IS IT MEETING ITS PURPOSE?	No
SUMMARY:	This expenditure exempts non-profit transit agencies from paying the special fuels excise tax on liquefied petroleum gas and natural gas used in vehicles for transit purposes.
POLICY CONSIDERATIONS	

(1) The General Assembly may want to review the tax benefit provided by the Non-Profit Transit Agency Fuel Tax Exemption to determine if it is sufficient to accomplish its purpose. Specifically, the six other states that we identified with similar tax expenditures have structured their expenditures to provide a more significant benefit for taxpayers because they apply to all types of fuel, not just liquefied petroleum gas and natural gas. This provides a more substantial reduction in operating costs for agencies in these states, making these provisions more attractive to taxpayers. We estimate that if Colorado's Non-Profit Transit Agency Fuel Tax Exemption applied to all types of fuel, it would have a revenue impact to the State of around $16,800 and non-profit transit agencies would see a reduction in their operating costs by this same amount, or about $640 per transit agency. We based this estimate on the percentage of non-profit transit vehicles that use particular types of fuel (e.g., gasoline, diesel, natural gas); the amount of miles traveled by non-profit transit vehicle type; Colorado's excise tax rates on gasoline, diesel, and natural gas; and the average miles per gallon that gasoline, diesel, and natural gas powered vehicles travel.

(2) Some eligible taxpayers may not be aware of how to claim the exemption due to a lack of information on the Department of Revenue's form. Specifically, the Gasoline/Special Fuel Tax Refund Permit Application (Form DR 7189), which is used for several fuel tax refund provisions, is where eligible taxpayers would claim the exemption. However, the form does not list non-profit transit agencies as a possible claimant and the form's instructions do not include information on the Non-profit Transit Agency Fuel Tax Exemption. Thus, taxpayers may be less likely to be aware of the exemption and how to claim it than if this information was provided on the form. Stakeholders we contacted reported that non-profit transit agencies have not been aware of the exemption.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: ADMINISTRATION	
SALES TO CHARITABLE ORGANIZATIONS EXEMPTION [SECTION 39-26-718(1)(a), C.R.S.]	
ESTIMATED REVENUE IMPACT	$45.5 million (CALENDAR YEAR 2016)
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure exempts charitable organizations from paying state sales tax on purchases related to their charitable activities and functions.

POLICY CONSIDERATION

Although most charitable organizations reported that they use the exemption, they also reported that administrative issues can make it difficult to claim under certain circumstances. Specifically, almost one-third of the respondents to our survey reported that they find this exemption to be very or somewhat difficult to claim. Respondent comments suggest that the difficulty arises during the retail transaction process, specifically because:

- There is not a consistent process applied by all retailers regarding which documents need to be provided by the charitable organization and whether the retailer stores the organization's information for future use or if the organization has to provide its documentation on each separate occasion.
- Some retailers do not understand how the exemption works and who is eligible for it.
- Many checkout staff have not been trained by retail management on how to apply the exemption during a transaction.
- It is time-consuming and difficult for some retailers to verify in advance of a purchase that an organization is eligible for the exemption.
- Some retailers decline to apply the exemption, though they do not always provide a reason.
- Some retailers are not aware of the exemption.

Further, these issues are complicated by Colorado's laws regarding local government taxes, which may result in confusion for retailers in applying the exemption. Specifically, the State's 71 home rule, self-collected municipalities have the authority [Colorado Constitution, Article XX, Section 6] to decide whether to exempt purchases made by charitable organizations from their local sales and use taxes and to create a separate local charitable organization exemption certificate application process. We reviewed the tax regulations for the fifteen most populous home rule, self-collected cities and found that they all provide some type of sales tax exemption for charitable organizations, but the requirements vary among cities and are not always the same as those for the state sales tax exemption. For example, seven home rule, self-collected cities provide a blanket exemption for charitable organizations without a separate application process, eight require a separate application and certificate, and one limits which charitable organizations qualify for the exemption based on their annual gross revenue. In addition, organizations located, or making purchases, in some home rule cities must often present two charitable certificates, one for the State and one for the city, when making purchases. Although the state exemption should be applied to the state sales tax regardless of local tax laws, the variation between locations can create uncertainty among retailers and charitable organizations regarding which documents are required in order to apply the exemption, and some charitable organizations reported difficulty using the exemption under these circumstances.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: ADMINISTRATION	
RURAL & FRONTIER HEALTHCARE PRECEPTOR CREDIT [SECTION 39-22-538, C.R.S.]	
ESTIMATED REVENUE IMPACT	$74,000 (TAX YEAR 2017)
IS IT MEETING ITS PURPOSE?	Yes, to some extent
SUMMARY:	This expenditure allows uncompensated health preceptors (e.g., doctors, dentists, advanced practice nurses, physician assistants) in rural and frontier areas of the state to claim a nonrefundable credit of $1,000 to reduce their Colorado income tax liability.
POLICY CONSIDERATIONS	

(1) We identified some issues with the administration of the Preceptor Credit's eligibility requirements. Specifically, we examined the DR 0366 Forms for preceptors who were approved to take the credit in Tax Year 2017 and determined, based on the information provided on these forms, that at least 14 preceptors (16 percent) who were approved for the credit by the Department of Revenue were not eligible to take the credit. Twelve of these preceptors subsequently claimed the Preceptor Credit on their tax returns. Specifically, we identified the following issues where the students precepted were not eligible mentees for the purposes of the Preceptor Credit or where the preceptors did not qualify:

- Six preceptors who were approved for the credit precepted students enrolled in non-Colorado schools (i.e., online or out-of-state schools).
- Four preceptors who were approved for the credit precepted only medical residents, who have already graduated from medical school and are not students.
- Preceptors (too few to report) who were approved for the credit were not located in rural or frontier areas.
- Preceptors (too few to report) who were approved for the credit precepted students enrolled in non-Colorado schools and were also not located in a rural or frontier area.
- Preceptors (too few to report) who were approved for the credit precepted only pharmacy students, which is not an eligible graduate program.

Although the credit cap was not reached in Tax Year 2017, in future years, if the credit cap is exceeded, the approval of ineligible preceptors could undermine the purpose of the Preceptor Credit if eligible preceptors are denied the credit because ineligible preceptors were approved to take it first.

(2) The General Assembly could consider defining the minimum preceptorship duration in terms of hours or days, rather than weeks. Statute [Section 39-22-538(2)(e), C.R.S.] specifies that the duration of a preceptorship must be "not less than four weeks per calendar year." However, it is unclear whether the General Assembly intended for 4 weeks to be counted as 28 days (i.e., four calendar weeks) or 20 days (i.e., 4 business weeks) and the Department of Revenue has not issued guidance regarding how taxpayers should interpret this requirement. Stakeholders reported that a single clinical rotation for Colorado graduate programs is often not more than 25 days, and many medical and dental practices are only open during the business week. Therefore, it is difficult for many preceptors to meet the minimum duration requirement if they only precept one student and 4 weeks is interpreted to be 28 days. This may prevent new preceptors who want to ease into precepting by training only one student from claiming the credit. All other states with a similar tax incentive specify the minimum required duration in terms of hours.

NOTE: This policy consideration was addressed by House Bill 19-1088, which defined the preceptorship duration as not less than 4 working weeks, or 20 business days per calendar year.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: ADMINISTRATION	
TAX-EXEMPT ORGANIZATION INSURANCE PREMIUM TAX DEDUCTION [SECTION 10-3-209(1)(d)(IV), C.R.S.]	
ESTIMATED REVENUE IMPACT	$3.8 million (TAX YEAR 2018)
IS IT MEETING ITS PURPOSE?	Yes, but the extent of its impact is unclear
SUMMARY:	This expenditure allows insurers to deduct from their premium tax any premiums collected for policies purchased by tax-exempt organizations for their employees.
POLICY CONSIDERATION	

Insurers may lack clear instructions on how to claim the Tax-Exempt Organization Deduction. Specifically, the Division of Insurance's filing system and instructions do not clearly indicate how insurers should deduct premiums for insurance purchased by non-profit, charitable, and religious organizations. The Division of Insurance provides no written instructions, other than statutes and regulations, to insurers for how to properly file their insurance premium taxes. In the past, the Division of Insurance provided written instructions; however, when it moved to a fully electronic premium tax filing system in 2007, it phased them out. Further, the space for reporting the deduction on the premium tax return form is labeled as "Political Subdivision" and does not indicate that insurers should also report deductions for other types of tax-exempt organizations, such as non-profits, in this space. While stakeholders told us that it is likely that many insurers' tax preparation staff are broadly aware of how to claim the deduction, staff from one insurer indicated that they were unaware that eligible premiums from non-profits and other tax-exempt organizations were also supposed to be listed in that category. This insurer and one other did claim the deduction in Tax Years 2017 and 2018, using a separate space labeled "Other Deductions" to report it. However, it is possible that other insurers might not be aware that the deduction is not limited to the State's political subdivisions, which could result in some insurers not claiming the deduction even though they would be eligible. According to Division of Insurance staff, it is currently developing updated premium tax filing instructions that will help address this issue.

TAX EXPENDITURE EVALUATIONS POLICY CONSIDERATIONS INVOLVING: ADMINISTRATION	
ENERGY USED FOR INDUSTRIAL & MANUFACTURING PURPOSES EXEMPTION [SECTION 39-26-102(21)(a), C.R.S.]	
ESTIMATED REVENUE IMPACT	$35.2 to $87.9 million (TAX YEAR 2017)
IS IT MEETING ITS PURPOSE?	Yes
SUMMARY:	This expenditure exempts sales or purchases of electricity, coal, gas, fuel oil, steam, coke, or nuclear fuel used for industrial or manufacturing purposes from state sales tax.
POLICY CONSIDERATION:	

Some taxpayers lack adequate guidance on how to claim the Industrial Energy Exemption and calculate the exempt amount. Because statute limits eligibility for the exemption to energy used for specific industrial purposes and Department of Revenue Regulations require taxpayers to estimate the amount of their total energy use for eligible versus ineligible purposes, administration of the expenditure can be a complex process for taxpayers. Specifically, taxpayers must establish a process to estimate and document their energy use at each facility (or each part of a facility) to be able to break out eligible uses, such as electricity used to run a machine that processes tangible goods, from ineligible uses, such as electricity used to light office spaces in the facility. However, Department of Revenue guidance does not include detailed instructions on acceptable methods to measure and document eligible energy use. In prior years the Department of Revenue provided guidance on the forms on how to calculate the exemption through its *FYI 71: Sales Tax Exemption on Industrial Utility Usage*. However, the Department of Revenue no longer provides this guidance to taxpayers and removed it from its website. Stakeholders reported that there are many "gray" areas when determining what activities to include as exempt and so additional guidance would help them understand how to claim the exemption. Although stakeholders reported that taking the exemption is generally a routine process for larger businesses that use CPA or tax consultant firms, smaller businesses may have difficulty determining how to properly claim it. Department of Revenue staff indicated that they are aware of this issue and they are currently working on additional guidance for taxpayers regarding the exemption.

Alternatively, the General Assembly may want to consider simplifying the administration of the Industrial Energy Exemption by allowing taxpayers to claim a flat percentage of their total energy use. For example, we identified 13 other states with similar exemptions that base the exemption amount on a percentage of the industrial users' total energy use, ranging from 50 to 100 percent. Structuring the tax expenditure in this manner could eliminate the complexity of estimating the actual percentage of energy that taxpayers used for an eligible purpose. However, depending on the rate, some taxpayers may not be able to claim the full amount used for an eligible purpose, while some may be able to claim more than what they actually used. This could also increase or decrease the revenue impact to the state, depending on the rate. However, the specific impact cannot be determined given the lack of data on this expenditure.