Office of the State Auditor

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

August 30, 2023

OFFICE OF THE STATE AUDITOR

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Newsprint & Printer's Ink and Newspapers Exemptions

Tax Expenditure Evaluation • May 2023 • 2023-TE6

The Newsprint & Printer's Ink Exemption allows newspaper publishers and commercial printers to purchase newsprint and printer's ink without paying state sales and use tax. The exemption was likely created to define the types of sales subject to state sales tax and avoid charging sales taxes on the production inputs of newspapers and commercial printers.

The Newspapers Exemption exempts the purchase and distribution of newspapers from state sales and use tax and was likely created to clarify which purchases were intended to be taxed under the State's sales tax, which was enacted in 1935.

The exemptions are meeting their purposes because newspaper publishers, commercial printers, and newspaper retailers are aware of the exemptions and both exemptions appear to be applied to eligible sales.

- Representatives from Colorado newspapers reported that they have not paid state sales or use tax on newsprint and printer's ink.
- Representatives from newspapers that we spoke with reported that their newspapers are consistently exempted from state sales and use tax.

Policy Considerations

We did not identify any policy considerations in this evaluation.

	Newsprint & Printer's Ink	Newspapers
Tax Type:	**Sales and Use**	**Sales and Use**
Expenditure Type:	**Exemption**	**Exemption**
Statutory Citation:	**Sections 39-26-102(21)(a) and 705(1), C.R.S.**	**Section 39-26-102(15)(a)(I), C.R.S.**
Year Enacted:	**1943 (sales tax), 1945 (use tax)**	**1943**
Repeal/Expiration Date:	**None**	**None**
Revenue Impact:	**$300,000 (2021)**	**$2.7 million (2017)**
Purpose given in statute or enacting legislation? **No**		

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Newsprint & Printer's Ink and Newspapers Exemptions

Background

This evaluation covers two related tax expenditures:

- **The Newsprint & Printer's Ink Exemption allows newspaper publishers and commercial printers to purchase newsprint and printer's ink without paying state sales and use tax.**
- **The Newspapers Exemption exempts the purchase and distribution of newspapers from state sales and use tax.**

We inferred that newspaper publishers and commercial printers are the intended beneficiaries of the Newsprint & Printer's Ink Exemption since they are the only eligible parties. Newspaper purchasers might also indirectly benefit from the Newsprint & Printer's Ink Exemption because some of the savings on paper and ink may be passed on to purchasers through lower retail prices. We inferred that the intended beneficiaries of the Newspapers Exemption are newspaper purchasers and newspaper publishers, including publishers of free newspapers since they would be responsible for paying use tax if the exemption did not exist. Both exemptions were created in 1943, and the use tax exemption was added to the Newsprint & Printer's Ink Exemption in 1945.

The Newsprint & Printer's Ink Exemption was likely created to define the types of sales subject to state sales tax and avoid charging sales taxes on the production inputs of newspapers and commercial printers. This exemption is consistent with other sales tax exemptions in the state, which exempt purchases of raw materials that are incorporated into a final product. Similar structural provisions are common in states with a sales tax to prevent the tax from being applied at multiple stages of a good's manufacturing and distribution process, which is referred to as "tax pyramiding." Tax pyramiding can increase the effective tax on a consumer good to the extent that taxes on manufacturers' inputs are passed on to the final consumers of their products. Of the 44 other states that impose a retail sales or similar tax, 43 provide an exemption for newsprint and printer's ink, either by exempting them specifically or because they are considered to be component parts of a manufactured product, which are also typically exempt from sales tax.

The Newspapers Exemption was likely created to clarify which purchases were intended to be taxed under the State's sales tax that was enacted in 1935. Specifically, the legislative

declaration for House Bill 43-155, which created the exemption, states that it was always the General Assembly's intent to exempt newspapers in their entirety from sales and use tax and that, in practice, they had never been taxed. This policy is consistent with other states with a sales tax, most of which have historically exempted newspapers from sales taxes because of their importance in fostering a more informed public and serving as a forum for posting required legal notices. Thirty-two states exempt newspapers from sales tax.

In order to determine whether the exemptions are meeting their purposes, we assessed the extent to which sales of newsprint and printer's ink purchased by newspaper publishers and commercial printers, along with newspapers purchased by consumers, are being exempted from state sales and use tax.

Evaluation Results

The exemptions are meeting their purposes because newspaper publishers, commercial printers, and newspaper retailers are aware of them and both exemptions generally appear to be applied to eligible sales.

Although we lacked data to confirm the exemptions are always applied, during our 2018 evaluation of these tax expenditures, we interviewed representatives from 23 Colorado newspapers—two of which oversee substantial printing operations of national and local newspapers in Colorado—and all of them reported that they have not paid state sales or use tax on newsprint and printer's ink. Both large printers reported that newsprint and printer's ink have continuously and consistently been exempted from Colorado sales and use tax—although some printers noted that they periodically must provide their printer's ink suppliers or distributers with documentation, such as an affidavit, attesting that the ink is being used to print newspapers. In 2022, during our most recent evaluation, our outreach to industry representatives confirmed that they have continued not to pay state sales or use tax on newsprint and printer's ink. The newspaper representatives we contacted in 2018 and 2022 reported that retail sales of their publications are also consistently exempted from state sales and use tax. Additionally, the Department of Revenue has issued guidance and regulations, which provide that newspaper sales should not be subject to state sales tax.

We estimate that the Newsprint & Printer's Ink Exemption had a revenue impact to the State of about $300,000 in Calendar Year 2021, which is a $200,000 decrease from its 2017 revenue impact. Based on the volume of newsprint sold and the average price of newsprint in Colorado in 2021 provided by the Pulp and Paper Products Council, we estimated that approximately $10.1 million in newsprint and about $600,000 in printer's ink sales

Technical Note:

We were unable to identify a source to directly obtain data on total printer's ink sales in Colorado; however, we used data provided by two large newspaper printers in Colorado to create an average ratio of the cost of printer's ink compared to newsprint, which, as of 2017, was about $0.06 for every $1.00 of newsprint sales. We used the ratio to estimate that there were about $600,000 in eligible printer's ink sales in Colorado in 2021.

occurred in Colorado in 2021. We then multiplied the printer's ink and newsprint sales estimates (totaling $10.7 million) by the State sales tax rate of 2.9 percent, which resulted in an estimated $300,000 revenue impact to the State. Using the same methodology in our 2018 evaluation, we estimated the revenue impact was $500,000 in 2017, so the exemption's revenue impact has decreased in recent years due to lower sales of newsprint and printer's ink.

Due to trends in the newspaper industry, the revenue impact of this expenditure will likely decline over time. While the price of newsprint has gradually risen over the last 10 years, the demand in Colorado for newsprint has continually and substantially declined since print circulation has decreased for most newspapers. This exemption will likely have a diminishing impact on state tax revenue as demand for newsprint and printer's ink continues to decline.

In our 2018 evaluation, we estimated that the Newspapers Exemption reduced state tax revenue in Calendar Year 2017 by about $2.7 million. It is likely that the revenue impact of the Newspapers Exemption has decreased since 2018, but we were unable to estimate a more recent revenue impact because the U.S. Census Bureau no longer publishes data on newspaper subscription sales by state, which is the data we used to estimate the revenue impact for Calendar Year 2017. According to the Pew Research Center, nationally, total circulation revenue for local newspapers dropped from $1.5 billion in 2019 to $1.1 billion in 2020. Additionally, demand for newsprint in the state also decreased substantially (41 percent) between 2018 and 2021, so it is likely that sales from print newspapers have decreased as well. This is consistent with stakeholder feedback from newspapers that print subscription sales have decreased, although newspapers mentioned that they have increased print subscription prices, which may partially offset some of the expected decrease in the revenue impact of the Newspapers Exemption.

In addition to the state exemption, sales of newsprint and printer's ink to newspaper publishers and commercial printers and sales of newspapers are exempt from local sales taxes levied by local governments that have their sales taxes collected by the State on their behalf. Statute mandates that these local governments apply most of the State's sales tax exemptions, including the Newsprint & Printer's Ink Exemption and Newspapers Exemption. Home rule municipalities established under Article XX, Section 6 of the Colorado Constitution that collect their own taxes have the authority to set their own tax policies independent from the State and are not required to exempt such sales from their local sales tax. Based on our review of the 15 most-populated home rule cities, all exempt both newsprint and printer's ink from sales tax, and only Denver and Broomfield impose a sales tax on newspapers. We estimated that the exemption reduced local government revenue by $1.7 million in Calendar Year 2017. To estimate this amount, we used the same newspaper sales estimate ($91.4 million) arrived at for calculating the state revenue impact, but applied the average population-weighted local sales tax rate of 1.8 percent after excluding home rule jurisdictions with self-collected sales taxes. Because we were unable to estimate a more current State-level revenue impact for the Newspapers Exemption for this report, we also were not able to estimate a more current local government revenue impact.

Policy Considerations

We did not identify any policy considerations for these exemptions. In our previous evaluation of the Newsprint & Printer's Ink and Newspapers Exemptions, released in September 2018, we included a policy consideration that the General Assembly could consider clarifying whether digital newspapers or other electronic news sources are also exempt from sales and use tax. The General Assembly did not take any legislative action on this policy consideration.

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DEDUCTION FOR WAGES & SALARIES DUE TO IRC 280C

EVALUATION SUMMARY

APRIL 2019
2019-TE8

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

YEAR ENACTED	1979
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	Less than $51.4 million (TAX YEAR 2015)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

The Deduction for Wages & Salaries Due to Internal Revenue Code Section 280C (IRC 280C Deduction) 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. IRC 280C limits the deduction of expenses that are used as the basis for federal credits referenced by IRC 280C.

WHAT DID THE EVALUATION FIND?

The IRC 280C Deduction is generally meeting its purpose since it appears that taxpayers are using it to offset the impact of IRC 280C on Colorado Taxable Income.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this deduction. We inferred that the purpose was to neutralize the effect of IRC 280C on the deductibility of wage and salary expenses for the purposes of determining Colorado taxable income.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider whether sole proprietors, partnerships, and limited liability companies should also be allowed to claim the deduction. Additionally, due to changes to the Federal Tax Code since the deduction was created, the General Assembly may want to determine whether limiting the deduction to only wages and salaries and only amounts disallowed from deduction by IRC 280C meets its intent.

DEDUCTION FOR WAGES & SALARIES DUE TO IRC 280C

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Deduction for Wages and Salaries Due to Internal Revenue Code 280C (IRC 280C Deduction) [Sections 39-22-304(3)(i), 322, and 323, C.R.S.], allows C-corporations and S-corporations to deduct for state tax purposes, wage and salary expenses that are not allowed to be deducted from federal taxable income under Internal Revenue Code, Section 280C (IRC 280C).

In 1977, the U.S. Congress passed IRC 280C as part of a broader bill that established federal employment tax credits. Under IRC 280C, taxpayers who claimed the federal employment tax credits were required to reduce the amount of wage and salary expenses that they could otherwise deduct from their federal taxable income by the amount of the credit they received. It appears that Congress included IRC 280C to prevent taxpayers from receiving a double tax benefit by both receiving a credit and deducting from their taxable income the associated expenses they incurred to qualify for the credit, up to the credit amount.

For Colorado tax purposes, IRC 280C had the side effect of increasing state tax liability for taxpayers subject to its requirements. This occurred because since 1965, Colorado has used federal taxable income as the starting point when calculating Colorado taxable income. Businesses subject to IRC 280C had a higher federal taxable income because they were no longer able to deduct a portion of their wage and salary expenses when calculating their federal taxable income and would, therefore, have had a higher Colorado taxable income, since it was tied to federal taxable income. However, because Colorado does not offer the same

employment credits that trigger the application of IRC 280C at the federal level, taxpayers would not receive an offsetting tax benefit for state tax purposes, resulting in higher state tax liabilities.

In 1979, the General Assembly created the IRC 280C Deduction to address the higher state tax liabilities caused by IRC 280C. The deduction applies only to C-corporations and S-corporations; it does not apply to sole proprietors, partnerships, or limited liability companies. C-corporations are subject to income tax, federally and in Colorado, at the entity-level. S-corporations are not subject to income tax at the entity-level, but rather, the income from an S-corporation passes through to the individual shareholders based on their pro-rata share of ownership in the S-corporation. Individual shareholders report their share of the S-corporation's income on their individual income tax returns. When calculating Colorado taxable income, the deduction allows C-corporations and shareholders of S-corporations to deduct the wage and salary expenses that were disallowed from being deducted when calculating federal taxable income due to IRC 280C. This has the effect of adjusting taxpayers' Colorado taxable income to be equivalent to what it would have been if not for IRC 280C. EXHIBIT 1.1 illustrates the application of the deduction.

EXHIBIT 1.1. APPLICATION OF THE IRC 280C DEDUCTION FOR THE PURPOSES OF CALCULATING FEDERAL AND COLORADO TAXABLE INCOME

Federal Gross Income

-

Federal Deductions

+

Amount not deductible due to a credit referenced in IRC 280C

=

Federal Taxable Income

-

Deduction for wages and salaries not deductible from federal taxable income due to IRC 280C

=

Colorado Taxable Income

SOURCE: Office of the State Auditor analysis of federal and Colorado taxable income calculations.

The deduction has not been modified since its enactment; however, Congress has made several additions to IRC 280C since 1977, so that it now disallows deductions for expenses related to 12 different federal credits, some of which are not limited to wage and salary expenses. At the state level, the IRC 280C Deduction applies to expenses related to these federal credits as well, but only to the extent that they are for wages and salaries.

EXHIBIT 1.2 lists the federal credits referenced in IRC 280C and indicates the types of expenses that taxpayers are disallowed from deducting from federal taxable income due to IRC 280C. For state tax purposes, Section 39-22-304(3)(i), C.R.S., allows taxpayers to claim the IRC 280C Deduction for all of the credits indicated in the exhibit, but only to the extent that the amount disallowed from deduction at the federal level included wages and salaries. Other business expenses, such as materials and overhead, that are disallowed from being deducted from federal taxable income for several credits under IRC 280C do not qualify for the deduction.

EXHIBIT 1.2. FEDERAL CREDITS REFERENCED BY IRC 280C AS OF JANUARY 2019		
CREDIT NAME	TITLE 26 USC SECTION	TYPE OF EXPENSE DISALLOWED DUE TO IRC 280C
Indian Employment Credit	45A	Wages and salaries only
Employer Wage Credit for Employees who are Active Duty Members of the Uniformed Services	45P	Wages and salaries only
Employer Credit for Paid Family & Medical Leave	45S	Wages and salaries only
Work Opportunity Credit	51	Wages and salaries only
Empowerment Zone Employment Credit	1396	Wages and salaries only
Credit for Qualified Clinical Testing Expenses for Certain Drugs	45C	Not limited to wages and salaries
Credit for Increasing Research Activities	41	Not limited to wages and salaries
Credit for Low-Sulfur Diesel Fuel Production	45H	Not limited to wages and salaries
Mine Rescue Team Training Credit	45N	Not limited to wages and salaries
Credit for Security of Agricultural Chemicals	45O	Not limited to wages and salaries
Credit for Health Insurance Premiums	36B	Not limited to wages and salaries
Employee Health Insurance Expenses of Small Employers	45R	Not limited to wages and salaries
SOURCE Office of the State Auditor review of IRC 280C.		

To claim the IRC 280C Deduction, C-corporations include the amount of the deduction on Line 13 for "Other Subtractions" on their Corporation Income Tax Return (Form DR 0112). Taxpayers also use this line for several other unrelated deductions, which they combine for tax reporting purposes. Individuals who receive income from an S-corporation may claim their pro-rata share of the deduction based on their ownership interest on Line 17, also for "Other Subtractions," on the Subtractions from Income Schedule (Form DR 0104AD) when filing their Individual Income Tax Return (Form DR 0104). This line also combines taxpayer reporting of several other unrelated deductions.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the IRC 280C Deduction. Based on statutory language and the interaction

between federal and state tax laws, we inferred that the intended beneficiaries of the deduction are C-corporations and individuals with income from S-corporations that IRC 280C does not allow to deduct a portion of their wage and salary expenses from their federal taxable income if they take the associated federal tax credits.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of the IRC 280C Deduction. Based on our review of the federal Internal Revenue Code, state statutes, legislative history, Department of Revenue taxpayer guidance, and similar statutes in other states, we inferred that the purpose is to neutralize the effect of IRC 280C as it applies to Colorado taxable income for wage and salary expenses for C-corporations and S-corporations doing business in Colorado. This is a common structural provision in states that tie their state taxable income amount to federal taxable income.

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

We found that the IRC 280C Deduction is likely meeting its purpose, although we lacked the information necessary to quantify how frequently taxpayers use it.

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

PERFORMANCE MEASURE: *To what extent are eligible taxpayers using the IRC 280C Deduction?*

RESULT: We found evidence that taxpayers are likely using the IRC 280C Deduction, although we lacked information from the Department of Revenue to quantify the extent to which it is used. Specifically, the 2018

U.S. Treasury Department's *Tax Expenditures* report estimated that, nationally, taxpayers claimed $23.7 billion in Fiscal Year 2018 for seven of the 12 federal credits referenced by IRC 280C. This indicates that Colorado taxpayers would likely continue to have a need to use the deduction to reduce their state taxable income for the amount disallowed by IRC 280C. This report did not include information for five of the credits referenced by IRC 280C, so it is likely the amount of credits claimed by taxpayers is higher than this amount. In addition, the Department of Revenue provides guidance for taxpayers specific to the deduction and its staff reported continued inquiries from taxpayers regarding the deduction's application, which indicates that Colorado taxpayers are aware of it and likely using it.

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

For C-corporations, Department of Revenue data indicate that the IRC 280C Deduction had a state revenue impact of less than $51.4 million for Tax Year 2015. Because taxpayers combine the IRC 280C Deduction with up to nine other deductions when reporting the deduction, the Department of Revenue cannot provide data specific to the total amount reported for the deduction. However, the Department of Revenue was able to provide aggregate data showing that taxpayers claimed a combined total of about $51.4 million for these 10 deductions, which is the basis of our revenue impact estimate.

For individuals who claim the IRC 280C Deduction through an S-corporation, we were unable to determine an estimated revenue impact for the deduction. Similar to C-corporations, individuals also combine the amount they claim for the deduction with several other deductions on a single reporting line; however, GenTax, the Department of Revenue's tax processing system, does not collect this information in a format that is easily extractable to allow for an aggregate total of the amount claimed for these deductions.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the IRC 280C Deduction were eliminated, corporations that have wages and salaries that cannot be deducted from federal taxable income due to IRC 280C would be unable to deduct those amounts for the purpose of determining Colorado taxable income and would, therefore, have a higher state tax liability. Eliminating the deduction could also be a relative disincentive for taxpayers to claim the federal credits subject to IRC 280C. Specifically, if the tax benefit at the federal level for the credits was less than the benefit of being able to deduct the associated expenses for state tax purposes, taxpayers may choose to forgo the federal credits.

EXHIBIT 1.3 shows the state tax liability for a hypothetical corporate taxpayer under two scenarios: (1) if the taxpayer claims a federal credit referenced by IRC 280C and claims the state deduction, and (2) if the taxpayer claims a federal credit referenced in IRC 280C and the state did not allow for the deduction.

EXHIBIT 1.3. HYPOTHETICAL STATE TAX LIABILITY WITH CURRENT IRC 280C DEDUCTION AND WITHOUT IRC 280C DEDUCTION		
	CLAIMING 280C CREDIT WITH STATE DEDUCTION	CLAIMING 280C CREDIT WITHOUT STATE DEDUCTION
Federal credit amount for credit referenced by IRC 280C	$20,000	
Salary/wage expenses used for the basis of federal credit referenced by IRC 280C	$100,000	
FEDERAL TAX CALCULATION		
Gross Income	$1,000,000	
Deduction for salary/wage expenses used for the basis of federal credit referenced by IRC 280C[1]	-$100,000	
Salary/wage expenses disallowed from deduction under IRC 280C	+$20,000	
Federal Taxable Income	=$920,000	
Federal Tax Liability (Federal Taxable Income x 21 percent) before credit	$193,200	
Federal credit	-$20,000	
Federal Tax Liability with Credit	=$173,200	
STATE TAX CALCULATION		
Federal Taxable Income	$920,000	$920,000
State deduction for wage/salaries disallowed by 280C	-$20,000	$0
Colorado Taxable Income	=$900,000	=$920,000
Colorado Tax Liability (Colorado Taxable Income x 4.63 percent)	$41,670	$42,596

SOURCE: Office of the State Auditor analysis of applicable state and federal tax provisions.
[1] Only includes deductible expenses used as the basis for the federal credit referenced by IRC 280C to isolate the impact of the IRC 280C Deduction. Businesses would typically deduct other expenses as well.

As EXHIBIT 1.3 demonstrates, if corporations were unable to deduct wages and salary expenses included in the calculation of the federal credits referenced in IRC 280C, then their state taxable income and tax liability would be greater due to their election to claim the federal credit.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES OR THROUGH OTHER PROGRAMS?

Of the 43 states (excluding Colorado) and the District of Columbia that have a broad-based corporate income tax that uses federal taxable

income as the starting point for calculating state taxable income, we identified 27 that provide a similar deduction for wage and salary expenses that are not deductible due to IRC 280C. Of these states, 11 provide a deduction for expenses related to federal credit provisions referenced in IRC 280C and 16 provide a deduction for only certain types of expenses disallowed from being deducted due to the federal credit provisions referenced by IRC 280C, similar to Colorado.

We did not identify any similar programs or expenditures available in Colorado.

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

The Department of Revenue was unable to provide data on the number of taxpayers who took the IRC 280C Deduction or the amount they claimed. As discussed, C-corporations claim the deduction on Line 13, “Other Subtractions,” of the Corporation Income Tax Return (Form DR 0112). Taxpayers combine the total amount of nine other deductions on this line, which the Department of Revenue cannot disaggregate. In all cases, the Department of Revenue requires taxpayers to submit explanations for the deductions taken as other subtractions that are reported on Line 13. However, GenTax does not capture and compile these explanations in an easily extractable format. Similarly, individuals who claim the IRC 280C Deduction due to having income from an S-corporation claim the deduction on Line 17, also “Other Subtractions,” on their Subtractions from Income Schedule (Form DR 0104AD) when filing their Individual Income Tax Return (Form DR 0104). This line also combines taxpayer reporting of several other unrelated deductions, which the Department cannot disaggregate or extract. Due to these limitations, we were unable to determine the revenue impact of the deduction and were unable to determine how many taxpayers claimed it.

To address these limitations, the Department of Revenue would have to create new reporting lines on the DR 0104, DR 0105, and DR 0112

forms and then capture and house the data collected on those lines in GenTax, which would require additional resources (see the Tax Expenditures Overview Section of the Office of the State Auditor's *September 2018 Tax Expenditures Compilations Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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.

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 (see EXHIBIT 1.1 above). 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.

STRUCTURAL CIGARETTE AND TOBACCO PRODUCTS EXCISE TAX EXPENDITURES

JANUARY 2020
2020-TE5

EVALUATION SUMMARY

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

	Unsalable Cigarettes Credit	Returned or Destroyed Tobacco Credit	Interstate Cigarette Sales Exemption	Out-of-State Tobacco Sales Credit (sales to retailers only)	Bad debt credit for Cigarette Sales	Bad Debt Credit for Tobacco Products Sales
Year enacted	1964	1986	1964	1986	2004	2004
Repeal/ Expiration date	None	None	None	None	None	None
Revenue impact (Calendar Year 2017)	$286,435	$637,377	Could not determine	$5,248,762	None	None
Number of Taxpayers	15	22	Could not determine	9	None	None
Average taxpayer benefit	$19,096	$28,972	Could not determine	$583,196	None	None
Is it meeting its purpose?	Yes	Yes	Yes	Yes	Yes, but it is rarely used	Yes, but it is rarely used

WHAT DO THE TAX EXPENDITURES DO?

The Unsalable Cigarette Credit and the Returned or Destroyed Tobacco Credit allow cigarette wholesalers or tobacco products distributors to claim a credit for excise taxes paid on unsalable cigarettes or tobacco products that have been returned to the manufacturer or destroyed by the wholesaler.

The Interstate Cigarette Sales Exemption exempts sales of cigarettes made by licensed distributors in interstate commerce from the Colorado cigarette excise tax.

The Out-of-State Tobacco Sales Credit allows tobacco products distributors to claim a credit for excise taxes paid on tobacco products that are shipped to retailers outside of Colorado.

The Bad Debt Credits allow cigarette wholesalers and tobacco products distributors to claim a credit for the excise tax portion of bad debts attributable to cigarette or tobacco products sales when the person who ordered the cigarettes or tobacco products does not pay.

WHAT DID THE EVALUATION FIND?

We determined that the exemptions are likely meeting their purposes since eligible taxpayers are aware of them and use them when appropriate.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider repealing the Bad Debt Credits because they are rarely used and have limited applicability.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not directly state a purpose for the structural cigarette and tobacco products excise tax expenditures. We inferred the following purposes:

- The purpose of the Unsalable Cigarettes Credit and the Returned or Destroyed Tobacco Credit is to avoid taxing cigarette wholesalers and tobacco products distributors for products that cannot be sold.

- The purpose of the Interstate Cigarette Sales Exemption and the Out-of-State Tobacco Sales Credit is to prevent double taxation of cigarettes and tobacco products that are sold in other states.

- The purpose of the Bad Debt Credits is to reimburse cigarette wholesalers and tobacco products distributors for the excise taxes they paid, but for which payment was never received from the retailer.

STRUCTURAL CIGARETTE AND TOBACCO PRODUCTS EXCISE TAX EXPENDITURES

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers the following six structural cigarette and tobacco products excise tax expenditures provided to licensed cigarette wholesalers and tobacco products distributors, and which apply to either the State's excise tax on cigarettes or the excise tax on tobacco products, which are administered separately.

- **Excise Tax Credit for Unsalable Cigarettes Returned to Manufacturer or Destroyed by Distributor** [Section 39-28-104(3), C.R.S.] (Unsalable Cigarettes Credit) was created by House Bill 64-1086 in 1964 and allows cigarette wholesalers to claim a credit for taxes paid on unsalable cigarettes that have been returned to the manufacturer or destroyed by the wholesaler.

- **Excise Tax Credit for Unsalable Tobacco Products Returned to Manufacturer or Destroyed by Distributor** [Section 39-28.5-107(1), C.R.S.] (Returned or Destroyed Tobacco Credit) was created by House Bill 86-1340 in 1986 and allows tobacco products distributors to claim a credit for taxes paid on tobacco products that are returned to the manufacturer by the distributor or destroyed by the distributor.

- **Interstate Cigarette Sales Excise Tax Exemption** [Section 39-28-111, C.R.S.] (Interstate Cigarette Sales Exemption) was created by House Bill 64-1086 in 1964 and exempts sales of cigarettes made by licensed distributors in interstate commerce from the cigarette excise tax.

- **EXCISE TAX CREDIT FOR TOBACCO PRODUCTS SHIPPED OUTSIDE THE STATE TO RETAILERS** [SECTION 39-28.5-107(1), C.R.S.] (Out-of-State Tobacco Sales Credit) was created by House Bill 86-1340 in 1986 and allows tobacco products distributors to claim a credit for excise taxes paid on tobacco products that are shipped to retailers outside of Colorado. This credit does not include taxes paid on tobacco products that are shipped to consumers outside of the state.

- **BAD DEBT CREDIT FOR EXCISE TAXES PAID ON CIGARETTE SALES** [SECTION 39-28-104(4), C.R.S.] and **BAD DEBT CREDIT FOR EXCISE TAXES PAID ON TOBACCO PRODUCTS SALES** [SECTION 39-28.5-107(2), C.R.S.] (Bad Debt Credits) were created by House Bill 04-1071 in 2004 and allow cigarette wholesalers and tobacco products distributors to claim a credit for the excise tax portion of bad debts attributable to cigarette or tobacco products sales when the person who ordered the cigarettes or tobacco products does not pay. To be eligible for these credits, the wholesaler or distributor must have written off the bad debt as uncollectible on their books, and the bad debt must be eligible to be claimed as a deduction pursuant to Section 166 of the Internal Revenue Code. When a wholesaler or distributor claims the Bad Debt Credits, the responsibility for paying the cigarette or tobacco products excise tax shifts to the purchaser that did not pay the wholesaler or distributor.

All of these tax expenditures have remained substantially unchanged since their enactment.

Colorado first imposed an excise tax on cigarettes in 1964, and in 2004 Colorado voters approved a constitutional amendment to impose an additional excise tax on cigarettes. Currently, the total excise tax on cigarettes is $0.042 per cigarette, which is $0.84 per pack of 20 cigarettes or $1.05 per pack of 25 cigarettes. Statute [Section 39-28-102(1), C.R.S.] requires wholesalers that sell or offer for sale cigarettes in the state to obtain a license from the Department of Revenue. Wholesalers are any people, firms, limited liability companies, partnerships, or corporations that import cigarettes into Colorado for sale or resale. Although cigarette excise taxes are typically passed on to

consumers, cigarette wholesalers are responsible for paying the tax. Cigarette wholesalers indicate that they have paid the tax by affixing a stamp purchased from the Department of Revenue to each pack of cigarettes.

Colorado first imposed an excise tax on tobacco products in 1986, and in 2004 Colorado voters approved a constitutional amendment to allow an additional excise tax on tobacco products. Tobacco products are any products made completely or partially from tobacco, with the exception of cigarettes, which are taxed separately from tobacco products. Currently, the total excise tax on tobacco products is 40 percent of the manufacturer's list price, which is, per statute [Section 39-28.5-101(3), C.R.S.], "the invoice price for which a manufacturer or supplier sells a tobacco product to a distributor exclusive of any discount or other reduction." Statute [Section 39-28.5-104(1), C.R.S.] requires tobacco products distributors to obtain a license from the Department of Revenue. Tobacco products distributors are anyone who first receives tobacco products in the state, sells tobacco products in this state who is liable for the tobacco products excise tax, or first sells or offers for sale in this state tobacco products that were imported into this state from another state or country. Although tobacco products excise taxes are typically passed on to consumers, tobacco products distributors are responsible for paying the tax.

The Department of Revenue requires that cigarette wholesalers and tobacco products distributors file their cigarette and tobacco products excise tax returns electronically through Revenue Online, the Department of Revenue's online tax filing system. Cigarette wholesalers must submit monthly returns, and tobacco products distributors must submit quarterly returns.

- Cigarette wholesalers claim the **UNSALABLE CIGARETTES CREDIT** on Line 11 (Credit for Returned Stamps) of the online Cigarette Tax Return (Form DR 0221) and must attach a certification or affidavit from the manufacturer stating that the cigarettes were returned.

- The Department of Revenue does not have any reporting requirements for cigarette wholesalers to claim the **INTERSTATE CIGARETTE SALES EXEMPTION**, and taxpayers receive this exemption by not purchasing and affixing Colorado cigarette stamps to the cigarettes that they sell outside of the state.

- Tobacco products distributors claim the **RETURNED OR DESTROYED TOBACCO CREDIT** on Line 6 (Returned to Manufacturer) or Line 7 (Destroyed by Distributor) of the online Tobacco Products Tax Return.

- Tobacco products distributors claim the **OUT-OF-STATE TOBACCO SALES CREDIT** on Line 5 (Shipped to Retailers Outside Colorado) of the online Tobacco Products Tax Return.

- Cigarette wholesalers and tobacco products distributors claim the **BAD DEBT CREDITS** by submitting the Claim for Refund form (Form DR 0137). They must provide sufficient documentation to verify that the cigarette excise tax was paid by the wholesaler and that the wholesaler never received payment from the purchaser, including (1) a copy of the original invoice issued by the wholesaler/distributor, (2) evidence that the cigarettes or tobacco products described in the invoice were delivered to the person that ordered them, (3) evidence that the wholesaler/distributor did not receive payment from the purchaser, (4) evidence that the wholesaler/distributor used reasonable collection practices to attempt to collect the debt, and (5) documentation that the bad debt is eligible to be claimed as a deduction under 26 USC 166 for federal tax purposes.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statutes do not directly state the intended beneficiaries of these tax expenditures. Based on our review of statutes, we inferred that the intended beneficiaries of the structural cigarette and tobacco products excise tax expenditures are cigarette wholesalers and tobacco products distributors in the state. According to Department of Revenue data, as

of September 2019, there were 26 licensed cigarette wholesalers and 207 licensed tobacco products distributors operating in Colorado.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statutes do not explicitly state a purpose for any of the structural cigarette and tobacco products excise tax expenditures. Based on the statutory language, we inferred the following purposes:

The purpose of the **UNSALABLE CIGARETTES CREDIT** and the **RETURNED OR DESTROYED TOBACCO CREDIT** is to avoid taxing cigarette wholesalers and tobacco products distributors for products that cannot be sold. Although cigarette wholesalers and tobacco products distributors are responsible for paying the excise taxes, it is generally intended that these taxes be passed through to consumers in the form of higher prices. Since unsalable products cannot be sold, the taxes already paid on the products cannot be passed through to consumers. Every state has some form of cigarette and tobacco excise tax, and credits or refunds for taxes paid on unsalable cigarettes and returned or destroyed tobacco products on which excise taxes have been paid are common structural provisions in most states.

The purpose of the **INTERSTATE CIGARETTE SALES EXEMPTION** and the **OUT-OF-STATE TOBACCO SALES CREDIT** is to prevent double taxation of cigarettes and tobacco products that are sold in other states. An exemption or credit for interstate sales or products shipped outside the state is a common structural provision among states that is necessary to avoid taxing the same products multiple times when they are sold through interstate sales.

The purpose of the **BAD DEBT CREDITS** is to reimburse cigarette wholesalers and tobacco products distributors for the excise taxes they paid, but for which they never received payment by the retailer. Cigarette and tobacco products excise taxes are generally built into the price of products as they move through the supply chain from the wholesaler or distributor (who initially pays the tax), to the retailer, and ultimately to the consumer. In the case of a bad debt, because the

cigarette wholesaler or tobacco products distributor has not been paid by the retailer, they are unable to pass on the excise taxes. These credits shift the liability of the excise tax from the cigarette wholesaler or tobacco products distributor to the nonpaying purchaser.

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that these tax expenditures are accomplishing their purposes, to some extent, since cigarette wholesalers and tobacco products distributors are generally aware of the tax expenditures and claim them when they are eligible. Statute does not provide quantifiable performance measures for these tax expenditures. Therefore, we created and applied the following performance measures to determine the extent to which these tax expenditures are meeting their purposes.

PERFORMANCE MEASURE #1: *To what extent do eligible taxpayers claim the* ***UNSALABLE CIGARETTES CREDIT*** *or the* ***RETURNED OR DESTROYED TOBACCO CREDIT*** *to avoid paying excise taxes on unsalable cigarettes or returned or destroyed tobacco products?*

RESULT: Overall, it appears that eligible taxpayers are likely claiming the credits. In Calendar Year 2017, 15 of the 37 cigarette wholesalers in Colorado that filed a Cigarette Tax Return (41 percent) claimed the Unsalable Cigarettes Credit using Line 11 of the return (labeled on the form as Credit for Returned Stamps). However, Line 11 is used to report both the Unsalable Cigarettes Credit and the return of unused cigarette stamps (i.e., cigarette stamps that were purchased but never affixed to cigarette packs) to the Department of Revenue. Therefore, it is possible that fewer than 15 taxpayers claimed the Unsalable Cigarettes Credit. We were not able to break out the total credit amount claimed on this line between these two reasons that an amount may have been entered. In Calendar Year 2017, 22 of the 169 (13 percent) tobacco products distributors that filed a Tobacco Products Tax Return claimed the Returned or Destroyed Tobacco Credit. Furthermore, although we lacked data to assess whether all eligible taxpayers took

the credits, we spoke with five licensed cigarette wholesalers and tobacco products distributors in Colorado, as well as a trade association that represents distributors in Colorado, and most were aware of the credits and said that they claim them when they are eligible.

PERFORMANCE MEASURE #2: *To what extent do eligible taxpayers claim the* ***INTERSTATE CIGARETTE SALES EXEMPTION*** *and the* ***OUT-OF-STATE TOBACCO SALES CREDIT****?*

RESULT: Although they only apply to a limited number of transactions in Colorado, we found that eligible taxpayers are likely using these tax expenditures. In Calendar Year 2017, 9 of the 169 licensed tobacco products distributors in Colorado (5 percent) claimed the Out-of-State Tobacco Sales Credit. Taxpayers are not required to report the Interstate Cigarette Sales Exemption on the Cigarette Tax Return. Therefore, the Department of Revenue does not have data on how many taxpayers claimed the exemption. However, we spoke with five licensed cigarette wholesalers and tobacco products distributors in Colorado, as well as a trade association that represents distributors in Colorado, and they were all aware of both of these tax expenditures. According to stakeholders, these tax expenditures are generally not claimed by cigarette wholesalers and tobacco products distributors unless they have a distribution center or substantial distribution operations in Colorado. This is because the distributors without distribution centers in Colorado ship products into Colorado to be sold only by retailers in Colorado, and the products are not subsequently exported from the state by the distributor. Therefore, these tax expenditures are applicable to only a small segment of the licensed cigarette wholesalers and tobacco products distributors in the state that ship cigarettes and tobacco products outside of Colorado. However, one stakeholder that ships cigarettes and tobacco products outside of Colorado reported that these tax expenditures are very important since out-of-state sales makes up a significant portion of their business, and if these tax expenditures did not exist, their products would be subject to excise tax in Colorado and the state in which the products are sold.

PERFORMANCE MEASURE #3: *To what extent are cigarette wholesalers and tobacco products distributors claiming the* ***BAD DEBT CREDITS*** *when they are not paid by purchasers?*

RESULT: No licensed cigarette wholesalers or licensed tobacco products distributors claimed the Bad Debt Credits in Calendar Years 2014 through 2018. There were claims of both Bad Debt Credits in Calendar Year 2013, but data on those claims is not releasable because publishing the data could violate taxpayer confidentiality, which is required under Section 39-21-113(4)(a) and (5), C.R.S., due to the small number of taxpayers claiming them. We spoke with five licensed cigarette wholesalers and tobacco products distributors in Colorado, as well as a trade association that represents distributors in Colorado, and three of the wholesalers and distributors and the trade association were aware of the Bad Debt Credits. One stakeholder reported that they do not claim the credits for their bad debts because the substantiation requirements outweigh the benefit they receive from the credits, and that the excise tax portion of the bad debt would have to be substantial for them to use the credits. Other stakeholders reported that bad debts resulting from retailers filing for bankruptcy or going out of business would be two common reasons that they would use the credits, and that these credits are important if those circumstances arise.

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

According to Department of Revenue taxpayer data, for Calendar Year 2017:

- The **UNSALABLE CIGARETTES CREDIT** reduced state tax revenue by approximately $286,000, a decrease of about 6 percent from the Calendar Year 2015 revenue impact of about $305,000. However, these revenue impacts may include some amount of unused stamps that cigarette wholesalers returned to the Department of Revenue since returned unused stamps are reported on the same line on the cigarette excise tax return as the Unsalable Cigarettes Credit.

- The **RETURNED OR DESTROYED TOBACCO CREDIT** reduced state tax revenue by approximately $637,000, a decrease of about 32 percent from the Calendar Year 2015 revenue impact of $937,000.

- The **OUT-OF-STATE TOBACCO SALES CREDIT** reduced state tax revenue by approximately $5.2 million, a decrease from the Calendar Year 2015 revenue impact. However, the 2015 revenue impact is not releasable because publishing the data could violate taxpayer confidentiality, which is required under Sections 39-21-113(4)(a) and (5), C.R.S.

- The Department of Revenue does not collect data on the **INTERSTATE CIGARETTE SALES EXEMPTION** since it does not require that taxpayers report this exemption on the Cigarette Tax Return. Therefore, no revenue impact is available for this exemption.

- The **BAD DEBT CREDITS** did not reduce state revenue in Calendar Years 2014 through 2018. The credits had a revenue impact in Calendar Year 2013, but the revenue impact cannot be released because publishing the data could violate taxpayer confidentiality, which is required under Sections 39-21-113(4)(a) and (5), C.R.S., due to the small number of taxpayers claiming them. Therefore, it appears that these tax credits are claimed infrequently.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If the **UNSALABLE CIGARETTES CREDIT** and the **RETURNED OR DESTROYED TOBACCO CREDIT** were eliminated, it would result in cigarette wholesalers and tobacco products distributors paying for excise taxes that are intended to be passed through to consumers, since the products are ultimately not sold. Although most stakeholders reported that the need for these credits does not arise frequently, some said that when they do have unsalable product, the credits are important to them.

If the **INTERSTATE CIGARETTE SALES EXEMPTION** and the **OUT-OF-STATE TOBACCO SALES CREDIT** were eliminated, cigarettes and tobacco

products could be subject to excise tax both in Colorado and in the jurisdiction in which the products are eventually sold. For example, if a Colorado cigarette wholesaler that sells cigarettes to Oklahoma retailers were responsible for paying Colorado cigarette excise taxes ($0.84 per pack of 20 cigarettes) in addition to the Oklahoma cigarette excise taxes ($2.03 per pack), the total tax on a pack of cigarettes would be $2.87, a 41 percent increase in the amount of tax due with the exemption in place. Likewise, if a Colorado tobacco products distributor were responsible for paying Colorado tobacco products excise taxes (40 percent of the manufacturer's list price) and Oklahoma tobacco products excise taxes (60 percent of the factory list price), the total tax would be 100 percent of the manufacturer's/factory list price, which would be significantly higher than the current tax. Many stakeholders reported that their business is not structured in a way that makes these tax expenditures necessary because they do not ship products into Colorado to be exported outside of Colorado. However, for the Colorado wholesalers and distributors that ship cigarettes and tobacco products to other states, one stakeholder reported that these tax expenditures are important because shipments to out-of-state retailers make up a substantial part of their business. Additionally, every other state has a similar exemption or credit, and eliminating these tax expenditures would make Colorado an outlier among the states.

If the **BAD DEBT CREDITS** were eliminated, it would result in cigarette wholesalers and tobacco products distributors being financially responsible for the excise tax portion of bad debts that result from retailers not paying for the products. Because these credits have been claimed infrequently, there would likely be minimal impact to beneficiaries if these credits were eliminated. However, one stakeholder reported that these credits serve as protective measures for cigarette and tobacco products distributors to recover the excise tax portion of bad debts, especially in cases when a nonpaying retailer has declared bankruptcy or gone out of business.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Every other state and the District of Columbia levies excise taxes on

cigarettes and tobacco products. We examined the tax laws of the 49 other states (excluding Colorado) and the District of Columbia and found that:

- All 49 other states (excluding Colorado) and the District of Columbia either explicitly exempt interstate cigarette and tobacco products sales from excise tax, provide a credit for taxes paid on products shipped outside the state, and/or effectively exempt interstate sales because they only tax products that are sold within the state.
- Forty-five states (excluding Colorado) and the District of Columbia provide a credit for excise taxes paid on unsalable cigarettes, and 38 states (excluding Colorado) provide a credit for excise taxes paid on unsalable tobacco products.
- Nine states (excluding Colorado) allow a bad debt credit for cigarettes, and eight states (excluding Colorado) allow a bad debt credit for tobacco products.

Therefore, interstate cigarette and tobacco products sales excise tax exemptions and credits, and credits for excise taxes paid on unsalable cigarettes and tobacco products are common structural provisions in other states' tax codes. Bad debt credits are less common structural provisions, and the only other state in the Rocky Mountain region that has a similar credit is Idaho.

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

There is a federal excise tax credit or refund [26 USC 5705] of any federal cigarette and tobacco products excise taxes paid on products that are withdrawn from the market, lost (except for theft), or destroyed by fire, casualty, or natural disasters when they are in possession of the claimant. The credit or refund must be claimed within 6 months of when the products are withdrawn from the market, lost, or destroyed.

We did not identify any similar tax expenditures or programs with similar purposes as the **INTERSTATE CIGARETTE SALES EXEMPTION, OUT-OF-STATE TOBACCO SALES CREDIT**, or **BAD DEBT CREDITS.**

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

The Department of Revenue does not require cigarette wholesalers to report their interstate sales on the Cigarette Tax Return. Therefore, we were unable to determine the extent to which the **INTERSTATE CIGARETTE SALES EXEMPTION** is being used or its revenue impact to the State. To collect this additional information, the Department of Revenue would need to add a reporting line specifically for the exemption on the Cigarette Tax Return (Form DR 0221) and add programming to GenTax, its tax processing and information system, to capture and extract this information, which would require additional resources (see the Tax Expenditures Overview section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REPEALING THE BAD DEBT CREDITS BECAUSE THEY ARE RARELY USED AND HAVE LIMITED APPLICABILITY. In Calendar Years 2013 through 2018, the Bad Debt Credits were claimed only in 2013, but data on those claims is not releasable because publishing the data could violate taxpayer confidentiality, which is required under Sections 39-21-113(4)(a) and (5), C.R.S., due to the small number of taxpayers claiming them. Statutes [Sections 39-28-104(4)(b) and (d), and Sections 39-28.5-107(2)(b) and (d), C.R.S.] provide an extensive list of substantiation documents that must be provided in order for a taxpayer to claim the Bad Debt Credits. One stakeholder reported that they do not claim the credits for their bad debts because the substantiation requirements outweigh the benefit they receive from the credits, and that the excise

tax portion of the bad debt would have to be substantial for them to use the credit. One stakeholder also reported that these credits serve as protective measures for cigarette and tobacco products distributors to recover the excise tax portion of bad debts, especially in cases when a nonpaying retailer has declared bankruptcy or gone out of business. However, the need for these credits appears to be limited to infrequent circumstances.

Additionally, we only identified nine other states with a bad debt credit for cigarette excise taxes and eight other states with a bad debt credit for tobacco products excise taxes, so these types of credits are not a common structural element of most states' tax codes.

STATE · OF · COLORADO
UNION AND CONSTITUTION
NIL SINE NUMINE
1876

CREDIT FOR PURCHASE OF UNIQUELY VALUABLE MOTOR VEHICLE REGISTRATION NUMBERS

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE10

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2018)	$0
YEAR ENACTED	2013	NUMBER OF TAXPAYERS (TAX YEAR 2018)	0
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The credit is not encouraging purchasers to bid higher amounts for uniquely valuable vehicle registration numbers that are part of the Colorado Disability Funding Committee's vehicle registration number fundraising auctions. The credit has rarely been claimed, and the Colorado Disability Funding Committee and its staff were not aware of the credit and have not been issuing certificates to vehicle registration number purchasers, which purchasers are required to attach to their tax returns to claim the credit.

WHAT DOES THE TAX EXPENDITURE DO?

The Credit for Purchase of Uniquely Valuable Motor Vehicle Registration Numbers [Section 39-22-535, C.R.S.] (Registration Number Credit) allows an income tax credit for taxpayers who purchase the exclusive right to use uniquely valuable motor vehicle registration numbers from the Colorado Disability Funding Committee (Committee). Uniquely valuable motor vehicle registration numbers, which are displayed on individuals' vehicle license plates, are letter and number combinations that are likely to be worth substantially more than the average value of a registration number (license plate), for example, COORS, BENTLEY, ROCKET, 1ST, and BOURBON. The credit is equal to 20 percent of the portion of the purchase price that the Committee certifies exceeds the registration number's fair market value.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the Registration Number Credit do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the credit and testimony from a witness during committee hearings for the enacting legislation [Senate Bill 13-170], we considered a potential purpose: to encourage bidders to pay more for vehicle registration numbers that the Committee sells as part of its vehicle registration number fundraising auctions.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Repealing the Registration Number Credit.
- If it does not repeal the Registration Number Credit, establishing a purpose and performance measures for Registration Number Credit.
- If it does not repeal the Registration Number Credit, clarifying the method that should be used to determine the credit amount.

CREDIT FOR PURCHASE OF UNIQUELY VALUABLE MOTOR VEHICLE REGISTRATION NUMBERS

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Credit for Purchase of Uniquely Valuable Motor Vehicle Registration Numbers (Registration Number Credit) [Section 39-22-535, C.R.S.] allows an income tax credit for taxpayers who purchase uniquely valuable motor vehicle registration numbers from the Colorado Disability Funding Committee (Committee), which is administered by the Lieutenant Governor's Office. Uniquely valuable motor vehicle registration numbers are letter and number combinations displayed on individuals' vehicle license plates that are likely to be worth substantially more than the average value of a registration number (license plate), for example, COORS, BENTLEY, ROCKET, 1ST, and BOURBON.

The credit is equal to 20 percent of the portion of the purchase price of the right to use a vehicle registration number that the Committee certifies exceeds the registration number's fair market value. For example, if a vehicle registration number had a fair market value of $500 and sold for $1,000, the tax credit would be $100, calculated as follows:

EXHIBIT 1. CALCULATION OF HYPOTHETICAL CREDIT	
Purchase Price	$1,000
Fair Market Value	$500
Amount that the Purchase Price Exceeds the Fair Market Value	$500
Tax Credit (20 percent of the Amount that Exceeds the Fair Market Value)	$100
SOURCE: Office of the State Auditor analysis of Section 39-22-535(1), C.R.S.	

The credit is not refundable, but may be carried forward for 5 years if the credit exceeds the taxpayer's income tax liability.

The Committee auctions the exclusive right to use uniquely valuable motor vehicle registration numbers as a means of raising money to support its mission of distributing funding to support programs benefiting Colorado's disability community. Specifically, statute [Section 24-30-2208(1), C.R.S.] provides that the Committee "shall raise money by selling to a buyer the right to use valuable letter and number combinations for a registration number… [and that the Committee] shall auction registration numbers that are likely to be worth substantially more than the average value of a registration number." According to Committee staff, the Committee identifies potentially valuable vehicle registration numbers by (1) taking suggestions from Committee members; (2) examining lists from the Division of Motor Vehicles (DMV), which is within the Department of Revenue (Department), of vehicle registration numbers that were recently in use but have since expired; and (3) taking recommendations from a contractor. The Committee then requests that the Department reserve vehicle registration numbers that it intends to auction.

Vehicle registration numbers that the Committee reserves can only be purchased through the Committee's auctions; they cannot be purchased as personalized license plates directly from the DMV. Statute [Section 24-30-2210(2)(a) and (b), C.R.S.] authorizes the Committee to sell vehicle registration numbers that deviate from the standard constraints for license plates. For example, these registration numbers can contain only one character (e.g., X) or include any symbol on the standard American keyboard (e.g., #, $), whereas personalized vehicle registration numbers requested directly from the Department must contain between two and seven characters and may only include numbers and letters [Section 42-3-211(3)(a), C.R.S.].

According to Committee data, between 2013 and 2021, the auction program has sold 225 vehicle registration numbers for between $40 and $20,000, with an average purchase price of $1,000. Recent Committee

auctions have included vehicle registration numbers with themes such as Colorado Day (e.g., CO, WELOVCO), cannabis (e.g., ISIT420, GREEN), and Colorado colleges and universities (e.g., ILOVECU, CORAMS). According to the Committee's website, when someone purchases the right to use a registration number through one of its auctions, that person retains the right to use that number on their license plate for 3 years. The license plate number may be transferred to another person only at the time of the initial purchase following the auction, but may not be transferred again. They may renew the registration number at 30 percent of the winning bid price for each 3-year renewal period, for a total ownership period of 12 years.

The money raised through the sale of the valuable vehicle registration numbers is used by the Committee to fund "program[s] to aid persons with disabilities in accessing disability benefits" [Section 24-30-2204(1), C.R.S.] or "projects or programs that study or pilot new and innovative ideas that will lead to an improved quality of life or increased independence for persons with disabilities" [Section 24-30-2204.5(1), C.R.S.]. The Committee and the vehicle registration number fundraising auction program are scheduled for repeal on September 1, 2026, and will undergo a sunset review by the Department of Regulatory Agencies prior to their repeal. If the Committee and auction program are repealed as scheduled, the Registration Number Credit would effectively become obsolete beginning in Tax Year 2027, except for taxpayers that are carrying forward credits; the credit does not currently have a statutory expiration or repeal date.

The General Assembly created the credit in 2013 with Senate Bill 13-170. When the credit was created, the License Plate Auction Group (LPAG), which was within the Governor's Office, was responsible for overseeing the vehicle registration number auctions and issuing certifications for the Registration Number Credit. In 2016, House Bill 16-1362 replaced the LPAG with the Committee. The credit has remained substantively unchanged since that time.

To claim the credit, all taxpayers are required to attach a copy of the certification from the Committee to their income tax return. According to Department staff, there is no specific form or format for the certification, but it must be issued by the Committee and certify the portion of the purchase price that exceeds the fair market value of the registration number; certifications for registration numbers sold in 2016 or earlier years would have been issued by the LPAG.

Individuals claim the credit on Line 30 of the Individual Credit Schedule (Form DR 0104CR), which they must attach to the Colorado Individual Income Tax Return (Form DR 0104). C-corporations claim the credit on Line 18 of the Credit Schedule for Corporations (Form DR 0112CR), which they must attach to the Colorado C Corporation Income Tax Return (Form DR 0112). S corporations and partnerships claim the credit on Line 16 of the Colorado Pass-through Entity Credit Schedule (Form DR 0106CR), which they must attach to the Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Estates and trusts claim the credit on the "Other Credits" line (Line 11) of the Schedule G of the Colorado Fiduciary Income Tax Return (Form DR 0105).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the intended beneficiaries of the Registration Number Credit. Based on the statutory language of the credit and testimony from a witness during committee hearings for the enacting legislation [Senate Bill 13-170], we inferred that programs funded by the Committee are the intended beneficiaries of the credit, to the extent that it incentivizes taxpayers to bid higher amounts for vehicle registration numbers, since there would be more funding available for those programs. Taxpayers who purchase motor vehicle registration numbers for more than their fair market value through the Committee's auctions are also intended to benefit since they get to reduce their income tax liability.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the bill that created the Registration Number Credit do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the credit and testimony from a witness during committee hearings for the enacting legislation [Senate Bill 13-170], we considered a potential purpose: to encourage bidders to pay more for vehicle registration numbers that the Committee sells as part of its vehicle registration number fundraising auctions. During committee hearings, the witness stated that he believed people would pay more for unique vehicle registration numbers if they could get a tax benefit.

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

We could not definitively determine whether the Registration Number Credit is meeting its purpose because no purpose is provided for it in statute or in the bill that established it. However, we found that the credit is not meeting the purpose we considered to conduct this evaluation because it is rarely claimed.

Statute does not provide quantifiable performance measures for this credit. Therefore, we created and applied the following performance measure to determine the extent to which the credit is meeting its potential purpose:

PERFORMANCE MEASURE: *To what extent does the Registration Number Credit encourage people to bid higher amounts for uniquely valuable vehicle registration numbers that are part of the Committee's vehicle registration number fundraising auctions?*

We determined that the Registration Number Credit is not encouraging purchasers to bid higher amounts for vehicle registration numbers that are part of the Committee's vehicle registration number fundraising auctions. According to Committee staff, the current Committee and its

staff were not aware of the credit and have not been issuing certificates to purchasers of vehicle registration numbers sold through the auctions since the Committee began operating the program in 2016. This creates a barrier to taxpayers claiming the credit because they must include a certification from the Committee of the amount the purchase price exceeds the fair market value of the vehicle registration number when they claim the credit on their tax returns. Additionally, language in the Committee's rules and frequently asked questions page of its website may lead taxpayers to believe that there is uncertainty regarding the availability of the credit by stating, "The Colorado Disability Funding Committee has not made any representations regarding whether all or part of a winning bid amount is eligible for a tax deduction or tax credit under any state or federal law." Furthermore, in Tax Year 2016, the most recent year that taxpayers claimed the credit, only $41 in credits were claimed, which indicates that the credit was unlikely to have had a significant impact on the amount purchasers paid for registration numbers.

Department data also indicate that awareness of the credit is low. In Tax Year 2018, which is the most recent year for which we had data on credit claims, no taxpayers claimed the Registration Number Credit. Data for Tax Year 2017 is incomplete, but the available data indicates that there were no claims by individuals or corporations in that year either. In Tax Year 2016, 10 taxpayers claimed credits. From Tax Years 2013 to 2015, too few taxpayers claimed the credit to report the number without revealing confidential taxpayer information. Although we lacked data to break down the number of eligible purchases from 2013 through 2018 on an annual basis, during this period 27 individuals purchased numbers, indicating that many eligible taxpayers did not claim the credit. It is also unclear whether taxpayers who claimed the credit did so properly, since the Committee has not issued the required certificates to taxpayers. However, in 2016 and prior years, certificates may have been issued by the LPAG, which administered the program from 2013 through mid-2016, and so it is possible that the 2016 claims could have come from taxpayers who carried forward credits from prior years for which the LPAG issued certificates.

However, due to time constraints and the low revenue impact of the credit, we did not investigate the claims to determine whether they were proper claims.

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

The Registration Number Credit had virtually no impact on state revenue between Tax Years 2013 and 2018. According to Department data, there was no revenue impact in Tax Year 2018 and there did not appear to be an impact in Tax Year 2017, although the data was incomplete. In Tax Year 2016, 10 taxpayers claimed the Registration Number Credit for a total state revenue impact of $41. Data for Tax Years 2013 through 2015 are not releasable because publishing the data could violate taxpayer confidentiality, which is required of the Department and the Office of the State Auditor under Section 39-21-113(4)(a), (5), and 305(2)(b), C.R.S., due to the small number of taxpayers claiming the credit.

In addition, the credit has not had any significant economic benefits for the State, the purchasers, or the Committee since it has not incentivized taxpayers to bid significantly higher amounts for the vehicle registration numbers that are part of the Committee's fundraising auctions.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Registration Number Credit would have little to no impact on the intended beneficiaries because it has rarely been claimed, and Committee staff were not aware of the credit, and therefore, have not used it to promote increased sales prices for the vehicle registration numbers that it auctions. Committee staff reported that they do not think that repealing the credit would reduce the sales prices of the registration numbers that are part of its auctions since purchasers did not appear to be aware of the credit. However, they reported that some purchasers, particularly purchasers of registration numbers worth thousands of dollars, have asked the Committee whether their

purchases would be eligible for a charitable contribution deduction. Because of this interest in receiving tax benefits related to registration purchases, Committee staff thought that promoting the credit going forward could potentially increase sales prices and stated that the Committee has expressed interest in promoting the credit. Therefore, eliminating the credit could potentially have an impact on registration number sales in the future.

Repealing the credit would not have an impact on the Committee's ability to conduct auctions of uniquely valuable vehicle registration numbers because the existence of the Committee and its fundraising auctions are not dependent on the existence of the Registration Number Credit.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We did not identify any similar tax expenditures in other states.

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

We did not identify any other tax expenditures or programs with a similar purpose available in the state.

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

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

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REPEALING THE REGISTRATION NUMBER CREDIT BECAUSE IT IS RARELY CLAIMED AND HAS NOT BEEN EFFECTIVE AT ENCOURAGING UNIQUELY VALUABLE VEHICLE REGISTRATION NUMBER PURCHASERS TO BID HIGHER AMOUNTS IN THE

COMMITTEE'S AUCTIONS. As discussed, no taxpayers claimed the Registration Number Credit in Tax Years 2017 and 2018, and in Tax Year 2016, only 10 taxpayers claimed the credit for a total of $41. Additionally, Committee staff reported that they were not aware of the Registration Number Credit and therefore, the Committee had not been issuing certificates to purchasers that certify the amount of the purchase price that exceeds the fair market value; Committee staff also did not believe purchasers were aware of the credit. This indicates that the credit has not incentivized taxpayers to bid higher amounts for uniquely valuable vehicle registration numbers that the Committee sells in its auctions. However, Committee staff reported that now that the Committee is aware of the credit, they believe that promoting it could potentially increase the purchase price of some of the registration numbers that are part of its auctions. However, it is unclear the extent to which this would occur.

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE CREDIT, IT MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE VEHICLE REGISTRATION NUMBER CREDIT. As discussed, statute and the enacting legislation for the credit do not state the credit's purpose or provide performance measures for evaluating its effectiveness. Therefore, to conduct our evaluation, we considered a potential purpose for the credit: to encourage bidders to pay more for vehicle registration numbers that the Committee sells as part of its vehicle registration number fundraising auctions. We identified this purpose based on the credit's operation and witness testimony for the enacting legislation [Senate Bill 13-170]. We also developed a performance measure to assess the extent to which the credit is meeting its potential purpose. However, the General Assembly may want to clarify its intent for the credit by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the credit's purpose and allow our office to more definitively assess the extent to which the credit is accomplishing its intended goal(s).

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE CREDIT, IT COULD CONSIDER PROVIDING CLARIFICATION ON THE METHOD THAT SHOULD BE USED TO DETERMINE THE CREDIT AMOUNT. Currently, statute [Section 39-22-535(1), C.R.S.] provides that the credit is allowed "for twenty percent of the portion of the purchase price that the Colorado [D]isability [F]unding [C]ommittee, created in section 24-30-2203, certifies exceeds the registration number's fair market value." However, establishing a fair market value for the sale of registration numbers is challenging. First, although statute states "[The fair market value] is the value the Colorado [D]isability [F]unding [C]ommittee expects from the sale of the registration number, not the cost of registering the vehicle," it does not provide a methodology for determining fair market value. Second, United States Treasury Regulations [26 CFR 1.170A-1(c)(2)] define fair market value as "the price at which the property would change hands between a willing buyer and a willing seller…" which also does not offer clear guidance for this situation. Since the Committee is a willing seller and the taxpayers who buy the auctioned registration numbers are willing buyers, the Federal regulations would indicate that the final sales price is the fair market value, so the difference between the two would be $0, which would result in a credit of $0. Since the Committee was not aware of the credit, Committee staff reported that it does not have a process in place for establishing fair market value and that it would be difficult to place a fair market value on the registration numbers besides $0 because the registration numbers only have a monetary value because of the Committee's exclusive right to sell them. Therefore, the General Assembly could consider clarifying how the fair market value should be determined or basing the credit on a more clearly established figure, such as a specific dollar amount or a percentage of the final purchase price.

STATE · OF · COLORADO
NIL SINE NUMINE
1876

LONG-TERM CARE INSURANCE CREDIT

EVALUATION SUMMARY | APRIL 2022 | 2022-TE17

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2018)	$2.6 million
YEAR ENACTED	1999	NUMBER OF TAXPAYERS	12,500
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The Long-Term Care Insurance Credit does not appear large enough to encourage most individuals who qualify to purchase long-term care insurance and its relative benefit has declined since it was established because premium costs have increased.

WHAT DOES THE TAX EXPENDITURE DO?

The Long-Term Care Insurance Credit [Section 39-22-122 (1) and (3), C.R.S.] allows certain taxpayers to claim a credit against their state income taxes for 25 percent of the premiums they paid during the year for long-term care insurance, up to $150 per policy. Statute allows the credit only for taxpayers who:

- Have federal taxable income below $50,000, are filing a single or joint federal return, and are claiming the credit for one policy; or
- Have federal taxable income below $100,000, are filing a joint return, and are claiming the credit for separate policies that cover both individuals on the return.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the credit do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the credit's legislative history and operation; similar credits in other states; and discussions with Division of Insurance staff, we considered two potential purposes:

1. To encourage taxpayers with lower and middle incomes to purchase long-term care insurance by making it more affordable, and
2. To reduce the State's costs for long-term care services and supports.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to:

- Consider amending statute to establish a statutory purpose and performance measures for the credit.
- Review the effectiveness of the credit and could consider changes to the credit cap and income limits.

LONG-TERM CARE INSURANCE CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Long-Term Care Insurance Credit (Long-Term Care Credit) [Section 39-22-122(1) and (3), C.R.S.] allows certain taxpayers to claim a credit against their state income taxes for 25 percent of the premiums they paid during the year for long-term care insurance, up to $150 per policy. If the credit exceeds the taxpayer's income tax liability, the remaining credit cannot be carried forward to be used in a future tax year or refunded. Statute allows the credit only for taxpayers who:

- Have federal taxable income below $50,000, are filing a single or joint federal income tax return, and are claiming the credit for one policy; or

- Have federal taxable income below $100,000, are filing a joint income tax return, and are claiming the credit for separate policies that cover both individuals on the return.

Long-term care insurance is designed to help pay for care that is needed due to chronic illness, disability, injury, or the general effects of aging. To be eligible for the credit, policies must provide coverage for no less than 12 consecutive months, and help cover the cost of assistance with activities of daily living, such as bathing and dressing; nursing care; and physical, occupational, or speech therapy for individuals who cannot perform the tasks independently due to a chronic illness or disability. Additionally, policies: (1) must provide coverage for care in a setting other than an acute care unit of a hospital, and (2) shall not include any insurance policy offered primarily to provide basic hospital expense or Medicare supplemental coverage [Section 10-19-103(5), C.R.S.].

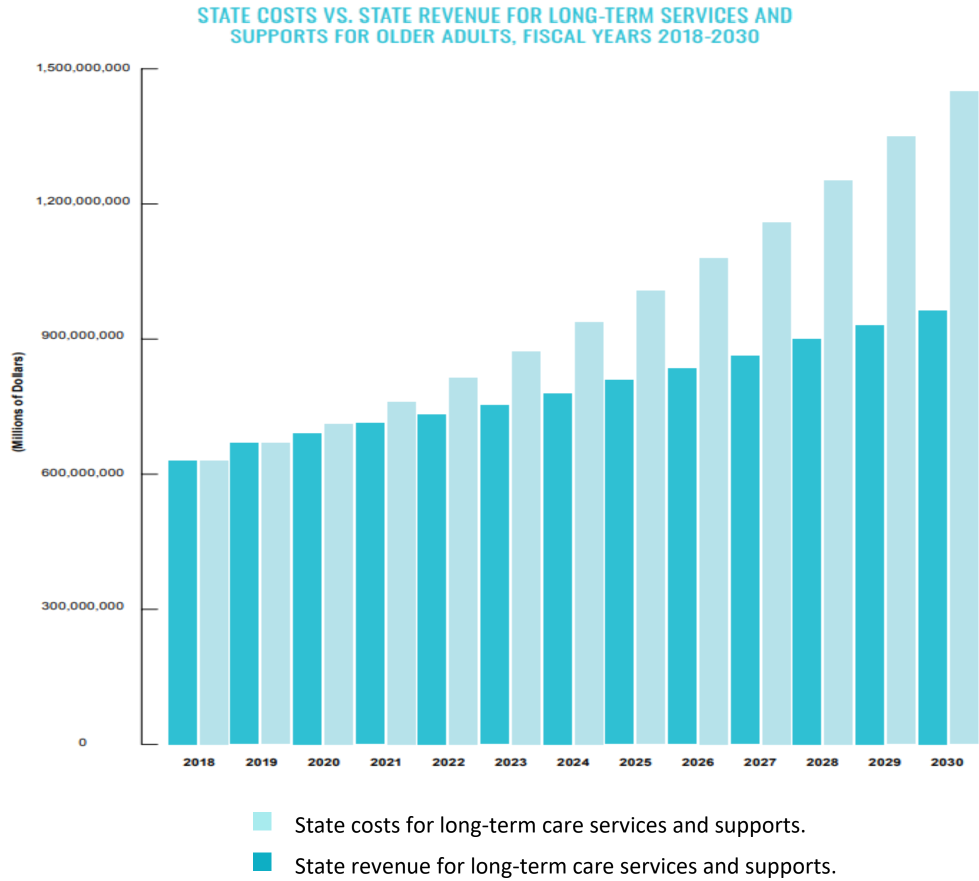
In 1999, House Bill 99-1246 created the Long-Term Care Credit and it has remained substantively unchanged since that time. Taxpayers claim the credit on Line 26 of the Individual Credit Schedule [Form 104 CR] when filing their income tax return and must also submit supporting documentation to show the premiums they paid.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the credit. Based on statute, Department of Revenue (Department) guidance, and discussions with the Division of Insurance within the Department of Regulatory Affairs (Division), we inferred that the beneficiaries of the Long-Term Care Credit are eligible Colorado taxpayers who incur expenses in purchasing or paying premiums on long-term care insurance. The U.S. Department of Health and Human Services estimated that 70 percent of individuals 65 years or older will require long-term care services or support at some point and that 48 percent will pay for at least some of their care. People buy long-term care insurance to protect their income and savings, and to give themselves options in their choice of care. In general, regular health insurance does not cover long-term care; Medicare provides limited coverage; and Medicaid offers some coverage, but with limited choices in service providers and requires recipients to have income and assets below certain thresholds.

Additionally, to the extent that the credit encourages individuals to purchase long-term care insurance, the State may also benefit, since individuals with insurance coverage may be less likely to need state-funded long-term care services. As shown in EXHIBIT 1, the cost for state-funded long-term care programs, such as those provided through Medicaid, are expected to increase significantly in the coming years, with costs significantly exceeding projected available revenue by 2030.

EXHIBIT 1. PROJECTED STATE-FUNDED COST AND REVENUE FOR LONG-TERM CARE SERVICES



SOURCE: The 2020 Strategic Action Plan on Aging by the State of Colorado's Strategic Action Planning Group on Aging.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the Long-Term Care Credit do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the credit's legislative history and operation; news articles from the time of its passage; similar credits in other states; and discussions with Division staff, we considered two potential purposes:

1. To encourage taxpayers with lower and middle incomes to purchase long-term care insurance by making it more affordable, and

2. To reduce the State's costs for long-term care services and supports.

At the time the credit was created, there was significant interest at the federal and state levels in ensuring private long-term care insurance was accessible. For example, the federal government enacted tax benefits for qualifying long-term care insurance policies under the Health Insurance Portability and Accountability Act (1996) and other states, including Minnesota, New York, and Maryland, enacted long-term care insurance tax credits between 1999 and 2000. According to Division staff and reviews of similar policies in other states, these type of tax credits were created to incentivize consumers to buy long-term care policies. In addition, according to reviews of similar tax expenditures in other states and other reports, states were interested in encouraging individuals to purchase private insurance both to improve the accessibility of care for individuals who require long-term care and also to help reduce the costs that states ultimately bear, often through increased Medicaid costs, when uninsured individuals require long-term care.

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

We could not definitively determine whether the Long-Term Care Credit is meeting its purpose because no purpose is provided in statute or its enacting legislation. However, we found that the credit is only

meeting the potential purposes we considered to conduct this evaluation to a limited extent because the benefit it provides appears insufficient to make long-term care insurance significantly more affordable. Therefore, it likely has only a small impact on individuals' decisions on whether to purchase qualifying policies.

Statute and the credit's enacting legislation do not provide performance measures to evaluate its effectiveness. We created and applied the following performance measures to determine whether the Long-term Care Credit is meeting its potential purposes:

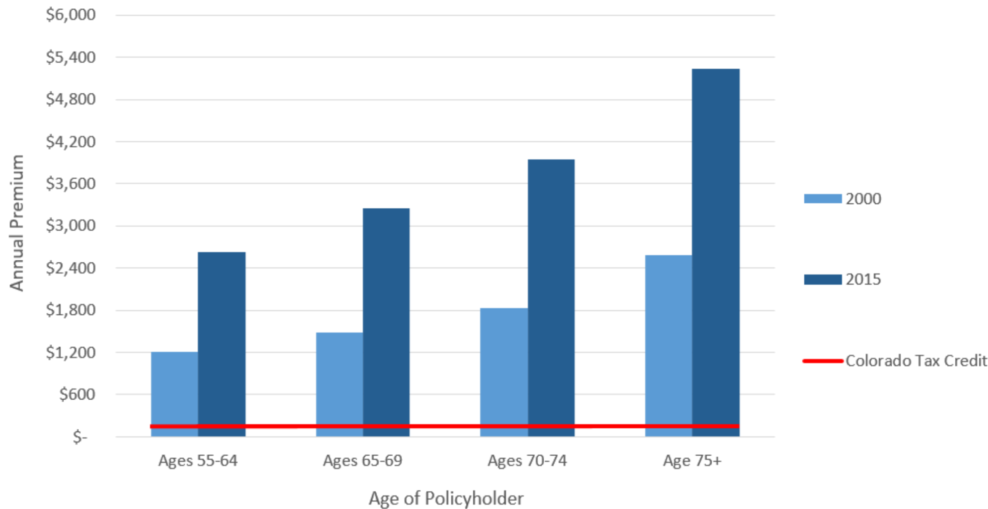
PERFORMANCE MEASURE #1: *To what extent has the Long-term Care Credit incentivized taxpayers to buy long-term care insurance policies, and made those policies more affordable for low- and middle-income taxpayers?*

RESULT: Overall, we found that the credit is likely too small to encourage most eligible taxpayers to purchase long-term care insurance, although it provides some financial support for individuals who qualify. As discussed, statute caps the credit at $150 per year, per policy. In comparison, according to information reported by the National Association of Insurance Commissioners (NAIC) and LifePlans, a long-term care and health insurance provider, in 2015, the most recent year with available data, the average cost of a policy ranged from $2,624 annually for individuals aged 55 to 64 years, up to $5,241 for individuals 75 and over. Therefore, in 2015, the credit would have offset the cost of these policies by between 3 and 6 percent. Although this tax benefit could be enough to influence some taxpayers for whom long-term care insurance is only marginally affordable, it appears insufficient to drive most individuals' decisions to purchase coverage or cause a significant increase in the number of individuals with long-term care insurance.

The cost of long-term care policies has continued to rise, while the credit amount has remained unchanged. EXHIBIT 2 compares the premium cost of long-term care insurance policies in 2000 and 2015 to the

maximum credit value. As shown, the premium cost for a policy more than doubled during this period, while the maximum credit amount, which has not been adjusted since it was created in 1999, has covered a decreasing proportion of the cost.

EXHIBIT 2. PROPORTION OF ANNUAL PREMIUM COSTS[1] COVERED BY THE CREDIT BETWEEN 2000 AND 2015



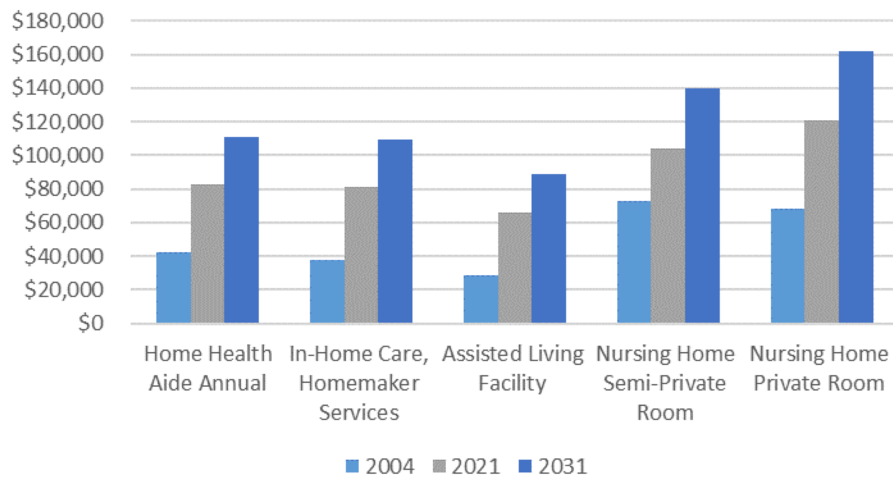
SOURCE: Office of the State Auditor analysis of data from LifePlans and the National Association of Insurance Commissioners.

1 The premium costs in this chart are an average of both single male and single female policies, ages 55 to over 75.

According to Division staff, long-term care insurance is increasingly difficult for most individuals to afford and is primarily purchased by those with higher incomes. This is consistent with Department data, which shows that between Tax Years 2011 and 2018, the number of taxpayers who claimed the credit decreased from 18,975 to 12,532, a 34 percent decline. Furthermore, the taxpayers who claimed the credit in 2018 represent only about 10 percent of the 127,216 long-term care insurance policies that were active in Colorado as of 2018, according to the NAIC. Therefore, although it is possible that some eligible taxpayers did not claim the credit, it appears that most individuals with long-term care insurance may not qualify for the credit, likely because those who can afford long-term care insurance policies are primarily individuals with higher incomes.

Increases in long-term care costs have caused insurance companies to increase premiums to cover expected benefits payments. As shown in EXHIBIT 3, the annual cost of long-term care services has increased over time and is expected to grow between 2021 and 2031. Therefore, it appears that the cost of long-term care insurance policies is likely to increase, further reducing their overall affordability and decreasing the relative impact of the credit because it will cover a decreasing percentage of annual premiums.

EXHIBIT 3. ANNUAL COSTS OF LONG-TERM CARE 2004 TO 2031 (ESTIMATED)



SOURCE: Office of the State Auditor review of Genworth Financial report anticipating long-term care insurance services and supports costs. Genworth Financial is an insurance provider that collaborates with the National Association of Insurance Commissions to produce reports on long-term care insurance.

PERFORMANCE MEASURE #2: *To what extent has the Long-Term Care Insurance Credit reduced the State's long-term care program costs?*

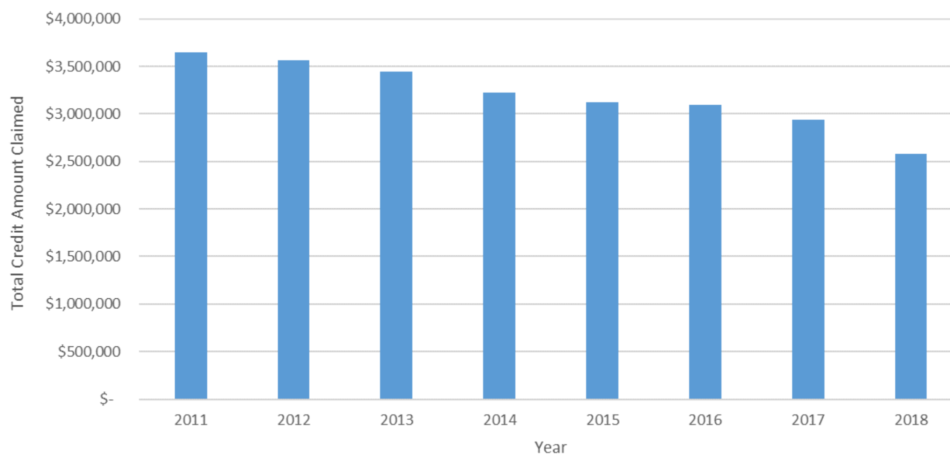
Due to the relatively low dollar amount of the credit, it appears that the credit is too small to influence many taxpayers to purchase long-term care insurance. As a result, the credit has also likely had a relatively small impact on the State's cost for providing long-term care services. Further, although $2.6 million in credits were claimed in Tax

Year 2018, this represents less than 1 percent of the $630 million the State spent on long-term care services during Calendar Year 2018. Therefore, it appears that the support the credit provides to taxpayers who purchase long-term care insurance has not likely had a substantial impact on overall state costs.

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

Based on Department data, the Long-Term Care Insurance Credit had a revenue impact of about $2.6 million in Tax Year 2018, and provided a corresponding benefit to about 12,500 taxpayers, who claimed an average credit amount of about $200. This amount exceeds the $150 per policy credit cap because joint filers may claim the credit for one policy each, up to $300. As shown in EXHIBIT 4, the amount claimed has steadily decreased from about $3.6 million in 2011, to about $2.6 million in 2018.

EXHIBIT 4. TOTAL CREDIT AMOUNT CLAIMED TAX YEARS 2011-2018



SOURCE: Office of the State Auditor analysis of the Department of Revenue Annual Reports data.

As discussed, long-term care insurance costs have increased substantially in recent years, which has resulted in fewer lower and middle-income taxpayers, who would qualify for the credit, purchasing coverage. Because long-term care costs are expected to continue rising, it is likely that the total credit amount claimed will continue to decline as fewer lower and middle-income taxpayers are able to afford policies.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the credit was eliminated, the 12,500 taxpayers who claimed the credit in Tax Year 2018 would not be able to claim 25 percent of their long-term care insurance premiums, up to $150 per policy, as a credit against their state income tax liability. To the extent that the credit caused these taxpayers to purchase policies, this could result in fewer Coloradans being covered by long-term care insurance. As discussed, we estimated that the credit reduced the cost of eligible policies by about 3 to 6 percent, which appears unlikely to be a significant enough difference to change most taxpayers' decisions regarding whether to purchase coverage. However, eliminating the credit would have the largest impact on taxpayers for whom long-term care is marginally affordable. Further, the credit provides some financial support for lower and middle-income taxpayers who purchase long-term care insurance, which would no longer be available. To the extent that eliminating the Long-Term Care Insurance Credit would cause some current beneficiaries to no longer be able to afford insurance, these individuals would be at risk of having to pay for long-term care out of pocket, the cost of which could be prohibitively expensive, or foregoing necessary services. In addition, to the extent these individuals would qualify for the State's long-term care programs, eliminating the credit could increase costs to the State, although as discussed, it appears this impact would be small compared to the amount the State currently spends on long-term care.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Forty-one other states (excluding Colorado) and the District of Columbia impose an individual income tax. Of these, 14 states and the District of Columbia allow taxpayers to take a deduction from state taxable income for long-term care insurance expenses, and, like Colorado, six states allow for a credit. For example, Maryland offers a onetime credit of $500 and Louisiana offers a credit equal to 7 percent of total premiums paid each year, which based on the cost of a policy, can exceed $150. Additionally, 21 states follow federal guidelines, which allow taxpayers to deduct the amount they spend for qualified long-term care insurance policies from their taxable income so long as 1) the taxpayer itemizes their deductions, and 2) their unreimbursed medical expenses exceed 7.5 percent of their adjusted gross income. However, as discussed below, most taxpayers do not meet these requirements.

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

We did not identify any state tax expenditures with a similar purpose; however, there are several federal tax expenditures that may help individuals to purchase long-term care insurance. Additionally, because Colorado uses federal taxable income as the starting place to determine Colorado taxable income, taxpayers who claim a federal deduction would also receive a state deduction. Two federal tax benefits are:

FEDERAL DEDUCTIONS—Federal tax laws allow taxpayers to deduct the amount they spend for qualified long-term care insurance policies from their federal taxable income so long as 1) the taxpayer itemizes their deductions, and 2) their unreimbursed medical expenses exceed 7.5 percent of their adjusted gross income. If the insured qualifies for federal deductions, the deduction limit is determined by age. However, according to the American Association of Retired Persons Public Policy Institute, few taxpayers meet this qualification.

SAVINGS ACCOUNTS—Taxpayers may also pay for long-term care insurance expenses using other federal tax-advantaged medical accounts such as a Health Savings Accounts, or Archer Medical Savings Accounts. Furthermore, if a taxpayer's policy is used to reimburse qualified expenses, then the insured may not owe federal income tax on their benefits.

There are also state-level programs that may help individuals with long-term care costs:

PARTNERSHIP POLICIES—The General Assembly passed legislation allowing for long-term care insurance partnership policies in 2006. This policy type allows consumers to protect their personal assets in the event that they must apply for Medicaid to pay for long-term care services. It was the General Assembly's intent that the legislation would "encourage individuals to purchase long-term care insurance" instead of first expending all of their personal resources, then ultimately relying on Medicaid, to cover the cost of long term care [Section 25.5-6-110(2), C.R.S.]. According to information presented by the NAIC, partnership policies represented slightly over two in five sales nationally in 2015.

LONG-TERM CARE PROGRAMS—Several state programs administered by the Colorado Department of Health Care Policy and Financing and Department of Human Services provide support for long-term care services. These programs include home care, long-term home health, home- and community-based services, assisted living, skilled nursing, and others—all of which are primarily funded through Medicaid and Medicare, and are provided to eligible taxpayers. According to information from the Colorado Health Institute, the State spent about $630 million on long-term care programs in Calendar Year 2018.

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

We did not encounter any data constraints that impacted our ability to evaluate the tax expenditure.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE CREDIT. As discussed, statute and the enacting legislation do not state the credit's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered two potential purposes for the credit:

1. To encourage taxpayers with lower and middle incomes to purchase long-term care insurance by making it more affordable.

2. To reduce the State's costs for long-term care services and supports.

We identified these purposes based on our review of other state credits, consideration of the historical context for long-term care insurance, and discussions with state departments. We also developed performance measures to assess the extent to which the credit is meeting this potential purpose. However, the General Assembly may want to clarify its intent for the credit by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the credit's purpose and allow our office to more definitively assess the extent to which the credit is accomplishing its intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EFFECTIVENESS OF THE CREDIT AND COULD CONSIDER CHANGES TO THE CREDIT CAP AND INCOME LIMITS. As discussed, we found that the Long-Term Care Insurance Credit is only meeting its purpose to a limited extent because it is likely too small to encourage most eligible individuals to purchase long-term care insurance, covering approximately 3 to 6 percent of typical annual premiums. Even with the credit, according to Division staff, long-term care insurance is often difficult for many individuals to afford and most coverage is purchased by individuals with high incomes. Additionally, the impact of the credit has decreased over time because, since 1999 when the credit was established, the cost of long-

term care policies has more than doubled, but the maximum credit available has remained at $150 annually per policy.

We also found that there has been a steady decline in the number of taxpayers who claim the credit, with claims falling from 18,975 to 12,532—a 34 percent decrease—between Tax Years 2011 and 2018. This decline appears to have occurred, at least in part, because the number of individuals who meet the income limits for the credit (i.e., under $50,000 for individual filers and $100,000 for joint filers) and can afford long-term care insurance has declined as household incomes in the state and costs for long-term care have grown. When the credit was established in 1999, the household median income of Coloradans was about $47,000. Since that time, the median household income in Colorado has grown by about 60 percent, to $75,000 in Calendar Year 2020. However, the credit's income limits have not been adjusted since it was established.

Therefore, the General Assembly could consider evaluating the amount of the credit and the income limits to determine whether changes are needed to increase the effectiveness of the credit. Any changes to the credit cap or income limits would likely increase the credit's revenue impact to the State.

Document: C.R.S. 39-26-102

C.R.S. 39-26-102

Copy Citation

Statutes current through Chapter 275 from the 2023 Regular Session and effective as of May 30, 2023. The text of this section is not final. It will not be final until compared to, and updated from, the text provided by the Colorado Office of Legislative Legal Services later this year.

39-26-102. Definitions.

As used in this article 26, unless the context otherwise requires:

(1) “Agricultural commodity” means any agricultural commodity as defined in section 35-28-104 (1), C.R.S.; except that, for purposes of this article, “agricultural commodity” shall also include sugar beets, timber and timber products, oats, malting barley, barley, hops, rice, milo, and any other feed grain.

(1.3) “Auction sale” means any sale conducted or transacted at a permanent place of business operated by an auctioneer or a sale conducted and transacted at any location where tangible personal property is sold by an auctioneer when such auctioneer is acting either as agent for the owner of such personal property or is in fact the owner thereof. The auctioneer at any sale defined in subsection (10) of this section, except when acting as an agent for a duly licensed retailer or vendor or when selling only tangible personal property that is exempt under the provisions of section 39-26-716 (4)(a) and (4)(b), is a retailer or vendor as defined in subsection (8) of this section and the sale made by the auctioneer is a retail sale as defined in subsection (9) of this section, and the business conducted by said auctioneer in accomplishing such sale is the transaction of a business as defined by subsection (2) of this section.

(2) “Business” includes all activities engaged in or caused to be engaged in with the object of gain, benefit, or advantage, direct or indirect.

(2.5) “Charitable organization” means any entity organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or

owned by the same shareholders in identical percentage of stock ownership amounts, computed on a share-by-share basis, when a tax imposed by this article was paid by the transferor corporation at the time it acquired such assets, except to the extent provided by subsection (12) of this section. For the purposes of this paragraph (k), a closely held subsidiary corporation is one in which the parent corporation owns stock possessing at least eighty percent of the total combined voting power of all classes of stock entitled to vote and owns at least eighty percent of the total number of shares of all other classes of stock.

(11) "Sale" or "sale and purchase", in addition to the items included in subsection (10) of this section, includes the transaction of furnishing rooms or accommodations by any person, partnership, limited liability company, association, corporation, estate, receiver, trustee, assignee, lessee, or person acting in a representative capacity or any other combination of individuals by whatever name known to a person who for a consideration uses, possesses, or has the right to use or possess any room in a hotel, apartment hotel, lodging house, motor hotel, guesthouse, guest ranch, trailer coach, mobile home, auto camp, or trailer court and park, under any concession, permit, right of access, license to use, or other agreement, or otherwise.

(12) Except as otherwise provided in this subsection (12), the sales tax is imposed on the full purchase price of articles sold after manufacture or after having been made to order and includes the full purchase price for material used and the service performed in connection therewith, excluding, however, such articles as are otherwise exempted in this article. In connection with the transactions referred to in paragraph (k) of subsection (10) of this section, the sales tax is imposed only on the amount of any increase in the fair market value of such assets resulting from the manufacturing, fabricating, or physical changing of the assets by the transferor corporation. Except as otherwise provided in this subsection (12), the sales price is the gross value of all materials, labor, and service, and the profit thereon, included in the price charged to the user or consumer.

(13) "School" means an educational institution having a curriculum comparable to grade, grammar, junior high, high school, or college, or any combination thereof, requiring daily attendance, having an enrollment of at least forty students, and charging a tuition fee.

(13.5) (Deleted by amendment, L. 2011, (HB 11-1293), ch. 299, p. 1437, § 4, effective July 1, 2012.)

(14) "State treasurer" or "treasurer" means the state treasurer of the state of Colorado.

(15)

(a)

(I) "Tangible personal property" means corporeal personal property. The term embraces all goods, wares, merchandise, products and commodities, and all tangible or corporeal things and substances that are dealt in and capable of being possessed and exchanged, except as set forth in this subsection (15). The term shall not be construed to include newspapers, as legally defined by section 24-70-102, preprinted newspaper supplements that become attached to or inserted in and distributed with such newspapers, or direct mail advertising materials that are distributed in Colorado by any person engaged solely and exclusively in the business of providing cooperative direct mail advertising; except that, commencing March 1, 2010, for purposes of the state sales or use tax, "tangible personal property" shall

include direct mail advertising materials that are distributed in Colorado by any person engaged solely and exclusively in the business of providing cooperative direct mail advertising.

(II) No funding received from revenues received as a result of the passage of House Bill 10-1189, enacted in 2010, shall be used to fund additional full-time equivalent state employees.

(b) (Deleted by amendment, L. 2011, (HB 11-1293), ch. 299, p. 1437, 4, effective July 1, 2012.)

(b.5)

(I) "Tangible personal property" includes digital goods. The method of delivery does not impact the taxability of a sale of tangible personal property. Examples of methods used to deliver tangible personal property under current technology include but are not limited to compact disc, electronic download, and internet streaming.

(II) As used in this subsection (15)(b.5), "digital good" means any item of tangible personal property that is delivered or stored by digital means, including but not limited to video, music, or electronic books.

(c)

(I) "Tangible personal property", commencing July 1, 2012, shall include computer software if the computer software meets all of the following criteria:

(A) The computer software is prepackaged for repeated sale or license;

(B) The use of the computer software is governed by a tear-open nonnegotiable license agreement; and

(C) The computer software is delivered to the customer in a tangible medium. Computer software is not delivered to the customer in a tangible medium if it is provided through an application service provider, delivered by electronic computer software delivery, or transferred by load and leave computer software delivery.

(II) As used in this paragraph (c), unless the context otherwise requires:

(A) "Application service provider" or "ASP" means an entity that retains custody over or hosts computer software for use by third parties. Users of the computer software hosted by an ASP typically will access the computer software via the internet. The ASP may or may not own or license the computer software, but generally will own and maintain hardware and networking equipment required for the user to access the computer software. Where the ASP owns the computer software, the ASP may charge the user a license fee for the computer software or a fee for maintaining the computer software or hardware used by its customer.

(B) "Computer software" means a set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task.

(C) "Electronic computer software delivery" means computer software transferred by remote telecommunications to the purchaser's computer, where the purchaser does not obtain possession of any tangible medium in the transaction.

(D) "Load and leave computer software delivery" means delivery of computer software to the purchaser by use of a tangible medium where the title to or possession of the tangible medium is not transferred to the purchaser, and where the computer software is manually loaded by the vendor, or the vendor's representative, at the purchaser's location.

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Copy Citation

Statutes current through Chapter 275 from the 2023 Regular Session and effective as of May 30, 2023. The text of this section is not final. It will not be final until compared to, and updated from, the text provided by the Colorado Office of Legislative Legal Services later this year.

Colorado Revised Statutes Annotated Title 24 . Government - State (§§ 24-1-101 — 24-116-102) Publication of Legal Notices and Public Printing (Art. 70) Article 70 .Publication of Legal Notices and Public Printing (Pts. 1 — 2) Part 1. Legal Notices - Publication (§§ 24-70-101 — 24-70-109)

24-70-102. Legal publications.

Every newspaper printed and published daily, or daily except Sundays and legal holidays, or on each of any five days in every week excepting legal holidays and including or excluding Sundays shall be considered and held to be a daily newspaper; every newspaper printed and published at regular intervals three times each week shall be considered and held to be a triweekly newspaper; every newspaper printed and published at regular intervals twice each week shall be considered and held to be a semiweekly newspaper; and every newspaper printed and published at regular intervals once each week shall be considered and held to be a weekly newspaper. No publication, no matter how frequently published, shall be considered a legal publication unless it has been admitted to the United States mails with periodicals mailing privileges.

History

Source: L. 21:P. 569, § 2.**C.L.**§ 5393. **L. 35:**P. 687, § 1.**CSA:**C. 130, § 2. **L. 45:**P. 449, § 1.**CRS 53:**§ 109-1-2.**C.R.S. 1963:**§ 109-1-2. **L. 97:**Entire section amended, p. 1021, § 38, effective August 6.