Bill 7

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

Fiscal Note

Drafting Number:	LLS 23-0128	**Date:**	September 20, 2022
Prime Sponsors:		**Bill Status:**	Bill Request
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Bill Topic: **SALES TAX COMPUTER SOFTWARE**

Summary of Fiscal Impact:

☒ State Revenue
☒ State Expenditure
☒ State Transfer
☒ TABOR Refund
☒ Local Government
☐ Statutory Public Entity

The bill changes the definition of tangible personal property subject to sales and use tax related to computer software. The bill increases state General Fund revenue, will minimally increase state workload, and will increase revenue for local governments and special districts with state-collected sales taxes.

Appropriation Summary: No appropriation is required.

Fiscal Note Status: The fiscal note reflects the bill requested by the Legislative Oversight Committee Concerning Tax Policy.

Table 1
State Fiscal Impacts Under Bill 7

		Budget Year FY 2023-24	Out Year FY 2024-25
Revenue	General Fund	$50.2 million	$104.7 million
	Total Revenue	**$50.2 million**	**$104.7 million**
Expenditures		-	-
Transfers	General Fund	($753,000)	($1.6 million)
	Housing Development Grant Fund	$753,000	$1.6 million
	Total Transfer	**$0**	**$0**
Other Budget Impacts	TABOR Refund	$50.2 million	$104.7 million

Summary of Legislation

The bill modifies the definition of tangible personal property related to sales and use tax by changing the criteria used to determine taxable computer software. Under current law, computer software is taxable when the software is:

- prepackaged for repeated sale or license;
- governed by a tear-open nonnegotiable license agreement; and
- delivered to the customer in a tangible medium.

Beginning January 1, 2024, the bill removes the requirements for prepackaging and a tear-open nonnegotiable license, and modifies the definition to include software designed for repeated sales or license and that is provided by application service provider (ASP), delivered electronically, or transferred directly by load and leave.

Background

Office of the State Auditor evaluation. The Office of the State Auditor (OSA) released a report on the Downloaded Software Exemption in April 2022 related to licensed and pre-written software products meant for repeated sale that were not delivered by tangible medium. The OSA found the impact of the exemption was at least $83 million in 2020. The OSA review of the tax expenditure is available on the General Assembly's website at:
https://leg.colorado.gov/sites/default/files/te20_downloaded_software_exemption.pdf

House Bill 10-1192. Prior to 2010, the Department of Revenue had a special regulation on taxable computer software that included prepackaged software purchased in tangible form with a license agreement as tangible personal property. House Bill 10-1192 repealed this regulation and added a new definition of "standardized software" to statute, generally defined as software that was not designed or developed to the specifications of a specific purchaser. Additionally, the mode of delivery was not relevant to the taxability of the software product.

House Bill 11-1293. The current definition of tangible personal property related to computer software was implemented with House Bill 11-1293 and took effect on July 1, 2012. This bill removed "standardized software" from the definition of tangible personal property. The Department of Revenue noted in its 2011 Annual Report that the bill codified the Department's special regulation related to taxable software sales that was in effect prior to House Bill 10-1192, including taxability based on receipt of software through a tangible medium.

Itemized exemption for computer software. Based on data from the Office of Research and Analysis in the Department of Revenue, retailers itemized $8.8 million of exempt computer software sales in calendar year 2021 on the sales tax form. This likely underestimates the actual sales of exempt computer software downloaded in the state that would become taxable under the bill. Sellers of downloadable software may not need a sales tax license or file a sales tax form under current law, as they do not sell any taxable goods or services. Additionally, sellers of downloadable software may classify these sales as an exempt service on the sales tax form, or continue itemizing them among other exempt sales. Lastly, the itemized value does not include use tax, as that is not itemized on the use tax forms.

State Revenue

The bill is estimated to increase General Fund revenue by $50.2 million in FY 2023-24 (half-year impact) and $104.7 million in FY 2024-25, with ongoing impacts in subsequent years that will grow with household growth and inflation. Sales and use tax revenue is subject to TABOR.

Data and assumptions. In 2020, gross domestic product for the nation's publishing industry sector was nearly $320 billion. The sector includes software publishers that design and support software for publishing and reproduction. Based on employment for software publishers compared with other types of publishers, an estimated two-thirds of sales in the industry sector are attributed to published software. Some published software is already taxable in Colorado, including software that is sold on a tangible medium and software that is essential to the basic operations of a computer. Therefore, potential sales were reduced by about 25 percent to account for these sales based on industry research and analysis by the Office of the State Auditor on the downloadable software exemption. After reducing software sales for items that are already taxed in Colorado, the estimate was weighted to Colorado according to the state's 1.8 percent share of the nation's households.

Based on projections of Colorado's households and inflation based on the September 2022 Legislative Council Staff forecast, the value of software sales in the state that would be taxable under the bill is estimated to be between $3.5 and $3.6 billion in FY 2023-24 and FY 2024-25. Based on the 2.9 percent state sales and use tax rate, the bill will increase revenue by $50.2 million in FY 2023-24 (half-year impact) and $104.7 million in FY 2024-25. To the extent that a higher or lower percentage of sales are attributable to software downloads, industry growth exceeds or trails projected inflation, or software products are already taxed in the state, will change the revenue impact estimated in the fiscal note.

State Expenditures

The bill will minimally increase workload for the Department of Revenue due to more sales and use tax accounts and returns filed each year. Additionally, workload may increase for updates to forms and guidance. The fiscal note assumes that workload impacts can be met with existing resources.

Transfers

Increased state sales tax revenue will increase the amount of revenue raised by the $1,000 cap on vendor fees and increase revenue that is transferred from the General Fund to the Housing Development Grant Fund. Transfers to the fund are based on the estimated amount that would have been retained by vendors absent the cap. Assuming the percent increase in state sales tax revenue generates a proportional increase in transfers to the fund, the bill will increase revenue to the Housing Development Grant Fund by an estimated $753,000 in FY 2023-24 (half-year impact) and $1.6 million in FY 2024-25 and subsequent years.

Other Budget Impacts

TABOR refunds. The bill is expected to increase the amount of state revenue required to be refunded to taxpayers by the amounts shown in the State Revenue section. Because the bill increases both General Fund revenue and the General Fund obligation for TABOR refunds, the bill will have no net impact on the amount available for the General Fund budget. A forecast of state revenue subject to TABOR is not available beyond FY 2024-25.

Local Government

The bill will increase revenue for state-collected local governments and special districts. Among the largest special districts are the Regional Transportation District (RTD) and the Scientific and Cultural Facilities District (SCFD). Based on the size of each district's tax base compared with the state tax base, increased revenue is estimated as follows:

- RTD – The bill will increase revenue to RTD by an estimated $9.3 million in FY 2023-24 (half-year impact) and $19.4 million in FY 2024-25.
- SCFD – The bill will increase revenue to SCFD by an estimated $944,000 in FY 2023-24 (half-year impact) and $2.0 million in FY 2024-25.

Effective Date

The bill takes effect January 1, 2024, assuming no referendum petition is filed.

State and Local Government Contacts

Counties	Information Technology	Municipalities
Personnel	Regional Transportation District	Revenue
Special Districts		