Office of the State Auditor

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

August 24, 2023

OFFICE OF THE STATE AUDITOR

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CATASTROPHIC HEALTH INSURANCE DEDUCTION

EVALUATION SUMMARY | APRIL 2022 | 2022-TE15

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2017)	Minimal
YEAR ENACTED	1994	NUMBER OF TAXPAYERS (TAX YEAR 2017)	Minimal
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: Because insurance that would qualify for the deduction is currently not being sold in the state, the deduction is not reducing the cost of catastrophic health insurance.

WHAT DOES THE TAX EXPENDITURE DO?

The Catastrophic Health Insurance Deduction [Section 39-22-104.5, C.R.S.] provides employees with a state income tax deduction on wages withheld by their employer to pay for catastrophic health insurance if the wages have not already been deducted on their federal income tax returns.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the expenditure. Based on our review of statute, legislative history, and news articles from the period when the expenditure was created, we considered a potential purpose: to reduce taxpayers' costs for catastrophic health insurance by reducing their Colorado tax liability.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Repealing the deduction, since eligible policies are not currently sold in the state.
- Amending statute to establish a statutory purpose and performance measures for the deduction if the deduction is not repealed.

CATASTROPHIC HEALTH INSURANCE DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Catastrophic Health Insurance Deduction [Section 39-22-104.5, C.R.S.] provides employees with a state income tax deduction on wages withheld by their employer to pay for catastrophic health insurance if the wages have not already been deducted on their federal income tax returns. Catastrophic health insurance provides coverage for unexpected high-cost health care, such as may be incurred due to an accident or a serious illness. Policies typically offer lower premiums to policy holders, but provide less coverage for routine health care, and require higher deductibles than other types of health insurance. For policies to qualify for the deduction, deductibles must be between $1,500 and $2,250 for individual coverage and between $3,000 and $4,500 for families [Section 10-16-116(3), C.R.S.]. Additionally, qualifying catastrophic health insurance policies must be issued by an employer, cover all employees who elect coverage, be priced according to specifications in law, and meet other requirements. According to the Division of Insurance (Division) within the Department of Regulatory Agencies, no insurer in Colorado is currently selling catastrophic health insurance that qualifies for the deduction.

The deduction was established in 1994 by House Bill 94-1094, which also established provisions allowing employers who do not provide other health plans to offer employees catastrophic health insurance. In 2013, House Bill 13-1266 clarified that catastrophic health plans that individuals can purchase through Connect for Health Colorado do not qualify for the deduction. Specifically, under Section 10-16-116(6)(a),

C.R.S., "catastrophic health insurance" is distinct from a "catastrophic plan" (more commonly called a "catastrophic health plan"), which is purchased directly by individuals through Connect for Health Colorado. While catastrophic health plan payments do not qualify for the deduction, wages withheld to pay for these plans are generally excluded from federal taxable income under federal law, which also effectively excludes them from Colorado taxable income because the State uses federal taxable income as the basis for calculating Colorado taxable income.

The deduction is structured to automatically apply when employers withhold wages to pay for catastrophic health insurance, with Section 10-16-116(5)(b), C.R.S., stating that employers should withhold wages for catastrophic health insurance premiums on a pre-tax basis for state income tax purposes. The employee and employer must sign an "Employees Election Regarding Catastrophic Health Insurance" (Form DR 0811) form to document their election to have wages withheld to pay for catastrophic health insurance. This form is maintained by the employer and is not filed with the Department of Revenue (Department). Department guidance states that employers must report premiums withheld in the form of a letter on the employer's letterhead, which is furnished to the employee and the Department. According to Department guidance, the letter must indicate why premiums may be deducted when calculating an employee's Colorado taxable income during that year. If an employer does not properly withhold the wages on a pre-tax basis and/or the wages were included in the individual's federal taxable income, taxpayers can claim the deduction using line 18 for "Other Subtractions" on their Subtractions from Income Schedule (Form DR 0104AD), which is filed with their income tax return.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the Catastrophic Health Insurance Deduction. We inferred, based on statutory language and Department guidance, that the intended

beneficiaries are individuals who have wages withheld by their employer to pay for catastrophic health insurance.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the expenditure. Based on our review of statute, legislative history, and news articles from the period when the expenditure was created, we considered a potential purpose: to reduce taxpayers' costs for catastrophic health insurance by reducing their Colorado tax liability. During the 1990s, both state and federal governments introduced several new types of insurance policies, savings accounts, and corresponding tax benefits intended to help lower health care costs. The deduction, created in 1994, appears to be part of this policy effort.

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

We could not definitively determine whether the deduction is meeting its purpose because no purpose is provided in statute or its enacting legislation. However, we found that the deduction does not appear to be meeting the potential purpose we considered for this evaluation because qualifying catastrophic health insurance does not appear to be sold in Colorado and few taxpayers claimed the deduction in a prior year, and it is possible that these taxpayers may have claimed the deduction in error.

Statute does not provide performance measures for the deduction. We created and applied the following performance measure to determine whether the deduction is meeting the potential purpose we considered:

PERFORMANCE MEASURE: *To what extent has the deduction reduced costs for catastrophic health insurance?*

RESULT: We found that the Catastrophic Health Insurance Deduction is not reducing taxpayers' costs for catastrophic health insurance because it does not appear that qualifying policies are being sold in the state.

According to the Division, there are currently no insurers offering catastrophic health insurance in Colorado that appear to qualify for the deduction. Although catastrophic health plans are available through Connect for Health Colorado, and provide similar coverage, as discussed, these plans do not qualify for the deduction under Section 10-16-116(6)(a), C.R.S., because the plans do not cover all employees who elect coverage and are not otherwise covered under Medicare or another policy, as required by Section 10-16-116(3)(d), C.R.S.

Further, although the Department did not have comprehensive data available to measure the use of the deduction in prior years, it appears that taxpayers rarely claimed it. Specifically, the Department conducted a study of Tax Year 2017 filings to determine which expenditures were being claimed on the "Other Subtractions" line of the Colorado Income Tax Return, which is where taxpayers would claim the deduction, and found that a minimal number of taxpayers claimed the deduction that year. Due to the small number of taxpayers who claimed the deduction, taxpayer confidentiality requirements [Section 39-21-305(2)(b), C.R.S.] prevent us from reporting the specific number of taxpayers who claimed it. Given the current lack of qualifying plans in the state and the small number of taxpayers who claimed the deduction in prior years, it is possible that these taxpayers may have claimed the deduction in error. For example, the taxpayers may have claimed it for amounts spent on catastrophic health plans that they purchased directly from Connect for Health Colorado, which would not have been eligible for the deduction.

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

We were unable to determine the Catastrophic Health Insurance Deduction's revenue impact to the State because taxpayers do not have to report amounts withheld pre-tax for catastrophic health insurance payments, and any amounts claimed on the Subtractions from Income Schedule are included on the same reporting line as several other deductions and cannot be disaggregated. However, as discussed, the Department's review of 2017 tax returns showed that the deduction

appears to have been used by few taxpayers in prior years and had a minimal revenue impact to the State. Due to Section 39-21-305(2)(b), C.R.S., which protects the confidentiality of tax information, we could not provide the exact revenue impact of the deduction due to the small number of taxpayers claiming it.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Since the Division is not aware of any insurance that meets the requirements to qualify for the deduction and the Department found few taxpayers who claimed the deduction in Tax Year 2017, eliminating the Catastrophic Health Insurance Deduction would have a minimal impact on intended beneficiaries. If the deduction is eliminated, any taxpayers who currently benefit from it would see a corresponding increase in their state income taxes. However, according to Department staff, taxpayers may potentially be eligible to exclude amounts withheld from wages to pay for catastrophic health insurance from taxable income under federal law, which would automatically result in a deduction on their state taxes because Colorado uses federal taxable income to calculate state income tax.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Out of the 42 states that impose a state income tax, Colorado is the only state that treats catastrophic health insurance and catastrophic health plans as separate types of insurance and the only state that has a specific catastrophic health insurance deduction.

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

Under federal law, taxpayers may be eligible to exclude amounts withheld from wages to pay for catastrophic health insurance from federal taxable income. Claiming a federal deduction would also effectively result in a reduction in taxpayers' Colorado taxable income because Colorado uses federal taxable income as the basis for calculating Colorado taxable income.

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

The Department could not provide comprehensive data on the deduction because GenTax, its tax reporting and information system, does not capture this information. In addition, the Department does not require taxpayers to submit the "Employees Election Regarding Catastrophic Health Insurance" (Form DR 0811), so we were not able to determine how many employees have elected to have employers withhold pre-tax wages to pay for catastrophic health insurance. In order to collect this information, the Department would need to require employers to submit their employees' election forms and report the amount they withhold from employees' wages for qualifying catastrophic insurance on a form that could be captured by GenTax. However, according to the Department, this type of change would require additional resources to develop the form and complete the necessary programming in GenTax to capture this information (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 data and the potential costs of addressing the limitations). Further, it would likely not be cost effective to implement these changes, since it appears that eligible insurance is not currently sold in the state.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REPEALING THE CATASTROPHIC HEALTH INSURANCE DEDUCTION. As discussed above, there are likely few, if any, taxpayers who are able to claim the deduction. Specifically, the Division is not aware of any insurers who are offering qualifying catastrophic health insurance in the state and a study by the Department identified a minimal number of taxpayers who claimed the deduction in Tax Year 2017. Catastrophic health plans, which are distinct from catastrophic health insurance, are sold in the state through Connect for Health Colorado, but are not eligible for the

deduction. However, these plans qualify for federal deductions, which would result in a reduction in Colorado taxable income due to Colorado using federal taxable income as the basis for state taxable income. Therefore, it appears that the deduction may not be necessary for taxpayers to receive the benefit that was intended and the General Assembly could consider repealing it.

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE CATASTROPHIC HEALTH INSURANCE DEDUCTION, THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES. Statute and the enacting legislation for the deduction do not state its purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of this evaluation we considered the following potential purpose: to reduce taxpayers' costs for catastrophic health insurance by reducing their Colorado tax liability. We identified this purpose based on statute, legislative history, and news articles. We also developed a performance measure to assess the extent to which the deduction is meeting its potential purpose. However, the General Assembly may want to clarify its intent for the deduction by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding its purpose and allow our office to more definitively assess the extent to which the deduction is accomplishing its intended goal(s).

MEDICAL SAVINGS ACCOUNT DEDUCTIONS

EVALUATION SUMMARY | APRIL 2022 | 2022-TE16

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2017)	$16,000
YEAR ENACTED	1994	NUMBER OF TAXPAYERS	Less than 250
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: Because similar federal deductions were established after their creation, the Medical Savings Account Deductions no longer appear to be necessary to allow taxpayers to reduce medical savings costs and are used by few taxpayers.

WHAT DO THE TAX EXPENDITURES DO?

The Medical Savings Account Deductions [Sections 39-22-104.6, 39-22-304(3)(k), 39-22-504.7(2)(e), and 39-22-104(4)(h), C.R.S.] allow employers and employees to deduct up to $3,000 in annual contributions made to an employees' medical savings account from the taxpayer's Colorado taxable income, to the extent that the contributions are not already deducted from their federal taxable income. The deduction is available to both employees who make contributions to their own medical savings accounts and C-corporation employers who make contributions to their employees' accounts. Section 39-22-504.6(3), C.R.S., defines a medical savings account as "an account established to pay the eligible medical expenses of an account holder and his or her spouse and dependent children, if any."

WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute does not explicitly state a purpose for the deductions. Based on our review of statute, legislative history, and news articles, for the purposes of our evaluation we considered a potential purpose: to lower the cost of saving for medical expenses by providing a tax benefit.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to:

- Review whether the deductions are necessary and consider repealing them.
- Consider amending statute to establish a statutory purpose and performance measures for the deduction if they are not repealed.

MEDICAL SAVINGS ACCOUNT DEDUCTIONS

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

The Medical Savings Account Deductions [Sections 39-22-104.6, 39-22-304(3)(k), 39-22-504.7(2)(e), and 39-22-104(4)(h), C.R.S.] allow employers and employees to deduct up to a combined $3,000 in annual contributions made to an employees' medical savings account from their Colorado taxable income, to the extent that the contributions are not already deducted from their federal taxable income. The deduction is available to both employees who contribute to their own accounts and C-corporation employers who contribute to an employee's account, but contributions from all sources are limited to $3,000 per year. Section 39-22-504.6(3), C.R.S., defines a medical savings account as "an account established to pay the eligible medical expenses of an account holder and his or her spouse and dependent children, if any." Eligible medical expenses are those allowed in Section 213(d) of the Internal Revenue Code, such as medical exams and procedures, medicine, equipment, and insurance costs.

According to Department of Revenue (Department) guidance, employers who establish medical savings accounts for employees are directed to withhold the amounts contributed to the accounts from employees' taxable income. Employees may also establish their own medical savings account if their employer does not do so, in which case the employee makes deposits directly into the account and is responsible for claiming the deduction when they file their annual income tax return. Because Colorado uses federal taxable income as the basis for calculating a taxpayer's Colorado taxable income, if taxpayers deduct contributions to medical savings accounts from federal taxable income,

the deductions will automatically be deducted from the employees' Colorado taxable income and they will not be eligible for the Medical Savings Account Deductions.

House Bill 94-1058, enacted in 1994, established Colorado medical savings accounts as a tax-advantaged account type and created the Medical Savings Account Deductions. In 1997, Senate Bill 97-054 clarified that the deductions could only be claimed by taxpayers who did not claim a deduction on their federal returns. When Medical Savings Accounts were created, there was not an equivalent account type at the federal level or a federal tax deduction for medical savings accounts that Colorado taxpayers could claim. Since that time, the federal government has created several other types of accounts for medical savings that also allow taxpayers to deduct contributions from their federal taxable income. Although these accounts do not necessarily qualify for the Medical Savings Account Deduction, the Department reported that because the statutory definition of Colorado medical savings accounts [Sections 39-22-504.6(3) and 39-22-504.7, C.R.S.] is fairly broad, other medical accounts established under federal law, could potentially qualify for the Medical Savings Account Deductions. However, because these accounts generally allow taxpayers to deduct or withhold contributions from their federal taxable income, which is the starting point for calculating state taxable income, contributions to these accounts would typically not qualify for the Medical Savings Account Deduction, since taxpayers are only able to claim it to the extent that the contributions have not been deducted from federal taxable income. Exhibit 1 provides information on federally established accounts that are similar to Colorado medical saving accounts.

EXHIBIT 1. FEDERALLY ESTABLISHED ACCOUNTS THAT ARE SIMILAR TO A COLORADO MEDICAL SAVINGS ACCOUNT	
Medicare Medical Savings Account Plans, (Medicare Advantage)	A plan issued by Medicare and private insurance companies. Medicare Medical Savings Accounts are high-deductible health plans and savings accounts that allow taxpayers to pay Medicare-covered costs before they meet Medicare eligibility levels.
Health Savings Account	A savings account utilized with a high-deductible health insurance policy that allows individuals to save money tax-free on medical expenses.
Flexible Spending Account	An arrangement through an employer that allows individuals to pay for out-of-pocket medical expenses with tax-free dollars.
Archer Medical Savings Account	A tax-exempt trust or custodial account established with a bank or insurance company, used to pay for healthcare expenses. Although individuals can continue to use existing accounts, new accounts can no longer be established.

SOURCE: Office of the State Auditor summary of federal medical accounts that are similar to Colorado medical savings accounts.

Colorado statute requires Colorado medical savings accounts to be issued by a state chartered bank, a national banking association, an insurance company, or an employer maintaining a self-insured health plan [Section 39-22-504.6(1), C.R.S.]. Employees must sign a Department form, Employees Election Regarding Medical Savings Account [Form DR 0810], before the first contribution can be made. The Medical Savings Account Deductions are claimed on the "Other Subtractions" line on the Subtraction from Income Schedule [Form DR 0104 AD]. Then, taxpayers claim the deductions on Line 6, of the Colorado Individual Income Tax Return [Form DR 0104], or, in the case of an employer corporation making contributions, Line 12 of the Colorado C Corporation Income Tax Return [Form DR 0112]. Taxpayers who withdraw funds from the accounts for purposes other than for paying eligible medical expenses must add the amount withdrawn to their Colorado taxable income.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not explicitly identify the intended beneficiaries of the Medical Savings Account Deductions. We inferred, based on the operation of the deductions, Department guidance, news articles, and legislative history, that the intended beneficiaries of the deductions are taxpayers, including employees and employers who contribute to an employee's medical savings account.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute does not explicitly state a purpose for the deductions. Based on our review of statute, legislative history, and news articles, for the purposes of our evaluation we considered a potential purpose: to lower the cost of saving for medical expenses by providing a tax benefit. Colorado House Joint Resolution 94-1005, which was adopted in 1994 during the same session as the Medical Savings Account Deductions, states, "patients and consumers will reduce health care costs if they are allowed to benefit from prudent individual spending decisions and if they use pre-tax dollars to establish individual medical accounts or medical savings accounts." Although the resolution was passed independently from House Bill 94-1058, which established the deductions, it shows the General Assembly's intention at the time was to reduce health care costs. Further, at the time, no similar federal deductions were available, so the deductions established a new tax benefit for Coloradans saving for health care costs.

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

We could not definitively determine whether the deductions are meeting their purpose because no purpose is provided in statute or their enacting legislation. However, we found that the deductions do not appear to be meeting the potential purpose we considered for the evaluation because similar federal deductions generally make them unnecessary.

Statute does not provide performance measures for the deductions. Therefore, we created and applied the following performance measure to determine whether the deductions are meeting their purpose:

PERFORMANCE MEASURE: *To what extent do the deductions help Colorado taxpayers reduce healthcare saving costs?*

RESULT: We found that the Medical Savings Account Deductions reduce few taxpayers' healthcare saving costs because taxpayers can deduct contributions to medical savings accounts from their federal taxable income, which if they do, means that they cannot use the deductions at the state level. Although similar federal deductions were not available in 1994 when the State's deductions were established, in 1996 Congress passed legislation establishing them. The following year, the General Assembly passed Senate Bill 97-054, which clarified that the Medical Savings Account Deductions are only available to the extent that contributions were included in federal taxable income. As outlined above in EXHIBIT 1, contributions to a variety of accounts for medical savings are now eligible for federal income tax deductions and, because Colorado's taxable income is based on federal taxable income, taxpayers who deduct the contributions for federal tax purposes automatically receive the same reduction in Colorado taxable income. Further, because medical savings accounts that qualify for the federal deduction are widely available, and typically provide taxpayers with a more significant tax benefit than the state deductions alone, it appears uncommon for taxpayers to forego the available federal deductions and use only the State's Medical Savings Account Deductions.

Although the Department was unable to provide comprehensive data on taxpayers' use of the deductions, in 2019, the Department conducted a review of Tax Year 2017 filings to determine which expenditures were being claimed on the "Other Subtractions" line of the Subtractions from Income Schedule [Form DR 0104AD], as part of the Colorado Income Tax Return [Form DR 0104], which is where taxpayers claim the Medical Savings Account Deductions. Out of the nearly 9,000 returns the Department reviewed, less than 250 (about 3 percent) included claims for the Medical Savings Account Deductions. When the Department reviewed the claims, it found that about 150 (60 percent) of the claims did not provide any documentation to support their claim for the deductions. The remaining taxpayers, approximately 100,

provided documentation that they made contributions to an account eligible for the medical savings account deductions. While these taxpayers could be using medical savings accounts that do not qualify for federal deductions, we were unable to determine why they would do so, since accounts that qualify for federal deductions typically provide a larger tax benefit and still effectively reduce taxpayers' Colorado taxable income by an amount equivalent to the Medical Savings Account Deductions. It is possible that some of these taxpayers claimed the deductions in error; for example, claiming them for contributions that were already deducted from their federal taxable income, although the Department lacked information to determine how often this may have occurred. However, regardless of the precise number of taxpayers that use the deductions, given that tax-advantaged medical savings accounts are widely used in the state, the Department's review indicates that few taxpayers who save for medical expenses use the deductions and the total savings provided by the deductions are not large enough to significantly reduce health care saving costs in the state.

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

The Department was unable to provide data necessary to comprehensively evaluate the Medical Savings Account Deductions' revenue impact to the State because the deductions are claimed on the same line as several other deductions and the amounts claimed cannot be disaggregated for analysis. However, based on the Department's review of 2017 tax returns, taxpayers claimed about $350,000 in Medical Savings Account Deductions in Tax Year 2017, which resulted in them saving approximately $16,000 in state income taxes. Although, as mentioned above, the Department found that about 60 percent of these taxpayers who claimed about $220,000 of the deductions (65 percent) did not provide documentation to support their claim. Due to their limited usage, the deductions do not appear to have a significant economic impact in the state or significantly reduce health care saving costs.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If the Medical Savings Account Deductions were eliminated, taxpayers who do not claim a federal deduction for contributions made to medical savings accounts would not be able to receive a deduction on their state income taxes. As discussed above, the Department identified less than 250 taxpayers who claimed the deductions in 2017 who each saved about $65 in income taxes, on average. If the Medical Savings Account Deductions were eliminated, these taxpayers would see a corresponding increase in their income taxes. However, because federally deductible medical savings accounts are available, even if the state deductions were eliminated, taxpayers could likely still benefit from one of several federally deductible account types. This would allow taxpayers to reduce both their federal and Colorado taxable income for eligible contributions.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 41 other states (excluding Colorado) and the District of Columbia that levy an income tax, all allow deductions for contributions to medical savings accounts. Most states with a deduction allow taxpayers to claim the same amount allowed by IRS rules, which generally exempt contributions to medical savings accounts. Other states still allow a deduction but restrict deductions to contributions to certain medical savings account types, modify the amount that can be deducted from state taxes, or have different requirements regarding when taxpayers can claim the deduction. For example, Ohio does not follow the federal tax treatment for Archer Medical Savings Accounts, Idaho modifies the amounts that taxpayers can deduct, and Indiana allows taxpayers to claim a deduction when money is withdrawn from a medical savings account instead of when it is deposited in the account.

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

As discussed, there are federal income tax deductions for contributions made to other types of accounts used for medical savings, like, Health Savings Accounts, Flexible Spending Accounts, and Archer Medical Savings Accounts. Because Colorado calculates taxable income based on federal taxable income, Colorado taxpayers also receive a deduction on their state income taxes for contributions to these federally recognized accounts for medical savings.

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

The Department was not able to provide comprehensive data necessary to determine how often the deductions are claimed and the revenue impact to the State. Specifically, taxpayers claim the deductions on the same reporting line as several other income tax deductions, which cannot be disaggregated for the purposes of analysis. The Department was able to provide some data for deductions based on a 2019 review that it conducted on Tax Year 2017 claims. However, since the purpose of the Department's review was to estimate the general frequency and cost of several deductions, the Department stated that the 2017 data for the deductions provide only a general estimate of how often the deductions are claimed.

In order to begin collecting comprehensive data on the deductions, the Department would need to require taxpayers to begin reporting the amount deducted on a separate reporting line. However, according to the Department, this type of change would require additional resources to modify the form and complete the necessary programming in GenTax, the State's primary information system for processing taxes collected by the State, to capture this information (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 data and the potential costs of addressing the limitations). Further, it may not be cost effective to implement these changes, since it appears few taxpayer use the deductions.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO REVIEW WHETHER THE MEDICAL SAVINGS ACCOUNT DEDUCTIONS ARE STILL NECESSARY AND COULD CONSIDER REPEALING THEM. As discussed, we found that because most taxpayers are able to subtract contributions to medical savings from their federal taxable income by using one of several federally deductible account types, they do not appear to have a need to use the Medical Savings Account Deductions. For this reason, the deductions are used by few taxpayers, with the Department identifying less than 250 taxpayers who used them in Tax Year 2017, the most recent year with available data. In 1994, when the deductions were established, there was not a similar deduction available at the federal level, so at that time, the deductions would have provided a unique benefit to taxpayers who contributed to eligible accounts. However, beginning in 1996, the federal government began creating deductions for medical savings accounts through a pilot program to promote their usage. Federal tax benefits have since expanded over time. Because taxpayers can now deduct contributions to these accounts from both their federal and state income, without using the Medical Savings Account Deductions, the deductions may no longer be necessary. Therefore, the General Assembly could consider repealing them.

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE MEDICAL SAVINGS ACCOUNT DEDUCTIONS, IT MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES. Statute and the enacting legislation for the deductions do not state their purpose or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of this evaluation we considered a potential purpose: to lower the cost of saving for medical expenses by providing a tax benefit. We identified this purpose based on statute, legislative history, and news articles. We also developed a performance measure to assess the extent to which the deductions are meeting this potential purpose. If the General Assembly does not repeal

the deductions, it may want to clarify its intent for the deductions by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding their purpose and allow our office to more definitively assess the extent to which the deductions are accomplishing their intended goal(s).

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NONRESIDENT DISASTER RELIEF WORKER SUBTRACTION

EVALUATION SUMMARY | SEPTEMBER 2022 | 2022-TE35

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2018)	At least $2,425
YEAR ENACTED	2014	NUMBER OF TAXPAYERS (TAX YEAR 2018)	At least 5
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The subtraction relieves some nonresident disaster relief workers of the burden of filing a Colorado income tax return and, depending on their home state, may reduce their net tax liability. However, the subtraction does not relieve regulatory burdens imposed on the employers of disaster relief workers, and does not appear to expedite disaster response in Colorado. Additionally, the subtraction appears to be infrequently used, and awareness of the subtraction appears to be low.

WHAT DOES THE TAX EXPENDITURE DO?

The Nonresident Disaster Relief Worker Subtraction [Section 39-22-104(4)(t), C.R.S.] exempts income earned by Colorado nonresidents for disaster-related work performed during a disaster period in Colorado from state income tax. The subtraction can be claimed either (1) by the exemption of a nonresident employee's eligible disaster relief wages from Colorado withholding at the time they are paid by the employer, or (2) by a nonresident disaster relief worker later filing a Colorado income tax return to receive a refund for any eligible disaster relief wages that were withheld.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

House Bill 14-1003, which established the subtraction, provides that its purpose is *"[to ensure that the state may focus on providing a quick response to the needs of the state and its citizens during a declared state disaster emergency and to reduce the regulatory burden in appreciation for those out-of-state workers and their employers who provide needed assistance to Colorado during declared state disaster emergencies."*

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider amending statute to:

- Reduce reporting requirements on employers of nonresident disaster relief workers.
- Clarify eligibility requirements.

NONRESIDENT DISASTER RELIEF WORKER SUBTRACTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Nonresident Disaster Relief Worker Subtraction [Section 39-22-104(4)(t), C.R.S.] exempts income earned by Colorado nonresidents for disaster-related work performed during a disaster period in Colorado from state income tax.

Disaster-related work means "repairing, renovating, installing, building, or rendering services that relate to infrastructure that has been damaged, impaired, or destroyed by a declared state disaster emergency, or, providing emergency medical, firefighting, law enforcement, hazardous material, search and rescue, or other emergency service related to a declared state disaster emergency" [Section 39-22-104(4)(t)(II)(C), C.R.S.].

A "disaster period" means a period beginning on the day the Governor declares a disaster emergency by executive order, and ending 60 days after the expiration of the Governor's executive order [Section 39-22-104(4)(t)(II)(C), C.R.S.]. The Governor can declare a disaster emergency for up to 30 days before having to reissue the order [Section 24-33.5-704, C.R.S]. In practice, all disaster emergencies have been declared for at least 30 days, and some disaster declarations have been reissued multiple times, resulting in disaster periods ranging from 60 days to over a year (for the COVID-19 pandemic).

The subtraction may be claimed in two ways:

First, an employer may exclude eligible wages of a Colorado nonresident from Colorado income tax withholding. Provided that the

proper wages are excluded, no further action is necessary by the employee in order to claim the subtraction. In the event that the employee is not a Colorado resident and has no Colorado income besides that earned performing disaster-related work during a declared disaster period, the employee is also exempted from filing a Colorado income tax return [Section 39-22-601(1)(a)(II), C.R.S]. However, an employee may still be required to pay taxes on those wages in their home state, depending on that state's laws.

Second, in the event that an employer withheld a portion of a Colorado nonresident's wages for income tax purposes and remitted them to the State of Colorado, a nonresident disaster relief worker may claim the subtraction by filing a Colorado income tax return and receiving a commensurate refund from the State. On returns for Tax Year 2021, nonresident taxpayers can claim this subtraction on line 15 of the Subtractions from Income Schedule (Form DR 0104AD). They must also list the executive order that declared the disaster emergency for which they performed disaster-related work.

The subtraction was established in 2014 by House Bill 14-1003. No changes have been made to the subtraction since it was established.

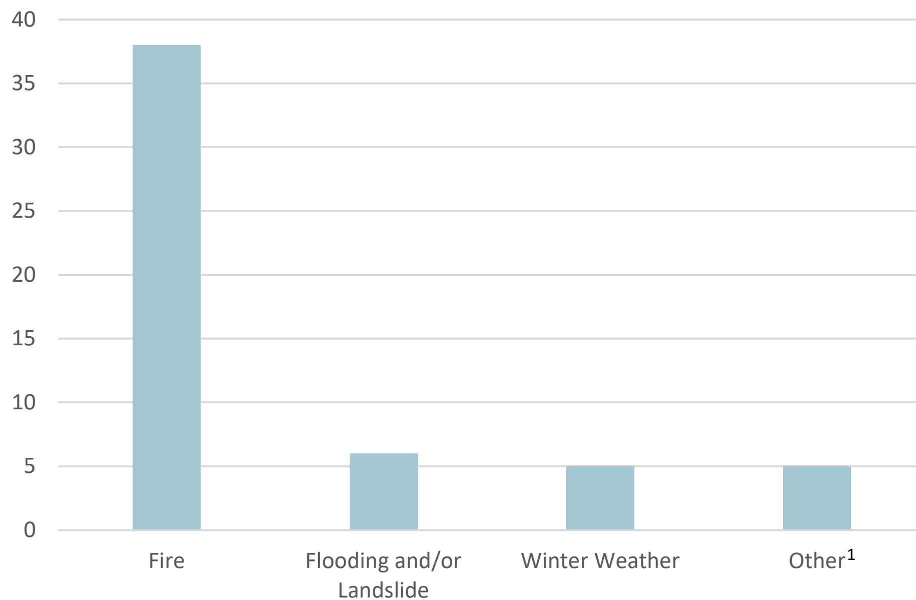
WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statue does not explicitly state the intended beneficiaries of the subtraction. Based on a review of statutory language, we considered the intended beneficiaries to be nonresident disaster relief workers who perform disaster-related work in Colorado during a declared disaster period and their employers. Such workers might be employees of a larger company that operates in multiple states, such as a utility provider or healthcare staffing agency, or could be nonresidents hired by a local firm directly.

Between January 1, 2015 and December 31, 2020, there were 54 declared disaster emergencies in Colorado. Most disaster emergencies (approximately 70 percent) were related to wildfires; several others

were related to flooding, landslides, or winter weather. Additionally, other types of disaster emergencies occurred only once during the period, such as a cybersecurity incident, and the COVID-19 pandemic. Exhibit 1 provides an overview of the types of disaster emergencies declared in Colorado between January 1, 2015 and December 31, 2020.

EXHIBIT 1: TYPES OF DISASTER EMERGENCIES DECLARED IN COLORADO BETWEEN JANUARY 1, 2015, AND DECEMBER 31, 2020



SOURCE: Colorado Office of the Governor and the Colorado State Archives.
[1]Other types of disasters include the Gold King Mine Incident, a state agency cyber security incident, severe drought, water supply emergency, and the COVID-19 pandemic.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

The General Assembly established the following purpose for the subtraction in its enacting legislation (House Bill 14-1003):

"to ensure that the state may focus on providing a quick response to the needs of the state and its citizens during a declared state disaster emergency and to reduce the regulatory burden in appreciation for those out-of-state workers and their employers who provide needed assistance to Colorado during declared state disaster emergencies."

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

We determined that the Nonresident Disaster Relief subtraction appears to be infrequently used and has not expedited the State's response to declared disaster emergencies, nor has it reduced regulatory or administrative burdens for the employers of nonresident disaster relief workers. However, we found some evidence that the deduction has reduced regulatory and administrative burdens for nonresident disaster relief employees.

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

PERFORMANCE MEASURE #1: *To what extent has the subtraction expedited the State's response to declared disaster emergencies?*

We did not find any evidence that this subtraction has expedited the State's response to declared disaster emergencies. We reached out to several state agencies involved in disaster relief (the Colorado Office of Emergency Management, the Colorado Division of Fire Prevention and Control, the Coronavirus Response Section of the Colorado Department of Public Health and Environment, and the Colorado Department of Transportation) and learned that, in most instances, state agencies do not hire nonresident disaster relief workers. Typically, when state agencies require nonresident disaster relief personnel to respond to a disaster emergency, they utilize private contractors, instead of hiring a nonresident directly. No state agency we talked with was aware of an instance in which this subtraction expedited their, or their contractor's, response to a disaster emergency. One agency noted that they had struggled with staffing some permanent positions and would have used nonresidents, but were unable to do so because Article XII, Section 13, Part 6 of the Colorado Constitution requires that permanent employees reside in Colorado (except for positions within 30 miles of the state border).

We were able to contact two companies that have been contracted with by the State to provide debris removal service after wildfires. Neither company reported having used Colorado's subtraction. However, one contractor did indicate that they believed the subtraction would provide a meaningful benefit to their employees and their organization's ability to leverage an out-of-state workforce to respond to disasters in Colorado in the future.

We also found the subtraction did not expedite disaster relief by non-state entities. We reached out to four Colorado utility providers to learn whether the subtraction has been utilized by their nonresident employees while repairing their infrastructure following a disaster emergency in Colorado; four Colorado hospital systems to learn whether the subtraction was utilized as they responded to the coronavirus pandemic; and two federal agencies involved in responding to wildland fires in Colorado to learn whether the subtraction was used to expedite their wildfire response. Many of the organizations we reached out to were unfamiliar with the subtraction and several reported that their employees were likely unfamiliar with the subtraction as well. Only one utility company reported that they had exempted their nonresident disaster relief employees from Colorado withholding in the past. Another utility company reported familiarity with the subtraction, but said they had never employed nonresidents to do disaster-related work in Colorado. There may be other organizations in the State that have used the subtraction that we did not identify, but it does not appear to be widely used. Therefore, we find it unlikely that this subtraction has significantly expedited disaster relief in Colorado, either by the State or other entities.

PERFORMANCE MEASURE #2: *To what extent has the subtraction reduced regulatory or administrative burdens for disaster relief workers and their employers?*

We found some evidence that the subtraction has reduced regulatory or administrative burdens on nonresident disaster relief workers, but no evidence that it has reduced regulatory and administrative burdens on

their employers. Additionally, due to its limited use, it appears that few employees and employers have benefited from it.

The subtraction can potentially reduce regulatory or administrative burdens for nonresident-disaster relief workers in two ways. First, the subtraction grants qualifying workers an exemption from filing a Colorado income tax return if their sole Colorado income was from qualified disaster relief work. This could provide a meaningful benefit to a nonresident worker who only worked in Colorado for a limited time and could reduce their overall tax liability depending on the tax laws of their home state. However, the extent to which this benefit is used by nonresident disaster relief workers may be limited, because, based on our conversations with employers about the subtraction, it is unlikely that many employers have exempted their nonresident employees' eligible wages from Colorado income tax withholding. Consequently, it appears that many nonresident disaster relief workers would still have to file a Colorado return to receive a refund for the wages their employer withheld, but only five employees did so in Tax Year 2018, the most recent year with available data.

Second, the subtraction could also benefit qualifying employees whose employers would not otherwise properly withhold wages when the employee works in Colorado. We encountered several employers who reported that they did not have the means to track when their employees performed work outside of their home state for a brief period of time. Therefore, prior to the subtraction, some employers of non-resident disaster relief workers may not have been in compliance with Section 39-22-604(3)(a), C.R.S., which requires employers to withhold taxes for all eligible wages paid to Colorado employees. For any nonresident disaster relief workers whose employers were not in compliance with Colorado law, the subtraction relieves the employee of the burden of filing and paying Colorado income tax themselves.

Additionally, we found that the subtraction does not fully eliminate regulatory and administrative burdens for employers of nonresidents performing disaster-related work in Colorado, because employers are

still required by Department of Revenue Rule 39-22-604(8)(b) to file W-2s (tax forms showing the individual earnings of each employee) with the Colorado Department of Revenue (Department) for all employees who perform work in Colorado. Consequently, employers must still track which part of a nonresident's earnings are attributable to their work in Colorado in order to fulfill their reporting requirements to the Department. One respondent noted that the payroll office would not necessarily be informed that an employee was performing work in Colorado, instead of their home state, in time for an adjustment of that employee's withholdings. Therefore, it appears that some employers may not be in compliance with reporting requirements and would not have withheld wages for Colorado income tax purposes regardless of the exemption.

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

As previously noted, the subtraction can be claimed either by a nonresident disaster relief worker filing a Colorado income tax return for wages that were withheld, or by an employer who exempts the eligible wages of a Colorado nonresident employee from Colorado withholding at the time they are paid. We were unable to quantify the total revenue impact of the subtraction to the State, because no data exists showing the extent to which the subtraction has been claimed by employers exempting nonresident employees' wages from Colorado withholding. However, we did obtain data on the extent to which individual disaster relief workers whose employers withheld Colorado income taxes on their behalf have retroactively claimed the subtraction by filing a Colorado income tax return. According to Department data, in Tax Year 2018, $2,425 was claimed by five employees for the Nonresident Disaster Relief Worker Subtraction. Given that Colorado's income tax rate was 4.63 percent in 2018, this amounts to approximately $52,400 in wages that were not subject to income tax. In 2015 and 2016, the only other years for which data is available, no amount was claimed by any persons.

Further, we encountered several employers who told us that they did not have a means by which to track whether an employee worked for a short period of time outside of their home state, indicating that in the absence of the subtraction, it is likely that some employers would still not collect Colorado withholding on wages for work in Colorado, and consequently, there would likely be no gain in the State's revenue.

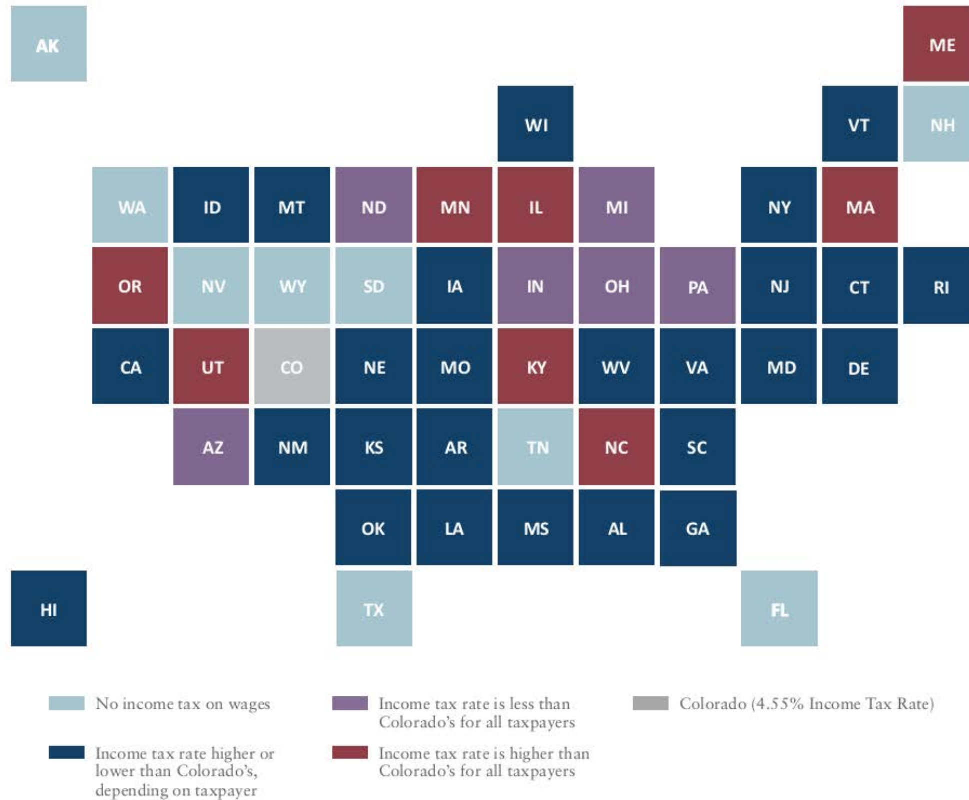
WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Based on the Department data we reviewed and our stakeholder outreach, the subtraction appears to be infrequently used. Consequently, elimination of the subtraction would have little impact on most nonresident disaster relief workers or their employers.

To the extent to which the subtraction is used by nonresident disaster relief workers, the elimination of the subtraction could affect their net tax liabilities, depending on their home state's tax rates and laws related to out-of-state income. We found that among the other 40 states that levy an individual income tax on wages, all 40 states tax income earned by their residents in other states, and all 40 states offer a credit for income tax paid to another state (usually not to exceed the tax liability for that income if it had been earned in the resident's home state). Therefore, if a nonresident disaster relief worker is a resident of a state with an income tax rate equal to or greater than Colorado's, they would generally derive no net benefit from Colorado's subtraction, since any savings in Colorado would be offset by a greater tax liability in their home state. A nonresident disaster relief worker would only incur a net cost from the elimination of Colorado's subtraction if their income tax rate in their home state is less than Colorado's income tax rate, or if their home state did not levy an income tax on wages. Eight states levy an income tax rate greater than Colorado's (4.55 percent) for all taxpayers, and 26 levy an income tax that may be greater or less than Colorado's, depending on the taxable income of each taxpayer. In the remaining 15 states, the income tax rates are less than Colorado's for all taxpayers (including 9 states that do not levy a tax on individual income from wages). Exhibit 2 provides an overview of the states that

have a lower or higher income tax rate than Colorado's and would, in turn, lead to a resident of that state incurring a net tax benefit or no net tax benefit, respectively.

EXHIBIT 2: STATE INCOME TAX RATES COMPARED TO COLORADO



SOURCE: Office of the State Auditor analysis of information provided by Bloomberg BNA.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified at least 17 states that offer an exemption from their state's income tax to nonresidents who came to the state to respond to a disaster and nine states that do not levy an income tax on wages. We also identified one other state that exempted wages from all nonresidents for the first 60 days a nonresident worked in the state. Therefore, in at least 27 other states, nonresidents are not taxed for their immediate response to a disaster emergency.

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

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

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

We were unable to definitively determine the extent to which the subtraction has been used, because the extent to which employers exclude eligible nonresident disaster relief wages from Colorado withholding is not reported to the Department. This data constraint could be remedied by requiring employers who exempt their employees' wages from Colorado withholding to report such exclusions to the Department. However, this could require significant resources from the Department to implement and enforce, and could place an additional burden on employers (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 AMENDING STATUTE TO REDUCE REPORTING REQUIREMENTS ON EMPLOYERS OF NONRESIDENT DISASTER RELIEF WORKERS. As discussed, we found that the subtraction does not fully eliminate regulatory and administrative burdens on the employers of nonresident disaster relief workers because employers are still subject to the State's wage reporting requirements. Specifically, employers in Colorado are required to report the amount of wages they have paid each employee to the Department via an annual transmittal of employees' W-2s [Rule 39-22-604(8)(b)]. The rule does not prescribe an exemption for the W-2s of employees who qualify for the subtraction, which may impose a burden on an employer who normally does not operate in Colorado (and who is not familiar with reporting to Colorado), or from an employer that would not ordinarily think they were required to file a W-2 for an employee for which no Colorado

income tax was withheld. Further, although employers in Colorado are required to apply for and maintain an active wage withholding account with the Department [Rule 39-22-604)(4)(a)], it is not clear whether this is required if an employer in Colorado uses the subtraction to exclude all wages they pay from Colorado withholding. Therefore, the General Assembly could consider amending statute to clarify that non-Colorado employers are not required to adhere to any reporting regulations with the Department if their sole activities in Colorado are the employment of nonresident disaster relief workers, and exempt all employers in Colorado from reporting the wages paid to nonresident employees whose sole work in Colorado was eligible disaster relief.

THE GENERAL ASSEMBLY MAY WANT TO AMEND STATUTE TO CLARIFY ELIGIBLY REQUIREMENTS FOR THE SUBTRACTION. Currently, statute indicates that employers are not required to withhold any amount of disaster relief wages "if the employee's withholding certificate indicates that the compensation is eligible [for the nonresident disaster relief worker subtraction]" (Section 39-22-604(19), C.R.S.) An employee's withholding certificate is the certificate the employee files with their employer at the outset of their employment, and is used to determine the amount that should be withheld from their wages. IRS Form W-4 is the primary withholding certificate used in Colorado, although employees may optionally file the Colorado Withholding Employee Certificate (Form DR 0004) as well. It is not clear what an employer would gain by referencing this certificate when determining an employee's eligibility for the subtraction; according to the Department, no part of the withholding certificate indicates whether an employee is eligible for the subtraction, and the address an employee has provided may not be their residence and thus, should not be used to determine an employee's residency. Therefore, the General Assembly may want to amend statute to remove language indicating that the determination of an employee's eligibility for the subtraction be based on the employee withholding certificate, and instead allow employers to rely on the eligibility criteria already established in Section 39-22-104(4)(t)(I), C.R.S.

COLORADO TUITION PROGRAM DEDUCTION

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE6

TAX TYPE	Deduction	REVENUE IMPACT (TAX YEAR 2018)	$25.7 million
YEAR ENACTED	2000	NUMBER OF TAXPAYERS	64,262
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The deduction provides taxpayers with an incentive to encourage and support saving for higher education; however, other benefits of saving provide a larger financial benefit and may play a greater role in individuals' decisions to save. Additionally, only about half of the amount contributed to 529 accounts was deducted by taxpayers, indicating that the deduction was not a significant factor for many account contributors who did not claim the deduction.

WHAT DOES THIS TAX EXPENDITURE DO?

The Colorado Tuition Program Deduction (529 Deduction) allows individuals, estates, and trusts to deduct an amount equivalent to their total contributions to a 529 account from their taxable income. The deduction is capped at $20,000 and $30,000 per taxpayer, per beneficiary for single and joint filers, respectively.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute and enacting legislation do not state the deduction's purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of research on tax incentives for saving for higher education, federal and state regulations, and the current operation of the expenditure, our evaluation considered a potential purpose: to encourage and support individuals to save for higher education.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the deduction.
- Reviewing the effectiveness of the deduction.

COLORADO TUITION PROGRAM DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Section 529 of the Internal Revenue Code allows states, state agencies, and education institutions to sponsor qualified tuition program savings accounts (529 accounts) that assist individuals in saving funds for higher education expenses. In Colorado, 529 accounts are administered by CollegeInvest, a state enterprise within the Department of Higher Education. 529 accounts are often used by parents to save money for their childrens' higher education expenses; however, an individual can establish a 529 to benefit anyone, including themselves, and any individual, not just the account holder, can make contributions to a 529 account. Interest earned on contributions to 529 accounts is exempt from federal taxable income as long as any funds distributed from the account are used for qualified education expenses, such as tuition, fees, books, supplies, equipment, and room and board at a qualified educational institution. Because Colorado uses federal taxable income as the starting point for determining Colorado taxable income, interest earned on 529 accounts is effectively exempt for state tax purposes as well.

The Colorado Tuition Program Deduction (529 Deduction) [Section 39-22-104(4)(i)(II), C.R.S.] allows individuals, estates, and trusts who make contributions to beneficiaries' 529 accounts to deduct from their Colorado taxable income an amount equal to the total contributions made. Beginning in Tax Year 2022, the deduction is capped at $20,000 annually per taxpayer, per beneficiary for single filers and $30,000 per taxpayer, per beneficiary for joint filers. For example, a single filer with two children could deduct $20,000 per child's account, resulting in a total of $40,000 in a given tax year. The cap is also adjusted annually

for an amount equivalent to the increase in tuition, room, and board at state institutions of higher education.

The 529 Deduction was created in Calendar Year 2000 by House Bill 00-1274 and was first available to taxpayers beginning in Tax Year 2001. House Bill 21-1311, which was passed during the 2021 Legislative Session, amended the 529 Deduction to establish the annual deduction cap.

To claim the deduction, taxpayers must create a 529 account through CollegeInvest, which is responsible for tracking taxpayers' contributions to 529 accounts and reporting contribution amounts to the Department of Revenue (Department) [Section 39-22-104(i)(V), C.R.S.]. Taxpayers report their contribution amounts on Line 8 and calculate their total subtractions on Line 20 of their 2020 Subtractions from Income Schedule (Form DR 0104AD). Taxpayers then report and deduct the sum of their total subtractions on Line 8 of their 2020 Colorado Individual Income Tax Return (Form DR 0104). The deduction is applied to taxpayers' taxable income and is not refundable, so taxpayers can only use it to the extent that they have taxable income. If the available deduction exceeds a taxpayers' taxable income, taxpayers cannot carry the excess amount forward to future tax years.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not state the intended beneficiaries of the 529 Deduction. Based on the operation of the deduction, we inferred that the intended beneficiaries are taxpayers who make eligible contributions to 529 accounts and individuals whose educational expenses are paid through 529 accounts. The deduction benefits contributors by reducing their taxable income by the amount contributed, up to the cap. Account beneficiaries may also benefit to the extent that the deduction encourages individuals to contribute funds towards their educational expenses. As of Fiscal Year 2021, there were 384,160 accounts

established through CollegeInvest's 529 program and about $1.2 billion in annual contributions were made to these accounts.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the 529 Deduction do not explicitly state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the deduction; conversations with stakeholders and our review of literature on tax incentives for saving for higher education; and IRS and Department regulations; we considered a potential purpose: to encourage and support individuals to save for higher education.

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

We could not definitively determine whether the 529 Deduction is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that it is likely meeting the purpose we considered in order to conduct this evaluation to a limited extent. Specifically, the deduction provides some financial support to individuals saving for higher education expenses and helps CollegeInvest market 529 accounts, but other financial benefits of saving are larger and may be more influential to individuals considering whether to save for higher education expenses. Further, we found that most individuals who contribute to CollegeInvest 529 accounts do not claim the deduction, indicating that the deduction may not be important to many individuals who contribute to 529 accounts.

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

PERFORMANCE MEASURE: *To what extent does the 529 Deduction encourage individuals to save for higher education?*

RESULT: We found that the 529 Deduction likely acts as a modest additional incentive to encourage individuals to save for higher education, but other benefits of saving may play a larger role in individuals' savings decisions. The deduction is frequently used by taxpayers, with 64,262 taxpayers claiming deductions for about $554 million in 529 account contributions in Tax Year 2018. As discussed, the deduction generally decreases a taxpayer's Colorado taxable income by the amount they contribute to a 529 account during the year. Therefore, based on the state income tax rate of 4.55 percent in Tax Year 2021, the deduction can lower a taxpayer's tax liability by $4.55 for every $100 they contribute to a 529 account, assuming the taxpayer has sufficient tax liability to offset. While this provides some financial support to individuals saving for higher education and may have encouraged some individuals to save, there are several additional benefits that likely also serve as an incentive to save for higher education.

- Investment earnings—Individuals saving money for higher education have a range of options to invest their savings, including 529 accounts, which allows them to earn interest and capital gains on their contributions.

- Tax-free distributions—When taxpayers take funds out of a 529 account to pay for eligible educational expenses, they are not subject to federal or state income taxes on the account earnings that are typically owed on non-529 account investments.

- Avoidance of college loan financing costs—To the extent individuals are able to save for higher education expenses, they are able to reduce the amount of college loan debt that they or their beneficiaries will have to repay, thereby saving the interest that they would otherwise owe. Individuals utilizing other vehicles for saving, such as a regular

savings account, benefit from finance cost savings, not just those that save within 529 accounts.

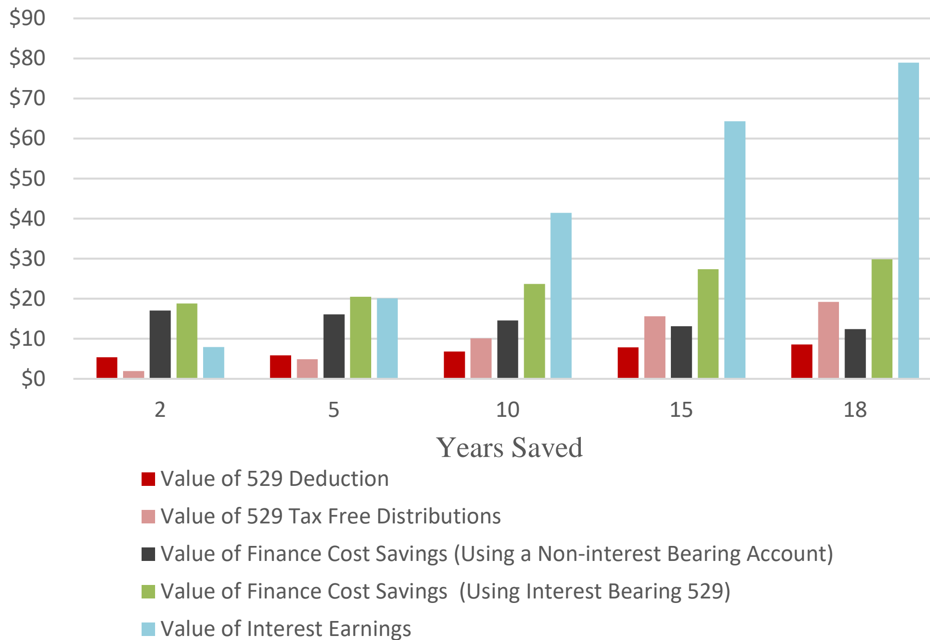
To assess the relative importance of each of these factors to taxpayers' decisions to save for higher education, we calculated the value of the deduction and the value of each of the incentives to save listed above that a hypothetical individual saving for higher education might consider. We made the following assumptions for our analysis:

- The individual saves $100.
- The individual can earn 5 percent annually on the amount saved by investing in an interest bearing account, either using a 529 account or other investment vehicle.
- If not using a 529 account for saving, the individual would be subject to a 15 percent federal capital gains tax and 4.55 percent state income tax on any investment earnings at the time the funds are withdrawn for educational expenses.
- The individual or their beneficiary would otherwise incur student loan debt equivalent to the amount saved that would be repaid over 10 years at a 3.73 percent interest rate, which was the published rate for Federal Direct student loans as of Academic Year 2021-2022.
- To calculate the potential value of the 529 Deduction, we assumed the individual increases the amount saved in their 529 account equivalent to the $4.55 tax benefit associated with the deduction.

To account for the time value of savings, we calculated the value provided by saving for several time intervals. We calculated these values using "net present value," which provides the current value of benefits that will be realized in future years by discounting the future benefits to account for the time value of money. For the purposes of our analysis, we used a 2 percent discount rate for our net present value calculations, to approximate the inflation rate in recent years. Exhibit 1 compares the value of the 529 Deduction to the value of other available benefits,

which the saver could receive depending on the type of account they choose to use.

EXHIBIT 1. VALUE OF AVAILABLE BENEFITS FROM SAVING $100 FOR A HYPOTHETICAL TAXAPAYER, BY NUMBER OF YEARS SAVED



SOURCE: Office of the State Auditor analysis based on the operation of the 529 Deduction.

As shown, the 529 Deduction provides a relatively small additional incentive compared to the other benefits offered by saving. For example, an individual who contributes $100 to a 529 account that earns 5 percent interest and saves for 18 years before withdrawing it for higher education expenses would see a $137 benefit, of which, about $9 would come from the deduction. If the same individual saved the same amount in a non-interest bearing account, meaning that they would be ineligible for the deduction, this decision would still have a value of about $12 based on avoiding the cost of student loan interest. However, the deduction may be a more significant incentive for individuals who plan to save for a shorter period of time since most of the other benefits of saving are relatively smaller when the funds are saved for less time. For example, the deduction makes up about 16 percent of the total value of

saving if the funds are withdrawn after 2 years, but only about 6 percent of the value if the funds are saved for 18 years. Although the relative benefit of the deduction would vary from this example based on the specific performance of individuals' investments and tax liability, generally, for most taxpayers the other potential benefits of saving significantly outweigh the benefit provided by the deduction.

Despite its smaller monetary value compared to other benefits of saving, the 529 Deduction may be more effective, for every dollar benefit received, at encouraging individuals to save than the other incentives in our analysis. Based on our review of economic research, tax benefits that are available to taxpayers sooner generally have a stronger impact on taxpayer decision-making than benefits that are not realized for several years. Additionally, benefits that are more certain tend to be more influential. CollegeInvest also reported that the deduction is a helpful marketing tool that it has found to be influential in its efforts to encourage individuals to save for higher education. According to its marketing survey, 93 percent of individuals indicated that the deduction was very important in their decision to open a 529 account with CollegeInvest. Therefore, the deduction may be more influential to taxpayers, relative to its monetary value, than other benefits because it provides a benefit in the same tax year that the money is saved and its value is relatively easy for taxpayers to determine.

In comparison, other benefits of saving may not be realized for years or decades after the money is saved. Further, the amount of some of the benefits may be less certain and more difficult for taxpayers to determine and consider in their decision-making. In particular, earnings received by investing the funds saved in the 529 account are uncertain because they are subject to the performance of the investments, with a risk of the investments losing value.

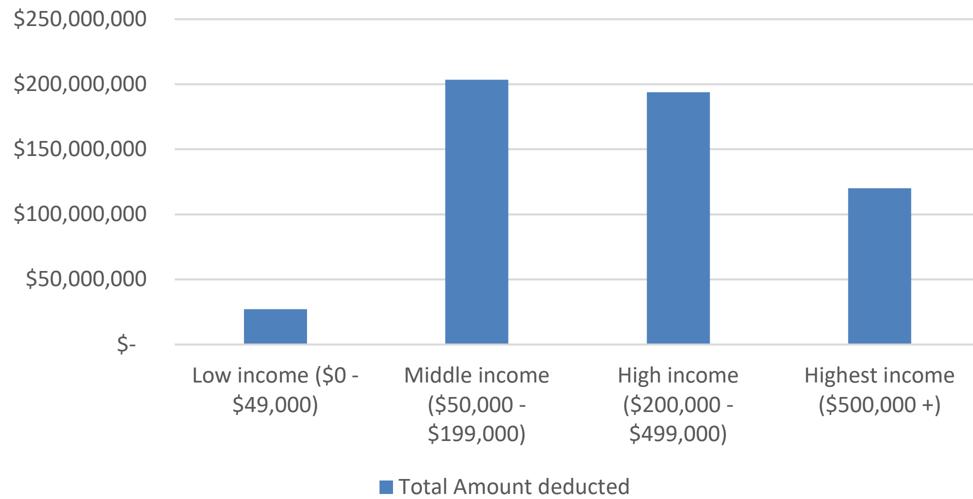
Additionally, we found that 529 account contributors did not claim a deduction for a substantial portion of their contributions, indicating that the 529 Deduction is likely not providing any additional incentive for some contributors. Specifically, there were about $988 million in

contributions made to CollegeInvest 529 accounts in Fiscal Year 2018, but taxpayers only claimed the deduction for $554 million in Tax Year 2018, about 56 percent, of the total contributions. It is likely that some of the contributors were not able to use the deduction because they are residents of other states. For example, CollegeInvest reported that about 9 percent of account owners were out-of-state, which would likely make them unable to use the deduction unless they file income taxes in Colorado. In addition, some non-account holders who contributed to 529 accounts were also likely non-residents, though we lacked data necessary to determine the location of these individuals. It is also possible that some contributors lacked sufficient taxable income to use the deduction, which could be the case for contributors with lower-incomes. Other contributors may not have been aware of the deduction, or may have been aware of it at the time of their contribution but later forgot to claim it, although we could not quantify the extent to which this occurred.

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

Based on our review of Department data, we found that 64,262 taxpayers claimed the 529 Deduction in Tax Year 2018, resulting in about $25.7 million in foregone revenue to the State and an average benefit of about $400 per taxpayer. Additionally, we found that taxpayers with higher incomes, who likely have more income available for saving, tend to contribute more and receive a larger tax benefit from the exemption than those with lower incomes. Specifically, taxpayers with annual incomes at or above $200,000, claimed about 58 percent of the total tax benefit of the deduction, nearly $15 million, while making up about 31 percent of claimants. In contrast, taxpayers with incomes below $50,000 claimed about 5 percent of the benefits, about $1.3 million, and made up about 11 percent of all claimants. EXHIBIT 2 provides the total amount deducted in Tax Year 2018, by income level.

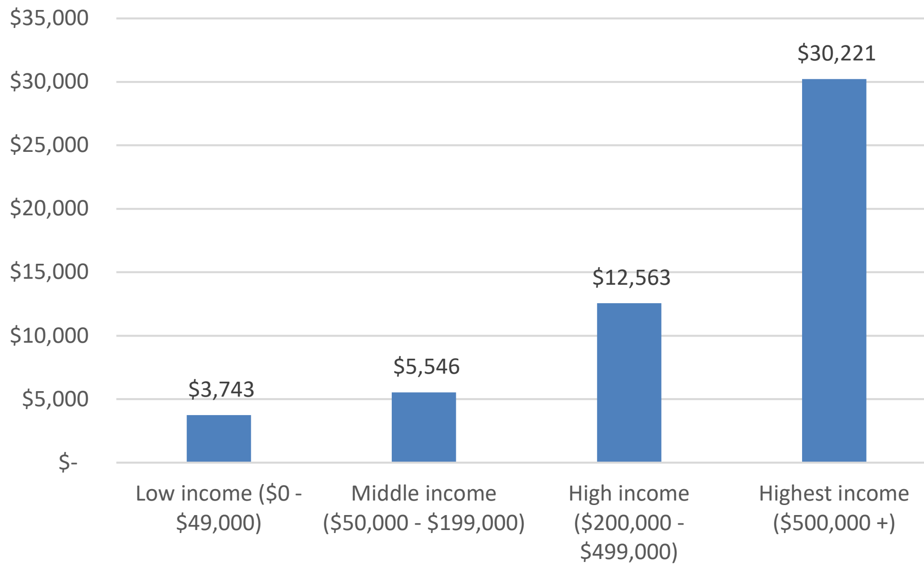
EXHIBIT 2. TOTAL AMOUNT DEDUCTED IN TAX YEAR 2018[1]



SOURCE: Office of the State Auditor's analysis of Department of Revenue data.
[1]Excludes claimants with negative federal taxable income.

Similarly, taxpayers with higher incomes tended to claim much larger average annual deductions. Specifically, those earning over $500,000 (roughly the top 1 percent of earners in Colorado) claimed an average deduction amount of about $30,000. In comparison, taxpayers who had less than $50,000 in federal taxable income deducted on average about $3,700. EXHIBIT 3 shows the average 529 deduction by income level.

EXHIBIT 3. AVERAGE DEDUCTION AMOUNTS BASED ON INCOME LEVELS IN TAX YEAR 2018



SOURCE: Office of the State Auditor's analysis of Department of Revenue data.

As shown, taxpayers with higher incomes tended to contribute more to their 529 accounts and claimed larger average deductions. However, due to the cap introduced in House Bill 21-1311, going forward, some taxpayers' deductions will be limited and the 529 Deduction's revenue impact to the State will likely decrease beginning in Tax Year 2022. As discussed, starting in Tax Year 2022, single-filer taxpayers will be limited to deducting $20,000 and joint-filers will be limited to deducting $30,000 annually per taxpayer, per beneficiary. Based on data provided by the Department, we estimate that in Tax Year 2018 about 3,700 taxpayers deducted amounts greater than the cap that will go into effect in Tax Year 2022, which resulted in about $5.3 million in forgone state revenue in Tax Year 2018. Of the 3,700 joint and single filers that deducted amounts greater than the cap, about 2,600 taxpayers had a federal taxable income of $200,000 or more. If the number of claimants and their contributions remain the same, the State would see a corresponding reduction in the amount of foregone state revenue due to the 529 Deduction as a result of the cap.

In addition, we found that although the deduction may help offset the cost of college for beneficiaries, this benefit is relatively small in comparison to the typical cost of higher education. Specifically, based on school tuition, room, and board data for Academic Year 2017-2018 from the National Center for Education Statistics, we estimated the average cost of attending an in-state public college in Colorado for 4 years starting in Academic Year 2017-2018 would cost about $94,000. After adjusting for annual tuition inflation of 6 percent, we estimated the cost of the same hypothetical college in Colorado would cost nearly $270,000 for 4 years starting in Academic Year 2036-2037. In comparison, if taxpayers received an annual tax benefit from the deduction of about $400 per year, the average tax benefit of the deduction in Tax Year 2018, through 18 years of saving, they would receive a total benefit of $7,200 or about 3 percent of the total cost of 4 years of tuition, room, and board at an in-state college starting in Academic Year 2036-2037. Further, it is likely that many individuals do not save for 18 years and do not save an additional amount equivalent to the tax benefit they receive from the deduction, so this example likely overstates the typical benefit it provides.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the 529 Deduction was eliminated, individuals contributing to 529 accounts that previously claimed the deduction would experience an annual increase of about $400 in their tax liabilities, based on the average amount deducted by taxpayers in Tax Year 2018. For a taxpayer claiming the average deduction amount over 18 years, eliminating the deduction would result in about $7,200 in lost tax savings. While taxpayers would still be able to receive the exemption from federal and state income taxes on interest earned on contributions, repealing the deduction could result in taxpayers deciding not to save, making fewer contributions to CollegeInvest 529 accounts, or utilizing other saving vehicles. Collectively, this could reduce the number of individuals and families saving for higher education in Colorado, though we could not quantify this potential impact.

Although the 529 Deduction provides a smaller financial benefit than other benefits of saving, it may act as a stronger incentive for Colorado residents to establish a 529 account through CollegeInvest, an incentive that would no longer exist if the deduction was eliminated. In a 2015 customer survey conducted by CollegeInvest, about 75 percent of 529 account holders said that if the 529 Deduction were eliminated, they would "investigate other options" to save for higher education and 63 percent indicated they would "likely close their CollegeInvest accounts." Although other states' 529 accounts offer benefits similar to those offered by CollegeInvest, without the 529 Deduction, Colorado residents would no longer have the additional incentive to save through CollegeInvest. Therefore, eliminating the deduction could have a negative impact on CollegeInvest.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

There are 49 states plus the District of Columbia that provide a 529 education savings plan, the exception being Wyoming, which partners with Colorado to offer 529 accounts to its residents. However, only 42 other states and the District of Columbia have an income tax and can therefore offer an income tax deduction. Of these states, 31 states and the District of Columbia provide a deduction for contributions made to 529 accounts, and three states provide a credit for contributions. Specifically, we found the following:

STATES WITH DEDUCTION CAPS AND CARRYFORWARDS—Of the 31 other states that offer a deduction, 28 states limit their deductions with a cap. States that cap the deduction amount typically cap the amount that can be deducted on a per-taxpayer, per-beneficiary, or a per-taxpayer/per-beneficiary basis. Per-taxpayer deduction caps limit the amount that can be deducted from a taxpayer's taxable income by the total amount contributed by the taxpayer to one or more 529 accounts. On the other hand, per-taxpayer/per-beneficiary caps limit the amount that can be deducted by the amount a taxpayer contributes to only one single 529 account, meaning the taxpayer can deduct contribution amounts up to

the cap for every beneficiary's account they contribute to. For example, Colorado's cap allows joint filers to deduct up to $30,000 from their taxable income for each account they contribute to and, therefore, could deduct $90,000 if they made $30,000 in contributions to three different accounts. In contrast to Colorado, most states either limit deduction amounts based on total contributions made by the taxpayer or contributions made to a single beneficiary account. Moreover, Colorado has the highest cap, followed by Pennsylvania's per beneficiary cap of $15,000 for single filers and $30,000 for joint filers. Illinois, Mississippi, and Oklahoma limit their deduction with a per taxpayer cap of $10,000 for single filers and $20,000 for joint filers. The average cap among states that limit deduction amounts is $4,974 for single and $8,596 for joint filers. Finally, 11 of the 28 states that have instituted caps allow unused deduction amounts to be carried forward to future tax years. Seven states limit the carryforward period to between 4 and 10 years while the remaining 4 states do not limit the number of years the deduction can be carried forward.

STATES WITH CREDITS FOR CONTRIBUTIONS TO 529 ACCOUNTS—Three states provide credits for contributions made to 529 accounts, as follows:

- Indiana provides a credit of 20 percent of contributions up to $1,000 annually.

- Utah provides a credit for 4.95 percent of contributions up to $2,070 for single and $4,140 for joint beneficiaries, with a max credit amount of $102 for single filers and $205 for joint filers.

- Vermont provides a credit for 10 percent of the first $2,500 in contributions for single filers and $5,000 for joint filers, with a max credit amount of $250 per taxpayer, per beneficiary.

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

We identified the following tax expenditures and programs designed to encourage individuals to save for higher education:

INCOME TAX CREDIT FOR EMPLOYER 529 CONTRIBUTIONS [Section 39-22-539, C.R.S.]—This provision allows Colorado employers who make contributions to a qualified tuition plan owned by an employee to take a credit against their Colorado state income tax liability equal to 20 percent of the total contributions made, up to $500 per employee who receives a contribution. We conducted an evaluation of the Income Tax Credit for Employer 529 Contributions, which can be found in the Office of the State Auditor 2020 Tax Expenditures Compilation Report.

ACHIEVING A BETTER LIFE EXPERIENCE (ABLE)—This program offers tax-advantaged savings plans for people living with disabilities. Eligible individuals and families can save up to $100,000 through Colorado ABLE saving accounts without affecting other public assistance provided to disabled persons. The earnings gained in Colorado ABLE accounts are considered nontaxable income on federal tax returns when spent on qualified expenses such as education; housing; transportation; employment training and support; personal support services; health care; and expenses that improve health, independence, and quality of life.

MATCHING GRANT PROGRAM—This program was created in 2004 and helps low to middle income families save for higher education expenses by matching up to $1,000 of eligible Colorado residents' contributions to a 529 savings account each year for up to 5 years. Applicants must have income at or below 600 percent of the federal poverty level, which is equivalent to a family of four with a combined annual income of $159,000 and below. Additionally, applicants must be Colorado residents and first apply when the beneficiary is younger than 9 years old, and the beneficiary must be claimed as a dependent. Over the last

5 years, CollegeInvest matched 4,057 families' contributions resulting in nearly $1.8 million in grants and about $445 in grants per family.

FIRST STEP PROGRAM—Created by House Bill 19-1280 in 2019, this program provides every child born or adopted in Colorado on or after January 1, 2020, a $100 contribution towards their CollegeInvest 529 savings account once the parent or legal guardian opens an account naming the child as the beneficiary and applies for the program prior to the child turning 5 years old. Children are eligible for the $100 contribution if they are a U.S. citizen or resident alien with a social security number or federal tax identification number. CollegeInvest has provided $13,530 in total contributions to 1,353 families since the program started.

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

CollegeInvest could not provide location information on non-account holders who contributed to 529 accounts. As a result of this data constraint, we could not assess how many 529 account contributors were likely ineligible for the deduction because they reside outside of Colorado.

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 529 DEDUCTION. Statute and the enacting legislation for the deduction do not state its purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for the deduction: to encourage and support individuals to save for higher education. We identified this purpose based on the operation of the deduction, conversations with stakeholders, research on the topic, and Department regulations. We also developed a performance measure to assess the extent to which the deduction is meeting this potential purpose.

However, the General Assembly may want to clarify its intent for the deduction by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the deduction's purpose and allow our office to more definitively assess the extent to which it is accomplishing its intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EFFECTIVENESS OF THE DEDUCTION. As discussed, we found that the deduction provides financial support to individuals saving for higher education expenses, with an average tax benefit of about $400 annually to current beneficiaries. Additionally, the deduction likely acts an as incentive for Colorado residents to contribute to an account administered by CollegeInvest, instead of saving through another state's 529 program. Further, CollegeInvest reported that the deduction acts as a helpful marketing tool in its efforts to encourage individuals to save for higher education and that children with access to a college savings account are more likely to enroll in higher education institutions. However, we also found that other benefits of saving through a 529 account, such as earning tax-free interest on contributions, and avoiding student loan debt, provide larger financial benefits than the deduction and may, therefore, be more important to individuals considering saving for higher education expenses. Further, we found that individuals only claimed the deduction for about 56 percent of the amount contributed to CollegeInvest 529 accounts in Fiscal Year 2018, indicating that it is not a significant factor for many individuals who contribute to 529 accounts and do not claim the deduction.

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LOW-EMITTING VEHICLES AND COMMERCIAL VEHICLES USED IN INTERSTATE COMMERCE EXEMPTIONS

EVALUATION SUMMARY | JULY 2022 | 2022-TE29

Expenditure	Low-Emitting Vehicles Exemption	Commercial Vehicles Used in Interstate Commerce Exemption
Tax Type	Sales and Use	Sales and Use
Year enacted	1999	2009
Repeal/Expiration date	None	None
Revenue impact (Tax Year 2019)	$2.2 million	$0
Number of Taxpayers	Could not determine	0

KEY CONCLUSION: The Low-Emitting Vehicles Exemption is not incentivizing the purchase of qualifying low-emitting gas and diesel fueled commercial trucks because federal emission requirements have made such vehicles the standard since 2014. The Commercial Vehicles Used in Interstate Commerce Exemption is not being used, and duplicates the Low-Emitting Vehicles Exemption.

WHAT DO THESE TAX EXPENDITURES DO?

Low-Emitting Vehicles Exemption [Section 39-26-719, C.R.S.]—Provides a sales and use tax exemption for the purchase, storage, or use of a new or used medium- or heavy-duty vehicle that is a qualifying alternatively fueled vehicle or a heavy-duty vehicle that meets Environmental Protection Agency's emissions standards. The exemption is also available for parts to convert a vehicle into a low-emitting vehicle.

Commercial Vehicles Used in Interstate Commerce Exemption [Section 39-26-113.5, C.R.S.]—Provides a proportional state sales and use tax exemption for the purchase, leases of 3 years or more, storage, or use of a model year 2010 or newer truck-tractor or semitrailer with a gross vehicle weight rating of 54,000 pounds or greater. The vehicle must be registered in the state and used in interstate commerce.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the exemptions do not explicitly state their purpose; therefore, we considered the following potential purposes:

Low-Emitting Vehicles Sales and Use Tax Exemption—To increase the sale of low-emitting heavy-duty vehicles, and alternatively fueled medium- and heavy-duty vehicles.

Commercial Vehicles Used in Interstate Commerce Sales and Use Tax Exemption—To increase the sale of newer model year heavy-duty commercial vehicles.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Amending statute to no longer allow gas or diesel fueled vehicles to qualify for the Low-Emitting Vehicles Exemption.
- Establishing a statutory purpose and performance measures for the Low-Emitting Vehicles Exemption.
- Repealing the Commercial Vehicles Used in Interstate Commerce Exemption.
- If the General Assembly does not repeal the Commercial Vehicles Used in Interstate Commerce Exemption, it may want to consider establishing a statutory purpose and performance measure(s) for the exemption.

LOW-EMITTING VEHICLES AND COMMERCIAL VEHICLES USED IN INTERSTATE COMMERCE EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This report covers the following two sales and use tax exemptions for medium- and heavy-duty vehicles:

LOW-EMITTING VEHICLES EXEMPTION [Section 39-26-719, C.R.S.]—Provides a sales and use tax exemption for the purchase, storage, or use of eligible new or used medium- or heavy-duty vehicles. To be eligible, vehicles that have a gross vehicle weight rating (gvwr) of more than 26,000 pounds, commonly referred to as heavy-duty vehicles (e.g., semi-tractors, trash trucks, busses, and dump trucks) must meet the U.S. Environmental Protection Agency's (EPA) greenhouse gas emission standards outlined in the Heavy-Duty National Program. Vehicles with over 10,000 and up to 26,000 gvwr, commonly referred to as medium-duty vehicles (e.g., delivery trucks and vans, and larger pick-up trucks) and heavy-duty vehicles can also qualify if they are alternative fuel vehicles that operate either solely or partially on one of the following alternative fuels:

- Compressed natural gas
- Liquefied petroleum gas
- Liquefied natural gas
- Electricity (battery electric or plug-in hybrid electric)

Additionally, the expenditure provides an exemption from sales and use tax for the purchase, storage, or use of a power source (e.g., engine or motor) or parts (e.g., wiring, fuel lines, fuel storage and control systems) for converting a vehicle to a qualifying low-emitting vehicle.

The Low-Emitting Vehicles Exemption was created in 1999 by House Bill 99-1271. However, the exemption has been amended multiple times, with the most significant amendment occurring in 2014 by House Bill 14-1326. The 2014 amendment changed the eligibility criteria for medium- and heavy-duty vehicles by: 1.) allowing only alternatively fueled, medium-duty vehicles to qualify (originally gas and diesel fueled medium-duty vehicles could qualify), and 2.) allowing heavy-duty vehicles to qualify if they use an alternative fuel or qualify as a low-emitting vehicle, as defined in statute. The qualification for a low-emitting vehicle was also changed to being certified by the EPA as meeting the mandatory emission standards for medium- and heavy-duty vehicles under the Heavy-Duty National Program. Originally, the exemption was allowed only if the vehicle was certified as a low-emitting vehicle by meeting the EPA's or another state's, as authorized under the Clean Air Act, low-emitting vehicle emission standards.

Vendors apply the exemption by not charging sales or use tax at the time of sale. Vendors are required to report the value of exempt sales to the Department of Revenue (Department) on their Colorado Retail Sales Tax Return Form (Form DR 0100) or Retailer's Use Tax Return Form (Form DR 0173), if applicable. Additionally, the vendor should submit the Colorado State Sales and Use Tax Exemption for Low-Emitting Heavy Vehicles Affidavit (Form DR 1369) verifying the vehicle meets the statutory eligibility requirements, and provide the purchaser with the gross vehicle weight rating and EPA certification to provide their county clerk to ensure that they are not assessed sales tax when registering the vehicle. If a purchaser is charged tax by a vendor at the time of sale, they can file a Claim for Refund Form (Form DR 0137B) with the Department to apply for a refund of the sales taxes they paid.

COMMERCIAL VEHICLES USED IN INTERSTATE COMMERCE EXEMPTION (Commercial Vehicles Exemption) [Section 39-26-113.5, C.R.S.]—Provides a partial state sales and use tax exemption for the purchase, lease of more than 3 years, storage, or use of a model year 2010 or newer truck-tractor or semitrailer with a gvwr of 54,000 pounds or more registered in the state to be used in interstate commerce. The availability of the exemption is contingent on the availability of funds in the Commercial Vehicle Enterprise Fund.

The exemption is administered as a refund paid over 3 years and is calculated in proportion to the percentage of miles a vehicle travels outside the state. For example, for a qualifying vehicle with a purchase price of $100,000 for which the purchaser pays $2,900 in state sales tax and which travels 100,000 miles each year with 20,000 occurring out-of-state, the purchaser would be eligible for a total refund of 20 percent of the sales tax paid, or $580. This amount would be refunded over 3 years, at $193.33 per year. Taxpayers claim the exemption by submitting the State Sales Tax Refund for Vehicles Used in Interstate Commerce form (Form DR 0202) to the Department.

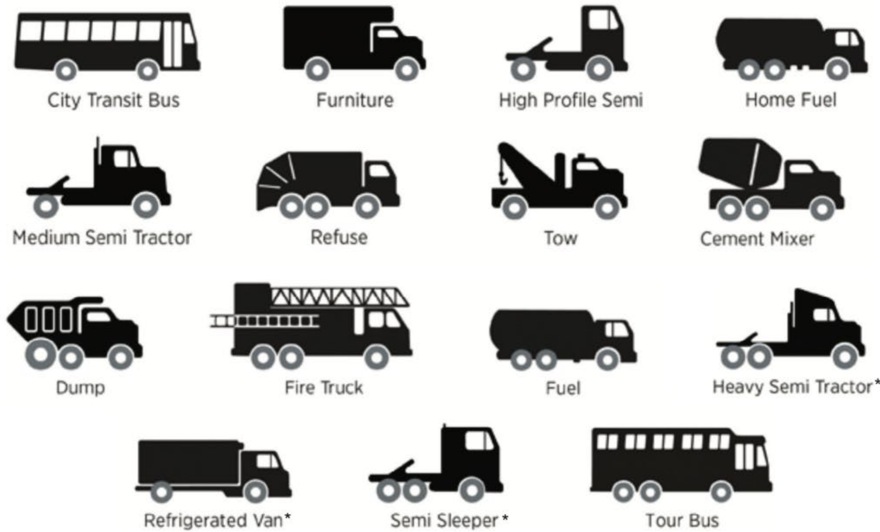
The exemption was created in 2009 by House Bill 09-1298 and amended once by House Bill 10-1285, which changed the refund timeline from 5 years to 3 years.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not explicitly state the intended beneficiaries of either the Low-Emitting Vehicles Exemption or the Commercial Vehicles Exemption. Based on language in statute, and the operation of the exemptions, we inferred that the intended direct beneficiaries are businesses and individuals who use medium- and heavy-duty vehicles, typically for commercial purposes. As of 2019, there were roughly 246,000 medium- and heavy-duty vehicles registered in the state, according to the Transportation Energy Data Book, published for the U.S. Department of Energy by the Oak Ridge National Laboratory.

Exhibit 1 provides examples of medium- and heavy-duty vehicles and their typical weights.

EXHIBIT 1. EXAMPLES OF COMMERCIAL VEHICLES AND WEIGHTS



**Denotes a vehicle that is commonly 54,000 gvwr or greater.*

SOURCE: Office of the State Auditor analysis of Alternative Fuels Data Center Information.

The general public also appears to be intended to indirectly benefit from the exemptions to the extent that they reduce air pollution by encouraging the use of lower emissions vehicles. According to the Colorado Energy Office, transportation is the largest contributor of pollution in the state and nation; medium- and heavy-duty vehicles tend to emit substantially more pollution on a per vehicle basis than passenger vehicles, accounting for 10 percent of all transportation pollution, but representing only 5 percent of all vehicle registrations in the state.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the exemptions do not state their intended purpose; therefore, we could not definitively determine the General Assembly's original intent for either exemption. Based on the operation of the exemptions, statutory language, and their legislative history, we considered the following potential purposes:

LOW-EMITTING VEHICLES EXEMPTION—To increase the sale of low-emitting heavy-duty vehicles, and alternatively fueled medium- and heavy-duty vehicles.

During legislative hearings, the bill sponsor for the Low-Emitting Vehicles Exemption's enacting legislation indicated the exemption was intended to incentivize the purchase of low-emitting medium- and heavy-duty vehicles. When the exemption was amended in 2014, bill sponsors indicated that the intent was still to incentivize the purchase of low-emitting vehicles, but that due to changes to national emissions requirements and improvements in vehicle technology, nearly all new vehicles greater than 10,000 gvwr were meeting the requirements to qualify for the exemption, and therefore, it was no longer providing an incentive to purchase vehicles that emit less pollution relative to other vehicles. Further, the sponsors wanted to encourage the use of alternatively fueled vehicles, which can also emit less pollution. Thus, the exemption was amended to create different eligibility requirements for medium- and heavy-duty vehicles, with medium-duty vehicles

(10,000+ lbs gvwr – 26,000 lbs gvwr) qualifying only as an alternatively fueled vehicle and updating the standards used to qualify heavy-duty vehicles (26,000+ lbs gvwr) as an eligible low-emitting vehicle.

COMMERCIAL VEHICLES EXEMPTION—To increase the sale of newer model year heavy-duty commercial vehicles.

The Commercial Vehicles Exemption was created alongside the State's Green Trucks Grant Program in 2009 by House Bill 09-1298. The legislative declaration in the enacting legislation for the Green Trucks Grant Program highlighted that older vehicles emit greater levels of pollution and consume more fuel and that the program was intended "to encourage the retirement and scrapping of older trucks in the interests of the state's environment." Although this language is related specifically to the Green Trucks Grant Program, we inferred that the Commercial Vehicles Exemption shared a similar purpose and was intended to work in tandem with the program, since the exemption was also created during the 2009 legislative session and only applied to 2010 and newer model year vehicles when created.

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

We could not definitively determine whether the Low-Emitting Vehicles Exemption or the Commercial Vehicles Exemption are meeting their purposes because their purposes are not provided in their respective sections of statute or enacting legislation. However, we found that the Low-Emitting Vehicles Exemption is not meeting the potential purpose we considered for this evaluation as it relates to gas and diesel fueled heavy-duty vehicles because, under EPA regulations, all new heavy-duty vehicles sold must meet the requirements of the Heavy-Duty National Program and are, therefore, eligible for the exemption. Although the exemption may provide an additional incentive to purchase alternatively fueled vehicles, we lacked sufficient data to determine the exemption's impact on these purchases.

We also found that the Commercial Vehicles Exemption is not meeting the potential purpose we considered for this evaluation because it provides a duplicative benefit to the Low-Emitting Vehicles Exemption and is not being used.

Statute does not provide quantifiable performance measures for the exemptions. Therefore, we created and applied the following performance measures to determine if the exemptions are meeting the potential purposes we used for this evaluation.

PERFORMANCE MEASURE #1: *To what extent has the Low-Emitting Vehicles Exemption increased the sale of eligible low-emitting vehicles, and alternatively fueled vehicles?*

RESULTS: We found that all sales of new heavy-duty vehicles are eligible for the Low-Emitting Vehicles Exemption since the EPA standards under the Heavy-Duty National Program become mandatory in 2014. Vehicles that qualify for the exemption have become the norm, and the exemption appears largely obsolete since it no longer provides an incentive to purchase lower-emitting vehicles. Additionally, stakeholders stated that they are aware of the exemption and use it, but also mentioned that it is their understanding that heavy-duty vehicles have qualified for the exemption since 2014, when federal emission standards became mandatory, so it is not a significant factor for them in determining which vehicle to purchase.

The exemption could encourage the purchase of alternatively fueled vehicles, in particular medium-duty vehicles, which, unlike heavy-duty vehicles, can only qualify for the exemption if they run on an alternative fuel source. However, we could not determine the extent to which taxpayers have purchased these vehicles and claimed the exemption. Specifically, the exemption is available for low-emitting vehicles, alternatively fueled vehicles, and parts for conversion, but the Department's data do not indicate which type of transaction the exemption was applied to. Therefore, we were unable to determine how many alternatively fueled vehicles were purchased under the exemption.

Additionally, we did not receive feedback from stakeholders we contacted who may purchase alternatively fueled vehicles.

PERFORMANCE MEASURE #2: *To what extent has the Commercial Vehicle Exemption increased the sale of model year 2010 and newer commercial vehicles?*

RESULTS: Based on data and discussions with the Department, we determined that the exemption is not increasing the sale of eligible vehicles because it is not being used and has not been used since at least 2017. Department staff specified that most, if not all, vehicles eligible for the Commercial Vehicle Exemption have also been eligible for the Low-Emitting Vehicles Exemption, which provides a full exemption from sales tax at the time of purchase instead of a partial refund for sales tax paid over the course of 3 years in proportion to the miles a vehicle travels outside the state. Therefore, taxpayers do not appear to have a need to use the exemption, which has more administrative requirements to claim, and provides a delayed, and likely lower, benefit amount.

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

Based on Department data, the Low-Emitting Vehicles Exemption had a revenue impact to the State of $2.2 million in Calendar Year 2019 and provided a corresponding benefit to taxpayers. For Calendar Year 2019, there were 53 accounts of vendors who filed forms to utilize the exemption. Although we were unable to determine the extent to which taxpayers received the benefit by purchasing an alternatively fueled vehicle, low-emitting vehicle, or parts for converting a vehicle, based on data from the Department, there were at least 465 submissions where the Low-Emitting Vehicles Exemption was used in Calendar Year 2019.

Additionally, the Low-Emitting Vehicles Exemption likely has a revenue impact to some local governments that have their sales taxes collected by the State. Statute [Section 29-2-105(1)(d)(I), C.R.S.] provides that

local governments for which the State collects sales taxes may adopt the Low-Emitting Vehicles Exemption. Therefore, the exemption reduces local sales tax revenues and provides a corresponding savings in the amount of local sales taxes in these jurisdictions. However, as of January 2022, only 18 local governments had adopted the exemption and we lacked data necessary to quantify the impact in these jurisdictions.

In addition, home rule cities established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes have the authority to set their own tax policies independent from the State. The top five most populated home rule cities—Aurora, Colorado Springs, Denver, Fort Collins, and Lakewood—do not have similar exemptions, but Fort Collins exempts the sales of vehicles used in interstate commerce and their parts from sales tax.

We found that the Commercial Vehicles Exemption does not have a revenue impact or provide any economic costs or benefits because it is not being used.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

Eliminating the Low-Emitting Vehicles Exemption would result in the State's 2.9 percent sales tax, and local sales taxes of the 18 local jurisdictions that have adopted it, being applied to purchases that currently benefit from the exemption. Based on Calendar Year 2019 data from the Department, and assuming that all 465 filings were for individual vehicle purchases as opposed to vehicle parts, the average cost per vehicle that was sold under the exemption was $165,000, and the average state sales tax that would otherwise have been due on the purchase was roughly $4,800.

As previously stated, the Commercial Vehicles Exemption is not being used so there would be no impact if it was repealed. However, it could be used in the future if it was not repealed and the Low-Emitting Vehicle Exemption were to be repealed. If both exemptions were repealed,

purchasers with operations in other states could choose to register their vehicle in another state in order to avoid paying sales tax, if it is possible for them to do so. By registering their vehicle outside the state, these vehicles may qualify for the State's Commercial Trucks and Trailers Licensed Out-of-State Exemption [Section 39-26-712, C.R.S.], which exempts vehicles registered in another state and used in interstate commerce from Colorado sales and use tax. However, if the vehicle is relocated to Colorado prior to it being registered and used outside of the state for at least 6 months, use tax will be due.

Additionally, the upfront cost of alternative vehicles would increase if the exemptions were repealed, which could impact some buyers' decisions when purchasing these vehicles. However, reports on alternatively fueled vehicles, news articles, and information from stakeholders shows that the exemption was likely not the primary reason most current beneficiaries chose to purchase an alternatively fueled vehicle. For example, the adoption of alternatively fueled vehicles may have been in their best interest because alternative fuels tend to be cheaper and have more price stability compared to gasoline and diesel, and the maintenance cost of alternatively fueled vehicles can be less.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

There are no states with a similar Low-Emitting Vehicles Exemption that provide a sales and use tax exemption for alternatively fueled medium- and heavy-duty vehicles or heavy-duty vehicles that meet EPA's Heavy Duty National Program emission standards. Only two other states, New Jersey and Washington, have a sales tax exemption for alternatively fueled vehicles and both of these exemptions are intended for passenger vehicles.

Of the 44 states, excluding Colorado, that have a sales and use tax, there are 15 states that provide an exemption that is similar to the Commercial Vehicles Exemption, with some of these states offering exemptions that apply to a broader range of vehicles. Additionally, there are 16 states that provide an exemption that is more limited than

Colorado's, for example providing only a reduced rate instead of an exemption, requiring that the vehicle be used exclusively in interstate commerce, or only providing an exemption for vehicles that will be registered under the International Registration Plan (a reciprocity agreement recognizing the registration and dividing the registration fees of commercial vehicles between 49 states, the District of Columbia, and select Canadian providences).

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

We identified the following state tax expenditures that apply to qualifying purchases of medium- and heavy-duty trucks:

INNOVATIVE MOTOR VEHICLE CREDIT [Section 39-22-516.7, C.R.S.]—Provides lessors or purchasers an income tax credit of $1,500 to $2,500 for a car that is either an electric, or plug-in hybrid electric.

INNOVATIVE TRUCKS CREDIT [Section 39-22-516.8, C.R.S.]—Provides lessors or purchasers an income tax credit ranging from $1,500 to $10,000 for an electric or plug-in hybrid electric truck. Eligible trucks range from light-duty passenger trucks to heavy-duty trucks.

ENTERPRISE ZONE COMMERCIAL VEHICLE TAX CREDIT [Section 39-30-104 (1)(b), C.R.S.]—Provides purchasers of new model year vehicles of 54,000 lbs gvwr or greater an income tax credit of 1.5 percent of the total cost, including parts associated with the sale. The credit is allowed only if the vehicle is registered in the state and predominantly housed within an enterprise zone for the 12-month period following its purchase.

COMMERCIAL TRUCKS AND TRAILERS LICENSED OUT-OF-STATE EXEMPTION [Section 39-26-712, C.R.S.]—Exempts the sale or long-term lease of commercial trucks and trailers from sales and use tax if they are used exclusively outside of the state or in interstate commerce, removed from the state within 30 days, and registered outside of the state. Trucks and trailers previously registered in another state for at

least 6 months are also exempt from use tax, if relocated and registered in the state.

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

The Department was not able to provide data on the specific types of vehicles that were purchased under the Low-Emitting Vehicles Exemption. Although this data is reported on the Colorado State Sales and Use Tax Exemption for Low-Emitting Heavy Vehicles Affidavit (Form DR 1369), it is not recorded in or retrievable by GenTax, the Department's tax filing and information system. In order for us to more accurately determine the exemption's impact on the sale of alternatively fueled vehicles, the Department would have to capture and house this data, 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 data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO NO LONGER ALLOW GAS- OR DIESEL-FUELED VEHICLES TO QUALIFY FOR THE LOW-EMITTING VEHICLES EXEMPTION. As discussed, federal emissions standards have made the exemption obsolete as an incentive to encourage the purchase of lower-emitting diesel or gas fueled vehicles. Specifically, since 2014, all new model year heavy-duty vehicles qualify for the exemption because they are required to meet the relevant EPA emission standards, and will be required to meet future standards. Thus, the General Assembly may want to consider repealing the specific section of statute, Section 39-26-719(1)(a)(II)(A), C.R.S., that provides gas and diesel fueled heavy-duty vehicles a sales tax exemption, since federal standards have made lower emitting vehicles the norm.

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE LOW-EMITTING VEHICLES EXEMPTION. Statute and the enacting legislation for the exemption do not state the exemption's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of this evaluation, we considered a potential purpose for the exemption: to increase the sale of low-emitting heavy-duty and alternatively fueled medium- and heavy-duty vehicles. We identified this purpose based on the operation of the exemption, statutory language, and its legislative history. We also developed a performance measure to assess the extent to which the exemption is meeting this potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REPEALING THE COMMERCIAL VEHICLES EXEMPTION. As discussed, we found that the Commercial Vehicles Exemption is not encouraging the purchase of qualifying vehicles because it is not being used, and has not been used since at least 2017. Based on our conversations with Department staff and stakeholders, the exemption is not used because vehicles that would qualify for the exemption also qualify for the Low-Emitting Vehicles Exemption, which is easier to claim and provides a larger benefit. Specifically, the Commercial Vehicles Exemption is structured as a refund that taxpayers must request over a 3-year period in proportion to the vehicle miles traveled outside the state instead of a full sales tax exemption at the time of sale, as is the case for the Low-Emitting Vehicles Exemption.

Further, even if it provided an unduplicated benefit, because the exemption applies to model year 2010 and newer vehicles, it no longer acts as an incentive for purchasing newer vehicles. As discussed, the exemption was implemented concurrently with the Green Trucks Grant

Program, which provided grants in order to encourage the purchase of newer, lower-emitting trucks, and appears to have been intended to work in tandem with this program. However, the program was repealed in 2012, leaving only the exemption in place. Without the addition of the grant, the exemption provides a relatively small benefit to the purchaser. Therefore, the General Assembly may want to consider repealing the Commercial Vehicles Exemption, since it appears obsolete.

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE COMMERCIAL VEHICLES EXEMPTION, IT MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE EXEMPTION. Statute and the enacting legislation for the exemption do not state the exemption's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of this evaluation we considered a potential purpose for the exemption: to increase the sale of newer model year heavy-duty commercial vehicles. We identified this purpose based on the operation of the exemption, statutory language, and its legislative history. We also developed a performance measure to assess the extent to which the exemption is meeting this potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).

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RURAL BROADBAND EQUIPMENT REFUND

EVALUATION SUMMARY | JULY 2022 | 2022-TE30

TAX TYPE	Sales and use
YEAR ENACTED	2014
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT (TAX YEARS 2014-2021)	$0
NUMBER OF TAXPAYERS (TAX YEARS 2014-2021)	0

KEY CONCLUSION: The refund has not encouraged broadband providers to expand service in rural areas because no providers have qualified for it.

WHAT DOES THE TAX EXPENDITURE DO?

The Rural Broadband Equipment Refund [Section 39-26-129, C.R.S.] allows broadband providers to claim a refund of state sales and use tax paid for tangible personal property that is installed in a target area for the provision of broadband service. Statute defines "target area" as the unincorporated part of a county or a municipality with a population of less than 30,000 people, according to the most recently available population statistics of the U.S. Bureau of the Census.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-26-129(1), C.R.S.] states the purpose of the refund is "To encourage broadband providers to deploy broadband infrastructure in rural areas of the state."

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Repealing the refund since it has not been used.
- If it chooses not to repeal the refund, it could consider establishing performance measures to evaluate the refund if it is used in future years.

RURAL BROADBAND EQUIPMENT REFUND

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

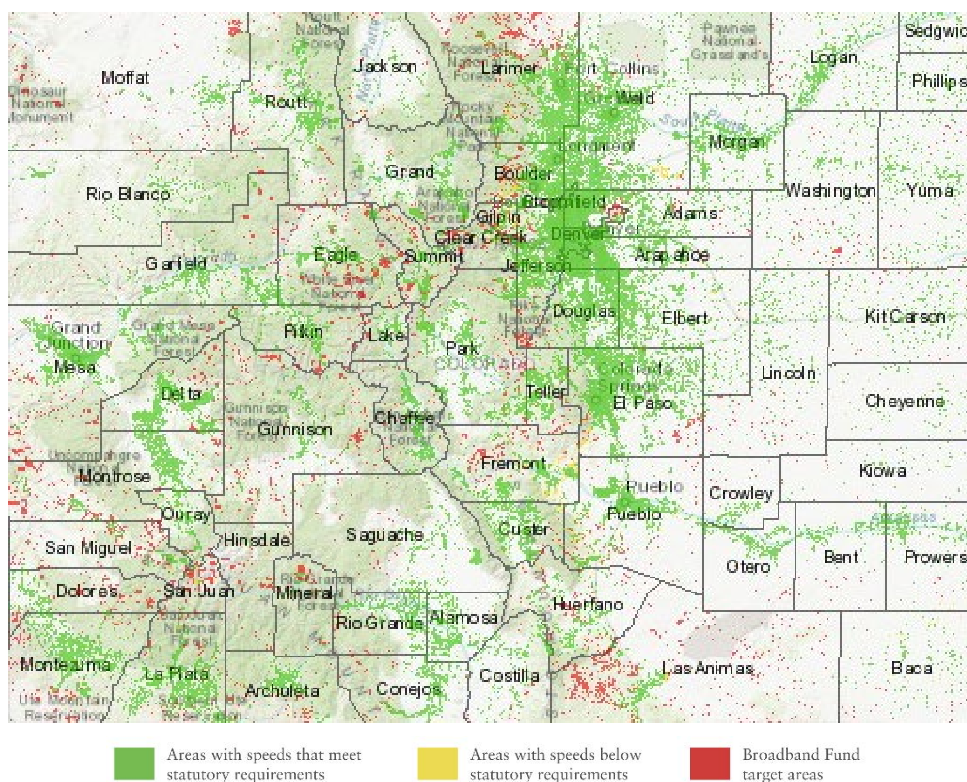
The Rural Broadband Equipment Refund allows broadband providers to claim a refund of state sales and use tax paid for tangible personal property that is installed in a target area for the provision of broadband service. Statute defines "target area" as the unincorporated part of a county or a municipality with a population of less than 30,000 people, according to the most recently available population statistics of the U.S. Bureau of the Census [Section 39-26-129 (2)(c), C.R.S.]. Broadband service means communications service having the capacity to transmit data at least four megabits per second (Mbps) for downloads and one Mbps for uploads, or the Federal Communications Commission's definition of broadband service, whichever is faster [Section 39-26-129 (2)(b), C.R.S.]. The Department of Revenue (Department) is allowed to refund up to $1 million per calendar year to all providers combined. If providers, in total, are approved for more than $1 million in refunds, the Department prorates the refunds based on the refund amount requested by each provider [Section 39-26-129(5), C.R.S.]. This expenditure has not been substantively changed since its enactment in 2014 as part of House Bill 14-1327.

In order to claim the refund, taxpayers must submit the Sales and Use Tax Refund for Broadband Equipment Form (Form DR 0137 C), along with supporting documentation, such as invoices, sales tax receipts, and census data, which establishes that the equipment was installed in a target area; as well as documentation showing the performance specifications and description of each piece of equipment and how they are used to provide broadband services. Taxpayers must submit their claims between January 1st and April 1st of the year following the calendar year in which the sales tax was paid [Section 39-26-129(4), C.R.S.]. The Department reviews the claim and supporting documentation to ensure it meets statutory requirements.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Based on our review of the refund's statutory language and Department forms, we considered the intended beneficiaries to be broadband providers that install broadband in target rural areas, and households in rural areas who receive broadband service as a result of the refund. According to the Colorado Broadband Office within the Governor's Office of Information Technology, 6.9 percent of rural households in CO did not have access to broadband as of 2021. According to the Broadband Office, broadband enables people to access basic amenities such as education, health care, public safety, and government services. Broadband access increases economic opportunities within a community; provides access to education such as remote learning; helps provide cost effective access to healthcare; and supports public safety systems, such as 9-1-1, early warning and public alert, and remote security monitoring and backup systems for public safety communications networks. Exhibit 1 provides current broadband access by speed throughout Colorado.

EXHIBIT 1. BROADBAND IN COLORADO



SOURCE: Colorado Broadband Office.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-26-129(1), C.R.S.] states the purpose of the refund is "to encourage broadband providers to deploy broadband infrastructure in rural areas of the state."

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

We found that the Broadband Refund is not meeting its purpose because, according to Department records, no providers have received it.

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

PERFORMANCE MEASURE #1: *To what extent has the expenditure encouraged broadband providers in Colorado to increase coverage to rural areas?*

RESULT: The refund has not encouraged providers to install broadband infrastructure in target rural areas of the state because it has not been used. First, according to the Department, as of March 2022, no providers have received the refund since it was established in 2014. Although Department records indicate that 14 providers submitted claims for the refund in 2014 through 2018, the Department reported that none provided sufficient information with their claims to verify that they qualified. The Department contacted these taxpayers, but none were able to produce the required documentation to substantiate their claims or they did not respond to the Department's request for additional information. Therefore, it is possible that these providers did not meet the refund's requirements or determined that the cost of documenting their eligibility outweighed the potential benefit. The

Department also indicated that some of these taxpayers could still correct their applications and receive the refund, although we lacked information on how many intended to do so.

For 15 claims from 10 providers, the Department provided documentation that stated the reason the Department rejected the provider's claim. Exhibit 2 summarizes the issues with those claims.

EXHIBIT 2: SUMMARY OF CLAIM ISSUES	
Problem with Claim	Number of Claims with This Issue
Missing Performance Specifications of Broadband Equipment	14
Missing Contract/Service Agreement	13
Missing Proof of Payment for Equipment	5
Missing or Incomplete Spreadsheet of Installed Equipment	3
Missing Bank Statement	1
Missing Amended Consumer Tax Report or Proof of Sales Tax Payment	6
Claim Not Submitted Timely and Attempted to Claim Local Tax	1

SOURCE: Office of the State Auditor analysis of Department of Revenue refund request data.

In addition, although providers may have purchased property that would qualify, it appears that many may not be aware of the refund. Specifically, the Rural Broadband Office emailed questions we prepared to providers who serve rural areas. We received responses from nine providers who reported that they had installed broadband in target areas of the state in the past 5 years. However, eight of the nine respondents reported that they were not aware of the exemption.

Finally, it also appears that the refund may not act as a significant incentive for providers to complete a project because it is a relatively

small portion of the overall cost of a typical project. For example, based on data from the Broadband Fund grant applicants in January 2022, about 22 percent of the cost of a typical project was for equipment and the remaining 78 percent was for other project costs such as installation and administration. Based on these costs, a refund of the State's 2.9 percent sales tax represents 0.64 percent of the total project cost (2.9 percent of 22 percent). Therefore, while the refund could potentially encourage providers to complete projects that are only marginally cost-effective, it is unlikely to be a deciding factor for most projects.

In contrast, state and federal grants have provided significant funding for rural broadband projects in recent years, which likely also makes the refund less significant for most providers. For example, the Broadband Fund from the Colorado Broadband Office covers approximately 60 percent of rural broadband project costs and the ReConnect Loan and Grant Program from the U.S. Department of Agriculture covers approximately 70 percent of rural broadband project costs. In addition, there are far more grant funds available than what providers could claim from the refund, which is statutorily capped at $1 million per year. Within the Broadband Fund alone, providers were awarded a total of $51 million in grants between 2016 and 2021 for installing broadband services. According to the Colorado Broadband Office, the significant funding provided by these grants has led to an additional 29,024 households in rural areas gaining access to broadband services, with 93.1 percent of Coloradoans in rural areas having broadband access in 2021.

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

The refund has had no revenue impact or other economic costs and benefits because, according to the Department, no refunds have been issued since its creation in 2014.

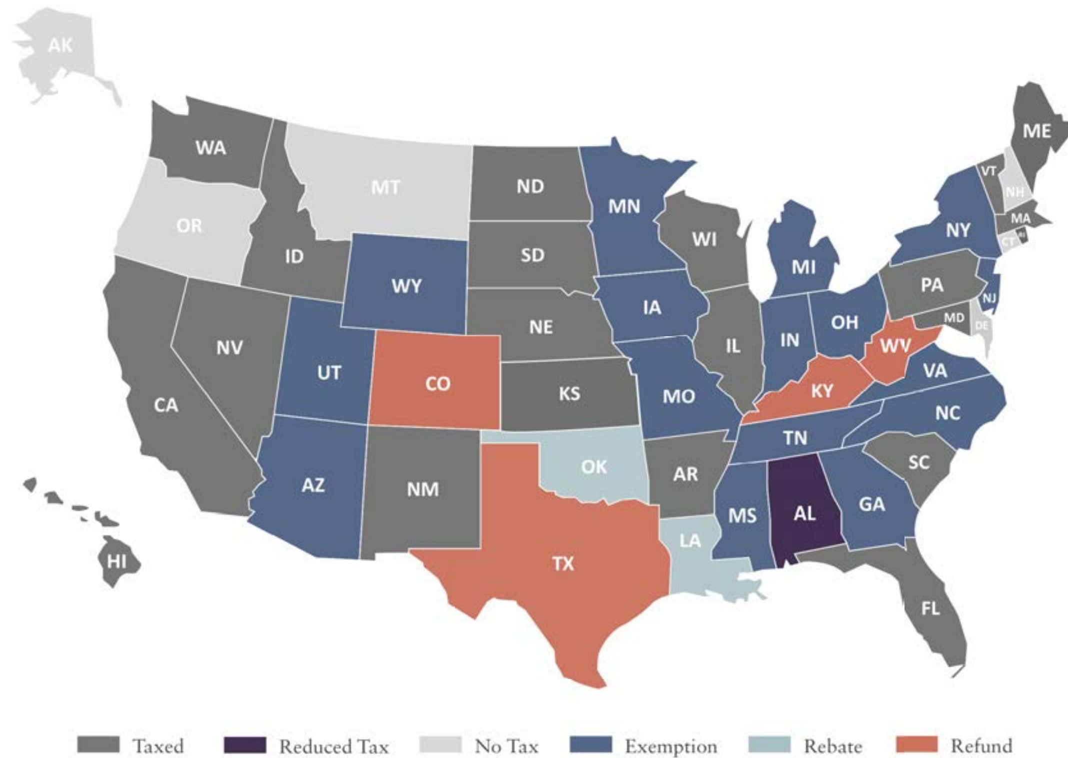
WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the refund would not have an impact on providers or the installation of broadband equipment in rural areas of the state. As mentioned, no provider has successfully claimed the refund and many providers installing broadband in rural areas do not appear to be aware of it. Additionally, state and federal grants may provide a significant portion of the installation costs.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 states that levy sales tax (excluding Colorado), 22 have expenditures that exempt broadband equipment from sales tax either through a refund, rebate, reduced tax rate, or exemption. Out of the 22 states with an exemption, only four allow exemptions for equipment installed in certain locations, like rural areas, and 18 provide an exemption at the time of purchase regardless of the location. The types of equipment eligible for an exemption also vary by state. Broadband encompasses internet and telecommunication services, so some states exempt telephone equipment while others exempt wireless internet equipment. For example, Kentucky defines equipment eligible for the refund as a “communication system” that must cost at least $100 million and, in contrast to Colorado, providers must submit paperwork prior to their purchases. Louisiana’s rebate includes fiber optic cabling used for installing broadband in rural areas of the state, but does not allow a refund for equipment purchased with state or federal funds, unless they are reported as taxable income. Exhibit 3 shows the tax treatment of broadband equipment purchases across the United States.

EXHIBIT 3. BROADBAND TAX EXPENDITURES IN THE UNITED STATES



SOURCE: Office of the State Auditor review of Bloomberg BNA data.

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

There are several grants available to providers that install broadband in rural areas of the state. Specifically, the Colorado Broadband Office currently offers a grant through the Broadband Fund, providing grants for projects in rural areas with a population of 7,500 or less people. To receive the grants, broadband providers must provide a minimum of 25 percent of the total project costs. Similar to the Rural Broadband Equipment Refund, the Broadband Fund only covers broadband infrastructure installation and does not cover ongoing maintenance costs. The Broadband Fund has issued a total of $51 million in grants over 63 projects since 2016, which the Colorado Broadband Office projects will result in 29,024 rural households receiving broadband

access. On average, the Broadband Fund covered roughly 60 percent of the total project costs.

The Department of Local Affairs (DOLA) also provides two grants to expand broadband access to rural areas of the state. The first is the Broadband Interconnectivity Grant Program, established by House Bill 21-1289. The grants are to provide broadband access to those in Colorado who are "unserved or underserved," which means that they do not have wireline connection capable of reliably delivering speeds of at least 25 Mbps for downloads and 3 Mbps for uploads; there is $5 million in total grants available. The second grant provided by DOLA is the Broadband Planning and Infrastructure Set-Aside program. This grant seeks to support the efforts of local governments to "improve Broadband service to their constituents to achieve enhanced community and economic development." The total funding available for this program is $3.6 million.

In addition to state-level grants, the U.S. Department of Agriculture offers a grant program called the ReConnect Loan and Grant Program. Similar to the Rural Broadband Equipment Refund, this program seeks to expand broadband access to rural areas. As provided in Exhibit 4, within Colorado, this program funded three projects in Fiscal Year 2020, the most recent year with data available.

EXHIBIT 4. USDA RECONNECT LOAN AND GRANT PROGRAM IN COLORADO FISCAL YEAR 2020

Data Input	Delta-Montrose Electric Association	Emery Telecommunications & Video, Inc.	Yampa Valley Electric Association, Inc.
Square Miles	126	358	122
Total Project Cost	$14,127,300	$12,049,900	$8,067,500
Grant Amount	$10,595,400	$6,302,200	$6,029,200
Percent of Project Covered by Grant	75	52	75

SOURCE: Office of the State Auditor analysis of USDA data.

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

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

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER REPEALING THE RURAL BROADBAND EQUIPMENT REFUND. As discussed, since the refund's enactment in 2014, none of the 14 providers who have applied for the refund have successfully claimed it. According to Section 39-26-129(4), C.R.S., taxpayers "must provide proof of the state sales and use tax paid by the broadband provider in the immediately preceding calendar year and proof that the tangible personal property was deployed in a target area for the provision of broadband service." Based upon stakeholder feedback and review of available data from the Department, it appears that providers have had difficulty documenting that they meet statutory requirements, such as providing proof that the broadband equipment was installed in an eligible location. We also found that most broadband providers we spoke with were not aware of the refund and it does not seem that the refund has encouraged broadband providers in Colorado to increase coverage to rural areas. Additionally, we estimate that if it was being issued, the refund would typically cover less than 1 percent of the total project costs, which may not be a large enough benefit to encourage providers to move forward with a project. Further, there are several grants available in Colorado that provide much larger financial incentives. As a result, the General Assembly may want to consider repealing the Rural Broadband Equipment Refund.

IF THE GENERAL ASSEMBLY CHOOSES NOT TO REPEAL THE RURAL BROADBAND EQUIPMENT REFUND, IT MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH STATUTORY PERFORMANCE MEASURES. As discussed, statute and the enacting legislation for the refund do not provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential performance measure for the refund: to what extent has the expenditure

encouraged broadband providers in Colorado to increase broadband infrastructure to rural areas of the state? We identified this performance measure based on our review of the defined statutory purpose, "To encourage broadband providers to deploy broadband infrastructure in rural areas of the state." [Section 39-26-129 (1), C.R.S.]. However, the General Assembly may want to clarify its expectations by adding performance measure(s) in statute, which would allow our office to more definitively assess the extent to which the refund is accomplishing its intended goal(s) if it is used in the future.

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COMPONENTS USED TO PRODUCE RENEWABLE ENERGY EXEMPTION

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE13

TAX TYPE	Sales and use	REVENUE IMPACT	$6.2 million
YEAR ENACTED	2008	NUMBER OF TAXPAYERS	Could not determine
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The exemption provides some support to Colorado's renewable energy industry, but because it provides a relatively small tax benefit in comparison to typical renewable energy project costs, it has likely had a limited impact on industry growth in the state.

WHAT DOES THE TAX EXPENDITURE DO?

The Components for Renewable Energy Exemption [Section 39-26-724(1)(a), C.R.S] allows "all sales, storage, and use of components used in the production of alternating current electricity from a renewable energy source…[to] be exempt from taxation…" According to Department of Revenue taxpayer guidance, examples of the components that qualify for the exemption include wind turbines, solar modules, inverters, and control systems. Components not directly used in the creation of renewable energy, such as energy storage devices and remote monitoring systems, are not eligible.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

The legislative declaration in House Bill 07-1279, which created the exemption and other provisions related to renewable energy, states that it is "the [G]eneral [A]ssembly's intent to encourage the development of projects that produce electricity from renewable energy sources in Colorado." Additionally, when discussing the most recent amendment for this expenditure, both the bill sponsor and witnesses stated that they believed the purpose of the exemption was to help grow and support the State's renewable energy industry.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing performance measures for the exemption.
- Reviewing the cost-effectiveness of the exemption.

COMPONENTS USED TO PRODUCE RENEWABLE ENERGY EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Components for Renewable Energy Exemption (Renewable Energy Exemption) [Section 39-26-724 (1)(a), C.R.S.] allows "all sales, storage, and use of components used in the production of alternating current electricity from a renewable energy source…[to] be exempt from taxation…" Alternating current (AC) electricity is the type of electrical current that is commonly produced by power plants, wind and solar farms, and household photovoltaic systems. According to Department of Revenue (Department) taxpayer guidance, examples of the components that qualify for the exemption include wind turbines, solar modules, inverters, and control systems. Components not directly used in the creation of renewable energy, such as energy storage devices and remote monitoring systems, are not eligible.

The exemption was created in 2007 by House Bill 07-1279. In 2008, House Bill 08-1368 made changes to clarify the types of components that are eligible. Additionally, there have been two temporary expansions of the types of components eligible for the exemption, which have both expired. In 2009, House Bill 09-1126 extended the exemption to include components used in solar thermal systems from 2009 through 2017. In 2014, House Bill 14-1159 made biogas components eligible for the exemption from 2014 through 2019.

In addition to providing a state level sales and use tax exemption, under Section 29-2-105(1)(d)(I), C.R.S., local governments that have their sales taxes collected by the State have the option of adopting ordinances to apply the exemption to their sales taxes as well. As of July 1, 2021, 30 state-collected cities, and 22 state-collected counties have adopted

this exemption. Under Article XX, Section 6 of the Colorado Constitution, home rule cities and counties that do not have their sales taxes collected by the State can set their own tax policies independently from the State and are not required to provide a similar exemption. We found that of the 15 most populous home rule cities, one has established a similar exemption.

The Renewable Energy Exemption is typically applied at the time of purchase by vendors who do not collect sales tax on eligible sales. Vendors must report exempt sales using either the Colorado Retail Sales Tax Return (Form DR 0100) or the Retailer's Use Tax Return (Form DR 0173). If a vendor does not apply the exemption to an eligible sale, the purchaser can apply for a refund using the Department's Claim for Refund of Tax Paid to Vendor (Form DR 0137B).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the intended beneficiaries of the exemption. Based on the operation of the exemption and taxpayer guidance provided by the Department, we considered the direct beneficiaries to be owners of renewable energy production facilities, and homeowners who purchase qualifying solar energy systems. In Calendar Year 2020, the renewable energy industry provided 30 percent of the state's electricity production, according to the U.S. Energy Information Administration. Colorado's total wind generating capacity for 2020 was 4,716 megawatts from wind and, in 2021, 2,130.9 megawatts installed for solar. Colorado is ranked seventh among states in installed wind power capacity and thirteenth among states in solar power-generating capacity. There are 347 solar power companies and about 90,000 installations of solar systems in the state.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

The legislative declaration in House Bill 07-1279, which created the exemption and other provisions related to renewable energy, states that it is “the [G]eneral [A]ssembly’s intent to encourage the development of projects that produce electricity from renewable energy sources in Colorado.” Additionally, when discussing the most recent amendment for this expenditure, both the bill sponsor and witnesses stated that they believed the purpose of the exemption was to help grow and support the state’s renewable energy industry.

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

We found that the exemption is meeting its purpose, but to a limited extent because the support it provides is relatively small compared to typical renewable energy project costs.

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

PERFORMANCE MEASURE: *To what extent has the Renewable Energy Exemption supported and incentivized the development of renewable energy projects?*

RESULT: Overall, we found that the exemption provides some support to the State’s renewable energy industry, but that support is relatively small compared to typical renewable energy project costs. Based on Department data, the exemption was applied to about $214 million in eligible sales in Calendar Year 2019. To assess the potential impact of the exemption, we compared the cost savings purchasers would realize due to the exemption to typical overall project costs, which include ineligible costs such as labor for site preparation, construction, and installation. According to our review of National Renewable Energy

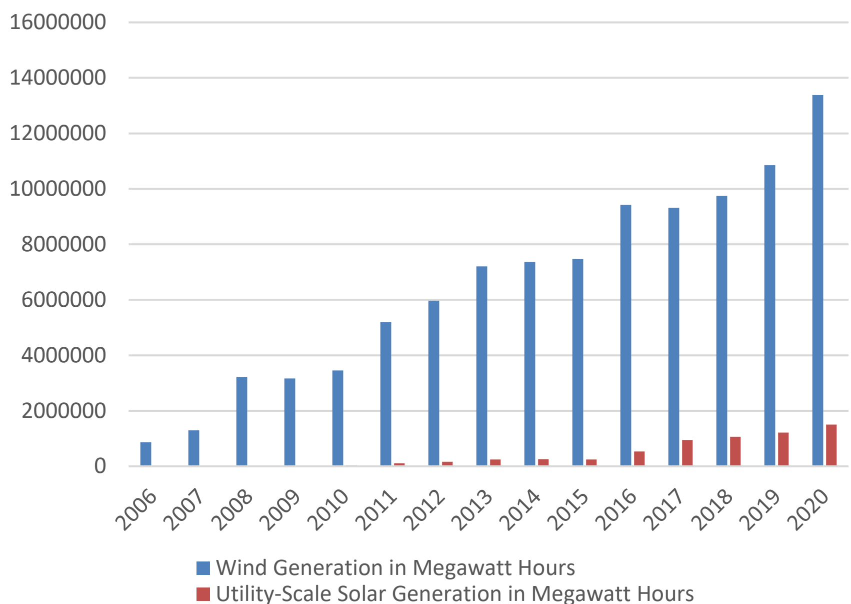
Laboratory (NREL) reports, components eligible for the exemption on typical utility-scale wind and solar projects make up about 69 percent of overall project costs. Therefore, based on the State's 2.9 percent sales tax rate, the exemption would reduce total project costs by about 2 percent.

Additionally, we found that while the exemption could act as an additional incentive to encourage businesses to invest in renewable energy projects in Colorado, other factors likely play a larger role in driving renewable energy industry growth in the state. According to stakeholders, the exemption has helped the industry grow in Colorado and is particularly helpful because it provides savings on the upfront cost of building renewable energy facilities. Reducing up-front costs may be important within the renewable energy industry sector since, according to the U.S. Energy Information Administration, the initial capital cost of building renewable energy facilities is typically higher than the cost of non-renewable energy facilities. However, based on the exemption's relatively small benefit compared to the typical cost of renewable energy projects, it appears unlikely to be the deciding factor for most businesses when considering whether to invest in renewable energy production in the state. Economic reports on business tax incentives, such as *A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States*, prepared in 2017 by Timothy Bartik for the Pew Charitable Trusts, indicate that tax credits can influence businesses to make additional investments; however, credits that are small in comparison to the investment amount, such as the exemption, have less impact on business investment decisions.

Furthermore, it appears that other factors are more likely to have driven growth in the State's renewable energy industry. For example, a 2018 study by the University of Texas found that, in Colorado, the cheapest method of energy production was either wind or solar, with wind resulting in the lowest cost. Based on our review of economic studies, in the coming years, the cost of renewable energy is expected to continue to decline due to the improvement of technology and increased production of components, which could further drive the adoption of

renewables. Our review of NREL data also indicates that Colorado, in particular eastern and southern parts of the state, receives a significant amount of wind and sun, and therefore, is a favorable location for renewable energy development. Additionally, in 2004, Colorado voters passed a Renewable Energy Standard, which generally required utilities to obtain 30 percent of their energy from renewable sources by 2020. This requirement may have also played a significant role in increasing investments in renewable energy. EXHIBIT 1 shows the growth in wind and solar electricity production in Colorado since 2006.

EXHIBIT 1. ELECTRICITY GENERATION IN COLORADO FROM WIND AND UTILITY-SCALE SOLAR SOURCES CALENDAR YEARS 2006-2020



SOURCE: Office of the State Auditor analysis of U.S. Energy Information Administration data on electricity generation from wind and solar sources.

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

According to the Department's 2020 Tax Profile & Expenditure Report, the Renewable Energy Exemption resulted in $6.2 million in forgone state revenue and a corresponding benefit to purchasers of renewable energy components in Calendar Year 2019. Similar to the increase in renewable energy capacity in the state, the revenue impact of the exemption has grown in recent years, up from about $400,000 in Calendar Year 2015 and $2.3 million in 2017.

The exemption also reduces local government sales tax revenue and provides a corresponding benefit to purchasers who buy components in the 30 cities and 22 counties for which the State collects sales taxes that have adopted the exemption. Although we lacked data necessary to quantify the impact to these local governments, the sales tax rates in these cities and counties range between 0.25 percent and 4 percent. Therefore, combined with the state sales tax exemption, purchasers would save between 3.15 percent and 6.9 percent in sales tax on eligible purchases in these jurisdictions. However, most local governments that have their sales taxes collected by the State do not apply the exemption. Furthermore, as discussed, home rule cities and counties that collect their own sales taxes are not required to apply a similar exemption and only one of the 15 most populous home rules cities and counties have done so. Therefore, purchases of components used to produce renewable energy are still subject to local sales tax in most areas of the state.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the Renewable Energy Exemption was eliminated, the State's 2.9 percent sales and use tax would be applied to every purchase of components used to produce renewable energy. As discussed, this additional cost would be relatively small compared to the typical cost of renewable energy projects. However, eliminating the exemption

would reduce the support the State currently provides to the industry and could have a greater impact on marginal projects that have smaller expected profits. Additionally, one stakeholder said that eliminating the expenditure could signal that Colorado is not as business friendly for this industry, which could have a negative impact on growth in the state. Another stakeholder stated that the cost of solar components would increase, which would likely result in a decrease in customer purchases if the exemption was eliminated. However, as discussed, we found that Colorado is generally a favorable location for renewable energy development and that factors other than the exemption are more likely to drive industry growth. Therefore, while eliminating the exemption may have a negative impact on some businesses and could factor into some businesses' decisions on where to invest, doing so would likely have a relatively small impact overall on the renewable energy industry in the state.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 45 states that levy a sales tax, 16 states (not including Colorado) have a sales and use tax exemption for components used to produce renewable energy: California, Connecticut, Florida, Indiana, Maryland, Massachusetts, Minnesota, Missouri, New Jersey, New York, North Dakota, Rhode Island, Texas, Utah, Virginia, and Washington.

We also looked at whether states with the highest wind and solar capacity offer a similar type of exemption. EXHIBIT 2 shows the sales tax treatment of wind and solar energy system components in the top five wind and solar energy capacity states. As shown, most of the wind energy states do not have a similar exemption, while a majority of the solar states do have some type of exemption.

EXHIBIT 2. SALES TAX EXEMPTIONS FOR WIND AND SOLAR ENERGY SYSTEM COMPONENTS FOR TOP FIVE U.S. WIND AND SOLAR ENERGY CAPACITY STATES

Top Five Wind Capacity States		Top Five Solar Capacity States	
State	Exemption?	State	Exemption?
Texas	Yes	California	Yes
Iowa	No	Texas	Yes
Oklahoma	No	Florida	Yes
Kansas	No	North Carolina	No
Illinois	No	Arizona	No

SOURCE: Office of the State Auditor review of Bloomberg BNA data and other state's statutes.

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

We identified the following tax expenditure and program that may also encourage renewable energy development in the state:

ENTERPRISE ZONES INVESTMENT TAX CREDIT [Section 39-30-104(1)(a), C.R.S.]—Allows taxpayers to claim a nonrefundable income tax credit for 3 percent of the qualified investment that they make in an enterprise zone when the property is used solely and exclusively in an enterprise zone for at least 1 year. Credits resulting from investments in renewable energy property that was placed in service prior to January 1, 2018, may be carried forward for 22 years. Credits resulting from investments in renewable energy property placed in service on or after January 1, 2018, may be carried forward for 14 years. For income tax years beginning on or after January 1, 2014, the amount that may be claimed by a taxpayer in an income tax year is the lesser of (1) $5,000 of the taxpayer's tax liability plus 50 percent of any portion of the tax liability that exceeds $5,000, or (2) $750,000.

COLORADO RENEWABLE ENERGY STANDARD [Section 40-2-124(1)(c), C.R.S.]—Created in 2004, this provision requires qualifying utilities, excluding municipal-owned facilities and some cooperative electric

associations, to produce a growing percentage of their total electricity using renewable sources, though the electricity is not required to have been generated in Colorado. The provision culminates with a final goal of 30 percent of all electricity in the state coming from renewable sources by 2020 and beyond. As of 2020, renewable energy sources accounted for 30 percent of the state's electricity production.

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

There were no 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 PERFORMANCE MEASURES FOR THE RENEWABLE ENERGY EXEMPTION. As discussed, statute and the enacting legislation for the exemption do not provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we developed a performance measure to assess the extent to which the exemption is meeting its purpose. However, the General Assembly may want to clarify its intent for the exemption by providing performance measure(s) in statute. This would allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE COST-EFFECTIVENESS OF THE EXEMPTION. As discussed, the revenue impact of the exemption grew from about $400,000 in Tax Year 2015 to about $6.2 million in 2019, and may continue to increase along with growth in renewable energy production capacity in the state. Although stakeholders indicated that the exemption has encouraged industry growth, which is the purpose of the exemption, our review indicates that the benefit provided by the exemption is relatively small in comparison to typical project costs and appears to act as one additional

factor among many that businesses are likely to consider when deciding whether to invest in renewable energy projects in the state. Additionally, other factors may be more likely to drive growth in the state's renewable energy industry, which, as of 2020, produced about 30 percent of the state's electricity and over 10 times the amount of electricity from wind and solar sources than in 2007 when the exemption was created. For example, the state's favorable wind and solar conditions, decreasing renewable energy costs, and Renewable Energy Standard have likely had a more significant impact on the growth in the renewable energy industry in the state.

On the other hand, stakeholders indicated that the exemption continues to be helpful to the industry, especially since renewable energy projects typically have high up-front costs, which are reduced by the exemption. Further, stakeholders indicated that the exemption helps keep Colorado competitive with other states and may signal to investors that the State continues to be "friendly" to the industry. We found that, although only one of the top five wind energy producing states has a similar exemption, three of the top five solar energy producing states have a similar exemption. Therefore, the General Assembly may wish to compare the costs of the exemption to its benefits to determine if it continues to meet its policy goals.

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NON-RESIDENT AIRCRAFT SALES & AIRCRAFT PARTS EXEMPTIONS

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE12

EXPENDITURE	Non-Resident Aircraft Sales Exemption	Aircraft Parts Exemption
TAX TYPE	Sales and use	
YEAR ENACTED	2008	1991
REPEAL/EXPIRATION DATE	None	None
REVENUE IMPACT	Could not determine	
NUMBER OF TAXPAYERS	Could not determine	

KEY CONCLUSION: The exemptions appear to provide some support to the State's aircraft manufacturing and maintenance industries by keeping Colorado competitive with other states with similar exemptions. However, they do not appear to have driven industry growth.

WHAT DO THESE TAX EXPENDITURES DO?

NON-RESIDENT AIRCRAFT SALES EXEMPTION (FLY-AWAY EXEMPTION) [SECTION 39-26-711.5, C.R.S.]—Provides non-residents with a sales and use tax exemption for the purchase of an aircraft that will be removed from the state within the latter of either 120 days or 30 days after the completion of maintenance or refurbishments associated with the sale.

AIRCRAFT PARTS EXEMPTION [SECTION 39-26-711(1)(b) AND (2)(b), C.R.S.]—Provides a sales and use tax exemption for the purchase, storage, or use of components and parts that are permanently affixed to an aircraft.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the exemptions do not explicitly state their purpose; therefore, we could not definitively determine the General Assembly's original intent.

Based on their operation and legislative history, for the purposes of our evaluation we considered the following potential purposes:

FLY-AWAY EXEMPTION—To increase aircraft sales and support aircraft manufacturing and maintenance businesses in the state.

AIRCRAFT PARTS EXEMPTION—To support the State's aircraft maintenance industry by encouraging aircraft owners and operators to have aircraft maintenance performed in the state.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the exemptions.
- Reviewing the effectiveness of the Fly-away and Aircraft Parts Exemptions.

NON-RESIDENT AIRCRAFT SALES & AIRCRAFT PARTS EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers the following two sales and use tax exemptions, which provide preferential tax treatment for purchasers of aircraft and aircraft components in the state:

NON-RESIDENT AIRCRAFT SALES AND USE TAX EXEMPTION (Fly-away Exemption)—Section 39-26-711.5, C.R.S., provides a sales and use tax exemption to non-residents who purchase an aircraft in the state and predominately use it outside of the state. To be eligible for the exemption, the purchaser must not be a resident of Colorado, and must remove the aircraft from the state within the latter of either 120 days after the purchase or 30 days from the completion of maintenance or refurbishment of the aircraft associated with the purchase. Additionally, the aircraft cannot be in the state for more than 73 days in any of the three calendar years following the initial removal of the aircraft from the state.

The Fly-away Exemption was created in 2008 by House Bill 08-1261, and has had only one major amendment since then. Specifically, in 2016, House Bill 16-1119 expanded the exemption's eligibility requirements to allow aircraft purchasers to leave the aircraft in the state longer than 120 days after the sale if the aircraft is undergoing maintenance or refurbishment associated with the sale, by allowing the aircraft to remain in the state up to 30 days after this work is complete.

To claim the exemption, the purchaser has to provide the vendor with an affidavit affirming they are a non-resident and that they will remit tax if they fail to comply with statutory requirements regarding removal of the aircraft within the specified time or maximum allowable use of the aircraft in the state. The vendor then applies the Fly-away Exemption by not charging sales or use tax at the time of sale. Vendors are required to report the value of exempt sales to the Department of Revenue (Department) on their Colorado Retail Sales Tax Return (Form DR 0100). If a purchaser is charged tax by a vendor at the time of sale, they can file a Claim for Refund (Form DR 0137B) with the Department to apply for a refund of the sales taxes they paid.

AIRCRAFT PARTS EXEMPTION—Section 39-26-711(1)(b) and (2)(b), C.R.S., provides a sales and use tax exemption for the sale, storage, or consumption of aircraft components and parts that are permanently affixed to an aircraft. According to Department guidance, eligible items include, but are not limited to, fuselage parts, parts for the engine, seats, and paint for the aircraft. The exemption was created in 1991 by House Bill 91-1046, and took effect July 1, 1992. The exemption has remained substantively unchanged since then. Since sales of equipment and parts to aircraft maintenance businesses that sell these items to final consumers were already exempt under the broader Wholesales Exemption [Section 39-26-102(19)(a), C.R.S.] at the time the exemption was created, it appears that the Aircraft Parts Exemption was intended to apply to sales to final consumers.

Vendors apply the Aircraft Parts Exemption by not charging sales or use tax at the time of sale. Vendors are required to report the value of exempt sales to the Department on their applicable Colorado Retail Sales Tax Return (Form DR 0100) or Retailer's Use Tax Return (Form DR 0173). If the purchaser is charged tax by a vendor at the time of sale, they can file a Claim for Refund (Form DR 0137B) with the Department to apply for a refund of the sales taxes they paid.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not state the intended beneficiaries of either exemption. However, based on the operation of the exemptions, their legislative history, and conversations with stakeholders, we inferred that the intended direct beneficiaries of the Fly-away Exemption are non-residents who purchase new or used aircraft in the state, typically for non-commercial purposes, such as recreational aviation and private transportation. According to stakeholders, most aircraft sales in the state are for used aircraft, though we could not identify a source of data to quantify the types of aircraft sold. For the Aircraft Parts Exemption, we inferred that the beneficiaries are commercial and non-commercial aviation operators who purchase aircraft parts to install on their aircraft. Additionally, based on legislative testimony at the time the exemptions were established, it appears that the General Assembly also intended for both exemptions to benefit aircraft manufacturing and maintenance businesses in the state. According to Bureau of Labor Statistics (BLS) Data, in Calendar Year 2020, there were six aircraft manufacturing facilities and 166 aircraft maintenance facilities in the state, with the aircraft maintenance industry employing roughly 2,500 employees, which is less than 1 percent of the state's total workforce. Bureau of Labor Statistics employment data is not available for the aircraft manufacturing industry.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the exemptions do not state their purpose; therefore, we could not definitively determine the General Assembly's original intent for either exemption. Based on the operation of the exemptions and their legislative history, we considered the following potential purposes:

FLY-AWAY EXEMPTION —To increase aircraft sales and support aircraft manufacturing and maintenance businesses in the state.

During legislative hearings for the Fly-away Exemption, the bill sponsor stated that the exemption was intended to support the aircraft manufacturing industry and increase the sale of used aircraft in the state. Additionally, when the Fly-away Exemption was amended in 2016, the bill sponsor indicated that the change was intended to support the state's aircraft maintenance industry by making it easier for non-residents to have work completed on aircraft they purchase in the state, which could support growth in the industry and increase employment and wages.

AIRCRAFT PARTS EXEMPTION—To support the state's aircraft maintenance industry by encouraging aircraft owners and operators to have aircraft maintenance performed in the state.

The Aircraft Parts Exemption was created in 1991 as a part of a large incentive package to attract United Airlines to build a maintenance facility at the soon-to-be constructed Denver International Airport. Ultimately, United Airlines built its maintenance facility in another state. However, legislators were also concerned more broadly with the tax burden that aircraft owners faced when having maintenance performed on their aircraft, which often requires the purchase of parts, and stated that the exemption was intended to serve as an economic incentive to support employment and wage growth in the aircraft maintenance industry.

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

We could not definitively determine whether the Fly-away Exemption or the Aircraft Parts Exemption are meeting their purposes because no purposes are provided in statute or their enacting legislation. However, we found that the exemptions may be meeting the potential purposes that we considered for our evaluation to some extent because they support the state's aircraft maintenance industry. Specifically, other states provide similar exemptions and stakeholders indicated that it is

common for aircraft owners and sales brokers to arrange for aircraft sales and maintenance to occur in states with sales tax exemptions. On the other hand, we found that the exemptions do not appear to have caused industry employment or wage growth above national industry trends.

Statute does not provide quantifiable performance measures for the exemptions. Therefore, we created and applied the following performance measures to determine if the expenditures are meeting the potential purposes we used for our evaluation.

PERFORMANCE MEASURE #1: *To what extent has the Fly-away Exemption increased aircraft sales in the state?*

RESULTS: We could not quantify the number of exempt aircraft sold in the state because the Department does not track the sale of aircraft and vendors are not required to report the number of exempt sales when they file their sales tax returns. However, we found that the Fly-away Exemption could encourage aircraft sales in the state to some extent. According to stakeholders, individuals purchasing aircraft and aircraft sales brokers are aware of the tax treatment of aircraft sales in states, and since aircraft are easily moveable, often look for jurisdictions that offer the most favorable tax treatment in which to make the sale. For this reason, stakeholders indicated that the exemption allows Colorado to be competitive with other states and potentially supports the sale of mostly used aircraft in the state, since they likely represent the majority of exempt sales. However, since the State's sales tax rate, at 2.9 percent, is the lowest sales tax of the 45 states that have a sales tax, the exemption may not have a strong impact on aircraft sales in Colorado compared to other states.

PERFORMANCE MEASURE #2: *To what extent have the Fly-away Exemption and the Component Parts Exemption increased the number of aircraft maintenance and manufacturing jobs and businesses in the state?*

RESULTS: We found that the exemptions may provide some support to the state's aircraft maintenance industry by keeping Colorado's sales taxes competitive with other states, though they do not appear to have driven industry growth.

As discussed, stakeholders indicated that the Fly-away Exemption supports aircraft sales in the state. Stakeholders also reported that most purchases of used aircraft require testing or maintenance before the completion of the sale and that it is common for purchasers to have additional refurbishing conducted after the sale. Therefore, to the extent that the Fly-away Exemption encourages additional aircraft sales in the state, it may also support the aircraft maintenance industry. Further, the Aircraft Parts Exemption may encourage both resident and non-resident aircraft owners to have maintenance and refurbishment work performed in the state since their associated purchases of parts are exempt from sales tax. Similar to the Fly-away Exemption, most other states have an exemption for aircraft parts and equipment, and so the Aircraft Parts Exemption may deter aircraft owners from having work performed in another state to avoid sales tax.

Though they could support aircraft sales in the state to some extent, it does not appear that either exemption has caused a substantial amount of industry growth in the state. Specifically, although we found that since 1992, when the Aircraft Parts Exemption took effect, the state's aircraft maintenance industry has grown substantially, the growth is consistent with population growth in the state and national industry trends and it does not appear that the exemptions are the primary cause. According to BLS data, from Calendar Year 1992 to 2020, the number of aircraft maintenance businesses in Colorado increased from 81 to 166 (105 percent). Similarly, the number of aircraft maintenance industry jobs increased from 1,285 to 2,497 (94 percent). However, during this time, the state's population also increased by about 66 percent, which indicates that much, but not all, of the growth in the state's aircraft maintenance industry may be associated with population growth, since it is likely that the number of aircraft operated in the state

and demand for associated maintenance increased as the population increased. Additionally, the number of aircraft maintenance businesses and jobs have also increased nationally since 1992 and so it is possible that other trends, such as a national increase in air travel and shipping, rather than the exemptions have been responsible for the growth in the state's aircraft maintenance sector. For example, based on Federal Aviation Administration data, national air travel has increased 57 percent from 2002 to 2019, and air cargo shipments have increased 109 percent. Further, Denver International Airport, which opened in 1995, has grown into the fifth busiest airport in the country as of 2019. Similarly, according to the Division of Aeronautics' 2020 *Colorado Aviation Economic Impact Study,* passenger travel at the state's five busiest commercial airports has increased by 99 percent from 2002 to 2019 and shipping has increased 41 percent. This increased demand may have also increased aircraft maintenance jobs in the state.

To better account for these factors, we reviewed industry trends using BLS location quotients information for the aircraft maintenance industry in Colorado. Location quotients (LQ) measure the relative size of a particular industry or a characteristic of the industry in a state compared to the national average, as described below:

- Greater than 1—a characteristic of the industry or occupation (i.e., employment, number of establishments, wages, etc.) is comparatively more concentrated than the national average.

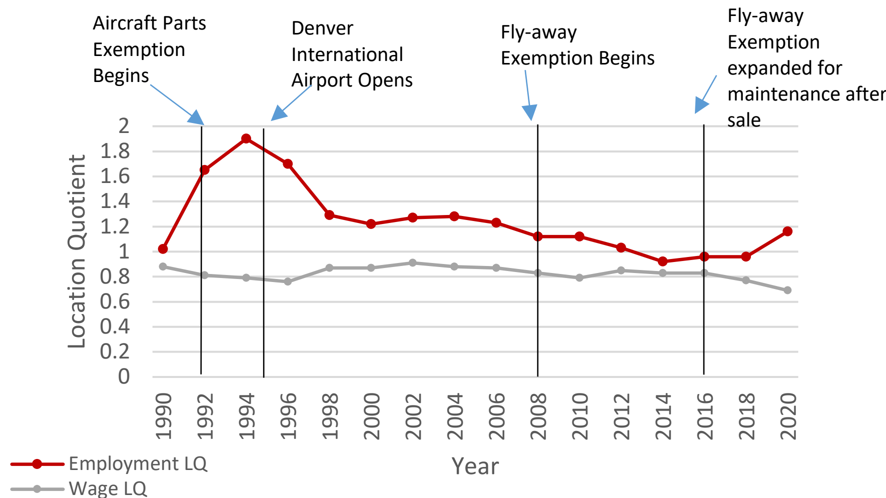
- Exactly 1—a characteristic of the industry or occupation is concentrated at the same rate as the national average.

- Less than 1—a characteristic of the industry or occupation is concentrated below the national average.

EXHIBIT 1 provides location quotients for aircraft maintenance industry employment and wages in Colorado from 1990 to 2020. As shown, employment concentration in the aircraft maintenance sector generally declined during the period after the exemptions were established and there does not appear to be a clear correlation between the exemptions

and the overall trend in employment concentration. Additionally, the location quotient for the industry's average annual wage has remained consistently below the national average.

EXHIBIT 1. CHANGES IN AIRCRAFT MAINTENANCE INDUSTRY EMPLOYMENT CONCENTRATION AND WAGE LOCATION QUOTIENTS, CALENDAR YEARS 1990-2020



SOURCE: Office of the State Auditor analysis of Bureau of Labor Statistics location quotient data.

Although the concentration of aircraft manufacturing employment in the state was well above the national average in 1992 when the Aircraft Parts Exemption was created, this appears to have been associated with the construction of Denver International Airport, and employment declined substantially after the airport opened, making it difficult to assess the initial impact of the Aircraft Parts Exemption. Additionally, it appears that the Fly-away Exemption, established in 2008, had little impact on the overall employment concentration trend, with the state's location quotient steadily declining from 2004 through 2014. However, in recent years, following the 2016 amendment of the Fly-away Exemption, the state's employment location quotient has increased modestly and was slightly above the national average at 1.16 in Calendar Year 2020. It is unclear whether this employment increase is

attributable to the exemption or will be sustained in future years. Additionally, since the creation of both exemptions, the wage location quotient for the aircraft maintenance industry has remained below the national average and it does not appear that the exemptions have had an impact on industry wages in the state relative to national trends. Further, the average annual wage for the industry in 2020 was $50,000, substantially below the state's $67,000 average annual wage for all private occupations.

It is important to note that we encountered a data limitation in the foregoing analysis. Specifically, to assess aircraft maintenance industry trends we used private sector data from the BLS for the category of "Other Support Activities for Air Transportation." Though this category includes aircraft maintenance, testing, and repair services, it also includes data for aircraft passenger screening security services provided by private-sector firms and cannot be further disaggregated to remove these jobs from the data. Since aircraft passenger screening security services performed by Transportation Security Administration employees, who are public sector employees, are not included in the same category, we considered the data used from the "Other Support Activities for Air Transportation" category to be reasonably representative of the aircraft maintenance industry. However, the additional jobs included in the data likely reduce the accuracy of the figures we present, as they relate to aircraft maintenance jobs, to some extent.

At the time the Aircraft Parts Exemption was established, the State, in coordination with the City and County of Denver, was attempting to provide an incentive package for United Airlines to establish a large maintenance facility at Denver International Airport. According to news accounts, the facility was expected to generate about 6,500 maintenance jobs in the state. Ultimately, the exemption and other incentives offered were not successful, and United Airlines chose Indiana, which offered the company a larger tax incentive package for the facility. Notably, the facility in Indiana only employed about 3,000 workers at its peak before permanently closing in 2003.

In addition to the impact of the exemptions on the aircraft maintenance industry, we also reviewed their potential impact on aircraft manufacturing in the state. We identified two Colorado businesses that manufacture new aircraft in the state that could potentially benefit from the exemptions. However, due to the small size of the state's aircraft manufacturing sector, the BLS did not release employment data for us to track employment over time for this industry. We attempted to contact the two businesses that we identified, but did not receive a response. Therefore, we could not determine the impact of the exemptions on the state's aircraft manufacturing businesses or aircraft sales. However, the exemptions do not appear to have attracted additional aircraft manufacturing businesses in the state. According to BLS data on the aircraft manufacturing industry sector, there were seven aircraft manufacturing businesses in the state in 2008 when the exemption was created, and as of 2020 there were six aircraft manufacturing businesses in the state. As noted, stakeholders mentioned that of the six businesses, there are likely only two manufacturers in the state that sell completed aircraft.

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

We lacked the information from the Department necessary to quantify the revenue impact to the State and the number of individuals who claimed the Fly-away and Aircraft Parts Exemptions. However, the exemptions may have a significant revenue impact to the State and provide a financial benefit to non-residents who purchase aircraft in the state and aircraft owners who purchase aircraft parts, since aircraft and their corresponding components are often high cost. As an example showing the potential impact of the Fly-away Exemption, we identified one aircraft manufacturer in the state that, based on its public financial report, had new aircraft sales totaling $422 million in 2020. If all of these sales occurred in-state and were to non-residents who qualified for the exemption, the revenue impact associated with the Fly-away exemption for just these sales, would have been $12.2 million.

However, this is probably an overestimation of the potential impact of these sales because it is not likely that all of the sales would have qualified for the exemption.

Additionally, the exemptions likely have a revenue impact to local governments that have their sales taxes collected by the State. Statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that local governments for which the State collects sales taxes apply most of the State's sales tax exemptions, including the Fly-away and Aircraft Parts Exemptions. As a result, the exemptions may reduce local tax revenues and provide a corresponding savings in the amount of local sales taxes paid for individuals or businesses who purchase components or aircraft as non-residents in those jurisdictions. Home rule cities established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes have the authority to set their own tax policies independent from the State. Of the five most populated home rule cities—Aurora, Colorado Springs, Denver, Fort Collins, and Lakewood—Colorado Springs and Denver provide a similar aircraft parts exemption and Fort Collins exempts component parts purchased for use by interstate operators. Additionally, these five home rule cities all have an exemption similar to the Fly-away Exemption, to the extent that the delivery occurs outside of the city and the aircraft will be registered outside of the city.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

Eliminating the Fly-away and Aircraft Parts Exemptions would result in the State's 2.9 percent sales or use tax being applied to purchases that currently benefit from the exemptions. The purchases would also be subject to local taxes if made in a local government jurisdiction for which the State collects sales taxes. Depending on the cost of the aircraft or aircraft parts, the additional tax cost could be considerable for some of the current beneficiaries. For example, aircraft sales prices can range from tens of thousands to tens of millions of dollars, so eliminating the exemptions could increase the after-tax cost of aircraft and aircraft

parts purchases. However, because many states offer similar exemptions, it is possible that some purchasers would avoid this cost by arranging for the sale to take place in a state that has an exemption. Because aircraft maintenance is common prior to and after sales, eliminating the exemption could reduce the amount of maintenance work performed in the state and have a potentially negative impact on the tate's aircraft maintenance industry if a significant number of aircraft sales move to other states.

Although eliminating the Fly-away Exemption could have an impact on some current beneficiaries, due to the relationship between sales and use taxes across states, some aircraft buyers would not see an increase in their overall tax burden if this exemption was eliminated. Specifically, because non-residents who qualify for the Fly-away Exemption are primarily using or registering their aircraft in another state, and they are likely liable for use tax in the other state, unless they locate the aircraft in a state that exempts all aircraft sales, or they are located in one of the five states that does not levy a sales or use tax. Additionally, states generally reduce taxpayers' use taxes equivalent to the amount of sales tax they have paid in another state. Therefore, depending on the state a non-resident relocates the aircraft to, eliminating the exemption may not reduce their overall tax liability on the purchase, but instead shift the taxes owed to each state. For example, currently, if a resident of Kansas purchases an aircraft in Colorado to be used primarily in Kansas, they would not owe sales tax to Colorado, but would be assessed Kansas's 6.5 percent use tax. If Colorado's Fly-away Exemption was not in place, they would owe the 2.9 percent Colorado sales tax, but in Kansas, would receive a credit for the amount paid to Colorado and would only owe Kansas use tax equivalent to 3.6 percent of the purchase price, resulting in a 6.5 percent combined tax rate on the purchase. Therefore, for this buyer, eliminating the Fly-away Exemption would not increase the total state sales and use taxes they owe.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 45 states that have a sales and use tax, 31 provide an exemption similar to the Fly-away Exemption for aircraft sold to non-residents. Of these states, four exempt all purchases of aircraft from sales and use tax, and 12 have a more limited exemption than Colorado. For example, these states only apply the exemption to aircraft that were manufactured in the state, or restrict the exemption based on aircraft size or value. Additionally, a majority of states that have an exemption require the aircraft to be removed from the state in 30 days or less from sale or the completion of repairs.

Of the 45 states that have a sales and use tax, 39 have a provision exempting aircraft parts sales from sales and use tax, though 20 limit the exemption to parts for commercial aircraft. Exhibit 2 provides neighboring states' tax expenditures related to nonresident aircraft purchases and aircraft component parts purchases.

EXHIBIT 2. NEIGHBORING STATES' FLY-AWAY AND AIRCRAFT PARTS EXEMPTIONS

State	Fly-away Exemption?	Aircraft Parts Exemption?
AZ	Yes, but no use in the state other than removal	Only for carriers of persons or property
KS	Yes	Yes
NE	Yes	Only for common and contract carriers of persons or property
NM	50% deduction from gross receipts or 100% for aircraft manufactured in the state	Yes
OK	Only for aircraft over $2.5 million	Yes
UT	No	Only for aircraft not registered in the state
WY	No	Only sales at Federal Aviation Administration certified facilities

SOURCE: Office of the State Auditor review of neighboring states' tax provisions and Bloomberg BNA data.

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

We identified two tax expenditures in the state that may also be intended to support the state's aircraft manufacturing and maintenance industries:

AIRCRAFT MANUFACTURER NEW EMPLOYEE CREDIT [SECTION 39-35-104(1), C.R.S.]—Provides eligible aircraft manufacturers in a designated Aviation Development Zone a non-refundable income tax credit equivalent to $1,200 for each net new employee they hire during the year. Eligible aircraft manufacturers include businesses that test, certify, or produce aircraft, as well as businesses that perform aircraft maintenance and repair, completion, or modification of aircraft. However, this credit expires January 1, 2023.

AIRCRAFT USED IN INTERSTATE COMMERCE EXEMPTION [SECTION 39-26-711(1)(a) AND (2)(a), C.R.S.]—Provides a sales and use tax exemption to commercial airlines for the purchase, storage, or use of aircraft used in interstate commerce.

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

The Department was unable to provide data necessary to quantify the exemptions' use and revenue impact. As discussed, although vendors are required to report the exemptions, they use a line for "other exemptions" on both forms (Forms DR 0100 or 0173) and the amounts listed on these lines are combined with several other tax expenditures and cannot be disaggregated for analysis. Additionally, the State does not require aircraft to be registered with the Department. Thus, the sales of aircraft are not tracked in a similar manner as motor vehicles that are required to be registered in the state. Therefore, we were unable to determine the total number of aircraft sold in any one year, which may have allowed us to better assess the potential impact of the Fly-away Exemption.

If the General Assembly determines that additional information on the revenue impact of these exemptions is needed, the Department would need to add separate reporting lines for the exemptions to Forms DR 0100 and 0173 and capture the data in GenTax, its tax processing and information system. However, according to the Department, this type of change would require additional resources to change the form and complete the necessary programming in GenTax (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 data and the potential costs of addressing the limitations).

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 FLY-AWAY EXEMPTION AND THE AIRCRAFT PARTS EXEMPTION. As discussed, statute and the enacting legislation for the exemptions do not state their purposes or provide performance measures for evaluating their effectiveness. Therefore, in order to conduct our evaluation, we considered the following potential purposes:

- FLY-AWAY EXEMPTION—To increase aircraft sales and support aircraft manufacturing and maintenance businesses in the state.

- AIRCRAFT PARTS EXEMPTION—To support the state's aircraft maintenance industry by encouraging aircraft owners and operators to have aircraft maintenance performed in the state.

We identified these purposes based on the operation of the exemptions and their legislative history. We also developed two performance measures to assess the extent to which the exemptions are meeting their potential purposes. However, the General Assembly may want to clarify its intent for the exemptions by providing purpose statements and corresponding performance measure(s) in statute. This would eliminate

potential uncertainty regarding the exemptions' purposes and allow our office to more definitively assess the extent to which the exemptions are accomplishing their intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EFFECTIVENESS OF THE FLY-AWAY EXEMPTION AND THE AIRCRAFT PARTS EXEMPTION. As discussed, we found that the exemptions might be meeting the potential purposes we used for our evaluation, to a limited extent. Specifically, we found that most states have similar exemptions and stakeholders reported that it is a common practice for aircraft and aircraft parts purchasers to arrange for sales to occur in states that have a sales tax exemption. Furthermore, it is common for aircraft to undergo maintenance and refurbishment at the time of sale. Therefore, the exemptions may support the state's aircraft maintenance industry by keeping the State's tax laws competitive with other states and encouraging maintenance work to occur in Colorado. However, we found that the exemptions do not appear to have caused growth in employment or wages in the industry. Additionally, because non-residents who purchase aircraft in Colorado and remove them from the state may still owe use tax in other states, the Fly-away Exemption may not be a significant factor for some taxpayers when deciding where to purchase aircraft. As discussed, the Aircraft Parts Exemption appears to have been intended, in part, to encourage United Airlines to establish a maintenance facility in Colorado at the time Denver International Airport was being constructed, but the company chose a different state for the facility. Although the legislative history for the exemption indicates that the General Assembly also expected the exemption to have more wide-ranging benefits, it is unclear whether it would have established the exemption absent the goal of attracting this facility to the state. Furthermore, while 39 states provide a sales and use tax exemption for sales of aircraft parts, 20 limit their exemption to commercial aircraft. Therefore, the General Assembly may want to review the effectiveness of the exemptions and consider whether they are having the intended impact and should continue or if changes are warranted.

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MARIJUANA RELATED TAX EXPENDITURES

EVALUATION SUMMARY | SEPTEMBER 2022 | 2022-TE37

Expenditure	Medical Marijuana Sales Tax Exemption for Indigent Patients	Retail Marijuana Sales Tax Exemption	Marijuana Business Expense Deduction
Tax Type	Sales and Use	Sales and Use	Income
Year Enacted	2010	2017	2013
Repeal/Expiration Date	None	None	None
Revenue Impact	$10,133 (Tax Year 2021)	$53 million (Tax Year 2021)	10.6 million (Tax Year 2018)
Number of Taxpayers	83	Could not determine	488

KEY CONCLUSION: The Medical Marijuana Sales Tax Exemption for Indigent Patients is underutilized and appears to benefit few indigent medical marijuana patients. The Retail Marijuana Sales Tax Exemption and Marijuana Business Expense Deduction are widely used and help define the tax base for taxing marijuana and marijuana businesses.

WHAT DO THESE TAX EXPENDITURES DO?

Medical Marijuana Sales Tax Exemption for Indigent Patients (Indigent Patients Exemption) [Section 39-26-726, C.R.S.]—Exempts purchases of medical marijuana by indigent patients from the state sales tax. Indigent patients are classified as individuals with income at or below 185 percent of the federal poverty level.

Retail Marijuana Sales Tax Exemption [Section 39-26-729(1)(a), C.R.S.]—Exempts sales of retail marijuana from the state sales tax.

Marijuana Business Expense Deduction [Section 39-22-304(3)(m), C.R.S. and Section 39-22-104(4)(r), C.R.S.]—Allows licensed marijuana businesses to deduct business expenses that are disallowed for federal tax purposes from their Colorado taxable income.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Indigent Patients Exemption—To eliminate the additional financial burden of the state sales tax for individuals with low incomes who purchase medical marijuana to treat debilitating medical conditions.

Retail Marijuana Sales Tax Exemption—To exempt purchases of retail marijuana from the state sales tax of 2.9 percent because they are instead subject to the special retail marijuana sales tax rate of 15 percent.

Marijuana Business Expense Deduction—To apply the same income tax treatment to marijuana businesses as other businesses in the state by allowing them to deduct business expenses from their Colorado taxable income.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the Marijuana Related Tax Expenditures.
- Whether it should amend statute to address the limited use of the Indigent Patients Exemption. This could include allowing alternative documentation to establish qualifying income or expanding the exemption to include all medical marijuana sales.

MARIJUANA RELATED TAX EXPENDITURES

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

This evaluation covers three tax expenditures that apply to the State's medical and retail marijuana industry, which we refer to as the Marijuana Related Tax Expenditures.

In Calendar Year 2000, Colorado voters approved Amendment 20, which created Article XVIII, Section 14 of the Colorado Constitution. This amendment legalized sales, possession, and cultivation of limited amounts of medical marijuana for patients with a debilitating medical condition. In order to qualify, patients must receive a certification from their health care provider indicating that they have a qualifying medical condition and apply for a medical marijuana card with the Colorado Department of Public Health and Environment (CDPHE). Generally, applicants for a medical marijuana card must submit a $29.50 fee with their application; however, patients with household incomes at or below 185 percent of the federal poverty level can receive a fee waiver.

In Calendar Year 2012, voters passed Amendment 64, which created Article XVIII, Section 16 of the Colorado Constitution, which legalized the retail sale, purchase, and possession of retail marijuana for individuals aged 21 years and above, beginning January 1, 2014, and allowed local governments to prohibit retail marijuana sales. Retail marijuana is sometimes referred to as recreational marijuana and individuals are not required to meet any qualification standards, other than the age requirement, to purchase retail marijuana.

In addition to legalizing medical and retail marijuana, Article XVIII, Sections 14 and 16, of the Colorado Constitution requires the Department of Revenue (Department) to establish a state marijuana regulatory structure. As a result, the General Assembly passed several

bills to implement Amendment 64, including House Bill 13-1318, which referred Proposition AA to voters. Proposition AA authorized the Department to tax the cultivation, sale, and use of marijuana. Marijuana sales and businesses that sell marijuana can be subject to several types of taxes in Colorado, including regular sales tax, a special retail marijuana sales tax, and a retail marijuana excise tax, with businesses that sell marijuana also subject to the State's income tax. However, medical and retail marijuana sales are subject to separate taxing structures and statute establishes several tax expenditure provisions that define when the taxes apply. These taxes and the relevant tax expenditures are discussed below.

SALES TAX

Statute [Sections 39-26-104(1)(a) and 105(1)(a)(I)(A), C.R.S.] provides that sales of tangible personal property are subject to the state sales tax rate of 2.9 percent unless specifically exempted by statute. Since marijuana is considered tangible personal property, sales of both medical and retail marijuana are subject to state sales tax unless a specific exemption applies. However, unlike most sales tax revenue, which supports the State's General Fund, the sales tax collected from medical marijuana is distributed to the Marijuana Tax Cash Fund. There are two sales tax exemptions related to marijuana:

- MEDICAL MARIJUANA SALES TAX EXEMPTION FOR INDIGENT PATIENTS (INDIGENT PATIENTS EXEMPTION)—Section 39-26-726, C.R.S., exempts purchases of medical marijuana by indigent patients from the state sales tax. Indigent patients are classified as individuals with income at or below 185 percent of the federal poverty level [Section 25-1.5-106(16)(a), C.R.S.]. The exemption was enacted in 2010 by House Bill 10-1284. In order for qualifying patients to claim the exemption, they must obtain a medical marijuana card and also submit a copy of their Colorado tax return from the most recent tax year along with their application for the indigent patient designation to the Medical Marijuana Registry, a division within CDPHE, showing that they meet the income requirement. A patient's medical

marijuana card is then updated to show that they qualify for the exemption and patients must present their card to retailers when making qualifying purchases. Retailers then apply the exemption at the point of sale and report the exempt sales on Schedule A, Line 12, of the 2021 Colorado Retail Sales Tax Return (Form DR 0100). There have been no legislative changes to the exemption since its enactment. Additionally, statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that statutory cities and counties that have their sales taxes collected by the State apply most of the State's sales tax exemptions, including the Indigent Patients Exemption.

- RETAIL MARIJUANA SALES TAX EXEMPTION—Section 39-26-729(1)(a), C.R.S., exempts all sales of retail marijuana from the state sales tax. This exemption was created by Senate Bill 17-267 in 2017 and there have been no substantive legislative changes since its enactment. Additionally, under Section 29-2-105(1)(d)(I)(O), C.R.S., local governments that have their sales taxes collected by the State may choose whether to apply the exemption to their local sales taxes. Retail sales exempt from the State's 2.9 percent sales tax are reported on Schedule B, Line 10, of the 2021 Colorado Retail Sales Tax Return (Form DR 0100).

SPECIAL RETAIL MARIJUANA SALES TAX

Section 39-28.8-202(1)(a)(I), C.R.S., levies a special, 15 percent retail marijuana sales tax on retail marijuana in lieu of the state sales tax that is typically applied to sales of tangible personal property. The special sales tax collected on retail marijuana is distributed between the General Fund, the State Public School Fund, and the Marijuana Tax Cash Fund [Section 39-28.8-203(1)(b)(I.5), C.R.S.]. Because the authorizing statute for the special retail marijuana sales tax does not include medical marijuana, we did not consider the exclusion of medical marijuana from this tax base as a separate tax expenditure for the purposes of our evaluation. We did not identify any tax expenditures that apply to the special retail marijuana sales tax.

RETAIL MARIJUANA EXCISE TAX

Section 39-28.8-302(1)(a)(I), C.R.S., levies an excise tax at a rate of 15 percent on the first transfer of retail marijuana between unaffiliated retail marijuana business licensees or retail marijuana cultivation facilities. Although cultivators or manufacturers are responsible for paying the excise tax, excise taxes are typically passed on to consumers in the form of higher prices. Excise tax revenue collected from retail marijuana is transferred into the Building Excellent Schools Today (BEST) fund for public school capital reconstruction [Section 39-28.8-305(1)(a)(III), C.R.S.]. The retail marijuana excise tax does not apply to the transfer of medical marijuana. However, we did not consider the exclusion of medical marijuana from the retail marijuana excise tax to be a tax expenditure for the purposes of this evaluation because it is prescribed by a constitutional provision approved by voters in Colorado that appears to establish retail marijuana as its own tax base for the purposes of the excise tax. We did not identify any tax expenditures that apply to the retail marijuana excise tax.

FEDERAL AND STATE INCOME TAX

Marijuana businesses are subject to federal and state income taxes. Both federal and state income taxes are based on a percentage of businesses' taxable income, which is generally equivalent to businesses' total proceeds for the year, less deductible expenses, such as the cost of goods sold and necessary business expenses. Because Colorado uses federal taxable income as the starting point for calculating taxable income for state tax purposes, most deductions that taxpayers claim at the federal level automatically apply to their Colorado taxable income. However, Section 280E of the Internal Revenue Code (IRC) disallows deductions or credits for amounts paid or incurred if "such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances..." This prevents marijuana businesses from deducting many business expenses at the federal level since marijuana is listed as a Schedule I substance under the federal Controlled Substance Act. The following income tax expenditure applies to marijuana businesses' Colorado income tax:

- MARIJUANA BUSINESS EXPENSE DEDUCTION [SECTION 39-22-304(3)(m), C.R.S. AND SECTION 39-22-104(4)(r), C.R.S.]—This deduction allows licensed marijuana businesses to deduct business expenses that are disallowed for federal tax purposes under Section 280E of the IRC from their Colorado taxable income. House Bill 13-1042 and Senate Bill 13-283, together, enacted the Marijuana Business Expense Deduction. House Bill 13-1042 created the deduction for medical marijuana and Senate Bill 13-283 created the deduction for retail marijuana, both effective for Tax Year 2014. Legislative changes in Calendar Year 2019 re-codified separate sections of statute concerning the regulation of retail and medical marijuana into the Colorado Marijuana Code.

Individuals claim the deduction on Line 14 of the 2021 Subtractions from Income Schedule (Form DR 0104AD), which is included in the total subtractions they report on Line 6 of the 2021 Colorado Individual Income Tax Return (Form DR 0104). Fiduciaries report the deduction on Line 3 of the 2021 Colorado Fiduciary Income Tax Return (Form DR 0105), while partnerships and S corporations report the deduction on Line 6 of the 2021 Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Lastly, C-corporations claim the deduction on Line 11 of the 2021 Colorado C Corporation Income Tax Return (Form DR 0112).

Exhibit 1 summarizes the taxation of medical and retail marijuana in the state.

EXHIBIT 1. TAXATION OF COLORADO'S MARIJUANA INDUSTRY		
Taxes	Medical Marijuana	Retail Marijuana
State Sales Tax (2.9 percent)	Taxed, unless the Indigent Patients Exemption applies	Exempt under the Retail Marijuana Sales Tax Exemption
Special Retail Marijuana Sales Tax (15 percent)	Not subject to tax	Taxed
Retail Marijuana Excise Tax (15 percent)	Not subject to tax	Taxed
Federal Income Tax (rate varies)	Taxed, with no deduction allowed for business expenses	Taxed, with no deduction allowed for business expenses
State Income Tax (4.55 percent)	Taxed, after deducting business expenses under the Marijuana Business Expense Deduction	Taxed, after deducting business expenses under the Marijuana Business Expense Deduction

SOURCE: Office of the State Auditor analysis of taxes that apply to marijuana.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statutes do not directly state the intended beneficiaries of the Marijuana Related Tax Expenditures. Based on our review of statutory language, we inferred that the provisions were intended to benefit the following:

- INDIGENT PATIENTS EXEMPTION—Low-income individuals treating medical conditions with medical marijuana. According to Medical Marijuana Registry data, the most commonly reported conditions among medical marijuana patients include severe pain or nausea, muscle spasms, opioid addiction, and post-traumatic stress disorder.

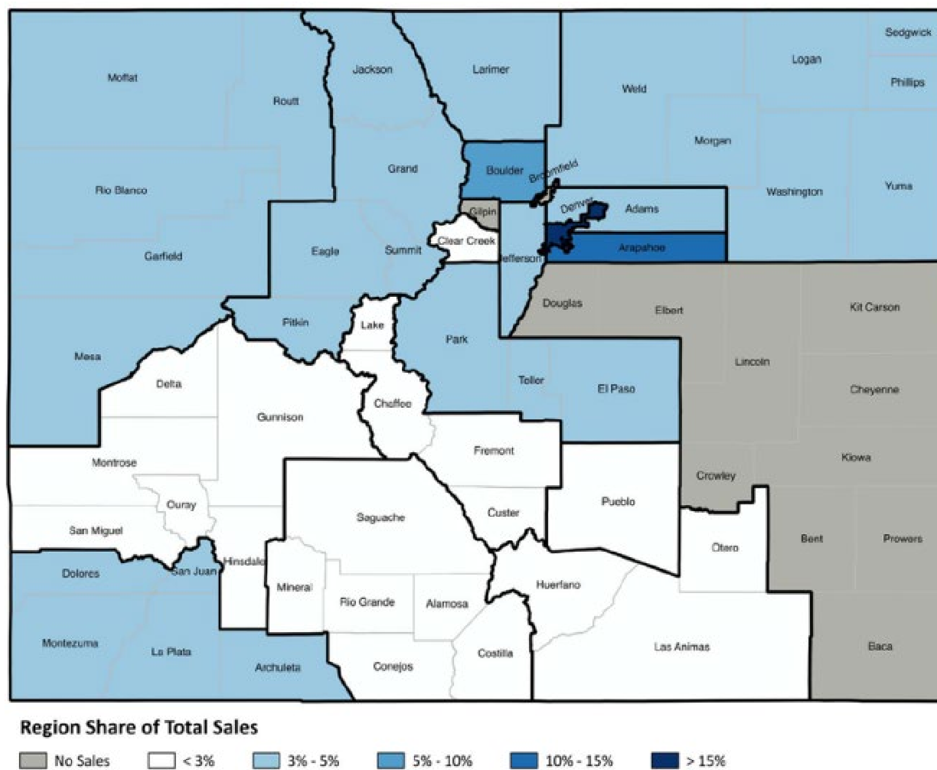
- RETAIL SALES TAX EXEMPTION—Consumers of retail marijuana, who would otherwise be subject to the State's 2.9 percent sales tax, in addition to the special marijuana retail sales tax, which was increased from 10 percent to 15 percent at the time the exemption was established. Marijuana businesses may also benefit indirectly to the

extent that consumers purchase more marijuana due to the exemption.

- MARIJUANA BUSINESS EXPENSE DEDUCTION—Marijuana businesses including stores, manufacturers, transporters, and cultivators with operations in Colorado. Marijuana consumers may also benefit indirectly to the extent that the deduction allows businesses to sell marijuana at lower prices.

Because the concentration of marijuana businesses varies across the State's regions, with some counties prohibiting the sale of marijuana altogether, the expenditures provide a more significant benefit in areas with more marijuana sales. Exhibit 2 shows the share of total retail marijuana sales in the state, by region, in Calendar Year 2017.

EXHIBIT 2. COLORADO RETAIL MARIJUANA SALES DISTRIBUTION BY REGION, CALENDAR YEAR 2017



SOURCE: Evaluation of the Colorado Department of Revenue's Use of Marijuana Inventory Tracking Data, Office of the State Auditor, August 2019.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statutes do not directly state a purpose for any of the Marijuana Related Tax Expenditures; therefore, we were unable to definitively determine their intended purposes. However, based on our review of statutory language, legislative audio, and discussions with stakeholders, we considered the following potential purposes:

INDIGENT PATIENTS EXEMPTION—To eliminate the additional financial burden of the state sales tax for individuals with low incomes who purchase medical marijuana to treat debilitating medical conditions.

RETAIL MARIJUANA SALES TAX EXEMPTION—To exempt purchases of retail marijuana from the state sales tax of 2.9 percent because they are instead subject to the special retail marijuana sales tax rate of 15 percent. Senate Bill 17-267, which enacted the exemption, also increased the special retail marijuana sales tax rate from 10 percent to 15 percent, indicating that the purpose of the exemption was to define the tax base for taxing retail marijuana sales and not to reduce the overall rate consumers pay on their marijuana purchases.

MARIJUANA BUSINESS EXPENSE DEDUCTION—To apply the same income tax treatment to marijuana businesses as other businesses in the state by allowing them to deduct business expenses from their Colorado taxable income. As discussed, marijuana businesses are not allowed to claim ordinary and necessary business expenses as a deduction at the federal level due to Section 280E of the IRC, which disallows this type of deduction for businesses that make sales of controlled substances that are illegal under federal law. As a result, based on legislative audio, we determined that the General Assembly intended to tax marijuana businesses the same as other businesses that operate legally under state law by calculating Colorado taxable income after the deduction of business expenses.

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

We could not definitively determine whether the Marijuana Related Tax Expenditures are meeting their purposes because no purposes are provided for them in statute or their enacting legislation.

Based on the potential purpose we considered in order to conduct the evaluation of the Indigent Patients Exemption, we found that the exemption is likely not meeting its purpose, because few eligible indigent medical patients use it.

Based on the purposes we considered for the Retail Sales Tax Exemption and the Marijuana Business Expense Deduction, we determined that they are meeting their purposes because eligible marijuana businesses are aware of and apply the exemption to eligible sales and regularly claim the deduction.

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 the tax expenditures are meeting their potential purposes:

PERFORMANCE MEASURE #1: *To what extent are sales of medical marijuana to indigent patients being exempted from Colorado's state sales tax?*

RESULT: It appears that most indigent medical marijuana patients are not receiving the benefit of the exemption when they purchase medical marijuana. Based on feedback from stakeholders, we found that the dispensaries are generally applying the exemption to sales of medical marijuana to indigent patients that present a medical marijuana card with indigent tax-exempt status. However, it appears that few eligible patients have applied to use the exemption.

To determine the extent to which the exemption is being applied to eligible purchases, we spoke to a Certified Public Accountant (CPA)

who confirmed that their clients, which are marijuana businesses in Colorado, are aware of the Indigent Patients Exemption and they see the exemption on their companies' records of financial transactions. However, we could not quantify the extent to which the exemption is being applied because the Department requires exempt sales to indigent patients to be reported on Schedule A, Line 12, of the 2021 Colorado Retail Sales Tax Return (Form DR 0100), which includes other exempt sales and cannot be disaggregated for analysis. Therefore, we analyzed Medical Marijuana Registry data to estimate the extent to which the exemption is being sought and used among potentially eligible low-income individuals that purchase medical marijuana in the state.

Based on Medical Marijuana Registry data from Calendar Years 2018 through 2020, there were an average of 84,688 certified medical marijuana card holders in Colorado during this period. Of those, an average of only 98, or 0.12 percent, were certified as indigent patients that qualified for the Indigent Patients Exemption. In comparison, according to the U.S. Census Bureau, the State's share of individuals with household incomes below 150 percent of the poverty level was about 17 percent of the total population from Calendar Year 2018 through Calendar Year 2020. Assuming that the proportion of individuals in or near poverty within Colorado's total population is consistent with that among medical marijuana card holders, we estimate that there were between about 14,000 and 16,000 total patients eligible for the Indigent Patients Exemption in the state. Therefore, it appears that less than 1 percent of eligible indigent patients applied for and received indigent tax-exempt status from Tax Year 2018 through Tax Year 2020.

We identified certain barriers for low income applicants that may have reduced the number of patients filing for tax exempt status. For example, Medical Marijuana Registry staff indicated that applicants must submit a certified copy of their Colorado income tax return from the most recent tax year to apply for a fee waiver or tax exempt status. However, individuals with gross incomes below the standard deduction, which was $12,550 for single filers and $25,100 for married joint filers

in Tax Year 2021, typically do not owe taxes and are not required to file a tax return. Therefore, many individuals who qualify for the exemption may not otherwise file tax returns, but they would need to do so to register as an indigent patient with the Medical Marijuana Registry. Additionally, Medical Marijuana Registry staff indicated that some applicants expressed concerns with having to obtain the documentation from the Department to meet the requirements. The low number of patients with tax exempt status may also be due to a lack of awareness, administrative requirements, and the potential stigma associated with acquiring and presenting a medical card that designates an individual as low income.

PURPOSE MEASURE #2: *To what extent are retail marijuana businesses exempting sales of retail marijuana from Colorado's state sales tax?*

RESULT: Our discussions with two CPAs who specialize in accounting for marijuana businesses in Colorado and a marijuana business with a dispensary and a grow operation indicated that the Retail Marijuana Sales Tax Exemption is widely known and applied to sales of retail marijuana by retail marijuana dispensaries. Additionally, marijuana retail stores typically use point-of-sale software that automatically applies local and state taxes and exemptions to their sales of marijuana, making the exemption relatively easy to administer. However, we were not able to quantify the extent to which the exemption is being applied because, prior to October 2019, the retailers reported their exempt sales under Exemptions Schedule - Part B, Line 10, titled "Other Exemptions," of the Colorado Retail Sales Tax Return with Deductions & Exemptions Schedule (Form DR 0100), which includes several other exemptions. At the time of our review, the Department had also not compiled data on the exemption's use since Tax Year 2019.

PURPOSE MEASURE #3: *To what extent do retail and medical marijuana businesses use the Marijuana Business Expense Deduction to deduct eligible business expenses for Colorado income tax purposes?*

RESULT: Department data indicate that marijuana businesses deducted a total of about $228 million in federally non-deductible operating expenses from their Colorado taxable income in Tax Year 2018, the

most recent year with data available. Further, stakeholders we contacted indicated that the Marijuana Business Expense Deduction is widely known and utilized by Colorado marijuana businesses and tax professionals that work with marijuana businesses.

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

INDIGENT PATIENTS EXEMPTION

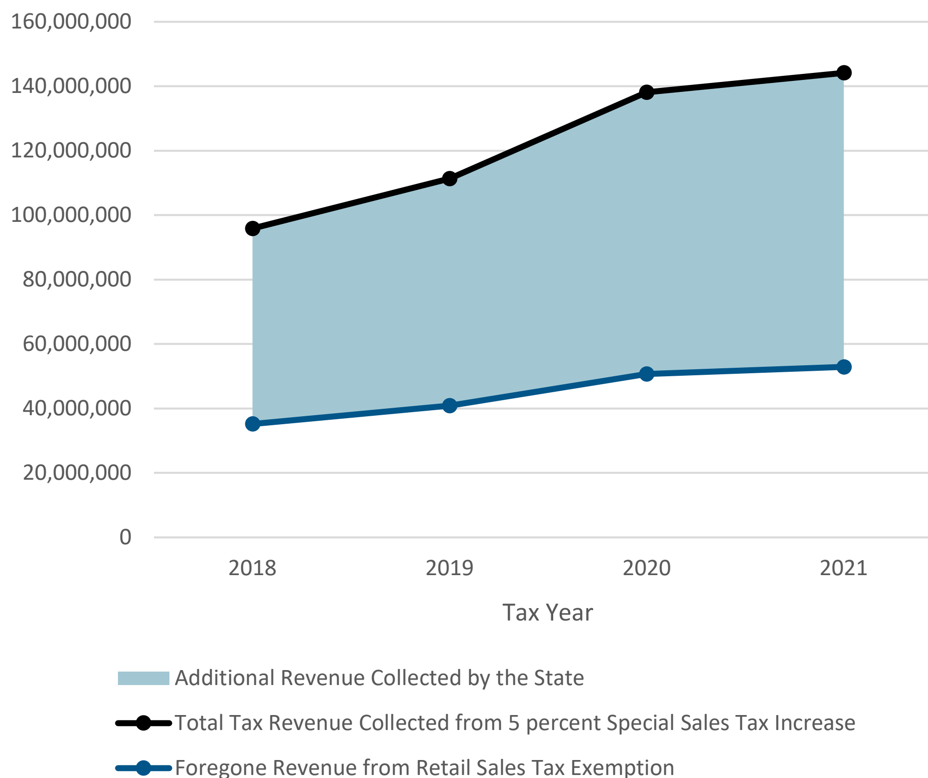
Based on data provided by CDPHE and the Department, we estimate that the Indigent Patients Exemption resulted in an average annual revenue impact to the State of about $11,000 from Tax Year 2018 through Tax Year 2021, with a revenue impact of $10,133 for Tax Year 2021.

Because the Department was not able to provide data on the use of the exemption, we estimated its revenue impact to the State using Department data on medical marijuana sales from Tax Year 2018 through Tax Year 2021 and Medical Marijuana Registry data on the number of individuals with medical marijuana registration cards at the end of each year. Based on Department data, there was an average of $379 million in annual sales of medical marijuana and accessories that do not contain marijuana during Calendar Years 2018 through 2021. Because accessories that do not contain marijuana are not covered by the exemption and make up about 10 percent of these sales, based on data from the Colorado Office of the State Controller, we adjusted this figure accordingly to estimate that there was an average of about $341 million in annual medical marijuana sales from Calendar Year 2018 through Calendar Year 2021. Assuming indigent patients who were certified to claim the exemption—which made up 0.12 percent of all medical marijuana card holders during this period—purchased an equivalent amount of medical marijuana as the average Medical Marijuana Registry patient, the indigent patients would have purchased roughly $380,000 in medical marijuana annually during Tax Years 2018 through 2021, resulting in an average annual revenue impact to the State of about $11,000 (calculated as $380,431 multiplied by the State sales tax rate of 2.9 percent).

Retail Marijuana Sales Tax Exemption

According to Department data on the total sales of retail marijuana, we found that the exemption had a revenue impact to the State of about $53 million in Tax Year 2021. However, at the time the exemption was enacted, Senate Bill 17-267 also increased the special retail sales tax imposed on sales of retail marijuana from 10 percent to 15 percent. We estimated that this increase in sales tax resulted in about $91.2 million in additional sales tax revenue collected by the State in Tax Year 2021, resulting in a $38.3 million net increase in revenue from the bill, factoring in the exemption. Exhibit 3 shows the revenue impact of Senate Bill 17-267 from Tax Year 2018 through Tax Year 2021.

EXHIBIT 3. SENATE BILL 17-267 HAD A NET POSITIVE REVENUE IMPACT TO THE STATE



SOURCE: Office of the State Auditor analysis of Department Marijuana Retail Sales Revenue Data.

According to Department data, the Marijuana Business Expense Deduction resulted in about $10.6 million in foregone revenue for the State and a corresponding benefit to taxpayers in Tax Year 2018, which was the most recent year that the Department had data. Specifically, 399 individuals and three fiduciaries claimed the deduction in Tax Year 2018, resulting in a revenue impact of $5.5 million, while 86 corporations claimed the deduction in Tax Year 2018, resulting in a revenue impact of about $5.1 million.

Furthermore, we determined that the benefit of the deduction for companies varies among different businesses within the industry, with retail dispensary stores likely realizing the greatest benefit. While federal law prohibits marijuana businesses from deducting business expenses, which include salaries for retail staff, wages, rent, and insurance, they are allowed to deduct the cost of goods sold, which includes direct costs they incur, such as materials, products purchased for resale, packaging, or direct labor costs associated with the production of marijuana. According to stakeholders, marijuana dispensaries typically have a greater amount of federally non-deductible expenses that are eligible for the Marijuana Business Expense Deduction, while cultivators' typically have a larger proportion of expenses that qualify as federally deductible costs of goods sold. For example, one stakeholder reported that operating expenses, which are eligible for the deduction, can range from between 10 to 40 percent of total expenses, depending on the type of business.

Although the deduction's benefit can vary, we found that it generally has a modest impact on the profitability of marijuana businesses. Stakeholders indicated that industry gross profit margins—total revenue minus costs of goods sold—ranged from 50 to 60 percent of total revenue for dispensaries and 20 to 40 percent of total revenue for cultivators. Based on the gross profit margins and standard operating expense ranges provided by stakeholders, we estimated that, on average, marijuana businesses' net profits after Colorado income tax increased by approximately 5 percent due to the deduction. In other words, the deduction increases marijuana companies' profits after

Colorado income tax by roughly $0.05 for every dollar of profit earned. This indicates that the exemption is likely to have the most significant benefit to marijuana companies operating closer to the margins and not necessarily the most profitable marijuana companies in the state.

Additionally, the deduction may provide a modest economic benefit by fostering economic development within the marijuana industry. Specifically, according to stakeholders, the tax benefit provided by the deduction reduces industry barriers to entry for new marijuana businesses and indicates to beneficiaries that the State supports the industry by providing equal tax treatment to marijuana businesses.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

INDIGENT PATIENTS EXEMPTION. Eliminating the exemption would increase the cost of medical marijuana for the roughly 100 indigent patients who use the exemption by at least 2.9 percent, due to the sales no longer being exempt from state sales tax. Additionally, their purchases would be subject to additional local city, county, and special district sales taxes in jurisdictions that have their sales tax collected by the State, since those local governments are generally required to apply the State's sales tax exemptions, including the Indigent Patients Exemption. We estimate that this would have resulted in indigent patients paying, on average, $122 more per year, per person in state sales taxes on medical marijuana in Tax Year 2021 (we lacked sufficient data to estimate the additional local taxes they would pay). We estimated the cost to indigent patients of eliminating the exemption by dividing the $10,133 estimated annual amount claimed by the 83 registered indigent patients for Tax Year 2021. As discussed, our estimate assumes that indigent patients purchase equivalent amounts of medical marijuana as other non-indigent medical marijuana patients. Additionally, to the extent that the price increase of medical marijuana due to eliminating the exemption curbs low-income marijuana patients' consumption by making it less affordable, low-income patients may not be able to treat medical conditions with medical marijuana as

effectively. However, we lacked data to quantify the types of medical conditions that were reported by indigent patients who used the exemption.

RETAIL MARIJUANA SALES TAX EXEMPTION. If the Retail Marijuana Exemption was eliminated, individuals purchasing retail marijuana would see a 2.9 percent increase in their cost of retail marijuana purchases due to the state sales tax, plus any additional local sales taxes that applied. Stakeholders reported that the additional price increases associated with eliminating the exemption may also have a modest negative impact on the marijuana industry in Colorado by potentially decreasing demand and consumption of retail marijuana.

COLORADO MARIJUANA BUSINESS EXPENSE DEDUCTION. Eliminating the deduction would reduce the after-tax income of marijuana companies filing as individuals on average by $13,660 per taxpayer and $59,151 per business for marijuana companies filing as C-corporations, based on Department data from Tax Year 2018. As discussed, because dispensaries have a greater proportion of operating expenses that are federally-nondeductible, dispensaries would experience the most significant impact in nominal terms if the deduction were eliminated. In addition to the negative income effects of reducing monetary relief, eliminating the deduction might signal a lack of state support for marijuana businesses and the marijuana industry.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Based on our review of other states' tax expenditures and marijuana tax policies, we identified the following similar tax expenditures:

INDIGENT PATIENTS EXEMPTION—We did not identify any other states that provide an explicit sales tax exemption from medical marijuana purchases for indigent patients. However, we found that of the 27 other states that have legalized medical marijuana and have a state sales tax, 14 states exempt all medical marijuana sales from state sales tax, while 13 states levy a state sales tax on medical marijuana similar to Colorado. Additionally, while six of the states that exempt medical

marijuana from state sales tax levy an excise tax on medical marijuana, the other eight fully exempt medical marijuana sales from tax.

RETAIL MARIJUANA SALES TAX EXEMPTION. We did not identify any states with a similar tax expenditure.

COLORADO MARIJUANA BUSINESS EXPENSE DEDUCTION—Based on our review of states that levy an income tax on marijuana businesses, we identified six other states—Arkansas, Hawaii, Michigan, Minnesota, New Mexico, and Oregon—that, similar to Colorado, do not conform to Section 280E of the IRC and allow all marijuana businesses to deduct business expenses for state tax purposes. Eight other states treat individuals and businesses differently with respect to conforming to Section 280E of the IRC. For example, California and Vermont do not conform to Section 280E of the IRC for the purpose of taxing C-corporations that sell marijuana, but do for tax treatment of individuals. On the other hand, New Jersey and Pennsylvania conform to Section 280E for the tax treatment of C-corporations, but do not for individuals.

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

Similar to the Indigent Patients Exemption, the Sales Tax Exemption for Prescription Drugs [Section 39-26-717(2)(a), C.R.S.] reduces the financial burden on patients purchasing drugs used to treat a medical condition. However, the exemption is broader than the Indigent Patients Exemption and exempts all purchases of medically necessary prescription drugs regardless of the purchasers' income.

We did not identify any tax expenditures or programs in the state similar to the Retail Marijuana Sales Tax Exemption or the Marijuana Business Expense Deduction.

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

The Department could not provide data showing the revenue impact for the Indigent Patients Exemption because this exemption is claimed on Schedule A, Line 12, titled "Other exempt sales" of the 2021 Colorado Retail Sales Tax Return (Form DR 0100), which taxpayers use to report several unrelated exemptions. For this reason, we estimated the exemption's revenue impact using Medical Marijuana Registry cardholder data and Department data on overall medical marijuana sales. If the General Assembly wants complete information, it could consider instructing the Department to add a reporting line for sales to indigent patients to the Sales Tax Return form. GenTax, the Department's tax processing and information system, would also have to be reconfigured to collect and extract this data. However, according to the Department, this type of change would require additional resources to develop the form and complete the necessary programming in GenTax (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). Further, this type of change may not be cost-effective, since it appears that the exemption is used infrequently and has a minimal revenue impact to the State.

Additionally, the Department could not provide data showing the revenue impact of the Retail Marijuana Sales Tax Exemption. Until Tax Year 2019, retailers reported their exempt sales under Exemptions Schedule - Part B, Line 10, titled "Other Exemptions," of the Colorado Retail Sales Tax Return (Form DR 0100), which includes several other exemptions. Beginning in October 2019, the Department added a reporting line for exempt retail sales of marijuana; however, at the time of our review, the Department had not compiled data on this exemption and could not provide data for our analysis. According to Department staff, this information will likely be available in future years.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH STATUTORY PURPOSES AND PERFORMANCE MEASURES FOR THE MARIJUANA RELATED TAX EXPENDITURES. Statutes and the enacting legislation for the Marijuana Related Tax Expenditures do not state their purposes or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of our evaluation, we considered the following potential purposes for the Marijuana Related Tax Expenditures:

- INDIGENT PATIENTS EXEMPTION—To eliminate the additional financial burden of the state sales tax for individuals with low incomes who purchase medical marijuana to treat debilitating medical conditions.

- RETAIL MARIJUANA SALES TAX EXEMPTION—To exempt retail marijuana sales from the state sales tax of 2.9 percent because they, instead, are subject to a special retail marijuana sales tax at a rate of 15 percent.

- MARIJUANA BUSINESS EXPENSE DEDUCTION—To apply the same income tax treatment to marijuana businesses as other businesses in the state by allowing them to deduct business expenses from their Colorado taxable income.

We identified these purposes based on the operation of the tax expenditures, conversations with stakeholders, and recordings of legislative hearings. We also developed performance measures to assess the extent to which the tax expenditures are meeting these potential purposes. However, the General Assembly may want to clarify its intent for the tax expenditures by providing purpose statements and corresponding performance measures in statute. This would eliminate potential uncertainty regarding the expenditures' purposes and allow our office to more definitively assess the extent to which they are accomplishing their intended goals.

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER WHETHER THE INDIGENT PATIENTS EXEMPTION SHOULD BE AMENDED TO ADDRESS ITS LIMITED USE. As discussed, we found that the exemption appears to be underutilized, with an average of only about 100 medical marijuana patients certified to use the Indigent Patients Exemption from Calendar Year 2018 through 2020. This represents about one-tenth of 1 percent of all medical marijuana cardholders in the state. In comparison, U.S. Census Bureau data indicate that more than 17 percent of the population in the state meets the exemption's income restrictions. Therefore, the General Assembly could consider making changes to the exemption to address its limited use. As discussed, we identified barriers for low income applicants that may have reduced the number of patients filing for tax exempt status. For example, Medical Marijuana Registry staff indicated that applicants must submit a certified copy of their Colorado tax return from the most recent tax year to apply for a fee waiver or tax exempt status. However, individuals with income below the federal standard deduction, which was $12,550 for single filers and $25,100 for married joint filers in Tax Year 2021, likely do not owe income taxes and are generally not required to file a tax return. Therefore, many individuals that qualify for the Indigent Patients Exemption may not otherwise file tax returns and would need to do so in order to register as an indigent patient with the Medical Marijuana Registry. Additionally, Medical Marijuana Registry staff indicated that some applicants express concerns about obtaining the documentation from the Department to meet the requirements. Furthermore, the small number of patients with tax exempt status may be due to a lack of awareness, burdensome administrative requirements, and the potential stigma associated with acquiring and presenting a medical card that designates an individual as having a low income. Therefore, the General Assembly could consider:

- ALLOWING ALTERNATIVE DOCUMENTATION FOR INDIGENT PATIENTS TO ESTABLISH THAT THEY MEET THE EXEMPTION'S INCOME REQUIREMENTS. For example, other income-restricted state programs, such as the Supplemental Nutrition Assistance Program (SNAP), allow participants to establish eligibility by providing proof

of earned income (pay stubs, employer statement that includes pay per hour and hours per week, etc.), self-employment bookkeeping records (if self-employed), or an agency letter showing unearned income (Social Security Retirement or Disability income, Supplemental Security Income, Veterans Affairs pension or disability benefits, Unemployment, child support, alimony, private retirement, pension, etc.). Identity can be proven with a driver's license or state-issued identification card, birth certificate, Social Security card, work or school identification card, or voter registration card. Alternatively, some programs' eligibility is based on eligibility for another income-restricted program. For example, families are automatically eligible for the Women Infant Children Program (WIC) if they are receiving benefits from Temporary Assistance for Needy Families (TANF), Health First Colorado (Colorado's Medicaid), SNAP, or Food Distribution Program on Indian Reservations (FDPIR).

- EXEMPTING ALL MEDICAL MARIJUANA SALES FROM SALES TAX. This change would ensure that indigent patients do not pay sales taxes on their medical marijuana purchases and would provide medical marijuana purchases the same tax treatment as prescription drugs, which are exempt from sales tax. As discussed, we found that eight states exempt medical marijuana sales from tax (both sales and excise). We also identified at least one other state, Vermont, which exempts medical marijuana from the state sales tax under its prescription drug exemption. However, exempting all medical marijuana sales from sales tax would increase the revenue impact of the exemption to a total of about $10.6 million from the current impact of $10,133 in Tax Year 2021 due to the Indigent Patients Exemption, and reduce the total Marijuana Cash Fund revenue by a similar amount, assuming sales of medical marijuana are equivalent in future years to Tax Year 2021. Because Marijuana Cash Fund revenue is distributed to fund programs, services, and for the general purpose of regulating medical marijuana, it may reduce revenue for programs and departments that implement programs funded by the Marijuana Cash Fund.

Rural & Frontier Healthcare Preceptor Credit

OFFICE OF THE STATE AUDITOR
C O L O R A D O

Tax Expenditure Evaluation • August 2023 • 2023-TE11

The Rural & Frontier Healthcare Preceptor Credit (Preceptor Credit) provides a $1,000 nonrefundable income tax credit to certain licensed healthcare providers in rural and frontier areas of Colorado who provide a mentoring program of personalized instruction, training, and supervision to eligible health professional students; these providers in this context are referred to as "preceptors". According to statute, the purpose of the credit is "to encourage preceptors to offer professional instruction, training, and supervision to students matriculating at Colorado institutions of higher education who are seeking careers as primary health-care providers in rural and frontier areas of the state." Additionally, statute provides that the general purposes of the credit are to "induce certain designated behavior by taxpayers…" and "provide tax relief to preceptors in rural and frontier areas of the state…"

The Credit has not encouraged a substantial number of providers in rural and frontier areas of the state to become preceptors. The tax relief provided by the credit varies depending on how many extra hours per day a provider spends training students and the type of provider the preceptor is. Stakeholders reported that there continues to be a shortage of preceptors in rural and frontier areas of the state.

- In 2021, 2 percent of physicians, 1 percent of dentists, 1 percent of advanced practice nurses, and 6 percent of physician assistants in rural and frontier areas precepted students and claimed the credit.

- The credit provides a lower hourly benefit than providers' regular hourly wages, and the amount becomes comparatively much less once the preceptor provides more than 1 hour of teaching per day outside of the regular workday.

Policy Considerations

The General Assembly could consider allowing taxpayers to claim more than one credit per year if they precept more students. In addition, the General Assembly could consider whether additional oversight regarding certification of the Preceptor Credit form is necessary, since we identified several taxpayers who claimed the credit but who did not meet the requirements to qualify.

Tax Type:	**Income tax**	Year Enacted:	**2016**
Expenditure Type:	**Credit**	Repeal/Expiration Date:	**January 1, 2033**
Statutory Citation:	**Section 39-22-538, C.R.S.**	Revenue Impact (2021):	**$82,065**

Purpose given in statute or enacting legislation? **Yes**

STATE · OF · COLORADO
UNION
AND
CONSTITUTION
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1876

Rural & Frontier Healthcare Preceptor Credit

Background

The Rural & Frontier Healthcare Preceptor Credit (Preceptor Credit) provides a $1,000 nonrefundable income tax credit to certain licensed healthcare providers in rural and frontier areas of Colorado who provide a mentoring program of personalized instruction, training, and supervision to eligible health professional students. These providers in this context are referred to as "preceptors."

To qualify for the credit, the healthcare provider (see technical note) cannot accept compensation for the mentoring program, and it must last at least 4 working weeks, or 20 business days. The weeks or days do not need to be consecutive, and the healthcare provider can precept multiple students to satisfy the duration requirement. The precepted student(s) must be enrolled at an accredited Colorado institution of higher education and seeking a degree or certification in a primary healthcare field. Many degree and certification programs require students to participate in clinical rotations, referred to as "preceptorships."

Additionally, each healthcare provider may only earn one tax credit per year regardless of how many students they precept, and only up to 300 total preceptors are allowed to claim the credit in a single income tax year. The credit is not refundable, but it can be carried forward for up to 5 years, after which time any unused amount expires.

Statute [Section 39-22-538(2)(b) and (g), C.R.S.] defines a rural area as "an area listed as eligible for rural health funding by the federal office of rural health policy" and a frontier area as "a county in the state that has a population density of six or fewer individuals per one square mile." Colorado has 52 counties that are entirely rural and/or frontier areas, and parts of eight additional counties are also considered to be rural. These are shown in Exhibit 1.

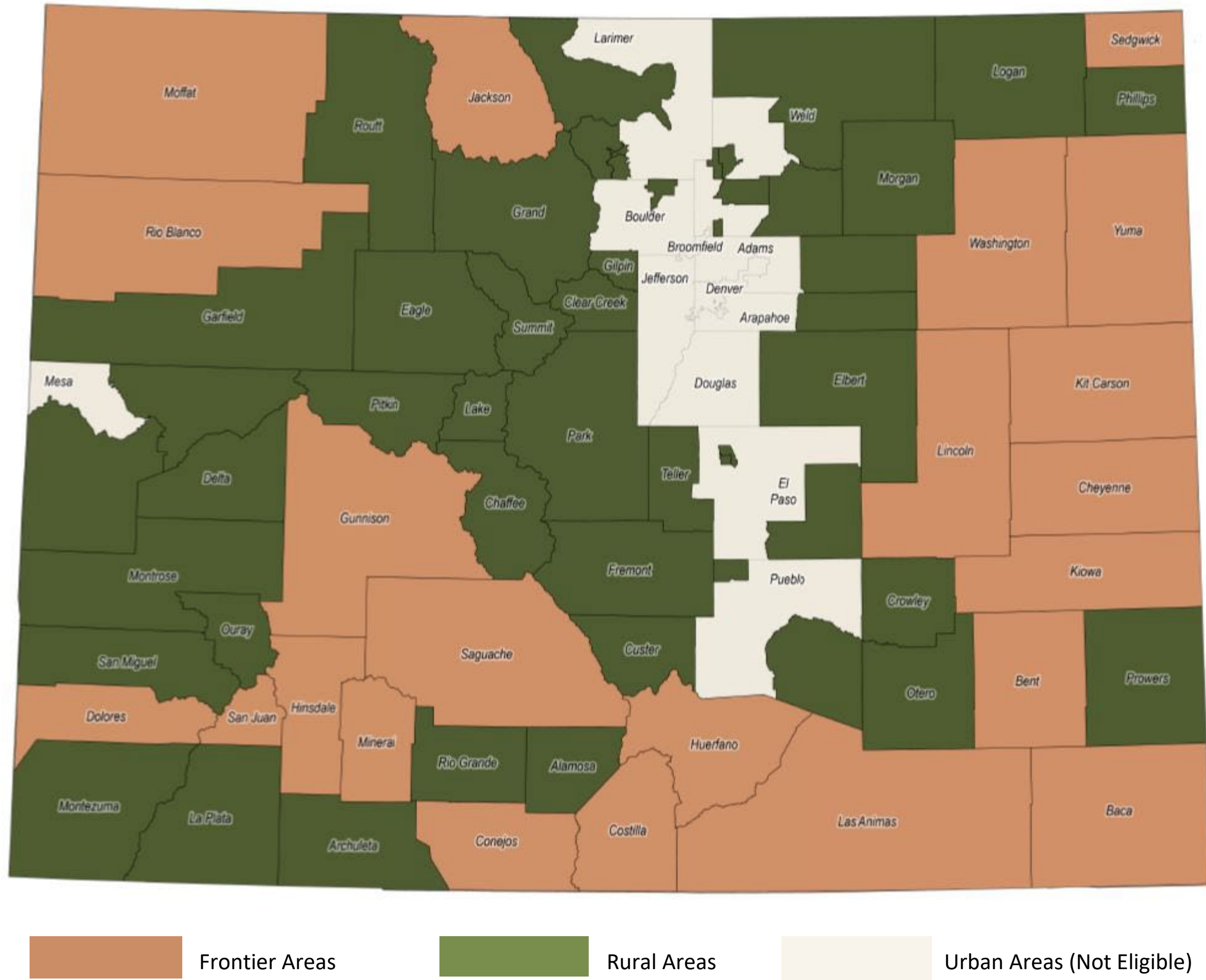
Technical Note

Beginning August 10, 2022, the following types of healthcare providers are eligible for the credit as long as they are licensed in their primary healthcare field and working in an outpatient clinical setting:

- Medical doctor
- Doctor of osteopathic medicine
- Physician assistant
- Advanced practice nurse
- Registered nurse
- Doctor of dental surgery or medicine
- Registered dental hygienist
- Pharmacist
- Licensed clinical or counseling psychologist
- Licensed professional counselor
- Licensed clinical social worker
- Licensed marriage and family therapist
- Psychiatric nurse specialist
- Licensed or certified addiction counselor

Prior to August 10, 2022, only medical doctors, doctors of osteopathic medicine, physician assistants, advanced practice nurses and doctors of dental medicine or surgery were eligible for the credit.

Exhibit 1
Map of Rural and Frontier Areas of Colorado for the Preceptor Credit



Source: Map created by Grant Smith - GIS Analyst, Governor's Office of Information Technology (OIT) based on Office of the State Auditor analysis of U.S. Census Bureau and Federal Office of Rural Health Policy data and Section 39-22-538(2)(b) and (g), C.R.S., requirements.

The credit was first available in 2017 and was initially scheduled to expire at the end of Tax Year 2019. Legislation in 2019 (House Bill 19-1088) and 2022 (House Bill 22-1005) extended the credit's expiration date, and it is currently set to expire at the end of 2032. House Bill 22-1005 also made other significant changes to the credit, including expanding it to include additional eligible healthcare provider and student types; increasing the annual cap on the number of preceptors allowed to claim the credit from 200 to 300; and broadening the definition of a rural area so that it encompasses rural areas in otherwise urban counties. The change in the definition of "rural" for purposes of the credit now allows certain census tracts in Adams, Arapahoe, Boulder, El Paso, Larimer, Mesa, Pueblo, and Weld Counties to be included in the credit's eligibility area; the eligible areas may change periodically in the future when the Federal Office of Rural Health Policy updates its eligibility for funding based on new census tract data.

To claim the credit, the preceptor must receive a certification indicating that they satisfied all requirements to receive the credit from the institution where they teach or from the regional area health education center (AHEC) office with jurisdiction over the area where the preceptorship took place. They must provide the certification to the Department of Revenue (Department) before they can claim the credit. They must also attach the certification to their income tax return to claim the credit.

According to statute [Section 39-22-538(1)(d)(I)(A) and (B), C.R.S.], the general purposes of the credit are to "induce certain designated behavior by taxpayers…" and "provide tax relief to preceptors in rural and frontier areas of the state…" **Additionally, statute [Section 39-22-538(1)(d)(II), C.R.S.] provides that the specific legislative purpose of the credit is "to encourage preceptors to offer professional instruction, training, and supervision to students matriculating at Colorado institutions of higher education who are seeking careers as primary health-care providers in rural and frontier areas of the state."**

We considered the beneficiaries of the credit to be primary healthcare preceptors in rural and frontier communities who do not receive compensation for providing structured mentoring programs to students enrolled in eligible programs at Colorado higher education institutions. Since 2017, there have been 246 preceptors approved to claim the credit. In addition to the preceptors, students enrolled in eligible programs at Colorado higher education institutions may also benefit from the credit because it may increase the number of preceptors and amount of preceptorships available to them in rural areas of the state. Finally, rural and frontier communities in Colorado may also indirectly benefit from the Preceptor Credit. According to the Colorado Rural Health Center, all rural and frontier counties in the state are experiencing shortages of healthcare professionals, which is compounded by difficulty in recruiting and retaining providers in these areas. Academic studies have demonstrated that students who participate in rural clinical rotations during school are more likely to practice in rural communities after they graduate. Therefore, in the long term, rural and frontier communities could potentially benefit from an increase in healthcare providers practicing in those communities.

We developed the following performance measures to evaluate the credit:

- The extent to which the credit encouraged eligible preceptors to offer preceptorships to students enrolled at Colorado institutions of higher education.

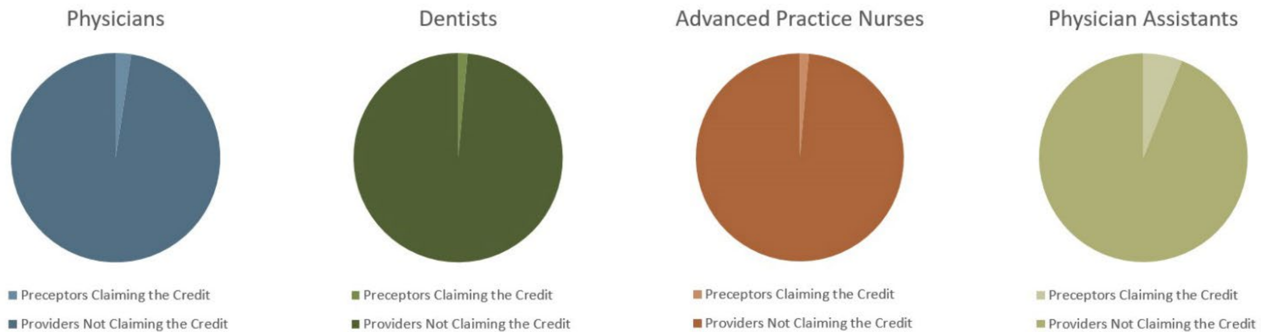
- The extent to which the credit provides tax relief to preceptors in rural and frontier areas of the state.

Evaluation Results

The Preceptor Credit has not encouraged a substantial number of providers in rural and frontier areas of the state to become preceptors. In Tax Year 2021, the Department approved 92 taxpayers to claim the credit and 83 subsequently claimed the credit on their 2021 income tax returns. We compared credit claims, by provider type, to data from the Colorado Health Systems Directory, which

is maintained by the Primary Care Office at the Colorado Department of Public Health and Environment (CDPHE), and shows the number of physicians, advanced practice nurses, physician assistants, and dentists practicing in rural and frontier areas of the state. As Exhibit 2 shows, 2 percent of physicians, 1 percent of dentists, 1 percent of advanced practice nurses, and 6 percent of physician assistants in rural and frontier areas precepted students and claimed the credit in 2021.

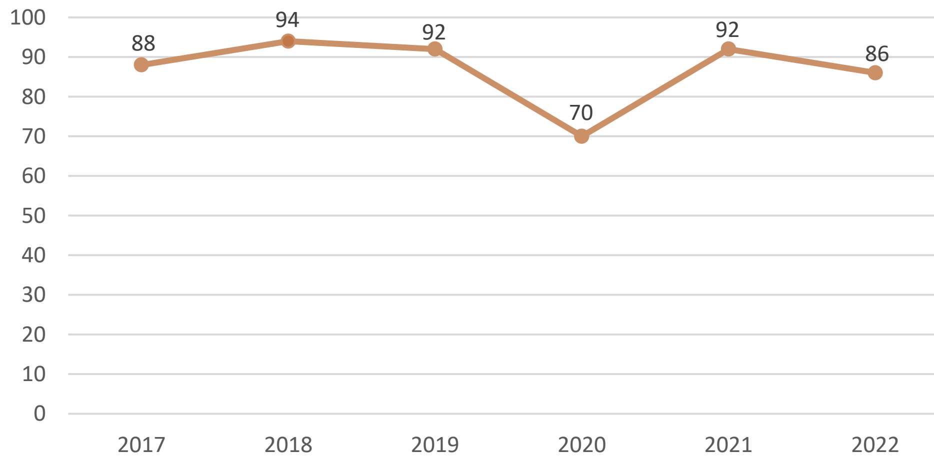
Exhibit 2
Eligible Healthcare Providers by Type Compared to Preceptors Who Claimed the Credit in 2021[1]



Source: Office of the State Auditor analysis of 2021 Rural & Frontier Health Care Preceptor Forms (Form DR 0366) for taxpayers who were approved for the credit and claimed it in 2021 and data from the Colorado Health Systems Directory, maintained by the Primary Care Office at CDPHE.
[1]The Colorado Health Systems Directory may include some providers who are not eligible for the credit. Specifically, the Colorado Health Systems Directory data includes all providers (e.g., specialists, emergency medical providers) and the credit is only available for providers who are in primary care. This analysis excludes nine taxpayers who were approved for the credit but did not claim it and six taxpayers who were approved and claimed the credit but were in located in areas that were not considered rural in 2021.

When we conducted an evaluation of this credit in 2019, stakeholders reported that there was a shortage of rural preceptors. In 2020, the COVID-19 pandemic made it difficult for students to get clinical rotations in rural areas due to restrictions from the schools, the clinical rotation sites, or both, which made the preceptor shortage worse during the pandemic. However, according to Department data showing credit certificates submitted and approved, the number of preceptors approved for the credit returned to pre-pandemic levels by 2021, although it slightly dropped in 2022 as shown in Exhibit 3.

Exhibit 3
Preceptors Approved to Claim the Credit, 2017-2022



Source: Office of the State Auditor analysis of Department of Revenue data.

The extent of the tax relief provided by the credit varies considerably depending on how many extra hours per day a provider spends training students and the type of provider the preceptor is. In order to be approved for the Preceptor Credit, the preceptor must provide at least 4 weeks of instruction, training, and/or supervision. However, preceptors typically spend 1-2 extra hours per day outside of their normal schedule training students based on information provided by preceptors to the Colorado Rural Health Center. Therefore, we calculated the hourly benefit that the Preceptor Credit provides based on how many extra hours a preceptor spends instructing students outside of their normal schedule. If a preceptor spends 20 extra hours during the preceptorship instructing students (i.e., an average of 1 extra hour per day), that equates to a $50 per hour monetary benefit from the credit. If a preceptor spends 40 extra hours instructing students (i.e., an average of 2 extra hours per day), that equates to a $25 per hour monetary benefit. For each additional hour spent, the hourly monetary benefit provided by the Preceptor Credit decreases. We did not have data on the actual number of hours preceptors spent each day instructing students since that information is not required to be included on the certification form. We compared the hourly benefit to data from the U.S. Bureau of Labor Statistics on the average hourly wage for several eligible provider types in Colorado, specifically:

- Family Physicians: $105
- Physician Assistants: $59
- Nurse Practitioners: $56
- Dentists: $74

For all of these providers, the Preceptor Credit provides a lower hourly benefit than the provider's regular hourly wage, and the amount becomes comparatively much less once the preceptor provides more than 1 hour of teaching per day outside of the regular workday. When we spoke with representatives from programs at Colorado institutions of higher education, they stated that the amount of time a provider

spends with students often depends on how advanced the students are in their studies. Students who are early in their studies often take more time to train and they may see fewer patients, whereas students who are more advanced in their studies can be more helpful and take less time to train.

Additionally, the actual tax liability decrease from the credit varied by provider type. In Tax Year 2021, on average, the credit reduced the tax liability for advance practice nurses by 18 percent, physician assistants by 16 percent, dentists by 14 percent, and physicians (MDs and DOs) by 8 percent. Therefore, all taxpayers experienced some tax relief but the extent varied among taxpayers.

Overall healthcare workforce shortages in rural areas may be contributing to preceptor shortages, particularly for students at Colorado institutions of higher education. Fewer healthcare providers in rural areas means there are fewer potential preceptors, and the remaining providers may have a higher patient load, which makes it difficult for them to also provide clinical training for students. We spoke with representatives from public college and university programs in Colorado and they reported that there continues to be a shortage of preceptors in rural areas of the state and that there is heavy competition for preceptors. They stated that the Preceptor Credit helps them compete with private programs that pay their preceptors and out-of-state programs that send students to Colorado, and that they use the credit as a tool to help them attract and retain preceptors. The representatives from the programs generally think the credit is helpful for attracting and retaining preceptors, but said it is difficult to determine how much the credit incentivizes providers to become preceptors relative to other factors such as university library access and the altruistic desire to provide a benefit to the public and their profession by providing training opportunities for students. Some providers may also be eligible for continuing medical education credits, which are required for many types of healthcare providers, for precepting students. In addition, some newly eligible fields might not be aware of the credit. We spoke with representatives in programs at three Colorado institutions of higher education that have students who could be precepted by newly eligible preceptors, and all three were not aware of the credit prior to us contacting them. However, they stated that now that they are aware of the credit, they plan to use it to try to attract and retain preceptors for their students.

Policy Considerations

The General Assembly could consider allowing taxpayers to claim more than one credit per year if they precept more students, which could help address the shortage of preceptors. Some program representatives mentioned that preceptors will take enough students to earn the credit but then not accept additional students and that allowing preceptors to claim more than one credit per year may encourage them to precept additional students. There are five other states that offer a tax credit similar to Colorado's credit—Georgia, Hawaii, Maryland, Missouri, and South Carolina. All other states allow preceptors to claim more than one credit if they participate in multiple preceptorships during the year; other states' credit amounts range from $375 to $1,000 per preceptorship.

Allowing preceptors to claim additional credits could provide an incentive for them to precept additional students, but would increase the credit's revenue impact to the State. For example, if each of the 86 preceptors who were certified for the credit in 2022 (see Exhibit 4) were allowed to claim two credits for precepting more students, the total credits certified would be 172 with a cost of $172,000 for the year—assuming all preceptors claimed all of the credits they were certified for that year. The number of credits issued and annual cost would still be less than the 300 credits with a corresponding cost of $300,000 per year anticipated by the fiscal note for House Bill 22-1005 when the General Assembly increased the number of preceptors who could claim the credit from 200 to 300 per year and expanded the list of eligible professions. As shown in Exhibit 4, over the past 6 years the number of taxpayers who claimed the credit has ranged from a low of 66 preceptors in 2020 to a high of 92 in 2019, while the revenue impact of the Preceptor Credit has ranged from a low of $65,211 in 2020 to a high of $90,392 in 2019.

Exhibit 4
Revenue Impact of the Preceptor Credit, 2017–2022

Year	Revenue Impact	Number of Claimants
2017	$76,000	76
2018	$87,781	89
2019	$90,392	92
2020	$65,211	66
2021	$82,065[2]	83[1]
2022	$86,000[3]	86[1]

Source: Office of the State Auditor analysis of Department of Revenue data.
[1] Number of claimants for 2021 is based on examination of individual tax returns in GenTax, the State's accounting system, and does not account for claimants that may have carried forward amounts from prior years. Number of claimants for 2022 is based on approvals and does not reflect actual claims on the tax returns.
[2] 2021 revenue impact is based on examination of individual tax returns in GenTax. This would not account for amounts carried forward from prior years.
[3] $86,000 would be the revenue impact if all approved preceptors claim the credit on their tax return The revenue impact will be less if not all approved preceptors claim the credit on their tax returns. This amount also does not take into consideration amounts carried forward from prior years.

The General Assembly could consider whether additional oversight regarding certification of the Preceptor Credit form is necessary. When we evaluated the credit in 2019, we found that in Tax Year 2017, 12 of the 74 taxpayers (16 percent) who claimed the credit had not met the requirements to qualify for it. Some of the reasons that these taxpayers were not eligible included precepting students who were not enrolled at Colorado institutions of higher education, precepting medical residents, precepting ineligible student types, or the preceptors were not located in rural or frontier areas. For this evaluation, we examined the forms for taxpayers who claimed the credit in Tax Year 2021. Of the 83 taxpayers who claimed the credit on their Tax Year 2021 tax returns, there were potential issues with the forms for 10 taxpayers (12 percent); in several of these cases, it was unclear who certified the taxpayers' forms because signatures were illegible and no other information about the certifiers was provided. We also noted the following additional issues with the 10 forms (some forms had more than one issue):

- Six taxpayers were not in eligible rural areas
- One taxpayer did not precept eligible students for enough days
- One form did not include any information on the students precepted (e.g., no student names or dates listed)
- Two taxpayers only listed students who were not enrolled at Colorado schools, which are not eligible
- Two taxpayers only listed medical residents, which are not eligible
- One taxpayer precepted a non-eligible student type

The Department reported that it has not disallowed or recaptured the credits claimed by the taxpayers we identified in 2017 because "eligibility for the health care preceptor credit is determined and certified by an outside agency with expertise in the field." According to statute [Section 39-22-538(4), C.R.S.], the agencies permitted to certify credits are "the institution for which the taxpayer teaches, whether it is an institution of higher education or a hospital, clinic, or other medical facility, or…the particular regional office of the A[rea] H[ealth] E[ducation] C[enter] program with jurisdiction over the area in which the preceptor's medical practice is located." The Department further reported, "the Department does not, as part of its review, re-evaluate the decisions of the certifying institution, agency, or entity on the certification. In this sense, the Department did not 'approve' these credits. Rather, we confirmed that they were claimed consistent with the certification provided pursuant to [S]ection 39-22-538(4), C.R.S. (which simply states that '[t]o qualify for the credit provided by this section, the taxpayer shall submit a certification form with each income tax return'). The Department lacks the expertise, resources, and statutory authority to audit and change the eligibility determinations of the agency charged with certification."

The issues we found with the certification forms, such as the preceptor not being in a rural area, not precepting students for enough hours, or precepting ineligible students did not require medical expertise to identify. However, if the General Assembly would like an organization with medical expertise and familiarity with the preceptorship program to review and approve the certification forms, it could consider giving this authority to the Colorado AHEC Program Office, which is located on the University of Colorado Anschutz Medical Campus. Colorado's six regional AHEC offices connect the Colorado AHEC Program Office with medically underserved communities in the state. Statute [Section 39-22-538(4), C.R.S.] already gives the AHEC Program the authority to charge preceptors a fee to certify their credits.

Since statute delegates certification authority to outside agencies and does not provide explicit authority to or require a state entity to review the eligibility determinations, there is a potential lack of accountability when someone improperly certifies the form (i.e., the preceptor did not meet the requirements but a certifier signs it anyway) or an ineligible person certifies the form. For example, we found that in several instances the taxpayers certified (signed) their own forms, but they were allowed to claim the credits. If the General Assembly amends statute to allow preceptors to earn and claim more than one Preceptor Credit per year (see section on Policy Considerations), and taxpayers are allowed to improperly claim credits, it is possible the cap of 300 credits per year could be reached and some eligible preceptors might not receive a credit when credits are being improperly claimed.

In our previous evaluation of the Preceptor Credit, we included an additional policy consideration that the General Assembly could clarify whether the minimum duration of a preceptorship, which is 4 weeks, should be counted as 28 days (i.e., 4 calendar weeks) or 20 days (i.e., 4 business weeks). In 2019, with House Bill 19-1088, the General Assembly clarified that preceptorships should be a minimum of 4 working weeks, or 20 business days, to qualify for the credit. Therefore, our previous policy consideration has been addressed.

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COLORADO WORKS PROGRAM EMPLOYER CREDIT

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE4

TAX TYPE	Income	REVENUE (TAX YEAR 2018)	$35,374
YEAR ENACTED	1997	NUMBER OF TAXPAYERS	32
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: Only a small number of taxpayers have used the credit, and it does not appear to have encouraged employers to provide many benefits, if any, to Colorado Works Program recipients, with none of the taxpayers who claimed the credit submitting the required documentation showing that their employees qualified. Additionally, we found that the credit's eligibility requirements limit its effectiveness since many employees likely exceed the applicable income limits once they begin receiving wages.

WHAT DOES THE TAX EXPENDITURE DO?

The Colorado Works Program (Program) Employer Credit allows employers to claim a credit against their income taxes equal to 20 percent of their annual expenditures for certain benefits provided to employees who are currently receiving public assistance under the Program. The following benefits are eligible:

- Child care services
- Health or dental insurance
- Job training or basic education
- Programs for employee transportation to and from work

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Neither statute nor the enacting legislation explicitly states the purpose of the credit; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of statutory language and legislative history, we considered a potential purpose: to encourage employers to provide employment benefits that align with the goals of the Program by partially offsetting the benefits' cost.

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.
- Reviewing the credit's effectiveness and either repealing it or making changes to its eligibility requirements.

COLORADO WORKS PROGRAM EMPLOYER CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Colorado Works Program provides low-income Colorado families with cash assistance and work support. It is provided in accordance with the federal Temporary Assistance for Needy Families (TANF) block grant program, which gives grants to states for the purpose of operating programs designed to help low-income families with children achieve economic self-sufficiency. A given family's continued eligibility for Colorado Works is dependent on the parent(s) or other caregiver(s) engaging in certain specified "work activities," such as employment, on-the-job training, job searches, or vocational educational training.

The Colorado Works Program Employer Credit (Colorado Works Credit) [Section 39-22-521(1), C.R.S.] allows employers to claim a credit against their income taxes equal to 20 percent of their annual expenditures for certain benefits they provide to employees who are currently receiving public assistance under the Colorado Works program. These expenditures must be made for the provision of any of the following benefits to these employees, provided that the benefits are incidental to the employer's business:

- Child care services or the payment of costs associated with child care services for children of employees
- Health or dental insurance for employees
- Job training or basic education of employees
- Programs for the transportation of employees to and from work

The Department of Revenue (Department) has not promulgated any regulations for this credit. However, according to the Department's taxpayer guidance (FYI Income 34), expenses for these benefits must be made specifically for eligible employee(s) in order to qualify. For example, tuition for a job training program for an eligible employee would qualify for the credit, but the cost of running a job training program for both eligible and ineligible employees would not qualify, even if the cost were prorated based on the percentage of all employees who were eligible. Additionally, FYI Income 34 states that the credit may only be claimed for expenditures made during the first 2 tax years of employment for any given eligible employee. According to statute [Section 39-22-521(3), C.R.S.], the credit is not refundable, but any unused credit amounts may be carried forward for up to 3 income tax years following the year in which the credit was initially claimed.

In order to claim the Colorado Works Credit, employers must submit, along with their income tax return, a letter from the county department of social or human services verifying that the employee(s) for whom expenditures are being claimed received public assistance from the Colorado Works Program. Taxpayers generally claim the Colorado Works Credit on the credit schedule for their respective income tax returns:

- Individuals claim the credit on Line 24 of the 2020 Individual Credit Schedule (Form DR 0104CR), which must be attached to the 2020 Colorado Individual Income Tax Return (Form DR 0104).

- Corporations claim the credit on Line 14 of the 2020 Credit Schedule for Corporations (Form DR 0112CR), which must be attached to the 2020 Colorado C Corporation Income Tax Return (Form DR 0112).

- Pass-through entities, such as S corporations and partnerships, report the credit on Line 11 of the 2020 Colorado Pass-Through Entity Credit Schedule (Form DR 0106CR), which must be attached to the 2020 Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Separate co-

owners of pass-through entities may claim their separate shares of the credit on their respective credit schedules, or, if the individual co-owners are nonresidents, the pass-through entity may claim the credit on the co-owners' behalf on Form DR 0106CR.

Senate Bill 97-120 enacted both the Colorado Works program and the Colorado Works Credit in 1997, and the credit has not been changed since then.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Neither statute nor the enacting legislation explicitly states the intended beneficiaries of the Colorado Works Credit. Based on our review of the credit's statutory language, we considered its intended beneficiaries to be Colorado employers that hire employees who receive public assistance through the Colorado Works Program. Employees may also benefit to the extent that the credit encourages employers to provide additional benefits. According to data on TANF programs from the U.S. Office of Family Assistance (OFA), 15,123 Colorado families received assistance through Colorado Works in Fiscal Year 2018, and an average of 2,546 individuals in these families were employed per month.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Neither statute nor the enacting legislation explicitly states the purpose of the Colorado Works Credit; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the credit's operation and legislative history, we considered a potential purpose: to encourage employers to provide employment benefits that align with the goals of the Colorado Works Program by partially offsetting the benefits' cost. Specifically, the credit was enacted in 1997 along with the Colorado Works Program itself. This suggests that the credit was intended to work in tandem with the program's goals, one of which is to "assist participants to terminate their dependence on government benefits by promoting job preparation [and] work" [Section 26-2-705(2)(a), C.R.S.]. Of the benefits that are eligible

for the credit, two (child care services and transportation) may reduce employment barriers for individuals; two (health and dental insurance) may reduce the extent to which individuals must rely on government benefits; and two (job training and basic education) may increase individuals' employability.

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

We could not definitively determine whether the Colorado Works Credit is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that the credit is likely not meeting the purpose that we identified in order to conduct this evaluation because it appears to be used by few employers, and Colorado Works Program recipients have likely received a relatively small amount of benefits from employers who claimed the credit. Additionally, we could not confirm that any of the taxpayers who claimed the credit provided qualifying benefits to employees because none of the taxpayers submitted the documentation required to support their claim of the credit, and several submitted other documentation indicating that they were not qualified for the credit or had intended to claim a different credit.

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 purpose:

PERFORMANCE MEASURE: *To what extent has the Colorado Works Credit caused employers to provide eligible benefits to individuals receiving assistance from the Colorado Works Program?*

RESULT: Based on its limited use, we found that Colorado Works Program recipients have likely received few qualifying benefits from employers as a result of the Colorado Works Credit. We could not confirm whether any employers provided qualifying benefits in order to

claim the credit, and our review of information in GenTax, the Department's tax processing and information system, indicates that few employers have claimed the credit. Specifically, we found that 32 taxpayers claimed the Colorado Works Credit in Tax Year 2018; however, six of these taxpayers submitted documentation showing they were not qualified to claim the credit, generally claiming it for assistance payments that they had personally received through the Colorado Works Program or claiming a different credit on the Colorado Works Credit line of the income tax return. None of the remaining 26 taxpayers had submitted either the required letter verifying that their employees had received public assistance from Colorado Works or any other documentation supporting their claim. Therefore, we could not verify whether any of these taxpayers qualified for the credit, and it is possible that some or all of them could have claimed it without providing any qualifying benefits to employees. EXHIBIT 1 provides the results of our analysis of GenTax data for the 32 taxpayers who claimed the credit.

EXHIBIT 1. SUMMARY OF IMPROPER COLORADO WORKS CREDIT CLAIMS, TAX YEAR 2018	
Credit claimed correctly	0
Unable to verify whether claim is valid due to lack of supporting documentation	26
Ineligible for credit	6
Total credit claims	32

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

Even if some or all of the 26 taxpayers claimed the credit for eligible employee benefits, we determined that few Colorado Works Program recipients would have received benefits from employers who claimed the credit. Specifically, according to data from the Colorado Department of Human Services, 8,331 individuals receiving assistance through Colorado Works in Calendar Year 2018 were employed for some part of the year. Although the Colorado Works Program does not collect data on the number of employers that have hired Colorado Works recipients, since at most only 26 taxpayers claimed the credit for

eligible expenses in Tax Year 2018, it appears that only a small proportion of Colorado Works Program recipients may have worked for an employer that provided benefits and claimed the credit. For example, if each of these 26 taxpayers hired about 11.2 employees—the average number of employees at Colorado businesses in Calendar Year 2018 according to data from the U.S. Bureau of Labor Statistics—and all of those employees were Colorado Works Program recipients and received eligible benefits from the employers, only about 291 employees, or about 3 percent of employed Colorado Works Program recipients, would have received a benefit from an employer who claimed the credit. This hypothetical may overestimate the potential number of employees receiving benefits though, since employer businesses organized as pass-through entities, such as S corporations and partnerships, can distribute the credit to multiple owners who then claim the credit on their individual tax returns, meaning that the 26 taxpayers likely represent fewer than 26 employers. It is also unlikely that an employer would hire only Colorado Works Program recipients.

Regardless of how many of the 26 taxpayers claimed the credit for eligible expenses, the overall value of benefits that they provided to Colorado Works Program recipients is relatively small. These taxpayers claimed a total of $25,758 in credits, and since the credit is calculated as 20 percent of eligible expenses, the total amount of credits claimed by these taxpayers represents at most $129,000 in potentially eligible benefits for employees' child care services, health insurance, dental insurance, job training, education, and/or transportation to and from work. Although we lacked data to determine the number of employees to which these benefits may have been allocated or how much of each benefit would have been provided, this amount is equivalent to about $15 in benefits per employed Colorado Works recipient in Calendar Year 2018. Using the example above, if 291 Colorado Works recipients received eligible benefit(s), the average value of benefits provided to these employees would be about $443 per employee. Furthermore, because some employers who claimed the credit may have provided the same benefits even if the credit was not available, the amount of benefits that the credit may have incentivized is likely less than the $129,000 in

benefits that may have been associated with the credit in Tax Year 2018.

We also found that the credit's eligibility requirements likely limit its effectiveness and could contribute to its limited use by employers. Specifically, expenses incurred for providing allowable benefits to eligible employees only qualify for the credit while the employees continue to receive assistance through the Colorado Works Program, and we determined that many individuals receiving assistance are unlikely to remain eligible for the program after they become employed. Households receiving Colorado Works Program assistance must demonstrate that their monthly gross income is below certain thresholds, which are established in the Code of Colorado Regulations [9 CCR 2503-6, Regulation 3.606.2] and vary depending on the number of caregivers and children in the household. For example, a household with one adult and one child must have no more than $1,003 in gross income per month in order to qualify for assistance, and a household with one adult and three children must have no more than $1,545 in gross income per month.

We used these income thresholds and OFA data on the percentage of benefitting families with different numbers of caretakers and children in Fiscal Year 2018 to estimate the percentage of benefitting families that would exceed the maximum income threshold under various employment circumstances. As demonstrated in Exhibit 2, we estimated that a significant percentage of families receiving Colorado Works assistance would earn monthly incomes that exceed the maximum income thresholds even if these families were paid a low hourly wage and only work part time. For example, if an individual worked for 20 hours a week at Colorado's minimum wage ($12.32 as of January 1, 2021), they would earn $1,068 in gross income per month. With this amount of monthly income, we estimated that 29 percent of Colorado Works benefitting families would be ineligible to receive assistance because their monthly income would exceed the maximum amount to qualify for assistance. For purposes of these and other calculations for

EXHIBIT 2, we assumed that families with no adults and families with at least four children would meet all income qualifications.

EXHIBIT 2. ESTIMATED PERCENTAGE OF FAMILIES INELIGIBLE FOR COLORADO WORKS ASSISTANCE DUE TO EXCESS INCOME (BASED ON COLORADO WORKS RECIPIENT FAMILY COMPOSITIONS IN FISCAL YEAR 2018) (Monthly Gross Income[1] // Estimated Percentage of Ineligible Families[2])		
Number of Hours Worked Per Week	$12.32 Per Hour (Minimum Wage)	$15 Per Hour
20	$1,068 // 29%	$1,300 // 49%
25	$1,335 // 49%	$1,625 // 60%
30	$1,602 // 60%	$1,950 // 61%

SOURCE: Office of the State Auditor analysis of 9 CCR 2503-6, Regulation 3.606.2, and U.S. Office of Family Assistance data.

[1]We calculated monthly gross income based on a 52-week work year because Colorado Works recipients must work a certain minimum number of hours *every* week on average in order to qualify. Additionally, our analysis assumes that all countable income for purposes of determining Colorado Works eligibility comes from earned wages received through employment.

[2]For purposes of estimating the percentages of Colorado Works benefitting families that would be ineligible, our analysis assumes that the only employed family members are adults. Therefore, all families with no adults meet the maximum gross income threshold requirement because they have no income. Additionally, we were unable to account for the portion of families with at least four children that may be ineligible at the given income levels because income thresholds increase with each additional child, and the available data on family compositions aggregates these families into a single category. Therefore, our analysis assumes that all families with at least four children meet the maximum income threshold requirement.

Additionally, to the extent that families meet the income requirement but do not participate in a sufficient number of hours of work activities, the percentage of ineligible families in EXHIBIT 2 would increase. Specifically, in addition to income limitations, families receiving assistance through Colorado Works must also engage in some combination of allowable "work activities" for at least 30 hours of work activities per week on average to continue to be eligible for assistance, or 20 hours per week for single parents with children below the age of 6.

Based on this analysis, we determined that employers are unlikely to be able to claim the credit for most employees for more than a brief period after their initial hire because most employees' families are likely to lose

Colorado Works Program eligibility due to either exceeding the maximum income thresholds allowed or not meeting the minimum required hours of work activity participation. Families that lose eligibility would no longer receive assistance through the Colorado Works Program, and employers would no longer be able to claim the credit for eligible expenditures that they had incurred for these employees once the employees no longer receive assistance. As discussed below, we found that other states with similar credits allow employers to claim the credit as long as employees were receiving benefits under the TANF program at the time of hire, even if the employees later lose eligibility.

Another factor that may limit the use of the credit is that eligible expenses are limited to those incurred for providing child care, health, dental, transportation, and training benefits. These benefits may be less likely to be provided for the lower paying or part-time positions that would allow the employees to continue to qualify for the Colorado Works Program than for higher paying positions. Furthermore, other significant employment costs, such as wages, unemployment insurance, and workers' compensation insurance, are not eligible for the credit. As discussed below, we found that most other states with similar credits tie the credit amount to more common expenses, such as wages. These factors likely lessen the credit's usefulness and appeal to employers and detract from its ability to influence employers' decisions regarding whether to provide Colorado Works recipients with eligible benefits.

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

According to data provided by the Department, the Colorado Works Credit resulted in a total of $35,374 in forgone revenue to the State in Tax Year 2018. As discussed, six taxpayers claimed the credit incorrectly, which accounted for $9,616 (27 percent) of this revenue. The 26 taxpayers who did not provide documentation to support their eligibility for the credit claimed the remaining $25,758. Since the credit is calculated as 20 percent of eligible expenses, the amount claimed by

these taxpayers is associated with a maximum of $129,000 in possibly eligible expenses for employees' child care services, health insurance, dental insurance, job training, education, and/or transportation to and from work. Although the credits were claimed in Tax Year 2018, some of these expenses may have been incurred in prior tax years, since any unused credit amounts may be carried forward for up to 3 tax years.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the Colorado Works Credit is eliminated, Colorado employers that incur expenses for providing qualifying benefits to employees who receive assistance through Colorado Works would no longer be able to claim a credit for these expenses against their state income tax liability. In Tax Year 2018, the 26 taxpayers who may have incurred eligible expenses claimed an average credit amount of $991. Most (73 percent) of these taxpayers received a credit amount between $100 and $2,000, but a few taxpayers received credits below or above this range.

To the extent that the credit may have incentivized employers to provide eligible benefits, eliminating it could also reduce the benefits employees receive, which could make it more difficult for employees to work and earn enough income to reduce their reliance on government benefits. For example, without child care or transportation benefits, which are eligible for the credit, some individuals may not be able to leave their children to go to work or may be unable to get to their place of work. However, as discussed, it is unclear whether any taxpayers who claimed the credit in Tax Year 2018 provided eligible benefits to employees, and based on the value of credits claimed, the potential total benefits associated with the credit appear to be relatively small.

Additionally, under the Internal Revenue Code [26 USC 162(a)], businesses may deduct all ordinary and necessary business expenses, which generally include training expenses and expenses for employee benefits like dependent care services and health insurance, when calculating federal taxable income. The only expenses eligible for the credit that are not generally deductible for federal income tax purposes

are transportation expenses, a change in the U. S. Code that resulted from the 2017 Tax Cuts and Jobs Act. Therefore, taxpayers would continue to be able to deduct most types of expenses that are currently eligible for the Colorado Works Credit from their taxable income, and these amounts would not be subject to either federal or Colorado income taxes.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We found that five other states offer a credit for employers that hire individuals receiving assistance through a TANF program. Four of the five states calculate their credits based on the amount of wages paid to the individual receiving public assistance. However, like the Colorado Works Credit, Nebraska limits the credit to certain benefits and is equal to 20 percent of the employer's expenditures for transportation and education.

In contrast with the Colorado Works Credit, four of the five other states do not require that the employee continue to receive assistance through a TANF program while employed in order for the employer to receive the credit. Instead, most of these states require that the employee have received assistance through the TANF program for a specified period of time prior to their hire date or simply be receiving program assistance on the date of hire. Notably, though, the use of the credit in these states also appears to be relatively low, with $114,000 being the largest amount of credits claimed annually among the states for which data were available.

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

We did not identify any other state tax expenditures or programs in Colorado that lessen employers' expenses related to employing individuals who receive public assistance. However, we identified the following federal income tax credit that does so:

FEDERAL WORK OPPORTUNITY TAX CREDIT [26 USC 51]. The federal Work Opportunity Tax Credit (WOTC) allows employers to claim an income tax credit for wages paid to individuals from certain targeted groups. Some of these targeted groups are the beneficiaries of various public assistance programs, including TANF programs, the Supplemental Nutrition Assistance Program (SNAP), recipients of Supplemental Security Income (SSI), and long-term recipients of unemployment compensation. The credit is equal to 25 percent of the first-year wages paid to employees who have worked for the employer for at least 120 hours but fewer than 400 hours, and it is equal to 40 percent of the first-year wages paid to employees who have worked for the employer for at least 400 hours, up to a total of $6,000 in wages per employee. Additionally, for employees who have received assistance through a TANF program for at least 18 consecutive months prior to being hired or who recently exceeded the maximum amount of time such assistance can be received, the credit is equal to 50 percent of second-year wages up to a total of $10,000 in wages per employee. Employers that claim the Colorado Works Credit may also be able to claim the federal WOTC for employees who meet the requirements for both credits. The federal WOTC is available through December 31, 2025.

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

We did not identify any data constraints during our evaluation of the credit.

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 COLORADO WORKS CREDIT. As discussed, neither statute nor the enacting legislation for the credit states the credit's purpose or provides performance measures for evaluating its effectiveness. Therefore, for the

purposes of our evaluation, we considered a potential purpose for the credit: to encourage employers to provide employment benefits that align with the goals of the Colorado Works Program by partially offsetting the benefits' cost. We identified this purpose based on our review of the following sources:

- THE CREDIT'S OPERATION. Due to its structure, the credit confers a financial benefit only on those employers that (1) hire individuals who are receiving public assistance through Colorado Works and (2) provide certain specified benefits to these individuals.

- LEGISLATIVE HISTORY. The credit was enacted in 1997 along with the Colorado Works Program itself. This suggests that the credit was intended to work in tandem with the program's goals, one of which is to "assist participants to terminate their dependence on government benefits by promoting job preparation [and] work" [Section 26-2-705(2)(a), C.R.S.]. Of the benefits that are eligible for the credit, two (child care services and transportation) may reduce employment barriers for individuals; two (health and dental insurance) may reduce the extent to which individuals must rely on government benefits; and two (job training and basic education) may increase individuals' employability.

We also developed a performance measure 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 COLORADO WORKS CREDIT AND CONSIDER MAKING CHANGES TO STATUTE. As discussed, the credit is not likely meeting the potential purpose that we identified in order to conduct this evaluation because it appears to be used by a small number of taxpayers, none of whom

submitted the required documentation or demonstrated that they provided eligible benefits to Colorado Works Program recipients. Specifically, 32 taxpayers claimed the credit in Tax Year 2018. Six of these taxpayers submitted documentation showing that they had claimed the credit improperly and had not provided eligible employee benefits, and none of the remaining 26 taxpayers submitted any documentation showing that they qualified. Given that none of the taxpayers who submitted documentation qualified for the credit, it appears likely that a substantial portion of the 26 taxpayers that did not provide documentation also did not qualify, and it is unclear whether any of them provided the employee benefits that the credit is intended to encourage. Therefore, it appears that only a few, or potentially no, employers provided qualifying benefits to employees in order to claim the credit.

Additionally, even assuming that the 26 taxpayers for whom we could not verify eligibility had properly claimed the credit and provided qualifying benefits to employees, these benefits appear to be relatively small. Based on the value of the credits claimed in Tax Year 2018, we estimated that at most, employers provided about $129,000 in benefits, which amounts to about $15 per employee when averaged among the 8,331 Colorado Works Program recipients who were employed during the year. Based on this limited use, it appears that overall, the credit is not acting as a significant incentive to encourage employers to provide employee benefits, and awareness of the credit may be low among employers that could potentially benefit from it. Therefore, the General Assembly may want to review the credit, and could consider repealing it if it is not meeting the General Assembly's policy goals.

Alternatively, the General Assembly could consider changes to the credit's eligibility requirements to address its low usage. Specifically, we identified the following issues that could limit the credit's ability to encourage employers to employ Colorado Works Program recipients and provide them with benefits:

- MOST EMPLOYEES ONLY QUALIFY UNDER THE CREDIT FOR A SHORT TIME AFTER BEING HIRED. As discussed, the credit is only available for eligible expenses incurred while the employee is still actively receiving public assistance through the Colorado Works Program. We determined that most individuals are likely to lose program eligibility soon after obtaining employment due to either exceeding the maximum monthly income thresholds allowed or not meeting the minimum required hours of work activity participation. As a result, the credit may be less useful to employers because they are likely to only be able to claim the credit for a few months' worth of eligible expenses for any given employee. Of the five other states that we identified with a similar credit for employers of TANF program recipients, four states do not require that the employee continue to receive assistance through the TANF program while employed in order for the employer to receive the credit. Instead, most of these states require that the employee have received assistance through the program for a specified period of time prior to their hire date or simply be receiving program assistance on the date of hire.

- THE TYPES OF BENEFITS ELIGIBLE FOR THE CREDIT MAY NOT BE COMMONLY PROVIDED BY EMPLOYERS. As discussed, the credit is only available to employers that provide certain benefits to employees, which include child care, health and dental insurance, transportation, and job training. Employers may be less likely to provide these types of benefits to employees in the low-wage and part-time positions that are more likely to allow employees to continue to receive Colorado Works Program benefits and maintain eligibility for the credit. Further, the benefits must be provided specifically for the employees who are Colorado Works Program recipients. For example, if an employer provides a job training program for all of its employees and some of them are not receiving benefits from the Colorado Works Program, then none of the employer's expenses for this program would qualify for the credit. We found that these requirements make Colorado's credit more narrowly targeted than similar credits in other states because four out of five of these states allow employers to qualify based on the wages they pay to qualifying employees,

which would generally make all employers who hire qualifying employees eligible for a credit.

However, given that we found that a substantial portion of taxpayers who claimed the credit in Tax Year 2018 likely did not qualify for the credit, there is a risk that without additional oversight or controls over eligibility, a continuation or expansion of the credit could result in more taxpayers claiming it improperly. According to Department staff, the Department manually reviews some credit claims and disallows the credit if the taxpayer does not submit supporting documentation. However, the Department does not have the resources to manually review all claims of the credit.

Finally, to the extent that statutory changes increase the number of employers claiming the credit, they could significantly increase the credit's revenue impact. For example, if employers could claim the credit for wages they paid to qualifying employees for the first 6 months of employment, based on the 8,331 Colorado Works recipients who were employed during Calendar Year 2018, the revenue impact could increase to around $16 million annually, assuming employees were employed for 30 hours per week and paid minimum wage.

STATE · OF · COLORADO
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SCHOOL-TO-CAREER EXPENSES CREDIT

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE7

TAX TYPE	Income	REVENUE (TAX YEAR 2018)	$41,860
YEAR ENACTED	1996	NUMBER OF TAXPAYERS	51
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The credit is likely not meeting its purpose because it has been used by a relatively small number of taxpayers, none of whom submitted the required documentation demonstrating that they were eligible for the credit.

WHAT DOES THE TAX EXPENDITURE DO?

The School-to-Career Credit allows taxpayers that incur certain expenses for employees or interns who are participating in a qualified school-to-career program to claim an income tax credit equal to 10 percent of these expenses. Expenses eligible for the credit are wages, training expenses, and premiums for workers' compensation insurance and unemployment insurance.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute states that the purpose of the School-to-Career Credit is "to encourage private investment in programs that integrate traditional education with on-the-job training [and] to foster and encourage cooperation among the private sector and the educational community in creating programs that will open doors of opportunity for students and enable them to develop the knowledge and skills that will empower them to become productive members of society."

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to:

- Establish performance measures for the credit.
- Review the extent to which the credit is meeting its purpose and consider repealing it or making changes to increase its usage.

SCHOOL-TO-CAREER EXPENSES CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Under the School-to-Career Expenses Credit (School-to-Career Credit) [Section 39-22-520(2)(a), C.R.S.], taxpayers that incur certain expenses for employees or interns who are participating in a qualified school-to-career program may claim an income tax credit equal to 10 percent of these expenses. In order to qualify, the funds must be "directly expended" to employ a student to work or allow a student to participate in an internship through one of these programs. Expenses eligible for the credit are wages, training expenses, and premiums for workers' compensation insurance and unemployment insurance.

Statute [Section 39-22-520(2)(b)(II), C.R.S.] defines "qualified school-to-career program" as "a program that integrates school curriculum with job training [and] encourages placement of students in jobs or internships that will teach them new skills and improve their school performance…" Additionally, qualified programs must be approved by one of the following entities:

- The board of education of the school district in which the program is operating
- The State Board for Community Colleges and Occupational Education
- The Colorado Division of Private Occupational Schools
- The Colorado Commission on Higher Education

Department of Revenue (Department) staff stated that the credit is only allowed for qualified expenses incurred during the tax year in which the credit is being claimed. The credit is not refundable, but any amounts exceeding the taxpayer's income tax liability may be carried forward for up to 5 years.

Taxpayers generally claim the School-to-Career Credit on the credit schedule for their respective income tax returns:

- Individuals claim the credit on Line 23 of the 2020 Individual Credit Schedule (Form DR 0104CR), which must be attached to the 2020 Colorado Individual Income Tax Return (Form DR 0104).

- Corporations claim the credit on Line 13 of the 2020 Credit Schedule for Corporations (Form DR 0112CR), which must be attached to the 2020 Colorado C-Corporation Income Tax Return (Form DR 0112).

- Pass-through entities, such as S corporations and partnerships, report the credit on Line 10 of the 2020 Colorado Pass-Through Entity Credit Schedule (Form DR 0106CR), which must be attached to the 2020 Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Separate co-owners of pass-through entities may claim their separate shares of the credit on their respective credit schedules, or, if the individual co-owners are nonresidents, the pass-through entity may claim the credit on the co-owners' behalf on Form DR 0106CR.

The Department also requires taxpayers to submit a certification letter from the program's approving authority that certifies the program qualifies and the taxpayer is approved for the credit.

The School-to-Career Credit was enacted in 1996 by Senate Bill 96-193. Originally, it required that the student(s) benefitting from the qualified expenses be employed to work "predominantly within an enterprise zone." However, this requirement was removed in 1997 by House Bill 97-1152, which also added a purpose statement and allowed for expenses for students in internships in addition to employed students. The credit has not been changed substantively since then.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Neither statute nor the enacting legislation explicitly states the intended beneficiaries of the School-to-Career Credit. Based on the operation of the credit, we considered the credit's intended beneficiaries to be businesses that incur qualified expenses for their employees who are students or interns and are participating in a qualified school-to-career program. Additionally, to the extent that the credit encourages employers to hire school-to-career program participants or pay for their employees to participate in these programs, the employees and interns also appear to be intended beneficiaries.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-22-520(1), C.R.S.] states that the purpose of the School-to-Career Credit is "to encourage private investment in programs that integrate traditional education with on-the-job training [and] to foster and encourage cooperation among the private sector and the educational community in creating programs that will open doors of opportunity for students and enable them to develop the knowledge and skills that will empower them to become productive members of society."

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

We determined that the School-to-Career Credit is likely not meeting its purpose because it has been used by relatively few employers. Additionally, none of the taxpayers who claimed the credit submitted the documentation required to show that they incurred eligible expenses for employed school-to-career program participants, and several submitted other documentation indicating that they were not qualified for the credit or had intended to claim a different credit.

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 purpose:

PERFORMANCE MEASURE: *To what extent has the School-to-Career Credit caused employers to incur eligible expenses for employees or interns who are participating in a qualified school-to-career program?*

RESULT: We determined that few, if any, employers have incurred qualified expenses related to a school-to-career program and claimed the School-to-Career Credit for these expenses. Specifically, our review of information in GenTax, the Department's tax processing and information system, indicates that although 51 taxpayers claimed the credit in Tax Year 2018, none of these taxpayers submitted the required letter certifying that the program qualifies and that the taxpayer is approved for the credit. Additionally, 12 of these taxpayers submitted documentation indicating that they had claimed the credit incorrectly, generally claiming it for their own tuition expenses at a vocational school or claiming a different credit on the School-to-Career Credit line of the income tax return. Only one taxpayer submitted documentation indicating that they claimed the credit for potentially eligible expenses, though it is unclear whether this taxpayer's employee was enrolled in a certified school-to-career program. For the remaining 38 taxpayers, we were unable to confirm or deny the validity of the taxpayers' credit claims because they had not submitted any documentation supporting their claims. Therefore, it is possible that some or all of these taxpayers may have claimed the credit without incurring any eligible expenses for an employee who was enrolled in a qualified program. EXHIBIT 1 provides the results of our analysis of GenTax data for the 51 taxpayers who claimed the credit.

EXHIBIT 1. SUMMARY OF IMPROPER SCHOOL-TO-CAREER CREDIT CLAIMS, TAX YEAR 2018	
Credit claimed correctly	0
Credit claim may be valid based on documentation submitted	1
Unable to verify whether claim is valid due to lack of supporting documentation	38
Ineligible for credit	12
Total credit claims	51

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

Additionally, even if some or all of the 39 potentially qualified taxpayers claimed the credit for eligible expenses, we determined that a significant number of employers with eligible expenses (or expenses that would be eligible if the relevant school-to-career program were approved) are not claiming the credit. We were unable to determine how many programs have been approved for the credit or how many businesses are participating in those programs because some of the entities with the authority to approve qualified programs were either unaware of the credit or stated that they had delegated approval authority to the individual schools under their purview. However, some of these entities stated that it is likely that most or all of the internship, apprenticeship, or similar programs available at secondary or post-secondary schools under their purview would meet the statutory definition for qualified school-to-career programs. Based on our examination of approving entities' websites, we determined that there were at least 800 potentially qualified programs available at Colorado schools between 2020 and 2021. This number does not include programs at several types of Colorado schools for which data was unavailable, so it is likely that the actual number of qualified programs in Colorado is higher than 800. Therefore, even if each of these programs only had one participating employer, the 39 potentially qualified taxpayers who claimed the credit in Tax Year 2018 represent, at most, 5 percent of eligible taxpayers. Furthermore, this hypothetical likely overestimates the potential percentage of employers that claimed the credit and participated in these programs because some of the

taxpayers who claimed it may have been co-owners of pass-through entities such as partnerships and limited liability companies, meaning than the credits claimed by the 39 potentially eligible taxpayers may have originated from fewer than 39 business entities.

Finally, the large number of qualified school-to-career programs in the state suggests that, despite the credit's low usage, the private sector and the educational community are creating programs that integrate traditional education with on-the-job training. This may be because there are a number of benefits available for employers participating in these types of programs even without the added benefits of the credit. For example, according to the Colorado Department of Labor and Employment (CDLE), the benefits of employer participation in apprenticeship programs include:

- Developing a highly skilled workforce, including training current employees for more advanced roles within the company
- Creating customized training solutions that meet the company's unique needs
- Retaining industry knowledge as experts within the company approach retirement
- Saving on recruitment costs, reducing turnover, and fostering employee loyalty

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

According to data provided by the Department, the School-to-Career Credit resulted in a total of $41,860 in forgone revenue to the State in Tax Year 2018. As discussed, some taxpayers claimed the credit incorrectly, and we were unable to confirm whether any of the remaining taxpayers claimed the credit for eligible expenses. The 39 taxpayers who may have done so, claimed a total of $33,035. Since the credit is calculated as 10 percent of qualified expenses, this forgone revenue is associated with a maximum of $330,350 in possibly eligible expenses. However, the actual amount is likely substantially less since,

as discussed, it appears that many of these taxpayers may not have incurred eligible expenses. In addition, although the credits were claimed in Tax Year 2018, some of these expenses may have been incurred in prior tax years since any unused credit amounts may be carried forward for up to 5 tax years.

Finally, as discussed above, we found that there are over 800 Colorado programs that likely meet the statutory definition of "qualified school-to-career program" and are available for employers' participation. This suggests that the revenue impact of the School-to-Career Credit could be higher if more programs become approved or if more taxpayers become aware of and/or begin claiming the credit for their eligible expenses.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the School-to-Career Credit were eliminated, taxpayers that incur expenses for wages, training, and premiums for workers' compensation insurance and unemployment insurance related to employing a student or hosting an intern who is participating in a qualified school-to-career program would no longer be able to claim a credit for these expenses against their state income tax liability. In Tax Year 2018, the 39 taxpayers who may have incurred eligible expenses claimed an average credit amount of $847 on their income tax returns. Most (77 percent) of these taxpayers received a credit amount between $100 and $2,000, but a few taxpayers received credits below or above this range. We also found that 44 percent of these taxpayers did not have any income tax liability remaining after the School-to-Career Credit was applied, and taxpayers claimed 18 percent of the total credit amount allowed. The remaining 82 percent of credit amounts may be carried forward to subsequent tax years, provided that the taxpayer in question had not reached the 5-year limit on the total number of tax years for which the credit can be carried forward.

To the extent that the credit may have encouraged employers to participate in or increase the amount of expenditures related to their employees' or interns' participation in qualified programs, these employers may decide to spend less on qualified expenses if the credit were eliminated. The credit may also have helped to defray the additional training and education expenses that employers may incur as a result of hiring less experienced employees as opposed to hiring employees who are already trained. However, as discussed, it is unclear whether any of the taxpayers who claimed the credit in Tax Year 2018 incurred eligible expenses.

Under the Internal Revenue Code [26 U.S.C. Section 162(a)], businesses may deduct all ordinary and necessary business expenses, which generally include wages, premiums for workers' compensation insurance, and education and training expenses, when calculating federal taxable income. The only expenses eligible for the credit that may not be deductible for federal income tax purposes are premiums for unemployment insurance. Therefore, if the School-to-Career Credit were eliminated, taxpayers would continue to be able to deduct most types of expenses that are currently eligible for the credit from their taxable income, and these amounts would not be subject to either federal or Colorado income taxes.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified 19 other states with a combined total of 21 credits for employers that offer educational or training programs to their employees, including apprenticeship programs, internship programs, and training programs for new or existing employees. As is the case for Colorado's School-to-Career Credit, a substantial portion of the credits in other states are calculated as a percentage of training costs (seven out of 21 credits, or 33 percent) and/or wages of the individual(s) receiving the training (eight out of 21 credits, or 38 percent), as shown in EXHIBIT 2. However, Colorado's credit also allows for the costs of premiums for unemployment insurance or workers' compensation insurance to be included in the calculation of the credit amount, and we did not identify

any other states that allow for these costs. Finally, we determined that 76 percent of the credits available in other states impose a cap on the credit amount for any given employer; in contrast, Colorado's credit is not capped.

EXHIBIT 2. METHODS OF DETERMINING CREDIT AMOUNTS FOR OTHER STATES' CREDITS

Method of Determining Credit Amount	Example	Number of Other States' Credits[1]	Range of Credit Amounts in Other States
Percentage of wages of individual(s) receiving training	Arkansas' apprenticeship credit is calculated as 10 percent of wages earned by the apprentice.	8	2.5% – 50%
Percentage of training costs	Rhode Island's training credit is calculated as 50 percent of vocational training costs for employees.	7	35% – 100%
Flat amount per individual receiving training	South Carolina's apprenticeship credit is $1,000 for each apprentice employed.	6	$750 – $7,000
Hourly rate (per hour of work completed by individual(s) receiving training)	West Virginia's apprenticeship credit is $2 per hour worked by the apprentice during the tax year.	3	$1.25 – $6 per hour
Total credits available in other states		21	–

SOURCE: Office of the State Auditor analysis of Bloomberg Law resources and other states' statutes, official websites, and tax forms.
[1]The sum of number of credits using each calculation method is over 21 because a few credits allow for more than one method of calculating the amount of the credit allowed.

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

We identified one tax expenditure and several programs in Colorado that support the integration of traditional education and on-the-job training, including:

ENTERPRISE ZONE QUALIFIED JOB TRAINING PROGRAM INVESTMENT TAX CREDIT [SECTION 39-30-104(4)(a)(II), C.R.S.]. This credit is one of a number of tax expenditures that are available to businesses located in designated economically distressed areas of the state known as enterprise zones. The credit is equal to 12 percent of an employer's expenses for a structured training or basic education program that is conducted to improve the job skills of employees. Allowable expenses include supplies, training staff wages or fees, and training contract costs.

We evaluated this credit in 2020, along with a number of other enterprise zone tax expenditures, and the evaluation report is available in the *Office of the State Auditor 2020 Tax Expenditure Compilation Report.*

SKILL ADVANCE COLORADO GRANT PROGRAM. Skill Advance Colorado offers reimbursement grants to employers for the costs of customized job training for their employees, which may be conducted by community college faculty and staff, college contractors, qualified internal employees, or third party training vendors. The program is administered jointly by the Colorado Community College System (CCCS) and the Colorado Office of Economic Development and International Trade (OEDIT), and it is managed locally by the individual community colleges participating in the program. In order for employers to be eligible, the employees receiving training must be full-time, non-seasonal employees and receive wages above certain thresholds. Additionally, employers must contribute a minimum of 40 percent of the total training costs in order to receive grant funds, and each business is limited to $200,000 in grant funds per year. According to the CCCS website, the average grant amount is $75,000, and the program's funds have gone towards training for over 4,000 Colorado employees per year.

Skill Advance Colorado offers two types of grants to Colorado employers:

- Colorado First Job Training Grants. These grants are available for training net new hires at companies that are relocating to or expanding in Colorado. For Fiscal Year 2022, the average grant amount per employee learner is capped at $1,400.

- Existing Industry Job Training Grants. These grants are available for employee training in order to help established Colorado companies remain competitive in their industry, adapt to new technology, and prevent layoffs. For Fiscal Year 2022, the average grant amount per employee learner is capped at $1,200.

Apprenticeship Programs. Apprenticeship programs are industry-driven career pathways that combine paid work experience with classroom instruction. Employers may work with the CDLE to register their apprenticeship programs with the U.S. Department of Labor (USDOL), which requires that programs adhere to certain standards for apprentices, including:

- At least one guaranteed wage increase.
- On-the-job training and workplace experience supervised by qualified mentors.
- Job-related instruction, which may be provided by post-secondary institutions (such as community, technical, and four-year colleges), unions, K-12 schools, private training providers, and/or internally at the company.
- An industry-recognized credential upon successful completion.

According to CDLE data, there were 222 Registered Apprenticeship Programs in Colorado as of July 2021. However, it is likely that there are more apprenticeships than this in Colorado, since apprenticeships are not required to register with USDOL.

Colorado Collegiate Apprenticeship Program. This program utilizes grant funds from the USDOL to establish new apprenticeship programs in healthcare and information technology. It is administered by the Colorado Department of Higher Education in partnership with Colorado colleges and universities, with the goal of creating over 6,000

apprenticeships by the summer of 2024. In addition to assisting employers with establishing and customizing their apprenticeship programs, the Colorado Collegiate Apprenticeship Program also offers wage reimbursements to small healthcare businesses for their employees who participate in these programs.

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

We did not identify any data constraints during our evaluation of the credit.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH PERFORMANCE MEASURES FOR THE SCHOOL-TO-CAREER CREDIT. As discussed, statute and the enacting legislation for the credit do not provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we developed a performance measure to assess the extent to which the credit is meeting its purpose. However, the General Assembly may want to clarify its intent for the credit by providing performance measure(s) in statute. This would 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 EXTENT TO WHICH THE SCHOOL-TO-CAREER CREDIT IS MEETING ITS PURPOSE AND COULD CONSIDER MAKING CHANGES TO STATUTE. As discussed, the credit is likely not meeting its purpose of encouraging private investment in programs that integrate traditional education with on-the-job training because few, if any, employers who provide eligible school-to-career programs use the credit. The credit is only being used by a small number of taxpayers, none of whom submitted the required documentation to substantiate that they hired employees or interns from a certified school-to-career program. Of the 51 taxpayers that claimed the credit in Tax Year 2018, only one submitted documentation indicating that they

claimed the credit for potentially eligible expenses. Twelve taxpayers submitted documentation indicating that they had claimed the credit incorrectly and had not incurred eligible expenses, and the remaining 38 taxpayers did not submit any documentation showing that they were qualified. Given that only one of the taxpayers who submitted documentation may have qualified for the credit, it is likely that a substantial portion of the 38 taxpayers who did not provide documentation also did not qualify, and it is unclear whether any of them incurred expenses related to qualified school-to-career programs that the credit is intended to encourage.

Additionally, even assuming that the 39 taxpayers for whom we could not verify eligibility had properly claimed the credit and incurred eligible expenses, we determined that a significant number of employers with eligible expenses (or expenses that would be eligible if the relevant school-to-career program were approved) are not claiming the credit. We estimated that there were at least 800 potentially qualified school-to-career programs available at Colorado schools between 2020 and 2021. Even if each of these programs only had one employer with a participating employee in 2018, we estimated that no more than 5 percent of these employers would have claimed the credit during the year.

Finally, the large number of qualified school-to-career programs in the state suggests that despite the credit's low usage, the credit's purpose is being met through other means. This may be because there are a number of benefits available for employers participating in these types of programs even without the added benefits of the credit, such as developing a more skilled workforce, creating customized training, retaining industry knowledge when experts reach retirement age, and saving on recruitment costs. Additionally, we identified a number of programs and organizations in Colorado that support employers in their endeavors to create or join apprenticeship, internship, or training programs for employees.

Therefore, the General Assembly may want to review the credit and could consider repealing it if it is not meeting its purpose to the extent intended. Alternatively, the General Assembly could make changes to address the credit's low usage. However, since a substantial portion of taxpayers who claimed the credit in Tax Year 2018 likely did not qualify for the credit, there is a risk that without additional oversight or controls over eligibility, a continuation or expansion of the credit could result in more taxpayers claiming it improperly. According to Department staff, the Department manually reviews some credit claims and disallows the credit if the taxpayer does not submit supporting documentation. However, the Department does not have the resources to manually review all claims of the credit. Finally, to the extent that statutory changes increase the number of employers claiming the credit, this could increase the credit's revenue impact.

STATE · OF · COLORADO
UNION AND CONSTITUTION
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JOB GROWTH CREDIT

EVALUATION SUMMARY | SEPTEMBER 2022 | 2022-TE38

TAX TYPE	Income
YEAR ENACTED	2009
REPEAL/EXPIRATION DATE	December 31, 2026
REVENUE IMPACT (TAX YEAR 2018)	$14.2 million
NUMBER OF TAXPAYERS	130

KEY CONCLUSION: The credit has likely had some effect on businesses' decisions to establish job creation projects in Colorado and may have resulted in the creation of new jobs.

WHAT DOES THE TAX EXPENDITURE DO?

The Job Growth Credit is available for businesses that create new jobs for a project "that encourages, promotes, and stimulates economic development in key economic sectors…" The credit is equal to the net job growth for the given calendar year multiplied by 50 percent of the FICA taxes imposed on the business during that year for the net new jobs of the project.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Neither statute nor the enacting legislation explicitly states the purpose of the credit; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the credit's operation, we considered a potential purpose: to encourage businesses to create new jobs in Colorado.

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.
- Clarifying the available credit period and the calculation of the credit amount.
- Examining the effects of remote work on companies' average annual wages for purposes of qualifying for the credit.

JOB GROWTH CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Job Growth Incentive Credit (Job Growth Credit) [Section 39-22-531, C.R.S.] is available for businesses that create new jobs for a project "that encourages, promotes, and stimulates economic development in key economic sectors…" Statute directs the Economic Development Commission (Commission) to administer most aspects of the credit. However, the Commission is situated within the Office of Economic Development and International Trade (OEDIT), which generally handles the application process and issues credit certificates for the credit, with the Commission approving businesses for the credit and setting the terms businesses must meet to qualify.

In order to be eligible for the credit, statute [Section 39-22-531(3)(a)(III)(B), C.R.S.] requires businesses to assert to the Commission and OEDIT during the application process that the credit "is a major factor in the decision to locate or retain the project in Colorado…" Additionally, projects must generally bring a net job growth of at least 20 net new jobs to Colorado, although this requirement is reduced to five net new jobs for projects located in an enhanced rural enterprise zone, which is an area of the state that OEDIT has determined to be economically distressed.

Under statute [Section 39-22-531(1)(f), C.R.S.], net job growth is calculated as the increase in the number of full-time equivalent (FTE) employees for the project between the project's commencement and the end of the given calendar year, as demonstrated in Exhibit 1. According to OEDIT staff, only those employees with a primary residence in Colorado and who pay Colorado state income tax are included in the calculation of net job growth.

EXHIBIT 1. CALCULATION OF NET JOB GROWTH PER CALENDAR YEAR (BASED ON NUMBER OF FULL-TIME EQUIVALENT EMPLOYEES EMPLOYED FOR THE PROJECT)

SOURCE: Office of the State Auditor analysis of Section 39-22-531(1)(f), C.R.S.

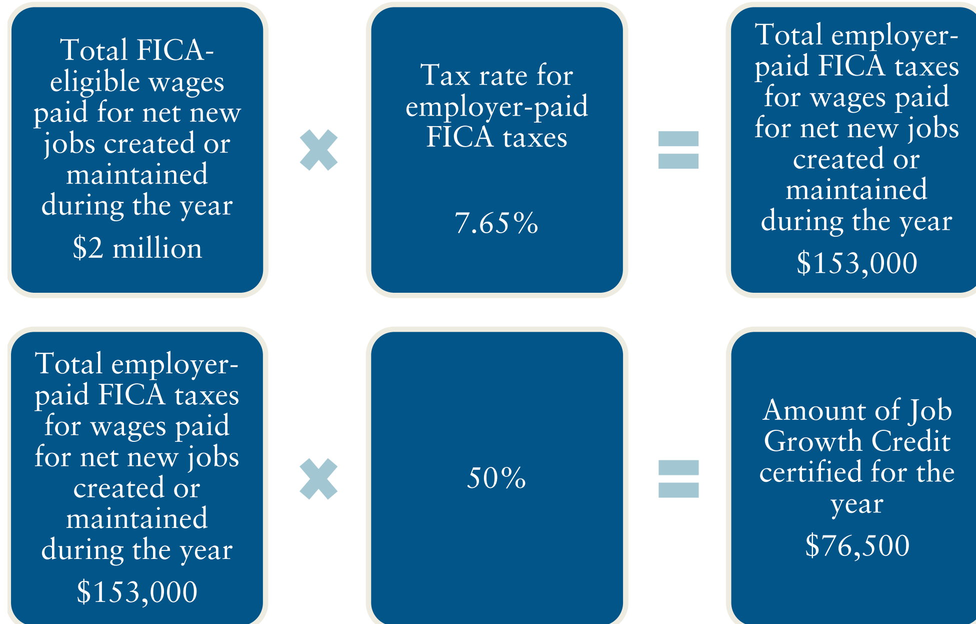
The new employees hired must be retained for at least 1 year, and the average annual wage of the jobs created must be at least 100 percent of the average annual wage of the county in which the project is located. OEDIT staff indicated that the county average annual wage used to verify that the project meets this requirement, both at the project's outset and on an annual basis thereafter, is set when the project is approved and is calculated based on the most recently available data from the U.S. Bureau of Labor Statistics at that time.

The credit may be claimed for a specific credit period that the Commission sets individually for each project, which cannot exceed 96 consecutive months, or 8 income tax years. If the amount of the credit exceeds the taxpayer's income tax liability for the income tax year in which the credit is claimed, the taxpayer may carry forward the remaining amount for up to 10 income tax years. The Commission can approve new projects for the credit through December 31, 2026.

Under OEDIT's interpretation of statute [Section 39-22-531(5)(b), C.R.S.], a company's annual credit amount is equal to 50 percent of the Federal Insurance Contributions Act (FICA) taxes imposed on the taxpayer during that year for the net new jobs for the approved project, as demonstrated in Exhibit 2 (see the *What policy considerations did this evaluation identify?* section below for a discussion on the operation of this statute). FICA taxes, which include social security taxes and Medicare taxes, are generally imposed on employers at a total rate of

7.65 percent of the wages paid to employees; therefore, the credit is typically equivalent to about 3.8 percent of the new employees' wages.

EXHIBIT 2. EXAMPLE CALCULATION OF JOB GROWTH CREDIT PER CALENDAR YEAR, BASED ON OEDIT'S INTERPRETATION OF STATUTE



SOURCE: Office of the State Auditor analysis of Section 39-22-531(5)(b), C.R.S., and Office of Economic Development and International Trade documentation of the credit.

Businesses seeking the credit are required to submit an application to OEDIT before a qualifying project begins. The application must provide:

- An employment plan that includes the forecasted number, titles, hire dates, and annual wages of the positions that will be created.
- Documentation demonstrating that the Job Growth Credit is a major factor in the decision to locate the project in Colorado. This documentation must indicate that the company "could reasonably and efficiently" locate the project outside of Colorado and that at least one other state is being considered for the project.

- A cost differential analysis that compares the projected costs of the project in Colorado with the projected costs if the project were to commence in at least one competing state. The analysis may include the impact of incentive programs available in the other state; the costs of labor, utilities, and taxes; and "the cost structure of the taxpayer's industry in the competing state."

- Three years of historical company financials.

OEDIT staff review the application and conduct an analysis of the project, after which the project goes before the Commission for consideration, along with OEDIT's analysis and recommendations. Provided that the project meets the credit's eligibility requirements laid out in statute, the Commission has discretion in whether to offer conditional approval to the project. In deciding whether to approve any given application, statute [Section 39-22-531(3)(c), C.R.S.] requires that the Commission consider only the following four factors:

- The economic health of Colorado
- The economic viability of the proposed new jobs
- The economic benefits to Colorado of the new jobs
- The maximum amount of the credit needed to attract the new jobs to Colorado

The Commission may also establish additional terms that the business must meet in order for the project to qualify for the credit, such as raising a certain amount of funds or providing data on all Colorado jobs, including those not employed for the approved project, on their annual reports. The conditional approval will be revoked if the business does not meet these terms, or if the project is canceled or otherwise becomes ineligible for the credit. The Commission also establishes the maximum amount of the credit available to the business for the credit period, which is equal to either the estimated net job growth for each of the years in the credit period multiplied by 50 percent of the total estimated FICA taxes imposed on the business for the net new jobs of the project during each year of the credit period or, at the Commission's

discretion, some lesser amount. OEDIT staff then formalize the terms established by the Commission in a contract that is signed by the company.

Businesses have 1.5 years from the receipt of the conditional approval to commence the project. Once the project has commenced, the company submits an annual request to OEDIT for a credit certificate by March 1 of each calendar year. This must include the number of employees hired for the project, the net job growth for the project, and all documentation needed to calculate the amount of the taxpayer's annual credit. If the project meets or exceeds the qualifications for the credit and the terms of the company's contract, OEDIT calculates the amount of the taxpayer's annual credit and issues a credit certificate in that amount for that calendar year, which certifies that the taxpayer qualifies for the credit. However, if the total amount of credits certified for the taxpayer for the credit period thus far, including the current credit certificate, exceeds the maximum amount of the credit established by the Commission in the project's conditional approval, OEDIT issues a credit certificate in the amount remaining up to the maximum credit amount. Pass-through entities may allocate the credit among their individual co-owners in any manner and must certify to the Commission and the Department of Revenue (Department) the amount allocated to each co-owner. OEDIT will then issue credit certificates in the certified amounts to the individual co-owners.

In order to claim the credit, taxpayers must submit the credit certificate along with their income tax return. Taxpayers generally claim the credit on the credit schedule for their respective income tax returns:

- Individuals claim the credit on Line 29 of the 2021 Individual Credit Schedule (Form DR 0104CR), which must be attached to the 2021 Colorado Individual Income Tax Return (Form DR 0104).

- Corporations claim the credit on Line 17 of the 2021 Credit Schedule for Corporations (Form DR 0112CR), which must be attached to the 2021 Colorado C Corporation Income Tax Return (Form DR 0112).

- Pass-through entities, such as S corporations and partnerships, report the credit on Line 14 of the 2021 Colorado Pass-Through Entity Credit Schedule (Form DR 0106CR), which must be attached to the 2021 Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Separate co-owners of pass-through entities may claim their separate shares of the credit on their respective credit schedules, or, if the individual co-owners are non-residents, the pass-through entity may claim the credit on the co-owners' behalf on Form DR 0106CR.

The Job Growth Credit was created in 2009 by House Bill 09-1001. Subsequent legislation extended the credit for additional tax years and made various changes to the credit. The most significant changes were enacted in 2014 with House Bill 14-1014, which:

- Decreased the minimum required average annual wages of the net new jobs from 110 percent to 100 percent of the average annual county wage.

- Extended the maximum length of a company's credit period from 5 years to 8 years.

- Relaxed the eligibility requirement regarding the extent to which the credit must influence companies' decisions. Under the original legislation, the Commission was authorized to approve a company's application only "if the project would not occur but for the credit." Starting in 2014, the Commission was authorized to approve an application only if the credit was "a major factor in the decision to locate or retain the project in Colorado."

The credit has not changed substantially since 2015.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute [Section 39-22-531(1)(h), (2), and (3)(a)(I), C.R.S.] provides that the intended beneficiaries of the Job Growth Credit are businesses in key economic industries, such as aerospace, tourism, and information technology, that:

- Create new projects that stimulate economic development
- Create a minimum number of jobs that pay, on average, at least the county average annual wage
- Have been approved for the credit by the Commission

Additionally, to the extent that the credit incentivizes businesses to commence new projects that create jobs, the credit was also likely intended to benefit Colorado residents, who may be hired for some of the new positions.

OEDIT data indicates that the Commission approved a total of 210 projects between 2014 and 2020, for an average of about 30 projects per year. As demonstrated in Exhibit 3, the county with the most approved projects was Denver (76 projects), followed by Boulder (25 projects).

EXHIBIT 3. NUMBER OF PROJECTS APPROVED FOR JOB GROWTH CREDIT BY COUNTY, 2014-2020

County	Number of Projects Approved[1]
Denver	76
Boulder	25
Broomfield	19
Arapahoe	15
Jefferson	15
Larimer	13
Adams	10
El Paso	10
Weld	6
Routt	3
Alamosa, Douglas, Logan, Mesa, Montezuma, Montrose, Morgan, Otero, and Pueblo	1 each
None specified[2]	10
Total projects approved[1]	210

SOURCE: Office of the State Auditor analysis of Office of Economic Development and International Trade data.
[1]The number of counties does not add to 210 because one project received approval for two counties, Denver and Boulder.
[2]According to OEDIT staff, a project's county location may not be finalized until the company completes its contract with OEDIT. None of the 10 projects without a specified county location have signed a contract with OEDIT.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Neither statute nor the enacting legislation explicitly states the purpose of the Job Growth Credit; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the credit's operation, we considered a potential purpose: to encourage businesses to create new jobs in Colorado.

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

We could not definitively determine whether the Job Growth Credit is meeting its purpose because no purpose is provided for it in statute or the enacting legislation. However, we found that the credit is meeting its potential purpose to some extent because it has likely had some effect on businesses' decisions to establish job creation projects in Colorado and may have resulted in the creation of new jobs, although we were unable to quantify the extent to which this is the case.

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

PERFORMANCE MEASURE #1: *To what extent has the Job Growth Credit influenced businesses' decisions to establish projects in Colorado that will create new jobs?*

RESULT: As discussed, in order to qualify for the credit, a company must have not yet started the qualifying project and must be considering at least one other location outside of Colorado for the project. Therefore, as one measure of the credit's effectiveness as an incentive, we reviewed the location decisions of companies that were approved for the credit. Of the 210 companies that were approved between Calendar Years 2014 and 2020, 135 companies (64 percent) chose to move forward with their approved projects in Colorado and signed a contract with OEDIT. These companies are eligible for annual tax credit certificates

as long as they continue to meet the credit's requirements and are still within the credit period outlined in their contract, although some of these companies have not yet fulfilled the requirements necessary to receive credits. Another 18 companies (9 percent) initially chose to move forward with their approved projects in Colorado and signed contracts with OEDIT but later canceled these contracts. According to OEDIT staff, a company may decide to cancel their contract if hiring for the approved project does not proceed to the extent that they had anticipated when the contract went into place. The remaining 57 companies (27 percent) did not move forward with their projects in Colorado. These companies may have located their projects out of state or decided not to go through with their projects at all. Exhibit 4 summarizes the location decisions of the companies with projects that were approved by the Commission between Calendar Years 2014 and 2020.

EXHIBIT 4. LOCATION DECISIONS
FOR PROJECTS APPROVED BY THE ECONOMIC DEVELOPMENT COMMISSION
CALENDAR YEARS 2014 THROUGH 2020

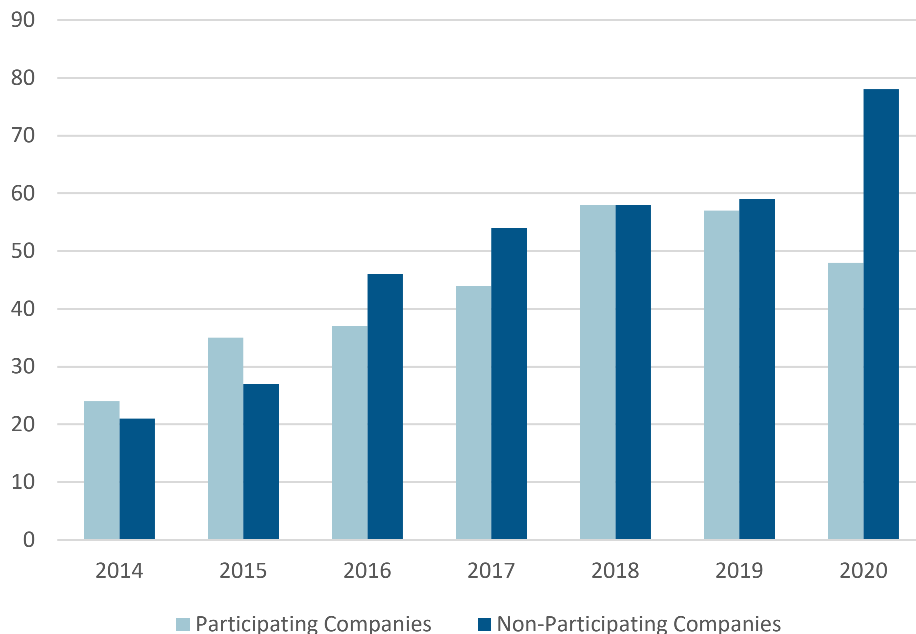
Company's Project Location Decision	Number of Projects	Percentage of Total
Chose Colorado and signed contract with OEDIT	135	64%
Chose Colorado, but canceled contract	18	9%
Did not move forward with project	57	27%
Total	**210**	**100%**

SOURCE: Office of the State Auditor analysis of Office of Economic Development and International Trade data.

In addition to looking at the number of companies that moved forward with their projects, we also measured companies' "participation" in the credit on an annual basis by comparing the total number of companies that were eligible for the credit in a given calendar year (i.e., those that had signed a contract with OEDIT and were still within their credit period) with the number of companies that actually received a credit certificate for the given year. From Calendar Year 2014 through Calendar Year 2020, we estimated that between 38 and 56 percent of

eligible companies were issued a credit certificate in any given year. These "participating companies" submitted the required annual report to OEDIT demonstrating that they had created or maintained a certain number of net new jobs during the previous calendar year. We considered the companies that were eligible for the credit but were not issued a credit certificate to be "non-participating companies." Exhibit 5 provides the number of participating and non-participating companies in each calendar year from 2014 through 2020.

EXHIBIT 5. COMPANY PARTICIPATION[1]
IN JOB GROWTH CREDIT
CALENDAR YEARS 2014-2020



SOURCE: Office of the State Auditor analysis of Office of Economic Development and International Trade data.
[1]A company is eligible to receive a credit certificate if they have been approved for the credit by the Commission, have signed a contract with OEDIT, and are still within their credit period for the calendar year in question. Of these eligible companies, we considered a company to be "participating" in the credit if they submitted their annual report to OEDIT and were issued a credit certificate. "Non-participating companies" were eligible during the given calendar year but were not issued a credit certificate.

Although non-participating companies have been approved for the credit, they will not receive the credit's benefits or reduce the State's income tax revenue unless they submit their annual reports and demonstrate that they have created new jobs. There are a number of possible explanations for company non-participation. For example, the company may not have begun the project, created enough jobs to receive the credit, and/or submitted the annual report.

Since it is possible that some participating businesses would have gone forward with their projects regardless of the credit, we conducted a survey of the businesses that received approval from the Commission for a job creation project between 2017 and 2021 in order to assess the credit's impact on businesses' location decisions. The survey was successfully delivered to 66 businesses, and we received responses from 26 businesses (a 39 percent response rate). Since this is a non-statistical sample, the survey results may not accurately represent the views of all businesses that have been approved for the credit.

Based on the survey responses, the credit appears to have had a moderate effect on project location decisions for the businesses that responded to the survey, although businesses reported that multiple factors went into their location decisions. As shown in Exhibit 6, 10 businesses (63 percent) reported that the credit was a moderate factor in their decision to locate their projects in Colorado, and two businesses (13 percent) reported that the credit was a major factor.

EXHIBIT 6. SURVEY RESPONSES, RELATIVE IMPORTANCE OF JOB GROWTH CREDIT TO BUSINESSES' LOCATION DECISIONS

Response	Explanation	Number of Businesses
Not a factor at all	The project would have been located in Colorado regardless of the credit's availability.	1
A small factor	Other factors were more important in the decision to locate the project in Colorado.	3
A moderate factor	The credit was one of multiple factors in the decision to locate the project in Colorado.	10
A major factor	The credit was one of the most important factors in the decision to locate the project in Colorado.	2
	Total Respondents	**16**

SOURCE: Office of the State Auditor survey of businesses that were approved for the Job Growth Credit between 2017 and 2021.

When asked to select the top four most important factors in their decisions to locate their projects in Colorado, 10 businesses (63 percent of the businesses that responded to this question) selected the Job Growth Credit, followed by the availability of a skilled workforce and/or educational opportunities (nine businesses, or 56 percent). A total of six businesses selected transportation infrastructure, availability of workforce and/or ease of attracting workers, geographic location, and quality of life (38 percent each).

Academic literature also indicates that companies consider many factors when determining where to locate. Some of the factors that have consistently ranked high in recent studies include:

- Availability of skilled labor
- Favorable local labor costs
- Proximity to transportation infrastructure, such as highways and airports

- Technology infrastructure, such as access to fiber optic lines, high-speed internet, and technological support
- Favorable tax rates

Studies have generally found that tax credits and other economic development incentives tend to have a relatively small impact on business location decisions, even when comparing companies that received these incentives with companies that did not. A recent meta-analysis of 30 academic studies, "'But For' Percentages for Economic Development Incentives" (Bartik 2018), concluded that economic development incentives likely "tip" between 2 percent and 25 percent of business location and expansion decisions, depending on factors such as the design and size of the incentive and companies' individual circumstances. The main reason why these percentages are relatively low is that "many other location and cost factors…have more major effects on a firm's costs and profitability," with taxes representing a small percentage of the costs of conducting business. Research also indicates that incentives may make more of a difference when a company is considering two locations with similar characteristics or when reducing costs would allow the company to achieve a more feasible rate of return. As discussed, statute requires companies to submit documentation indicating that they are considering at least one other state when they apply for the Job Growth Credit.

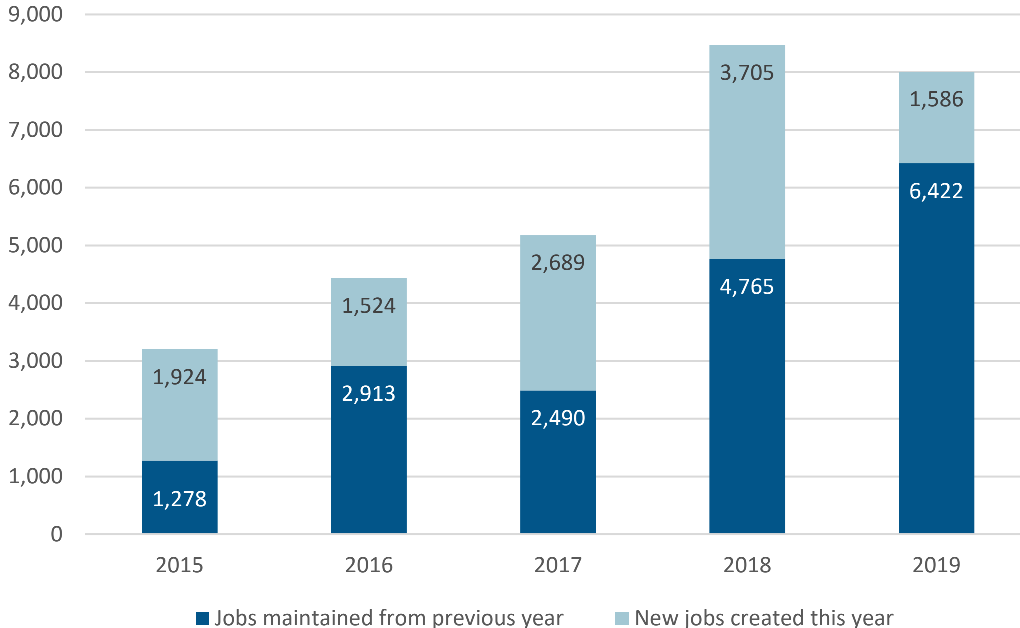
PERFORMANCE MEASURE #2: *To what extent has the Job Growth Credit resulted in the creation of new jobs in Colorado?*

RESULT: We found that participating companies created new jobs in each calendar year and maintained some of the jobs created in previous calendar years. Although it is likely that some of these jobs were created as a direct result of the credit (i.e., would not have been created without the credit), we were unable to determine the extent to which this is the case.

Exhibit 7 provides the total number of net new jobs reported by participating businesses for each calendar year, including a breakdown

of the net number of jobs maintained from the previous year and the net number of new jobs created in the current year. Collectively, participating businesses created between 1,524 and 3,705 new jobs in each calendar year between 2015 and 2019, along with maintaining between 1,278 and 6,422 of the jobs that were created in earlier calendar years. The Exhibit does not include the number of jobs created in previous years that are no longer reported to OEDIT, which averaged 1,029 jobs per calendar year between 2015 and 2019. Some of the jobs no longer reported were created by companies that have reached the end of their credit periods, after which they no longer submit an annual report to OEDIT, and, as discussed, companies may also cease reporting to OEDIT for other reasons. We were unable to determine the extent to which the jobs that are no longer reported have been maintained by companies.

EXHIBIT 7. ESTIMATED CUMULATIVE JOBS
CREATED AND MAINTAINED BY PARTICIPATING BUSINESSES
CALENDAR YEARS 2015-2019



SOURCE: Office of the State Auditor analysis of Economic Development Commission annual reports and Office of Economic Development and International Trade data.

Although Exhibit 7 provides information about job creation at companies that have received the credit, it does not indicate that these jobs were created as a direct result of the credit. If a company would have created a given job regardless of the credit's existence, that job cannot be attributed to the credit, despite the fact that the company received the credit based on the wages paid for this position.

In general, it is difficult to determine the true impact of tax incentives on job creation. Using a simulation model of economic development incentives in the United States, a recent study ("Who Benefits From Economic Development Incentives?" Bartik 2018), determined that these incentives do create jobs that would not have existed otherwise, but only in a minority of incented companies. The typical state economic development incentive provides businesses with a value of 2 to 3 percent of the company's wages, which is estimated to induce 10 to 15 percent of the total job creation associated with the incentive. In comparison, Colorado's Job Growth Credit is typically about 3.8 percent of the total wages paid for new jobs that are created after the company is approved by the Commission, not including any wages paid for positions that already exist when the company is approved. However, OEDIT staff indicated that in their experience, the total percentage of jobs influenced by the credit may be much higher than 10 to 15 percent of jobs reported, based on the following:

- OEDIT's review process of each company's application, including a cost comparison analysis of the company's potential locations.
- The statutory requirement that companies state that the incentive is "a major factor" in their decision to go forward with the project in Colorado.
- OEDIT's observations of the marketplace.

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

According to Department data, the Job Growth Credit resulted in a total of $14.2 million in forgone revenue to the State in Tax Year 2018. This amount may include credits issued to companies for Calendar Year 2018 or earlier, including amounts carried forward from previous income tax years. Exhibit 8 provides the amount of credits claimed by each type of taxpayer, with the bulk of the credits ($13.3 million, or 94 percent) claimed by corporate taxpayers. OEDIT's staffing costs for this credit are included in their annual administrative budget, which they submit to the Commission for approval.

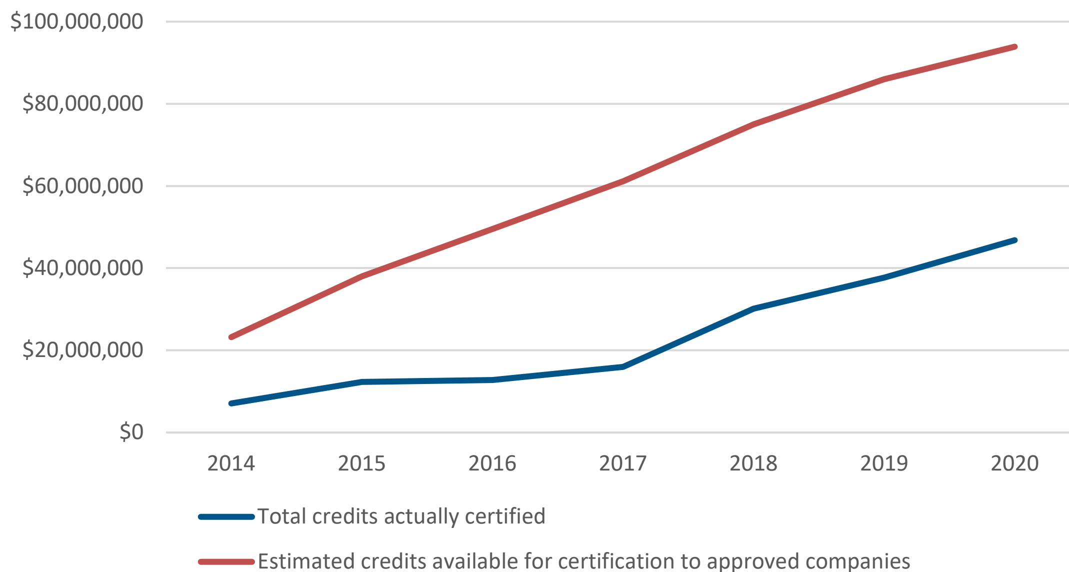
EXHIBIT 8. JOB GROWTH CREDIT REVENUE IMPACT BY TAXPAYER TYPE, TAX YEAR 2018

Taxpayer type	Amount
Corporate returns	$13.3 million
Individual returns	$546,000
Non-resident composite returns	$344,000
Total	**$14.2 million**

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

Additionally, as demonstrated in Exhibit 9, OEDIT has certified between $7 million and $47 million in credits per calendar year between 2014 and 2020, with the total amount certified increasing each year from the previous year. This suggests that the revenue impact of the credit may increase substantially in future income tax years. We also compared the total amount certified each year with the estimated amount available for certification to approved companies, which we calculated for each year on a company-by-company basis by dividing the total approved credit amount by the number of years in the company's credit period (typically, 8 years). As shown in Exhibit 9, the total amount issued to participating companies has been much lower than the estimated amount potentially available to all approved companies. For example, in 2018, we estimated that approved companies may have been eligible for up to $75 million in credits, provided that they had created the required jobs and submitted their annual reports to OEDIT. In comparison, the total amount actually certified for participating companies in 2018 was about $30 million.

EXHIBIT 9. COMPARISON OF TOTAL ESTIMATED CREDITS AVAILABLE FOR CERTIFICATION AND TOTAL CREDITS ACTUALLY CERTIFIED, CALENDAR YEARS 2014-2020



SOURCE: Office of the State Auditor analysis of Office of Economic Development and International Trade data.

The credit's cost effectiveness is largely dependent on the amount of revenue forgone per job induced by the credit. As discussed above, it is difficult to estimate the number of jobs created as a direct result of the credit. Therefore, although we can calculate the amount of revenue forgone per job *associated* with the credit (i.e., the new jobs reported by companies that have been approved for the credit), we are unable to provide an accurate estimate of the cost per job *directly induced* by the credit.

For each job *associated* with the credit, the amount of the credit certified is calculated as:

	Employee's annual wages
x	Employer-paid FICA tax rate for these wages
x	50%

For example, if a company hired a new employee with an annual wage of $70,000, the company's credit amount for that employee would be:

$70,000	x	7.65%	x	50%	=	$2,678

If this employee was hired in the first year of the company's 8-year credit period and earned the same wages each year, the State would forgo up to $21,420 in income tax revenue for this job as a result of the credit.

As discussed, academic research suggests that similar economic development incentives may *directly induce* between 10 and 15 percent of the total number of jobs associated with the incentives. Although we were not able to quantify the percentage of jobs that were induced by Colorado's Job Growth Credit, in order to illustrate the relationship between the credit's ability to induce companies to create new jobs and its cost effectiveness, we estimated the hypothetical revenue impact per job directly induced by the credit based on different assumptions regarding the percentage of total jobs directly induced by the credit, as provided in Exhibit 10.

EXHIBIT 10. HYPOTHETICAL REVENUE IMPACT PER JOB DIRECTLY[1] INDUCED BY THE CREDIT, BASED ON CREDITS CLAIMED IN TAX YEAR 2018

Total jobs created by participating businesses in Calendar Year 2018: 3,705

Hypothetical Percentage of Total Jobs Directly Induced by Credit	Hypothetical Number of Jobs Directly Induced by Credit	Estimated Amount of State Revenue Forgone per Job Induced
5%	185	$76,696
10%	371	$38,348
15%	556	$25,565
20%	741	$19,174

SOURCE: Office of the State Auditor analysis of Office of Economic Development and International Trade data, Department of Revenue data, and "Who Benefits From Economic Development Incentives?" (Bartik 2018).

[1]This analysis only accounts for jobs directly induced by the credit. To the extent that demand for products and services sold by other businesses increases due to participating businesses' decisions to locate projects in Colorado, the credit may also induce indirect job growth in the state, which is not included in the figures presented in this exhibit.

As shown, if the credit had induced between 10 and 15 percent of total jobs created in 2018, the revenue impact to the State per directly induced job would have ranged from $25,565 to $38,348. However, this does not fully account for the impact to the State per job created because it does not account for a variety of factors that affect this cost, including:

- The 8-year credit period. Companies can receive the credit for any given created job for up to 8 years. Therefore, the credit's total revenue impact for 2018 may have resulted from credits that were based on all 8,470 jobs reported for the year, including the 4,765 jobs created in earlier calendar years that were maintained in 2018. Additionally, the 3,705 jobs created in 2018 may continue to reduce state revenue in future calendar years, provided that the companies maintain those jobs, are still within their credit periods, and continue to submit their annual reports to OEDIT.

- Other taxes and economic impacts that result from the created jobs. Employees who fill the newly created positions are subject to Colorado sales tax on in-state purchases and Colorado income tax on their earnings. If an individual would have been unemployed or received lower wages without the credit, then the additional taxes that they pay represent a gain in state tax revenue. If an individual moved to Colorado to accept their position with the company, then their taxes paid would increase state revenue, but the increase in the State's population would also increase the State's expenses for government services. Finally, the creation of new jobs can also have "multiplier effects," in which the increased demand for local products and services resulting from the new job can increase economic activity and induce additional local job creation.

Finally, we examined academic studies to identify best practices for designing effective economic incentives and assessed the extent to which the credit's structure aligns with these practices. As shown in Exhibit 11, we found that Colorado's credit aligns with some of the recommendations for well-designed economic incentives but does not align with others. For example, Colorado's credit is discretionary rather than automatic, which is a recommended best practice, but provides incentives that are long-term, which may reduce its impact.

EXHIBIT 11. COMPARISON OF JOB GROWTH CREDIT WITH ECONOMIC INCENTIVE BEST PRACTICES

Best Practices for Well-Designed Economic Incentives	Does Colorado's Job Growth Credit align with best practices?
Target incentives at firms in industries that tend to create jobs both directly and indirectly through supporting jobs at other firms (i.e., firms with high job multipliers).	Yes. Under statute, the credit is allowed for "key economic sectors," including seven advanced industries specified in statute and any other industries approved by the Commission. Some of these industries tend to have higher job multipliers.
Target firms that pay higher wages	To some extent. The credit is only available to companies that pay an average annual wage for the newly created jobs that is at least 100% of the average annual wage in the county where the project is located.
Target created jobs at the local unemployed population	No. Statute does not require newly created jobs to be filled by unemployed locals.
Target firms that are actively considering other locations outside the state	Yes. Under statute, companies must be considering at least one other state for their project in order to qualify for the credit.
Minimize long-term incentives by coupling front-loaded incentives with claw-back provisions	No. The Job Growth Credit can reduce Colorado income tax revenue for up to 18 years, since businesses have an 8-year credit period in which they can earn credits and a 10-year credit period in which they can carry forward unclaimed credits. However, statute does provide a claw-back provision for the credit, and OEDIT staff indicated that they have a process in place for adjusting taxpayers' credit amounts as needed. Although the credit's annual reporting requirement helps ensure that participating businesses actually create jobs before receiving a credit, academic studies indicate that incentives are generally more impactful on businesses' decisions when benefits are front-loaded.
Discretionary rather than automatic and rules-based	Yes. Statute allows the Commission discretion in deciding whether to approve any given project for the credit, provided that the project meets all of the credit's statutory requirements. Additionally, the credit is not issued automatically but rather is calculated and issued by OEDIT only after the company has reported the number and wages of the jobs created.

SOURCE: Office of the State Auditor analysis of Section 39-22-531, C.R.S., information provided by the Office of Economic Development and International Trade, "Who Benefits From Economic Development Incentives?" (Bartik 2018), and "Economic development incentive program deadweight: The role of program design features, firm characteristics, and location" (Rephann 2020).

Although it is difficult to determine the effects of tax incentives on economic growth and job creation, some research indicates that the net benefits of typical incentives are modest relative to their costs, which suggests that a tax incentive must be particularly well designed in order to have a significant positive effect. Finally, as discussed, studies have found that companies generally view tax credits and other economic development incentives as a relatively small factor in their business location decisions. Based on this information, the authors of one of these studies (Jolley et al. 2015) suggested that the revenue forgone due to incentives might be better spent on improving those factors that consistently rank high for companies' location decisions, which, as discussed, include the availability of skilled labor, transportation infrastructure, and technology infrastructure.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Job Growth Credit would remove the tax benefit that approved businesses currently receive for creating new qualified jobs in Colorado. On average, OEDIT approved about 30 businesses for the credit and issued credit certificates to 43 businesses each calendar year between 2014 and 2020. Based on OEDIT data, the majority of businesses (55 percent) were certified for annual credit amounts between $100,000 and $600,000.

Additionally, Department data indicates that 130 taxpayers claimed the credit in Tax Year 2018, with 97 taxpayers (75 percent) claiming less than $5,000. Fifteen taxpayers (13 of them corporate) claimed credit amounts of at least $100,000. We also found that the average claimant's credit amount was about 1.1 percent of their Colorado taxable income. If the credit were eliminated and future claims followed the same trend as the claims in Tax Year 2018, taxpayers that would otherwise have claimed the credit would see a 1.1 percent increase in their average Colorado income tax rate, and the State would experience a corresponding increase in income tax revenue.

To the extent that the credit influences businesses' decisions regarding company location, expansion, and/or job creation, eliminating the credit may have a negative impact on businesses that would otherwise have made these business decisions based on receiving the credit. As discussed, research indicates that typical economic incentives such as the Job Growth Credit are the deciding factor in location and expansion decisions for between 2 and 25 percent of recipient businesses. This suggests that eliminating the credit may reduce the number of businesses that would otherwise have chosen to locate their project in Colorado as a result of the credit. Some businesses that would have moved forward with their projects regardless of the credit's availability may also be impacted, since half of the businesses (9 of 18) that responded to the relevant survey question stated that the credit had a meaningful impact on their company's operations in Colorado. We also spoke with a professional site selector who helps companies decide where to locate new facilities, and they stated that the credit can reduce the cost of doing business in Colorado, which can help keep Colorado on the "short list" of potential locations that a company is considering.

Finally, if the credit resulted in the creation of new jobs, eliminating the credit may decrease the number of jobs created by businesses that would have received the credit. As discussed, research indicates that typical economic development incentives may induce between 10 and 15 percent of the total jobs associated with those incentives, so the number of jobs created by these businesses may decrease by a corresponding amount. This may also impact the individuals who would otherwise have been employed with the project. When asked to select the types of employees who had been hired to fill the newly created positions, the 16 businesses that answered the relevant survey question indicated that they had hired:

- Locals who lived in the area where the project is located before the project was started (14 businesses, or 88 percent)
- Individuals who moved from out-of-state to accept employment with the project (9 businesses, or 56 percent)
- Remote workers who live in Colorado (8 businesses, or 50 percent)

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Job creation credits are common in the United States. For purposes of this report, we considered job creation provisions in other states to be similar to Colorado's Job Growth Credit only if they are:

- Tax expenditures that can be claimed against a business income tax
- Predicated on the creation of new jobs rather than, for example, simply requiring the business to create a new facility or incur expenses for a new project
- Broadly available to a variety of businesses rather than being restricted to a small set of industries or to certain areas in the state
- Broadly available for new jobs created rather than being restricted to certain types of newly hired employees (e.g. veterans, unemployed individuals)

We identified 20 credits in 18 other states that meet these criteria and are thus similar to Colorado's Job Growth Credit. Exhibit 12 summarizes the number of credits in other states that share other characteristics with Colorado's credit. As shown, most credits (16, or 80 percent) require businesses to create a minimum number of new jobs in order to be eligible for the credit. Additionally, 14 credits (70 percent) have a statutory application or review process in place before businesses can receive the credit, and 13 credits (65 percent) require businesses to pay wages exceeding a certain amount for the newly created jobs.

EXHIBIT 12. COMMON CHARACTERISTICS OF JOB CREATION CREDITS IN OTHER STATES

Credit Characteristic	Number of Other States' Credit with Characteristic	Percentage of Other States' Credit with Characteristic
Minimum job creation requirement	16	80%
Application and/or review process in place	14	70%
Minimum wage paid for new jobs requirement	13	65%
Can be carried forward for use in multiple tax years	13	65%
Increased value and/or decreased requirements for businesses in economically distressed areas	12	60%
Total credits in other states	20	—

SOURCE: Office of the State Auditor analysis of Bloomberg Law resources and other states' statutes.

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

We identified the following programs and tax expenditures, all administered by OEDIT, that provide financial benefits to companies that create new jobs in Colorado:

LOCATION NEUTRAL EMPLOYMENT (LONE) INCENTIVE. The LONE Incentive is available only for companies that receive the Job Growth Credit and employ remote rural workers. The amount of the cash payment is capped at $300,000 and is based on the number of net new jobs that the company plans to create and maintain over the course of 5 years. These new positions must be filled by remote workers living in rural counties outside the county where the company's project is located. The incentive amount is equal to $2,500 for each remote worker living in a Rural Jump-Start county and $5,000 for each remote worker living in a Just Transition Rural Jump-Start county transitioning away from coal dependent economic strategies or in Southern Ute Indian Reservation or Ute Mountain Ute Reservation lands. In Fiscal Year 2021, the Commission approved three projects for a total of $825,000 in LONE incentives, which was associated with 165 remote rural jobs. The incentive is slated to end December 31, 2022.

STRATEGIC FUND JOB GROWTH INCENTIVE. The Strategic Fund Job Growth Incentive is a cash payment granted to companies that meet the incentive's requirements and create permanent, full-time net new jobs in Colorado. Among other things, the company must secure a commitment for local funding that matches the State's incentives one-to-one, consider locating in at least one other state instead of Colorado, and have the potential for significant economic spin-off benefits. The amount of this incentive per net new job created ranges from $3,000 to $6,500, depending on whether the company is located in an economically disadvantaged area and on the average annual wages paid for the new jobs. In Fiscal Year 2021, the Commission approved seven projects for up to $2.9 million in Strategic Fund Job Growth Incentives. OEDIT staff indicated that per Commission policy, businesses generally cannot receive this incentive and the Job Growth Credit for the same net new jobs created.

ENTERPRISE ZONE NEW EMPLOYEE CREDIT. The Enterprise Zone program is intended to encourage development and job growth in economically distressed areas of the state, which are designated as enterprise zones on the basis of unemployment rates, per capita income, and/or population growth. Businesses with facilities located in these zones that complete the pre-certification process with OEDIT are eligible for a $1,100 income tax credit per net new employee hired at the facility. Businesses located in an enhanced rural enterprise zone receive an additional $2,000 credit per net new employee. In Fiscal Year 2021, OEDIT certified 2,688 businesses for about $7.4 million in New Employee Credits, which was associated with a total of 6,124 net new employees. According to OEDIT staff, businesses can receive this credit and the Job Growth Credit for the same new jobs. The Office of the State Auditor evaluated this credit, along with most other Enterprise Zone tax expenditures, in January 2020.

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

We did not identify any data constraints during our evaluation of the credit.

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 JOB GROWTH CREDIT. As discussed, neither statute nor the enacting legislation for the credit states the credit's purpose or provides performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for the credit: to encourage businesses to create new jobs in Colorado. We identified this purpose based on our review of the credit's operation; due to its structure, the credit confers a financial benefit only on approved companies that create at least 20 new jobs in Colorado (or 5 new jobs if located in an enhanced rural enterprise zone).

We also developed performance measures 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).

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO CLARIFY THE AVAILABLE CREDIT PERIOD AND THE CALCULATION OF THE CREDIT AMOUNT FOR THE JOB GROWTH CREDIT. Under statute [Section 39-22-531(4)(b) and (c), C.R.S.], a company with an approved project may be issued an annual credit certificate for each year of their credit period, provided that the company meets the credit's requirements and submits the required annual report to OEDIT. However, statute [Section 39-22-531(2), C.R.S.] also establishes that the credit may only be claimed for income tax years beginning prior to January 1, 2027. This may cause confusion and uncertainty among taxpayers and may also reduce the credit's effectiveness because it is not clear whether taxpayers with credit periods that extend beyond this date can be issued with or claim new credit amounts earned after 2026. In 2019, OEDIT and the Department executed a Memorandum of

Understanding (MOU) establishing that the credit's end date of January 1, 2027 "applies only to the [Commission's] discretionary decision of whether to grant conditional approval" to a company for this credit and does not apply to OEDIT's ability to issue new credit certificates or taxpayers' ability to claim the credit. However, since statute is not clear on this point, if at some point a court order determines any portion of the MOU to be invalid or inconsistent with statute, the relevant portion would no longer be binding on either OEDIT or the Department. Therefore, the General Assembly may want to clarify in statute whether new credit amounts can be issued to and claimed after January 1, 2027 by companies that were approved for the credit prior to but have credit periods that extend beyond this date.

Additionally, the calculation of taxpayers' credit amounts, as established in statute, does not appear to be consistent with the legislative intent for or OEDIT's method of calculating the Job Growth Credit. Specifically, OEDIT calculates the amount of a taxpayer's credit as 50 percent of the taxpayer's FICA taxes imposed on wages paid for the project's net new jobs. However, statute provides that the amount of a company's credit for a given calendar year is calculated by "multiply[ing] the actual net job growth for that year by fifty percent of the taxpayer's [FICA] taxes imposed on the employer for the new employees of the project…" [Section 39-22-531(5)(b), C.R.S.]. Therefore, OEDIT's method of calculating the credit does not account for the clause about multiplying by the project's net job growth.

Although OEDIT's method of calculating the credit does not align with a plain reading of statute, OEDIT's approach appears to be consistent with the original legislative intent for the credit. The language in the relevant statutory provision has not changed since the credit's enactment in 2009, and bill summaries and fiscal notes for the credit's enacting legislation indicate that both legislators and legislative staff understood the credit's calculation to be 50 percent of the company's FICA taxes for net new jobs, the same method used by OEDIT. Notably, calculating the credit in accordance with a plain reading of statute would generally result in a very substantial credit for

participating companies. Exhibit 13 uses the average number of net new jobs reported per participating company, per calendar year between 2015 and 2019 to provide an example of the typical difference in credit amounts when the credit is calculated based on the original legislative intent and OEDIT's interpretation of statute as opposed to a plain reading of statute. As shown, the original legislative intent and OEDIT's current approach to calculating the credit results in a credit amount of about 3.8 percent of the total wages paid by the company for the net new jobs. In contrast, a plain reading of statute would result in a credit amount for a single calendar year that is over 6 times what the company paid in wages for the net new jobs in the given calendar year (a $71.1 million credit compared with total wages of $11.4 million).

EXHIBIT 13. COMPARISON OF JOB GROWTH CREDIT CALCULATIONS, ORIGINAL LEGISLATIVE INTENT / OEDIT'S INTERPRETATION OF STATUTE VERSUS PLAIN READING OF STATUTE

(Based on Average Number of Net New Jobs Reported per Participating Company per Calendar Year 2015-2019)

Number of net new jobs	163
Hypothetical annual wages paid per net new job	$70,000
Total wages paid for net new jobs	$11,410,000
Total FICA taxes paid by employer (7.65% of total wages)	$872,865
Job Growth Credit calculated based on the original legislative intent and OEDIT's interpretation of statute (50% of total FICA taxes paid)	**$436,433 (3.83% of total wages paid)**
Job Growth Credit calculated based on a plain reading of statute (50% of total FICA taxes paid x number of net new jobs)	**$71,138,498 (over 6 times the total wages paid)**

SOURCE: Office of the State Auditor analysis of Section 39-22-531(5)(b), C.R.S., bill summaries and fiscal notes, and Office of Economic Development and International Trade data and documentation of the credit.

Since the statutory method of calculating the credit does not appear to align with the original legislative intent for or OEDIT's method of calculating the credit, the General Assembly may want to consider examining the credit and, if necessary, amending statute to accurately reflect how the credit should be calculated.

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER THE EFFECTS OF REMOTE WORK ON COMPANIES' AVERAGE ANNUAL WAGES FOR PURPOSES OF QUALIFYING FOR THE JOB GROWTH CREDIT. As discussed, in order for a company's project to qualify for the credit, statute requires the average annual wages of all newly created jobs to be at least 100 percent of the average annual wage of the county in which the project is located. The purpose of this provision may be to ensure that the jobs being created meet a certain standard for locals employed at the project. However, when asked to select the types of individuals employed in the newly created positions, eight businesses (50 percent) that responded to the question indicated that they had hired remote workers in Colorado. Since remote workers may be located anywhere in the state, the average annual county wage of the county in which the project is located may not correspond with the typical wages paid in remote workers' actual locations. Therefore, the General Assembly may want to examine whether the recent increase in remote work has impacted the functionality of the credit's average annual wage requirement and amend statute to address how remote work should be treated for purposes of this requirement.

Wildfire Mitigation Deduction

Tax Expenditure Evaluation • February 2023 • 2023-TE4

The Wildfire Mitigation Deduction allows owners of private property in a wildland-urban interface area to claim an income tax deduction for 50 percent of costs of performing wildfire mitigation, up to a maximum deduction of $2,500 per tax year. Per statute [Section 39-22-104(4)(n.5)(III)(D), C.R.S.], wildfire mitigation is defined as "the creation of a defensible space around structures; the establishment of fuel breaks; the thinning of woody vegetation for the primary purpose of reducing risk to structures from wildland fire; or the secondary treatment of woody fuels by lopping and scattering...or prescribed burning...".

We found that the Wildfire Mitigation Deduction provides landowners with a relatively small financial benefit relative to the cost of wildfire mitigation.

- At most, the deduction provides a $110 tax benefit and covers 2.2 percent of project costs. If a landowner spends more than $5,000 on mitigation, the tax benefit would represent an even smaller percentage of the total cost of the mitigation work. For example, if a landowner spends $10,000 on mitigation work, the tax benefit would only cover 1.1 percent of the cost.

- Other tax credits and programs in the state provide a greater financial benefit to landowners who perform wildfire mitigation activities. For example, the Wildfire Hazard Mitigation Expenses Credit, starting in Tax Year 2023, provides an income tax credit worth up to $625 to landowners who perform wildfire mitigation on their property and have a federal taxable income at or below $120,000.

Policy Consideration

The General Assembly may want to review the eligibility requirements for the Wildfire Mitigation Deduction and the Wildfire Hazard Mitigation Credit to determine if they are consistent with legislative intent.

Tax Type:	**Income**	Year Enacted:	**2008**
Expenditure Type:	**Deduction**	Repeal/Expiration date:	**2026**
Statutory Citation:	**Section 39-22-104(4)(n.5), C.R.S.**	Revenue Impact (2020):	**$103,000**

Purpose given in statute or enacting legislation? **No**

STATE · OF · COLORADO
UNION
AND
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Wildfire Mitigation Deduction

Background

The Wildfire Mitigation Deduction allows owners of private property in a wildland-urban interface area to claim an income tax deduction for 50 percent of costs of performing wildfire mitigation, up to a maximum deduction of $2,500 per tax year.

The deduction is available to individuals, estates, and trusts that are landowners, but not C-corporations, partnerships, S-corporations, or similar entities that own private land as an entity. The deduction was created in 2008, and the only substantial change that has occurred was with House Bill 16-1286, which increased the percentage of landowners' costs eligible for the deduction from 50 to 100 percent for Tax Years 2017 through 2019. The total deduction was still capped at $2,500 per landowner during this time. In addition, House Bill 22-1007, passed in 2022, extended the deduction's expiration date to January 1, 2026.

Per statute [Section 39-22104(4)(n.5)(III)(D), C.R.S.], wildfire mitigation is defined as "the creation of a defensible space around structures; the establishment of fuel breaks; the thinning of woody vegetation for the primary purpose of reducing risk to structures from wildland fire; or the secondary treatment of woody fuels by lopping and scattering…or prescribed burning..." The Colorado State Forest Service (CSFS) and the Division of Fire Prevention and Control, within the Department of Public Safety, establish the minimum standards for the mitigation measures in order for the costs to be eligible for the deduction. Qualifying costs include paying contractors or purchasing equipment to perform wildfire mitigation measures. Costs that are not eligible include a landowner's own time and labor, donations in-kind, grants, and inspection or certification fees. Taxpayers claim the deduction when they file their income tax return and submit receipts for eligible expenses.

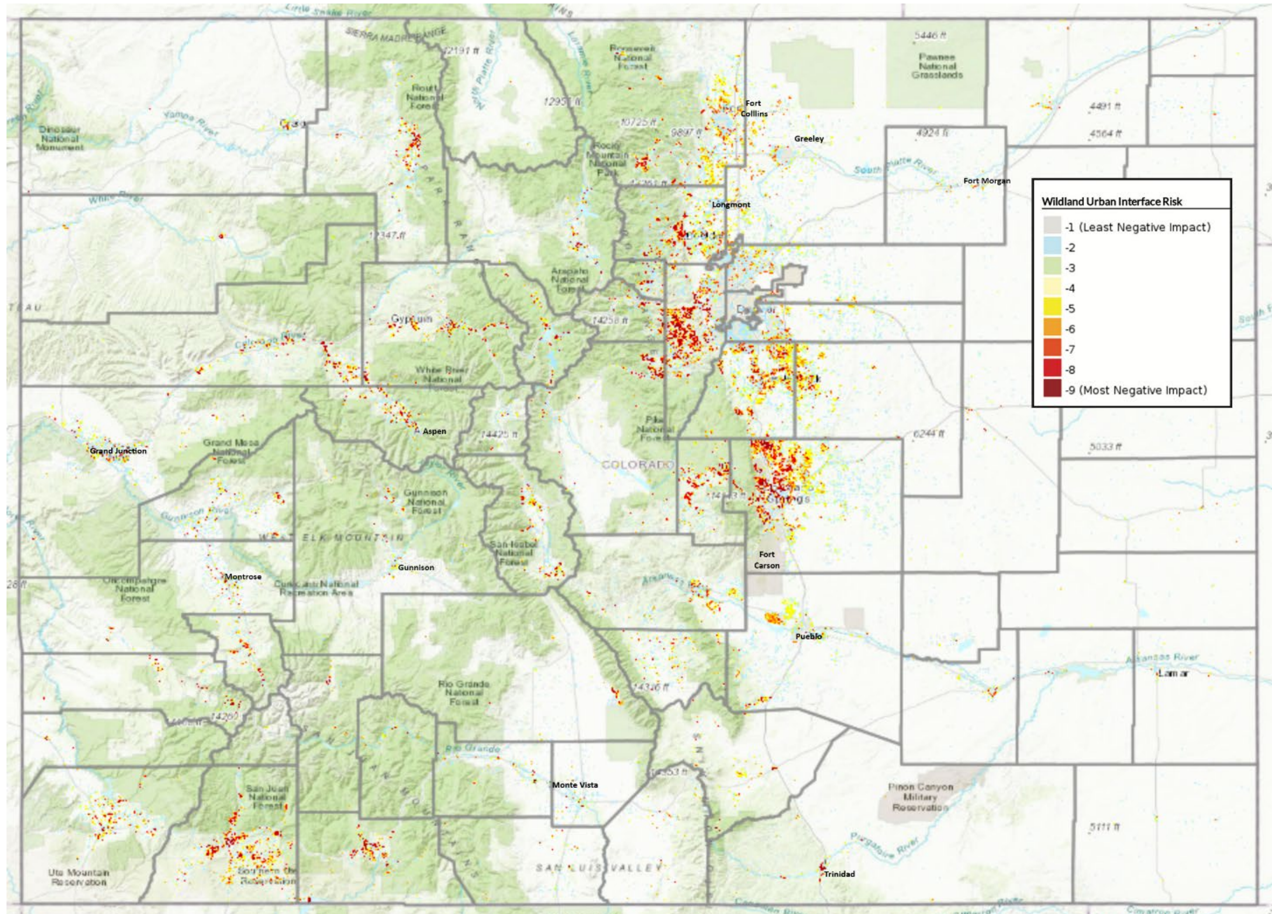
Technical Note

Department of Revenue guidance for the deduction defines wildland-urban interface area as a place where structures or other development are built close to natural terrain and flammable vegetation with high potential for wildland fires.

Wildfires cause significant damage to property in Colorado each year. For example, according to the Rocky Mountain Insurance Information Association, the 2021 Marshall Fire in Boulder County resulted in insurance claims of over $2 billion, with more than 1,200 properties lost or damaged. Wildfire mitigation can reduce damage to property when a wildfire occurs nearby. According to the National Fire Protection Association, removing flammable materials, such as vegetation and mulch, from the perimeter of a home and thinning trees can significantly decrease wildfire damage or destruction.

CSFS estimated that about 11 percent of Colorado's population lived in an area with high risk of wildfire in 2017, and, due to population growth and development in rural areas, the number of properties in wildland-urban interface areas is projected to increase. Exhibit 1 shows the high risk wildland-urban interface areas for wildfires.

Exhibit 1
High Risk Wildland-Urban Interface Areas



Source: Colorado State Forest Service's Wildfire Risk Public Viewer.

We considered the purpose of the deduction to be to provide financial support for taxpayers who incur wildfire mitigation costs. House Bill 22-1007, which extended the deduction and created a new Wildfire Hazard Mitigation Expenses Credit for taxpayers who incur wildfire mitigation costs, stated that the purpose of the credit is "…to reimburse a landowner for the costs incurred in performing wildfire mitigation measures…" on private property in Colorado. Although this purpose statement only applies specifically to the new credit and not the deduction, because statute does not provide a separate purpose statement for the deduction, we considered it to have a similar purpose as the credit. We evaluated the effectiveness of the deduction at meeting the purpose we considered by measuring the extent to which it provides financial support to private landowners who incur costs related to completing wildfire mitigation activities.

Evaluation Results

We found that the Wildfire Mitigation Deduction provides landowners with a relatively small financial benefit relative to the cost of wildfire mitigation.

Exhibit 2 shows the potential tax benefit from the deduction, depending on the total cost of the wildfire mitigation project. As shown, the deduction provides no more than a $110 tax benefit and covers, at most, 2.2 percent of the project costs. Because the deduction is capped at $2,500, if a landowner spends more than $5,000 on mitigation, the tax benefit would represent an even smaller percentage of the total cost of the mitigation work. For example, if a landowner spends $10,000 on mitigation work, the tax benefit would only cover 1.1 percent of the cost.

Exhibit 2
Potential Tax Benefit Provided by the Deduction

Project Cost	$1,000	$2,500	$5,000	$10,000
Maximum Deduction (50 percent of costs up to $2,500)	$500	$1,250	$2,500	$2,500
Tax Benefit Based on 4.4 Percent Income Tax Rate	$22	$55	$110	$110
Percentage of Project Cost Covered by Deduction	2.2%	2.2%	2.2%	1.1%

Source: Colorado Office of the State Auditor analysis of statute [Section 39-22-104(4)(n.5), C.R.S.].

According to CSFS, the cost to perform wildfire mitigation varies based on several factors including the type of forest, the size and location of the property, and the terrain. On average, CSFS estimates mitigation costs to be about $1,700 per acre statewide, but can vary from about $1,050 to $2,100 per acre. It also notes that mitigation work around homes in wildland-urban interface areas, which requires more handwork and mastication of vegetation, costs more per acre.

In addition, there are other tax credits and programs in the state that provide a greater financial benefit to landowners who perform wildfire mitigation activities. As discussed, House Bill 22-1007, which extended the deduction, created the Wildfire Hazard Mitigation Expenses Credit, which, starting in Tax Year 2023, provides an income tax credit worth up to $625 to landowners who perform wildfire mitigation on their property and have a federal taxable income at or below $120,000, which will be adjusted for inflation in each subsequent tax year. The landowner can claim the credit for 25 percent of the cost up to $2,500 in project costs. In addition, CSFS administers several programs that can help private landowners address wildfire risks. The Forest Stewardship Program provides landowners with technical assistance and, in some cases, financial assistance in managing their forest for overall health, including wildfire mitigation. Private landowners can also participate in several programs administered by CSFS that can help reduce the cost of fire mitigation, such as selling lumber through the Forest Ag or Tree Farm Programs. Finally, CSFS also administers grant programs for local governments and communities to address wildfire risks, such as the Forest Restoration & Wildfire Risk Mitigation Grant Program, although these grants are not

available for individual landowners. While these types of programs are common in other states, we did not identify any tax expenditures similar to the Wildfire Mitigation Deduction in other states.

According to Department of Revenue data, about 1,760 taxpayers claimed the deduction in Tax Year 2020, with the average deduction being about $1,280, for an average reduction in tax liability of $58 per taxpayer. As shown in Exhibit 3, the deduction has had a relatively small financial impact to the State.

Exhibit 3
Wildfire Mitigation Deduction Revenue Impact

Year	Revenue Impact
2015	$68,000
2016	$64,000
2018	$105,000
2020	$103,000

Source: Colorado Department of Revenue's 2022 Tax Profile & Expenditure Report.

Policy Consideration

The General Assembly may want to review the eligibility requirements for the Wildfire Mitigation Deduction and the Wildfire Hazard Mitigation Expenses Credit to determine if they are consistent with legislative intent. As discussed, House Bill 22-1007 established the Wildfire Hazard Mitigation Expenses Credit to reimburse landowners for wildfire mitigation costs that, in many cases, would also qualify for the Wildfire Mitigation Deduction, with the same types of wildfire mitigation costs being eligible for both the credit and the deduction. However, there are several differences regarding eligibility for these tax expenditures. Specifically, the credit is limited to taxpayers with federal taxable income of $120,000 or less, but can be claimed statewide and for land owned by both individuals and partnerships when there is a dwelling on the land. In contrast, the deduction has no income qualifications, but can only be claimed for mitigation work conducted in a wildland-urban interface area and is limited to land owned by individuals, and partnerships are never eligible to claim it. Therefore, an individual landowner in a wildland-urban interface area could potentially claim both the deduction and credit for qualifying wildfire mitigation costs (a potential tax benefit of $735); whereas, if the same work was performed on land owned by a partnership or outside of a wildland-urban interface area, it would only be eligible for the credit (a potential $625 tax benefit). Based on our review of the legislative history of House Bill 22-1007, it is not clear whether the General Assembly intended the two provisions to create a duplicative benefit or a larger potential benefit for certain taxpayers. Therefore, the General Assembly may want to review the eligibility requirements for both provisions and make changes if their current requirements are contrary to its intent.

BIOTECHNOLOGY SALES AND USE TAX REFUND

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE9

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

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

WHAT DOES THE TAX EXPENDITURE DO?

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

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

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

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

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

BIOTECHNOLOGY SALES AND USE TAX REFUND

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

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

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

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

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

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

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

The title of House Bill 99-1335, which created the Biotechnology Refund, states that the purpose of the refund is to create "financial incentives for the development of biotechnological activity in Colorado."

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

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

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

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

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

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

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

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

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

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

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

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

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

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

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

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

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

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

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

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

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

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

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

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

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

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

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

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

MILITARY SERVICE PERSONS REACQUIRING COLORADO RESIDENCY DEDUCTION

EVALUATION SUMMARY | APRIL 2022 | 2022-TE22

TAX TYPE	Income
YEAR ENACTED	2015
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT (TAX YEAR 2018)	$168,939
NUMBER OF TAXPAYERS (TAX YEAR 2018)	63

KEY CONCLUSION: The deduction is used infrequently and appears to have encouraged few military service members to reestablish residency in Colorado. The operation of the deduction is also inconsistent with the purpose established by the General Assembly in its enacting legislation.

WHAT DOES THE TAX EXPENDITURE DO?

The Military Service Persons Reacquiring Residency Deduction allows some taxpayers to deduct their military pay when calculating their Colorado income tax liability. In order to be eligible for this deduction, a taxpayer must be an active-duty member of the U.S. military, have a "home of record" in Colorado on their military record, be a former resident of a state other than Colorado on or after January 1, 2016, who subsequently reestablished residency in Colorado.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

The legislative declaration for the enacting legislation [House Bill 15-1181] states that the purpose of the deduction is "…to encourage Colorado residents who serve on active duty in the armed forces of the United States to retain their resident status in Colorado and to allow active duty service members to retain their identity as Colorado residents so that no matter where they serve, they can always call Colorado their home." However, the stated purpose is inconsistent with the operation of the deduction because service members must establish residency in another state before they can claim the deduction. Therefore, we also considered an alternative potential purpose based on the operation of the deduction: to encourage active-duty service persons who have a Colorado home of record and have established residency in another state to reestablish residency in Colorado.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider clarifying the purpose of the deduction and reviewing its effectiveness. Speciffically, the General Assembly could:

- Establish a statutory purpose to reflect that the deduction only applies to service members from Colorado who have already established residency in another state
- Expand eligibility for the deduction to all active-duty service persons with a home of record in Colorado to conform the operation of the deduction to the purpose as it exists in its enacting legislation; or
- Repeal the deduction since it is not used by many taxpayers and appears to have a limited impact.

MILITARY SERVICE PERSONS REACQUIRING COLORADO RESIDENCY DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Military Service Persons Reacquiring Colorado Residency Deduction (Military Residency Deduction) [Sections 39-22-104(4)(u) and 110.5, C.R.S.] allows some taxpayers to deduct their military pay when calculating their Colorado income tax liability. House Bill 15-1181 established the deduction in 2015. In order to be eligible for this deduction, a taxpayer must:

- Be an active-duty member of the United States military,
- Have a "home of record" in Colorado on their military record. Home of record is a term used by the U.S. military in internal personnel operations, which usually refers to the location where a service member joined the armed forces, but can under certain circumstances be changed at the discretion of military authorities.
- On or after January 1, 2016 be a resident of a state other than Colorado, and
- Subsequently reestablish residency in Colorado.

Once initially qualified for the deduction, a taxpayer may continue to claim the deduction for all tax years in which they continue to meet these requirements. The deduction applies only towards a taxpayer's military pay; any other sources of income (e.g., dividends) are subject to Colorado income tax.

Taxpayers claim this exemption on Line 16 of the Subtractions from Income Schedule (Form DR 0104AD), which they must attach to their Colorado Income Tax Return (Form DR 0104). They must also include with their return: (1) a military form showing Colorado as their home of record, (2) evidence of acquiring residency in another state, and (3) evidence of reacquiring residency in Colorado. Statute [Section 39-22-601(1)(a)(III), C.R.S.] also allows taxpayers who qualify for this deduction and have no non-military income to be exempt from filing a Colorado income tax return.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute provides that active-duty military service persons from Colorado who established residency elsewhere and subsequently reestablished residency in Colorado are the intended beneficiaries of the Military Residency Deduction. In Fiscal Year 2019, based on data from CNA, a nonprofit research and analysis organization contracted by the Department of Defense, we estimate that there were about 26,000 active-duty service persons from Colorado in the U.S. military.

Although we lacked information on how many of these 26,000 service members have established residency in another state and could potentially benefit from the deduction, stakeholders from military and veteran's groups, as well as the Judge Advocate Office (on-base legal counsel available to service members) at a Colorado military base indicated that it is common for military service members to change their residency while they serve, particularly if they are stationed in, or have familial ties to, a state that offers more favorable tax rates, or does not levy an income tax. Only about 3 percent of active-duty service members are stationed in Colorado, according to the most recent data available, and it is common for service members to be stationed in many locales throughout their career.

Active-duty service members are not permitted to change their state of legal residency at-will; to do so, they must take steps to demonstrate their intent to make that state their permanent home, such as registering

to vote, buying residential property, registering a vehicle, or getting a driver's license. However, federal law allows a service member to retain their state of legal residency while they serve elsewhere, which grants military service members significant flexibility in where they establish residency. Members of the military have significant mobility, and are often stationed outside of their home state.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

House Bill 15-1181 established the following purpose for the deduction in its legislative declaration:

"…to encourage Colorado residents who serve on active duty in the armed forces of the United States to retain their resident status in Colorado and to allow active duty service members to retain their identity as Colorado residents so that no matter where they serve, they can always call Colorado their home."

Based on our review of the deduction's legislative history, we determined that this statement was intended to describe the purpose of the deduction in House Bill 15-1181 as it was originally introduced, rather than the final legislation that was passed by the General Assembly. When first introduced, the deduction applied to all active-duty military service persons from Colorado, not only those who reestablish residency in Colorado after having already established residency elsewhere. Subsequent amendments narrowed eligibility for the deduction to its current requirements and excluded members of the military who continuously maintained residency in Colorado. This appears inconsistent with the original purpose, since an individual would need to first establish residency in another state before they could claim the deduction; however, the original language in the legislative declaration regarding its purpose was not changed. Therefore, we also considered an alternative potential purpose based on the operation of the deduction: to encourage active-duty service persons who have a Colorado home of record and have established residency in another state to reestablish residency in Colorado.

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

We determined that the tax expenditure is not meeting the purpose set forth by its enacting legislation, "to encourage Colorado residents who serve on active duty in the armed forces of the United States to retain their resident status in Colorado" because statute requires the service person to first establish residency outside of Colorado in order to be eligible for the deduction.

In addition, it appears that the deduction is only meeting the alternative potential purpose we considered, "to encourage active duty service persons who have a Colorado 'home of record' and have established residency in another state to reestablish residency in Colorado," to a limited extent because it is claimed by relatively few taxpayers.

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

PERFORMANCE MEASURE #1: *To what extent has the deduction incentivized active-duty military service persons from Colorado to retain their resident status?*

RESULT: We found that this deduction has not incentivized active-duty military service persons from Colorado to maintain their resident status. After conducting a review of the relevant statutes and legislative history of the deduction, we concluded that the provision requiring claimants of this deduction to first establish residency outside of Colorado effectively prevents the deduction from incentivizing service members to maintain their residency in Colorado.

This conclusion was further supported by conversations with stakeholders, as one stakeholder noted that the current operation of the expenditure does not provide an incentive for a service member from Colorado to maintain their residency, but rather creates an incentive for

them to declare residency elsewhere to potentially reestablish Colorado residency and take advantage of this deduction later. However, we were not able to determine the extent to which that incentive exists and whether any taxpayers have done so due to the deduction.

PERFORMANCE MEASURE #2: *To what extent has the deduction incentivized active-duty military service persons from Colorado who have a Colorado home of record and have established residency in another state to reestablish residency in Colorado?*

RESULT: We found that the deduction has a limited impact on where military service persons establish residency because it appears to be used by few taxpayers. Specifically, according to Department of Revenue (Department) data, only 63 taxpayers claimed the Military Residency Deduction in Tax Year 2018. In Tax Year 2016, the only other year for which the Department has data, approximately 33 taxpayers claimed it. Further, because a taxpayer can claim the deduction for each year that they remain eligible, it is possible that not all taxpayers who reacquired residency in Colorado in a given year were first-time claimants (except for in the deduction's inaugural year, 2016, in which all claimants were first-time claimants). It is possible that some additional taxpayers benefitted from the deduction, but did not file a state income tax return, which is allowable under Section 39-22-601(1)(a)(III), C.R.S., if they had no other sources of income, and would mean that the Department would not have a record of these taxpayers using the deduction. Because the Department does not have data on the number of taxpayers that use the deduction and do not file a state income tax return pursuant to Section 39-22-601(1)(a)(III), C.R.S., we were not able to account for these taxpayers in our analysis. However, because taxpayers who use the deduction would need to proactively work with military payroll administrators to not withhold state taxes from earnings in order to not need to file, and because as discussed below, awareness of the deduction among potential beneficiaries appears low, it appears likely that a relatively small number of military service members would have used the deduction without filing.

Although we could not determine the number of taxpayers who were potentially eligible for the deduction, based on its limited usage, it appears that a small proportion of military service members from Colorado who establish residency in other states claim the deduction. For example, as noted, we estimate that there were about 26,000 active-duty military service persons from Colorado in Fiscal Year 2019. If just 5 percent of them had established residency in another state and were eligible for the deduction, the 63 taxpayers who claimed the deduction would represent only about 5 percent of the eligible population. The limited use of the deduction may be attributable to a number of factors. First, there may be a lack of awareness among potentially eligible individuals. Specifically, most of the representatives of military groups, or military attorneys who we contacted were unaware of this deduction prior to speaking with us. Second, because the service members for whom this incentive is intended are located in military installations across world, and may have little, to no, interaction with Colorado authorities, it is possible that many of those who could take advantage of the incentive are not aware of it. Finally, Department instructions for claiming the deduction on Form DR 0104 require that the taxpayer provide "evidence of reacquiring residency in Colorado during the tax year," which may cause taxpayers to believe that they are only eligible for the deduction in the year in which they reestablish residency. Taxpayers may continue to claim the deduction in years subsequent to the year in which they reestablished Colorado residency as long as they continue to meet the requirements. However, we lacked evidence on how many, if any, taxpayers may not have claimed the deduction as a result of the instructions. Department staff reported that they plan to clarify the instructions to make it clear that taxpayers may continue to claim the deduction as long as they continue to meet all the requirements in statute.

Additionally, it appears that the potential incentive provided by the deduction is limited because many states do not tax military income. Specifically, we conducted a review of the tax rates and income tax treatment of military earnings in the other 49 states and the District of Columbia, and found that 26 other jurisdictions do not tax most military income for most service members. Service members who

established residency in one of these states would not receive a tax benefit by reestablishing residency in Colorado.

Furthermore, there are other reasons a service member might choose to reestablish residency in Colorado, such as desire to vote in Colorado elections, movement of their familial home, or other personal circumstances. Proponents of this expenditure's enacting legislation in 2015 also asserted that maintaining a Colorado residency provides an intangible benefit to service members from Colorado by providing them greater connection to their home while they serve. Therefore, it is possible that some of the 63 claimants would have reacquired residency in the state regardless of the deduction.

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

We estimate that the deduction had a revenue impact to the State of less than $168,939 in Tax Year 2018. According to Department data, in Tax Year 2018—the most recent year for which the Department has data on the deduction—about $3.6 million of active-duty military income was deducted on 63 individual tax returns, reducing these taxpayers' tax liability by $168,939. We considered this amount to represent the maximum potential impact of the deduction; however, the actual revenue impact is likely less. This is because only service members who reestablish residency in Colorado for reasons besides claiming the deduction, and would otherwise have paid Colorado taxes, would result in a revenue loss to the State. If a service member reestablished Colorado residency as a result of this deduction, the amount they claim would not represent a true revenue impact to the state, since they would not have established residency or paid Colorado taxes without it.

Additionally, as discussed, because statute [Section 39-22-601(1)(a)(III), C.R.S.] allows taxpayers who qualify for this deduction and have no other income to be exempt from filing a Colorado income tax return, there could be additional claimants of this deduction that are not included in the Department's data and which we are not able to quantify. However, it appears that few, if any, service members would use this provision, as doing so would require a service member to have

preemptively worked to ensure that Colorado tax was not withheld on their behalf by military payroll administrators, and would not allow them to claim any other refunds or credits for which they may be eligible. Therefore, it appears that the impact of this data constraint is likely small.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the deduction were eliminated, it would increase the income tax liability for active-duty service members who currently claim the deduction and those who reestablish residency in Colorado and would claim it in the future. In Tax Year 2018, the average claimant had $57,917 in taxable military income, and saved $2,682 in taxes by being able to deduct that income. If the deduction was no longer available, those service members might remain Colorado residents and begin paying Colorado income tax on their military earnings, or it may provide them with greater incentive to establish residency outside of Colorado, should their individual circumstances allow them to do so. Eliminating the expenditure could also decrease the number of active-duty service members who have a home of record in Colorado and who have established residency outside of Colorado, from reestablishing residency in Colorado, to the extent the deduction would otherwise incentivize them to do so.

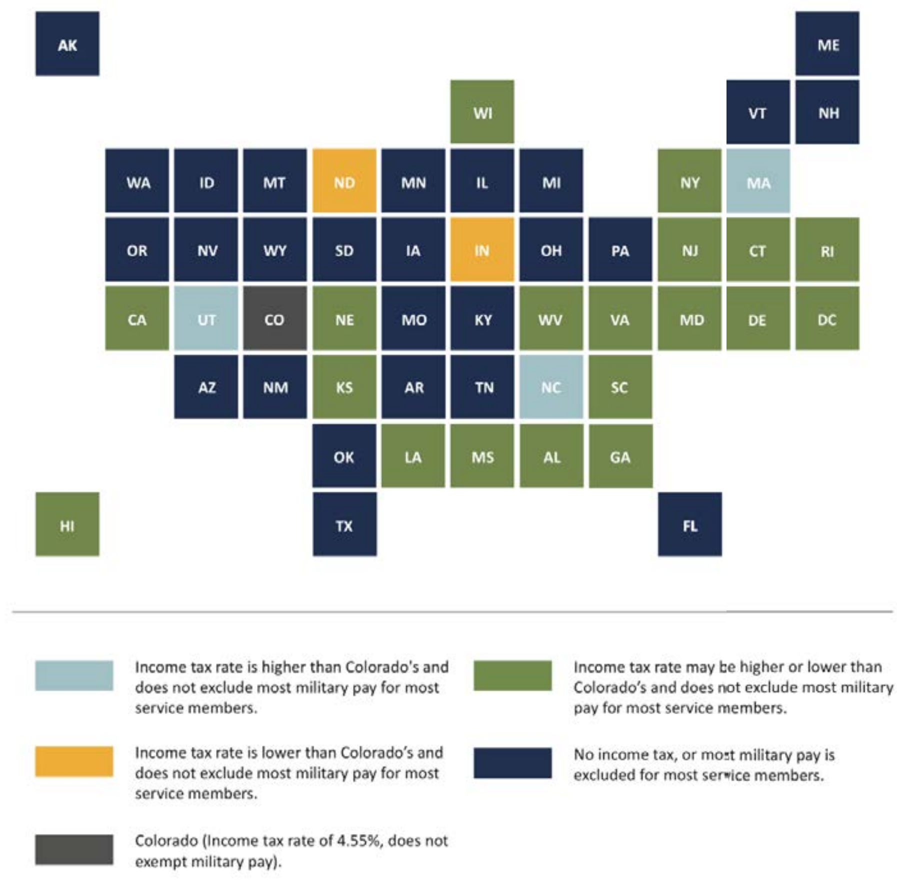
ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We did not identify any similar tax expenditures specifically intended for active-duty service members who reestablished residency in other states.

Because the deduction appears designed to provide a tax incentive for military service persons to reestablish residency in Colorado, we also reviewed the income tax rates, exemptions, and treatment of military earnings in the other 49 states and the District of Columbia. We found that 28 jurisdictions had more favorable tax rates on military income than Colorado, 19 jurisdictions may have more or less favorable tax rates on military income (depending on a service member's tax bracket,

where they are stationed, and other variable characteristics), and only 3 jurisdictions had less favorable tax rates on military income than Colorado. EXHIBIT 1 provides an overview of the income tax treatment of active-duty military earnings in other states, by both their income tax rate relative to Colorado's, and whether they exempt most military income for most service members. While there is significant variability in the income tax rate and treatment of military pay across these jurisdictions, we found that an active-duty service member would generally incur a lesser tax liability in many other states compared to Colorado, with 26 jurisdictions either exempting most military income for service members from income tax, or levying no income tax.

EXHIBIT 1. COMPARISON OF INCOME TAX RATES RELATIVE TO COLORADO, AND INCOME TAX TREATMENT OF ACTIVE-DUTY MILITARY PAY



SOURCE: Office of the State Auditor analysis of Bloomberg BNA information on tax provisions in other states, information compiled by the State of Wisconsin Legislative Fiscal Bureau, and other states' statutes and Departments of Revenue guidance.

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

The Military Retirement Income Deduction [Section 39-22-104(4)(y), C.R.S.] allows taxpayers who receive military retirement income to deduct up to $15,000 of that income from their state income tax liability. This deduction was enacted by House Bill 18-1060 in 2018, and is scheduled to expire at the end of 2023. This expenditure has not yet been evaluated by the Office of the State Auditor.

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

The Department could not provide information on service members who used the Military Residency Deduction, but did not file state income tax returns, pursuant to Section 39-22-601(1)(a)(III), C.R.S. According to Department staff, because statute [Section 39-22-604(20), C.R.S.] also waives the requirement for withholding Colorado state income taxes from an employee's pay if they meet the requirements of the deduction, they do not have a way of tracking how many taxpayers claimed the deduction without filing a return. To address this limitation, the General Assembly could require all taxpayers who claim the deduction to file an income tax return.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY COULD CONSIDER CLARIFYING THE PURPOSE OF THE MILITARY RESIDENCY DEDUCTION AND REVIEWING ITS EFFECTIVENESS. The legislative declaration for the enacting legislation [House Bill 15-1181] states that the purpose of the deduction is "…to encourage Colorado residents who serve on active duty in the armed forces of the United States to retain their resident status in Colorado and to allow active duty service members to retain their identity as Colorado residents so that no matter where they serve, they can always call Colorado their home." However, as discussed, statutes [Sections 39-22-104(4)(u) and 110.5(1), C.R.S.] require service persons from Colorado to first establish residency outside of Colorado before they

reestablish their Colorado residency and claim the deduction, which effectively prevents the deduction from incentivizing service members to maintain their residency in the state. Based on a review of the legislative history of the deduction, we determined that the purpose, as stated in the legislative declaration, was intended to apply to the deduction as House Bill 15-1181 was introduced, which would have exempted all Colorado active-duty military pay from state income tax, but was not adjusted when the bill was later amended to only apply to those who reestablish residency in the state. Therefore, for the purposes of conducting our evaluation, we considered an alternative potential purpose based on the operation of the deduction: to encourage active-duty service persons who have a Colorado home of record and have established residency in another state to reestablish residency in Colorado. However, it is not clear whether this purpose aligns with the General Assembly's intent for the deduction.

We also found that the deduction has a limited impact on most military service members' residency decisions, since only 63 taxpayers claimed it in Tax Year 2018, which likely represents a small fraction of the service members for whom it is intended. Stakeholders reported that awareness of the deduction is low, which may limit its use. We also found that 26 states do not tax most military income for most service persons, so military service persons who establish residency in these states would not receive a tax benefit by reestablishing residency in Colorado and claiming the deduction.

Therefore, the General Assembly could review the intended purpose of the deduction and its effectiveness at meeting that purpose and amend statute accordingly. For example, it could:

- Establish a statutory purpose to reflect that the deduction only applies to service members from Colorado who have already established residency in another state;

- Expand eligibility for the deduction to all active-duty service persons with a home of record in Colorado to conform the operation of the deduction to the purpose as it exists in its enacting legislation; or

- Repeal the deduction since it is not used by many taxpayers and appears to have a limited impact.

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CHILD CARE FACILITY INVESTMENT CREDITS

EVALUATION SUMMARY | JANUARY 2022 | 2022-TE8

Expenditures	Facility Owner Investment Credit	Employer Facility Investment Credit
Tax Type	Income tax	
Year enacted	1992	
Repeal/Expiration date	None	
Revenue impact (Tax Year 2018)	\$114,458 - \$267,164	\$0
Number of Taxpayers (Tax Year 2018)	Could not determine	None

KEY CONCLUSION: The Facility Owner Investment Credit provides a relatively small amount of support to some for-profit child care facilities in the state, though many eligible facilities do not claim it. Additionally, the Employer Facility Investment Credit has been rarely used in recent years and does not appear to provide an effective incentive to encourage employers to provide child care facilities for their employees.

WHAT DO THESE TAX EXPENDITURES DO?

Facility Owner Investment Credit [Section 39-22-517(1), C.R.S.]—Allows the owners of licensed child care facilities, family care homes, and foster care homes a tax credit for 20 percent of their investment in qualified property and equipment.

Employer Facility Investment Credit [Section 39-22-517(2), C.R.S.]—Allows employers that operate a licensed child care facility for their employees a tax credit for 10 percent of the employer's investment in qualified property and equipment for the facility. The child care facility must be 'incidental' to the business, meaning that it cannot be a major part of the employer's business activities.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the Child Care Facility Investment Credits do not state the purpose of the credits; therefore, we could not definitively determine the General Assembly's original intent. However, based on the legislative testimony recordings from the enacting bill (House Bill 92-1191), the General Assembly's ongoing legislative efforts to address the availability of child care, and the credits' operation, we inferred a potential purpose for each credit:

Facility Owner Investment Credit—To provide financial assistance to for-profit child care facilities by making property and equipment more affordable in order to help facilities stay open.

Employer Facility Investment Credit—To incentivize employers to provide child care facilities for their employees by making property and equipment for the facility operations more affordable.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the credits.
- Reviewing the effectiveness of the credits and either repealing them or making changes to increase their impact.

CHILD CARE FACILITY INVESTMENT CREDITS

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

The Child Care Facility Investment Tax Credits provide taxpayers with income tax credits for investments in tangible personal property and equipment for the operation of a child care center [Section 39-22-517, C.R.S.]. There are two credits available:

FACILITY OWNER INVESTMENT CREDIT [SECTION 39-22-517(1), C.R.S.]—Allows the owners of licensed child care facilities, family care homes, and foster care homes a tax credit for 20 percent of their investment in qualified property and equipment.

EMPLOYER FACILITY INVESTMENT CREDIT [SECTION 39-22-517(2), C.R.S.]—Allows employers that operate a licensed child care facility for their employees a tax credit for 10 percent of the employer's investment in qualified property and equipment for the child care facility. The child care facility must be 'incidental' to the business, meaning that it cannot be a major part of the employer's business activities.

Qualified investments for both credits include purchases of items that are depreciable and have a useful life of more than 1 year (e.g., crib mattresses, stoves, vehicles, and playground equipment). Operating expenses (e.g., rent, utilities, and property taxes), purchases of real estate, and single use products (e.g., paper products, diapers, food, and office supplies) are not eligible.

If the amount of either credit exceeds the taxpayer's income tax liability in any year, the taxpayer cannot claim a refund for the excess amount, but they can carry the unused amount forward for up to 3 years [Section 39-22-517(3), C.R.S.]. Individual taxpayers claim the credits on the 2020 Individual Credit Schedule (Form DR 0104CR), lines 21 and 22,

and corporations claim the credits on the 2020 Credit Schedule for Corporations (Form DR 0112CR), lines 11 and 12. As part of the claim, taxpayers are required to submit their facility license number and a list of the qualified property and equipment they bought.

Both of the Child Care Facility Investment Credits were originally established in 1992 through House Bill 92-1191 and have not been modified substantially since.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not state the intended beneficiaries of the credits. Based on our review of legislative testimony recordings from the credits' enacting legislation (House Bill 92-1191), the credits' operation, as well as a review of research on the child care industry in Colorado (e.g., typical expenses, profit margins, types of operators, etc.), we inferred that each credit has its own intended direct beneficiaries, but that the two credits have similar indirect beneficiaries.

The Facility Owner Investment Credit directly benefits for-profit child care facilities that buy qualified equipment and property. Department of Human Services (Human Services) data indicate that about 1,200 of the State's 5,000 licensed facilities (about 24 percent) reported operating on a for-profit basis and would be able to claim the income tax credit. Nonprofit entities are not eligible to claim the credit since they do not pay income taxes to the State.

The Employer Facility Investment Credit directly benefits employers that provide child care for their employees and that buy qualified equipment and property for the child care facility. While the exact number is unknown, stakeholders reported that there are very few employers in Colorado that operate a child care facility for their employees.

Additionally, because child care facilities and employers that claim the credit are investing in equipment and property used to care for children

in the facilities, we inferred that the indirect beneficiaries of both credits include those children and their parents.

Accessibility of quality, affordable child care has been an ongoing national issue. In Colorado specifically, research from the Colorado Health Institute, on behalf of Human Services' Office of Early Childhood, showed that in 2019, the demand for child care for children under age 5 was about 34 percent higher than the supply of licensed child care or preschool programs. This gap reduces the ability of families to seek out employment, which disproportionately affects low-income, minority, and rural families as well as women. The supply gap exists because it is difficult for child care organizations to operate at the cost that parents are able to pay for child care. For example, according to research from the Committee for Economic Development, in 2017, Colorado families paid about $10,500-$15,000 a year for infant care and $10,000-$12,100 for care for a 4-year old child. While these costs make up a significant portion of many families' earnings, child care centers nationally report that the average cost to provide center based infant care is about $14,800 and $9,100 for care for preschoolers, per year, per child. Further, according to stakeholders, the COVID-19 pandemic and resulting economic downturn has led to increases in staff turnover and operating costs, as well as reductions in capacity and revenue, thereby reducing the number of child care providers available in the state since early 2020.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute and the enacting legislation for the Child Care Facility Investment Credits do not state the purpose of the credits; therefore, we could not definitively determine the General Assembly's original intent. However, based on the legislative testimony recordings from the enacting bill (House Bill 92-1191), the General Assembly's ongoing legislative efforts to address the availability of child care, and the credits' operation, we inferred a potential purpose for each credit:

FACILITY OWNER INVESTMENT CREDIT—To provide financial assistance to for-profit child care facilities by making property and equipment more affordable in order to help facilities stay open.

EMPLOYER FACILITY INVESTMENT CREDIT—To incentivize employers to provide child care facilities for their employees by making property and equipment for the facility operations more affordable.

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

We could not definitively determine if the Child Care Facility Investment Credits are meeting their purposes because statute and the enacting legislation do not provide purposes for the credits. However, we found that the Facility Owner Investment Credit is likely only meeting the purpose we considered for this evaluation to a limited extent because it is rarely used. Additionally, we found that the Employer Facility Investment Credit is not meeting the purpose we considered because employers are not using the credit.

Due to taxpayer reporting errors, discussed in detail below, we could not determine the exact number of child care facilities or employers that claimed the Child Care Facility Investment Credits for Tax Years 2015 through 2018.

PERFORMANCE MEASURE #1: *To what extent has the Facility Owner Investment Credit provided financial assistance to child care facilities by making certain property and equipment more affordable in order to help facilities stay open?*

RESULT: Overall, we found that the credit is used by a small proportion of eligible child care facilities and provides a relatively small amount of financial assistance to facilities.

First, data indicate that fewer than half of the State's 1,200 for-profit child care facilities claimed the credit for Tax Year 2018, the most

recent year of available data. Although the Department of Revenue (Revenue) reported that 538 taxpayers claimed the credit in Tax Year 2018, upon reviewing documentation of income tax filings in GenTax, we found that many of the taxpayers made filing errors by filing forms for the Child Care Contribution Credit or Enterprise Zone Contribution Credit, but listing the credit on their tax returns as the Facility Owner Investment Credit. These filing errors did not affect actual revenue to the State or the taxpayers' final tax liability, but they did affect the accuracy of the Department's data on the use of the Facility Owner Investment Credit. For example, we found that in a sample of 29 taxpayers, 17 taxpayers (59 percent) who claimed the credit appear to have intended to claim other credits and may not have been eligible for the Facility Owner Investment Credit. Though we cannot project this error rate to the entire population, our review indicates that many potentially eligible child care facilities are not using the Facility Owner Investment Credit.

Second, we determined that the credit provides a relatively small monetary benefit to facilities that claim it. Due to taxpayer misreporting, we could not estimate the average impact of the credit on child care facilities. However, we used industry research on the average amount of child care facility expenses that would qualify for the credit to develop a likely range of the financial assistance that the credit would provide. Specifically, we estimate that qualified expenses range from 2 to 8 percent of total facility costs based on industry research from a 2020 IBISWorld Inc., report as well as a 2011 study conducted by Development Research Partners on the economic impact of the Child Care Contribution Credit. Additionally, while expenses can vary greatly for facilities, depending on size, location, age range of children served, and quality level, according to a 2017 economic analysis—*Bearing the Cost of Early Care and Education in Colorado*—conducted by the University of Denver Butler Institute for Families and Brodsky Research and Consulting (a consulting organization that focuses on improving child care systems), a medium-sized provider with five classrooms, in a mid-range cost of living area in the state, is anticipated to have annual expenses of about $600,000 to $790,000, of which 2 to 8 percent would

be for costs that are eligible for the credit. Based on these estimates, and assuming that the taxpayer has sufficient tax liability to use the entire value of the credit, the credit would provide a financial benefit of about .4 to 1.6 percent of total facility expenses. Additionally, based on our review of a sample of 29 taxpayers that claimed the credit, which included all taxpayers who claimed more than $5,000 in credits, we found that only four taxpayers had valid claims of $5,000 or more. Overall, in our sample of 29 taxpayers, we found that 12 taxpayers had valid claims for the Facility Owner Investment Credit; their credit amounts ranged in value from $256 to $12,200.

Due to the relatively low use and the small financial impact of the credit, we asked stakeholders who represent, or work with child care facilities, if they were aware of any barriers to claiming the tax credit. According to stakeholders, the most likely reasons that facility owners do not claim the credit are that they are unaware of the credit, or they operate on small profit margins and, therefore, do not have enough tax liability to claim the credit.

PERFORMANCE MEASURE #2: *To what extent has the Employer Facility Investment Credit incentivized employers to provide child care for their employees by making investments in property and equipment more affordable?*

RESULT: Overall, we found that the Employer Facility Investment Credit has not incentivized employers to provide child care facilities for their employees because it is rarely used and may not be large enough to overcome barriers to employers providing child care.

The Department reported that in Tax Year 2018, the most recent year of available data, 14 taxpayers claimed the credit. However, we reviewed documentation submitted by all 14 taxpayers and found that none of them intended to claim the Employer Facility Investment Credit; instead, they appear to have misreported the credit on their returns when attempting to claim other credits, including the Enterprise Zone Contribution Credit and Child Care Contribution Credit. According to

stakeholders we interviewed who represent businesses that advocate for employers supporting child care, there are few employers in Colorado that provide child care facilities for their employees and who would, therefore, qualify for the tax credit. These stakeholders told us that many employers do not operate child care facilities for employees because of the upfront investment costs, a lack of appropriate space for the facility, confusion about regulations and perceived legal risk, or leadership disinterest—none of which are addressed through the tax credit. These barriers are not unique to Colorado's tax credit, as research from the National Women's Law Center in 2002 showed that other state employer tax credits for child care are not strong enough incentives to overcome these barriers for many companies, and few, if any, corporations claim the credits. According to stakeholders, employers are more likely to contract with a third party to operate a child care facility, offer employees monthly stipends for child care, or contribute to employee dependent care plans. Thus, it does not appear that the credit is incentivizing employers to provide child care facilities for their employees.

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

FACILITY OWNER INVESTMENT CREDIT—Due to taxpayer misreporting, we found that the Department's data on the revenue impact of the credit, which showed $469,346 in credit claims for Tax Year 2018, overstate the true revenue impact. Further, because identifying taxpayers who made reporting errors requires manual review of each taxpayer file, we could not determine the actual impact of the Facility Owner Investment Credit on state revenue due to time constraints. Instead, we used a monetary unit sampling approach for credits claimed for Tax Year 2018 to estimate a likely range of valid credit amounts claimed. Monetary unit sampling allows for the statistical projection of monetary values for a population based on sample results. Using the monetary unit sample which totaled 33 percent of the total credits claimed ($155,373 out of the $469,346 that Revenue reported) and represented 29 taxpayers (all 11 taxpayers claiming $5,000 or more in

credits, plus an additional 18 randomly selected taxpayers), we estimate with 90 percent confidence that in Tax Year 2018, the credit resulted in foregone revenue to the State of between $114,458 and $267,164, with the most likely amount being $190,811. We did not have data to show the total amount of investments that child care facilities claiming the Facility Owner Investment Credit made in the same year. However, since the credit is 20 percent of the value of the investments, we estimated that the child care facilities claiming this credit would have invested $954,055 in purchases of property and equipment ($190,811 in credits = 20 percent of $954,055).

Although the fiscal impact of the Facility Owner Investment Credit has been small, this amount could grow in future years if more taxpayers begin taking the credit. As discussed, we found that less than half of the state's 1,200 for-profit child care facilities used the credit, though expenses eligible for the credit include costs that are regularly incurred by child care facilities. According to stakeholders, some eligible taxpayers may not be using the credit due to a lack of awareness, though one industry representative we spoke with indicated that they intend to conduct additional outreach to increase awareness of the credit. Additionally, although we lacked data after Tax Year 2018, child care facilities may have increased spending on qualified property by using COVID-19 grant funds that the federal government and the State have appropriated to stabilize the child care sector and aid in its recovery from the pandemic. Specifically, during the 2020 Legislative Special Session, the General Assembly passed House Bill 20B-1002 and appropriated $44 million to provide grants to child care centers to construct, renovate, or remodel child care facilities. These activities could include the purchase of property and equipment eligible for the 20 percent tax credit. As of January 2022, Human Services awarded $33.8 million to 3,919 facilities to maintain operations and capacity, and another $7.7 million to 180 grantees to open new facilities or expand existing capacity. Additionally, during the 2021 Legislative Session, the General Assembly passed Senate Bill 21-236, creating four additional grant programs for the child care sector, and appropriated $292.5 million in federal funds for child care sustainability grants.

Human Services reported that as of January 2022, more than 4,700 providers are eligible to receive a total of $221.7 million to cover operational expenses.

EMPLOYER FACILITY INVESTMENT CREDIT—Due to taxpayer misreporting, the Department's data, which showed that taxpayers claimed $15,371 in credits for Tax Year 2018, overstate the true revenue impact. Our review of taxpayer files indicates that the credit had $0 revenue impact to the State for Tax Year 2018. Specifically, we manually reviewed data for all 14 taxpayers that claimed the Employer Facility Investment Credit in Tax Year 2018, the most recent year of data available, and found that the taxpayers had intended to claim different credits, like the Child Care Contribution tax credit, but had misreported this on their tax returns. The Department's data from prior years showed that, on average, the Employer Facility Investment Credit resulted in about $10,000 of foregone revenue to the State each year. However, due to time constraints, we were unable to perform additional manual review to evaluate the accuracy of this amount. Therefore, we estimate that this credit had no, or very minimal, revenue impact to the State.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

FACILITY OWNER INVESTMENT CREDIT—If the credit were eliminated, child care facilities that buy qualified property and equipment and generate enough revenue to owe state income taxes would no longer receive the financial relief the credit offers. However, because of the low use of the credit, and the small percentage of total operating costs that facilities typically have for qualifying property and equipment (between 2 and 8 percent), eliminating the credit would have a relatively small impact on reducing the costs of licensed, for-profit child care facilities. Based on the monetary unit sample we reviewed, we found that the 12 taxpayers with valid claims were able to claim credits from $256 to a maximum of about $12,200.

Although the credit typically has a relatively small impact for child care facility owners (about .4 to 1.6 percent of total expenses), it is possible that eliminating it could be detrimental to individual facilities and the children they care for, as well as to the child care industry in Colorado. In particular, eliminating the credit could have a substantial impact on facilities that plan to make large investments in eligible equipment in a particular year. Additionally, eliminating the credit could cause facilities to delay purchases and upgrades, purchase lower quality and less expensive property and equipment, or reduce their overall spending on things like materials, food, or staff wages to compensate for the additional income tax they would owe. Any of these changes in spending could result in a lower-quality experience for the children in the facilities.

Additionally, stakeholders we interviewed reported that, currently, even large facilities that typically have higher profit margins are operating on tighter margins and are relying on loans to cover payroll expenses and other operating costs, which have increased due to the COVID-19 pandemic. Therefore, eliminating the credit would remove a financial support that could be important for some child care facilities.

EMPLOYER FACILITY INVESTMENT CREDIT—Eliminating the Employer Child Care Facility Investment Credit would likely have little to no impact on current beneficiaries because few employers provide eligible child care facilities for employees and the credit is rarely used, if at all. However, it is possible that employers will begin to use this credit in the future if other incentives motivate them to offer child care. For example, during the 2021 Legislative Session, the General Assembly passed Senate Bill 21-236 and appropriated $8.7 million to provide grants to employers to construct, renovate, or remodel child care facilities. These activities could include the purchase of property and equipment eligible for the 10 percent tax credit. According to Human Services, four employers qualified and were awarded grant funds; three of these employers are creating new child care programs for their employees. As of January 2022, the Human Services has about $5.6 million available for a second round of applications.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

In addition to Colorado, we identified two other states that offer tax expenditures that are similar to the Facility Owner Investment Credit and 13 other states that offer tax expenditures similar to the Employer Facility Investment Credit, although there is variation in how the tax expenditures operate.

FACILITY OWNER INVESTMENT CREDIT—Louisiana and Nebraska both offer tax credits to increase the availability of affordable and quality child care as part of a broader package of credits aimed at ensuring school readiness for children. However, unlike Colorado, the credits are based on the states' child care facility quality rating systems; facilities with higher quality ratings are eligible to receive larger tax credits. Louisiana and Nebraska also provide credits based on how many children a facility serves that are part of a child care subsidy program, such as the Child Care Assistance Program, or a foster care program. Louisiana also offers child care facility employees a refundable tax credit, based on their credentials and level of education. For example, Louisiana offers a credit of up to $3,000 for staff at the highest quality rated centers.

EMPLOYER FACILITY INVESTMENT CREDIT—There are 13 states that offer tax credits to employers to invest in child care for employees, and three of these states make their credits refundable. In general, these tax credits apply to a broader range of costs and are larger than Colorado's credit, but range from 3.9 to 75 percent of eligible costs, though some states put a cap on the total dollar amount an employer can claim, such as a fixed amount per taxpayer (e.g., $25,000), a percentage of the employer's income tax liability (e.g., no more than 50 percent), or a statewide maximum (e.g., $3 million). Some of these states offer multiple child care-related tax credits. Specifically,

- 11 states offer credits for employers prior to when the facility is operating. Specifically, four states—Connecticut, Illinois, New York, and Virginia—offer credits for facility planning and preparation

costs as well as facility acquisition, construction, and/or renovation. An additional seven states—Georgia, Kansas, Louisiana, Mississippi, Oregon, Rhode Island, and South Carolina—offer credits for facility acquisition, construction, and/or renovation.

- 11 states offer employer tax credits for child care facility operating expenses. For example, eight states—Georgia, Kansas, Illinois, Mississippi, New Mexico, New York, Rhode Island, and South Carolina—provide credits for purchases of materials and supplies, staff wages, maintenance costs, and rental expenses, in addition to equipment costs.

- 10 states—Connecticut, Georgia, Kansas, Louisiana, Mississippi, New Mexico, New York, Oregon, Rhode Island, and South Carolina—offer tax credits to employers that contract with a third party to operate a child care facility for their employees, provide financial subsidies to their employees to purchase child care services, or provide resource and referral services for their employees to locate child care.

A 2002 study from the National Women's Law Center on the use and impact of tax credits to incentivize employers to support child care found that, across states, credits that have lower credit limits, cover a lower percentage of expenses, or are limited to a narrow range of expense types are weaker at incentivizing employers. In contrast, credits that combine a variety of qualifying types of expenses with a large credit percentage and/or no monetary cap tend to provide stronger encouragement for employers to establish child care facilities. However, no states had high usage of their employer child care investment tax credits. While we do not have data to assess current usage rates across other states, Colorado's tax credit does not cover as many qualifying expenses and is a much smaller percentage of employer expenses than other states' credits.

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

Statute provides the following tax expenditures, which similar to the Child Care Facility Investment Credits, provide financial support to child care facilities, employers, and families:

CHILD CARE CONTRIBUTION CREDIT [SECTION 39-22-121, C.R.S.]—This credit provides an income tax credit of up to 50 percent of the total value of a monetary contribution to "promote child care in the state." The credit is limited to $100,000 and taxpayers cannot claim a refund for any excess amount over their income tax liability, but any unused credit amount may be carried forward for up to 5 years. Under statute [Section 39-22-121(2), C.R.S.], eligible contributions include monetary contributions for:

- The establishment or operation of a child care facility.
- The establishment of a grant or loan program for parent(s) requiring financial assistance for child care.
- Training of child care providers.
- The establishment of an information dissemination program to provide information and referral services to assist parent(s) in obtaining child care.

Contributions must be given without receiving services in exchange (i.e., parent tuition payments to a facility are not eligible.) According to Department of Revenue regulations, this does not prohibit a company from making contributions to a child care facility and claiming the credit, if the facility provides discounted child care to the company's employees [Section 39-22-121(9)(e), 1 CCR 201-2]. However, stakeholders representing employers stated that, generally, employers avoid claiming the Child Care Contribution Credit under these circumstances due to the ambiguity of whether the employer is receiving services in exchange for the contribution. We published an evaluation

of this tax credit in September 2021, which found that the Child Care Contribution tax credit has a revenue impact of about $30.8 million annually, with a median benefit to taxpayers of $333. This tax credit is set to expire effective January 1, 2025.

COLORADO WORKS PROGRAM EMPLOYER CREDIT [SECTION 39-22-521(1), C.R.S.]—This credit allows employers to claim a credit against their income taxes equal to 20 percent of their annual expenditures for certain benefits, including child care services, they provide to employees who receive public assistance under the Colorado Works Program, a federally funded program that is designed to help low-income families with children achieve economic self-sufficiency. We published an evaluation of this tax credit in January 2022, and found that few employers use this credit and it was unclear if any employers claimed it specifically for child care expenses.

CHILD CARE EXPENSE CREDIT AND LOW-INCOME CHILD CARE EXPENSE CREDIT [SECTIONS 39-22-119 AND 119.5, C.R.S.]—Statute states that the purpose of these credits is to "make child care more affordable for working families." The credits are based off the federal Child and Dependent Care Tax Credit, which allows a credit for expenses paid for the care of a qualifying dependent in order to enable the taxpayer to work, or seek out work. Both of these credits allow taxpayers to claim a refund if the credit exceeds their state income taxes, as follows:

- The Child Care Expense Credit allows taxpayers who have an adjusted gross income of $60,000 or less and who claim the federal Child and Dependent Care Tax Credit to claim up to 50 percent of their federal credit amount on their state income tax, up to $525 for a single child or $1,050 for two or more children.

- The Low-Income Child Care Expense Credit allows taxpayers who have an adjusted gross income of $25,000 or less, but who do not have a sufficient tax liability to claim the federal Child and Dependent Care Tax Credit, to claim up to 25 percent of their annual child care expenses up to $500 for a single child or $1,000 for two or more children.

We published an evaluation of these credits in January 2019, which found that the revenue impact was about $5 million. We found that for Tax Year 2016, the most recent data available during our review, the average benefit of the Child Care Expense credit was $101 and the average benefit of the Low-Income Child Care Expense credit was $391.

CHILD TAX CREDIT [SECTION 39-22-129, C.R.S.]—Allows a refundable state tax credit for taxpayers with children under 6 years old equal to a percentage of the federal credit allowed, which is scaled based on a family's adjusted gross income. In 2021, the General Assembly passed House Bill 21-1311 that, beginning in Tax Year 2022, allows taxpayers who have an eligible child, but who do not meet the IRS eligible child criteria and cannot claim the federal credit, to still claim the state credit.

In addition to state tax credits, federal regulations provide for two employer-based child care tax credits:

CREDIT FOR EMPLOYER-PROVIDED CHILD CARE FACILITIES AND SERVICES [26 USC 45F]—To encourage businesses to provide child care to their employees, the federal government offers companies a tax credit for 25 percent of qualified child care expenditures and 10 percent of qualified child care resource and referral expenditures, up to $150,000. Qualified expenditures for this tax credit are broader than the state tax credit, and include costs associated with acquiring, constructing, or rehabilitating property as well as operating costs such as staff wages and training. Employers may also claim the tax credit if they contract with a third party licensed child care program that provides child care, on or off-site, for employees. However, it appears most employers do not provide child care, or, if they do, they have not taken advantage of this tax credit. According to the 2018 IRS Corporation Income Tax Returns report, the most recent available, the aggregate credit amount claimed by active corporations (excluding S-corporations, real estate investment trusts, and regulated investment companies) was an estimated $16.5 million, making it about 0.04 percent of the aggregate $45.9 billion in general business credits claimed by such corporations for the year.

DEPENDENT CARE ASSISTANCE PROGRAM [26 USC 129]—Employers can provide direct payments to employees or child care providers to cover the cost of child care, which can include child care that the employer provides. In addition to these payments being a business expense, which reduces the business's taxable income, up to $5,000 in payments are excluded from the employee's wages, and therefore, are not taxable to the employee. However, these expenses cannot be used to claim child care expenses tax credits (i.e., Child and Dependent Care Credit).

In addition to tax expenditures, the State provides several other financial assistance programs for child care and early childhood education:

GRANTS FOR CHILD CARE SECTOR—During the 2020 Special Session and the 2021 Legislative Session, the General Assembly passed two bills to support the child care sector in recovering from the impacts of the COVID-19 pandemic. Specifically, House Bill 20B-1002, created two emergency relief grant programs to provide financial support to licensed child care providers. As of January 2022, Human Services had awarded $33.8 million of the $34.8 million appropriated to 3,919 grantees for sustainability grants for facilities to maintain operations and capacity, and awarded $7.7 million of the $8.8 million appropriated to 180 grantees to cover the costs for opening a new facility or expanding existing capacity.

In addition, to increase the capacity of quality early childhood education, Senate Bill 21-236 created four additional grant programs, using state and federal funds, for:

- The construction, renovation, or remodeling of employer-based child care facilities.

- Child care centers to cover tuition, fees, materials, credentialing, licensing, and wage increases for early childhood staff for recruitment and retention.

- Wage increases for early childhood educators working at centers that serve families that are subsidized through the Colorado Child Care Assistance Program (CCCAP).

- Community-based programs that cover tuition subsidies or scholarships, employer-based cost sharing, ensuring equitable access for all children, and strengthening child care business practices that improve early childhood outcomes.

As of January 2022, Human Services reported that it was in the award process for the employer-based child care facilities grants and had selected four grantees and intends to open a second round of applications. Human Services reported it will be opening the remaining three grant programs for applications in 2022. Appropriations for these grants totaled $8.7 million for the employer-based child care facilities grants, and $323 million for the remaining three grants.

COLORADO CHILD CARE ASSISTANCE PROGRAM (CCCAP)—Human Services administers CCCAP, which provides child care assistance to families with incomes at or below 185 percent of the federal poverty level and are employed, looking for work, or enrolled in an education program. CCCAP is funded with state general funds, federal block grant funds, and local county funds, and reduces the cost of child care for families. According to a Colorado Health Institute study, the Colorado Shines Brighter, Birth through Five Needs Assessment, in 2019, about 40 percent of licensed child care providers had a fiscal agreement with Human Services to accept children enrolled in CCCAP. The study also estimates that this program serves about 8 percent of the families that are eligible due to funding limitations, available providers, and family barriers to enrollment and affordability. In Fiscal Year 2020, CCCAP provided about $116.5 million in financial assistance to families to reduce the cost of child care for about 26,500 children.

COLORADO PRESCHOOL PROGRAM (CPP)—The CPP is administered by the Department of Education and provides funding for eligible children to attend half or full-day preschool located in public schools, child care centers, community preschools, or Head Start programs. According to the Department of Education, in Fiscal Year 2020, the CPP budget was about $128.1 million, to serve up to 29,360 students statewide. According to a Department of Education analysis, this number represents about 38 percent of the eligible children in 2020.

In 2019, the Committee for Economic Development, a nonprofit and nonpartisan policy research center, released a report on Child Care in State Economies, which showed that in 2016, the most recent year of data available, an estimated 18 percent of child care industry revenue in Colorado came from federal and state child care assistance programs, such as CCCAP and CPP; Colorado ranks 45th in terms of the percentage of child care revenue that comes from federal and state assistance programs. In addition, according to *Bearing the Cost of Early Care and Education in Colorado*, these publicly funded programs do not provide enough assistance such that all businesses could serve the amount of families that need subsidized care, nor do the reimbursement rates incentivize businesses to incur additional costs that increase the quality of a child care center.

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

When we reviewed taxpayer data for Tax Year 2018, the most recent data available, we found that many taxpayers who had claimed the Child Care Facilities Investment Credits had submitted documentation showing that they intended to claim different tax credits, such as the Child Care Contribution Credit or Enterprise Zone Contribution Credit. These filing errors did not impact state revenue, but did impact the accuracy of the Department's data on credits claimed under the Child Care Facility Investment Credits. Because of this, for the Facility Owner Investment Credit, we could not determine how many of the 538 taxpayer claims were valid and used a sampling approach to provide an

estimate of its revenue impact to the State. For the Employer Facility Investment Credit, only 14 taxpayers claimed the credit in Tax Year 2018, so we were able to review all of the claims manually.

When we shared information on the taxpayer reporting errors we found with Department , staff said that in some cases, when a variety of different credits are allowed in relation to a similar activity, taxpayers may accidently claim a credit on the incorrect line of their tax form. While the Department performs reviews on the accuracy of income tax returns, and had identified and corrected some of the misreporting errors for the Child Care Facility Investment Credits, those corrections do not fix the reported totals for prior tax years. In order to collect data that are more accurate for future tax years, the Department said staff will reach out to tax practitioners and the developers of tax preparation software to advise them on the differences between the credits and the errors that have occurred.

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 CHILD CARE FACILITY INVESTMENT CREDITS. As discussed, statute and the enacting legislation for the credits do not state the purposes of the credits or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for each credit.

FACILITY OWNER INVESTMENT CREDIT—To provide financial assistance to child care facilities by making property and equipment more affordable in order to help facilities stay open.

EMPLOYER FACILITY INVESTMENT CREDIT—To incentivize employers to provide child care facilities for their employees by making property and equipment for the facility operations more affordable.

We identified these purposes based on the statutory language about the credits and their operation, as well as from review of legislative testimony recordings and feedback from stakeholders. We also developed performance measures to assess the extent to which the credits are meeting these potential purposes. However, the General Assembly may want to clarify its intent for the expenditures by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the purpose of the credits and allow our office to more definitively assess the extent to which the credits are accomplishing their intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EFFECTIVENESS OF THE CHILD CARE FACILITY INVESTMENT CREDITS AND COULD CONSIDER EITHER REPEALING THEM OR MAKING CHANGES TO INCREASE THEIR IMPACT. As discussed, we found that the Facility Owner Investment Credit, which is limited to for-profit child care facilities, is not used by most of these facilities and typically provides a relatively small amount of financial support for those that do use it. Additionally, we found that there are few employers providing childcare facilities for employees and that no eligible employers used the Employer Facility Investment Credit in Tax Year 2018. Therefore, the General Assembly could consider repealing the credits.

However, stakeholders indicated that the Facility Owner Investment Credit, which we estimate provided about $190,811 in credits statewide in Tax Year 2018, ranging from $256 to $12,200 per taxpayer, could be an important support for child care facilities in the state. Additionally, we found research indicating that many child care providers in the state are operating on small profit margins, which likely impacts the availability of child care in Colorado. Therefore, if the General Assembly wants to continue to provide these tax credits to offer financial assistance to the child care sector to support the availability of child care, it could consider the following changes to allow greater access to the credits as well as to complement current statute and child care funding programs:

- ALLOWING ADDITIONAL EXPENSES TO BE ELIGIBLE. Operating costs, such as staff salaries and wages are the largest driver of child care facility costs, but are currently not eligible for the credits. Additionally, startup costs, like the costs of purchasing property or facility construction are not included. We found 13 states allow credits for employer-provided child care facilities based on facility start-up costs and/or for operating costs such as materials, supplies, rent expenses, and staff wages; nine states allow both startup and operating expenses; and four states allow either start-up costs or operating expenses

- CREATING TIERED CREDIT LEVELS FOR TYPE OF CARE. According to the 2019 Colorado Shines Brighter, Birth through Five Needs Assessment, the largest area of need for parents in Colorado is for infant care; however, infant care requires additional staffing, equipment, and safety measures, which drive up operating costs. Data from Child Care Aware of America, as of 2017, shows that the cost for infant care ranged from about $10,500 up to $15,000, which is not affordable for many families. However, current subsidies, such as CCCAP, may only cover part of the cost of care leading to a shortage of quality infant care. Therefore, the General Assembly could consider modifying the current credit to offer more assistance for the most costly types of care that are the most in demand.

- MAKING THE CREDITS REFUNDABLE. Because the credit is not refundable, only child care facilities that generate a profit would receive financial assistance when they invest in qualified property and equipment. However, many child care facilities operate on very small profit margins, or sometimes at a loss, and cannot use the credit, or claim the full value of the credit, even though these are facilities that likely need the most financial assistance. According to a 2017 economic study conducted jointly by the University of Denver Butler Institute for Families and Brodsky Research and Consulting (a consulting organization that focuses on improving child care systems), Bearing the Cost of Early Care and Education, in Colorado, "Across all regions, providers struggle to make ends meet, especially

at higher quality levels, where expenses far exceed revenues from tuition and public subsidies." One way to address this issue is to modify the credit so that it is refundable so facilities can still receive some financial assistance even if they do not owe income tax. As discussed, we found that three of the 13 states we identified with similar credits make the credits refundable.

- OFFERING BROADER EMPLOYER CREDITS. According to research from the National Women's Law Center from 2002 on employer child care facility tax credits, the administrative burden and liability of operating a child care center are major barriers for employers, and the existing tax credits are not enough to incentivize employers to offer child care and, therefore, do not increase availability or affordability of care. Stakeholders we interviewed reflected the same concerns and said that there are few employers in Colorado that provide child care because of these barriers. Broadening the credit to include employer costs to provide on- or near-site care contracted through a third party, child care stipends to employees, or contributions to dependent care assistance plans would likely make the credit more attractive to employers considering providing child care assistance to employees. We found that 10 of the 13 states with similar credits offered broader employer credits that included these types of expenses.

Although these changes would increase the availability of the credits, it is also important to note that they could substantially increase the credits' revenue impact to the State and we lacked information necessary to estimate this.

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FIRST-TIME HOME BUYER SAVINGS ACCOUNT DEDUCTION

EVALUATION SUMMARY | JULY 2022 | 2022-TE32

TAX TYPE	Income
YEAR ENACTED	2016
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT (TAX YEAR 2018)	$1,942
NUMBER OF TAXPAYERS	4

KEY CONCLUSION: The First-Time Home Buyer Savings Account Income Tax Deduction is not meeting its purpose of encouraging savings for the first-time purchase of a home because it has been used by few taxpayers and provides a small tax benefit.

WHAT DOES THE TAX EXPENDITURE DO?

The First-Time Home Buyer Savings Account Deduction [Sections 39-22-4704 and 104(4)(w)(I), C.R.S.] allows taxpayers who set up a savings account to set aside money for a down payment and/or closing costs of a home to deduct the interest earned on that account from their income. Taxpayers are limited to contributing $14,000 per year as individuals or $28,000 per year for account holders who file taxes jointly, up to a maximum total contribution of $50,000. The account can earn interest, tax free, up to the point when there is a total of $150,000 in the account; once the account reaches $150,000, it can continue to earn interest, but any interest earned is not deductible.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-22-4702, C.R.S.] provides that "the purpose for allowing taxable income to be reduced by earnings from a first-time home buyer savings account is to encourage first-time home ownership through incentivizing saving for a down payment and closing costs because of the significant financial and civic benefits home ownership provides for our state."

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to:

- Review the extent to which the deduction is meeting its purpose and consider repealing it or making changes to increase its usage.
- Establish performance measures for the deduction.

FIRST-TIME HOME BUYER SAVINGS ACCOUNT DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The First-Time Home Buyer Savings Account Deduction [Section 39-22-4704, and 104(4)(w)(I), C.R.S.] (First-Time Home Buyer Deduction) allows taxpayers who set up and designate a savings account to set aside money for a down payment and/or closing costs for the purchase of a first home to deduct the interest earned on that account from their income when calculating their Colorado taxable income. Taxpayers are limited to contributing $14,000 as individuals or $28,000 for account holders who file their taxes jointly per year. According to statute [Section 39-22-4704(3)(a)(II), C.R.S.], "The maximum amount of all contributions for all taxable years to a first-time home buyer savings account is fifty thousand dollars." The account can earn interest, tax free, up to a total of $150,000; once the account reaches $150,000 it can continue to earn interest but any interest earned on the first-time home buyer savings account is not deductible. House Bill 16-1467 created this income tax deduction in 2016, and it became available to taxpayers beginning January 1, 2017. The operation of this deduction has remained unchanged since its creation.

To qualify for the First-Time Home Buyer Deduction, individuals must have never owned a home before or, as a result of a dissolution of marriage, not been listed on the title of a property title for at least 3consecutive years. Individuals must also set up an account and designate the account as a First-Time Home Buyer Savings Account. According to Department of Revenue (Department) staff, because the deduction is limited to qualifying savings accounts, the money cannot be saved in investment accounts, such as mutual funds.

For example, if a couple puts the $28,000 annual limit into a savings account that earns 1 percent interest and designates it as a First-Time Home Buyer Savings Account, the couple will earn $280 on their savings during the year, which they can deduct from their taxable income. In the next year, if the couple adds $22,000 to reach the statutory maximum contribution of $50,000 in principal, the account would total $50,280 and earn about $503 in interest over the year, which they could then deduct from their taxable income. The total tax savings as a result of the deduction during the 2 years would be about $36.

The First-Time Home Buyer Deduction is not available to taxpayers who withdraw the money to pay for a home before 1 full year has elapsed or use it to purchase a manufactured or mobile home that is not taxed as real property. Further, if the taxpayer uses the money for something other than the down payment or closing costs on a primary residence, the deducted interest or other income is subject to recapture, meaning that the taxpayer would owe the tax for the deducted interest back to the State. Additionally, statute imposes a penalty of 5 percent of the tax recapture if the taxpayer withdraws the money to pay an ineligible expense 10 or fewer years after the first deposit and 10 percent of the recapture if more than 10 years have elapsed since the first deposit. For example, if a couple withdrew the $28,000 they put into the home savings account to pay for an ineligible expense, such as a car, after 1 year, they would owe the $12.74 they should have paid in tax plus 5 percent of the $12.74, or an additional $0.64, for a total of $13.38. However, if the taxpayer uses the money for the purchase of a primary residence in another state or if the primary beneficiary dies without naming a new beneficiary prior to their death, there is no penalty.

Individuals claim the First-Time Home Buyer Deduction on Line 17 of the Subtractions from Income Schedule (Form DR 0104AD), which they must attach to their Colorado Individual Income Tax Return (Form DR 0104). Taxpayers must also attach the First-time Home Buyer Savings Account Interest Deduction form (Form DR 0350), which includes information about the eligible savings account, to their return.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly state the intended beneficiaries of the First-Time Home Buyer Deduction. Based on our review of the statute and the operation of the deduction, we inferred that the intended beneficiaries are Coloradans who have never owned homes and are saving to purchase a home. Additionally, statute mentions that homeownership provides, "significant financial and civic benefits…[to the] state" [Section 39-22-4702, C.R.S.]. Therefore, indirect beneficiaries could be the residents of the State and the State itself, since homeowners pay property tax and income tax, and may actively participate in the communities in which they live.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 39-22-4702, C.R.S.] provides that "the purpose for allowing taxable income to be reduced by earnings from a first-time home buyer savings account is to encourage first-time home ownership through incentivizing saving for a down payment and closing costs because of the significant financial and civic benefits home ownership provides for our state."

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

We found that the First-Time Home Buyer Deduction is likely not meeting its purpose because it has been used by only a few taxpayers, and some of those claims were improper claims. Additionally, the tax benefit the deduction provides is extremely small relative to the typical down payment for a home and the median price of a home in Colorado, likely providing little to no incentive for a potential home buyer to increase their savings and restrict their money in a first-time home buyer's savings account.

Statute does not explicitly provide performance measures for this deduction. Therefore, we created and applied the following

performance measure to determine if the expenditure is meeting its purpose:

PERFORMANCE MEASURE: *To what extent are eligible taxpayers using the First-Time Home Buyer Deduction and does it provide an incentive for saving for a personal residence?*

RESULT: Based on Department data, we found that only four taxpayers claimed the First-Time Home Buyer Deduction in Tax Year 2018, which was the most recent year of data available. Furthermore, according to Department staff, taxpayers who claim the credit often do so improperly with most sending a statement indicating they are deducting their mortgage interest rather than interest from an eligible first-time home buyer savings account, in which case the Department disallows the deduction. The Department confirmed that at least one of the four claimants in Tax Year 2018 claimed the deduction in error; we lacked data to determine whether the other three claims were legitimate claims of the deduction.

We also spoke to two stakeholders, one in banking and another in real estate. Both reported that they did not think many Coloradans know about the deduction. The banker reported that with interest on savings being so low over the last few years, the tax benefit may not outweigh the risk to taxpayers who are not certain that they are going to purchase a home. The real estate professional told us that people confuse this tax deduction with the federal mortgage interest tax deduction and so do not take steps to use this deduction. However, he also said that a real estate stakeholder group had plans to start promoting this deduction to increase general knowledge of it and better encourage its use.

Additionally, the deduction appears to provide a relatively small benefit in comparison to the cost of a down payment on a home. For example, as previously discussed, if a married couple filing a joint tax return maxed out the principal in their eligible savings account in the second year with a total of $50,000, assuming a 1 percent interest rate, by the second year they would have earned just under $800 in interest, which would result in a tax savings of about $36 across both years. If, however, a taxpayer was only able to put $2,000 each year into the

account, the account would grow to $4,060 at 1 percent interest, or a gain of $60, over 2 years. The taxpayer would save $3 in taxes on that interest income across both years. For comparison, according to data published by the National Association of Realtors, the median down payment on a home was 12 percent nationally in 2019 and, according to the Colorado Association of Realtors, the median home price in Colorado in April 2022 was about $600,000—though prices were higher in metro areas such as Denver ($660,000), meaning that, statewide, a typical down payment would be about $72,000. Therefore, in comparison to the median down payment and home prices in Colorado, the tax savings provided by the First-Time Home Buyer Deduction is likely insufficient to act as an incentive for a potential home buyer to increase their savings or restrict their money in a first-time home buyers savings account.

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

According to Department data, the First-Time Home Buyer Deduction resulted in four taxpayers claiming a total of $1,942 in income tax deductions in Tax Year 2018, or an average of $486 per taxpayer. However, as discussed previously, at least one of the taxpayers claimed the deduction improperly and we lacked data to determine whether the other taxpayers qualified. Due to this limited usage, it appears that the deduction has had no significant economic impact or encouraged increased overall home ownership in the state.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If this deduction was eliminated, individuals saving for their home down payments and closing costs who use the deduction would see a relatively small increase in their state income tax liability. For example, an individual with $50,000 in a qualifying savings account earning 1 percent interest would see an annual tax increase of about $23. As discussed, the deduction appears too small to have a substantial impact on taxpayer saving decisions. However, for taxpayers who save over a long period and put the maximum amount of principal in their

accounts, the interest deduction and tax savings would be somewhat higher. Further, the deduction could become more significant if interest rates for typical savings accounts increase in the future.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified 13 other states with similar deductions for first-time home buyers. Of these states, two limit the deduction to the interest earned on savings similar to Colorado. The other 11 states provide a more substantial benefit by offering the deduction for both the contribution to the account and the interest income. Exhibit 1 outlines the policies in each state.

EXHIBIT 1. OTHER STATES WITH FIRST-TIME HOME BUYER SAVINGS ACCOUNT INCOME TAX DEDUCTIONS AS OF APRIL 2022

State	Eligible Principal Contribution Amount Per Year (Individual/Couple)	Maximum Principal Contribution (Individual/Couple)	Maximum Principal and Interest Eligible for Deduction (Individual/Couple)	What Can Be Deducted?
Alabama	No limit	$25,000/$50,000	$25,000/$50,000	Up to $5,000/$10,000 contribution per year for 5 years is deductible.
Idaho	$15,000/$30,000	$100,000	$100,000	Contributions and interest income are deductible.
Iowa	$2,000/$4,000	Ten times the annual eligible deduction limit of the beneficiary.	$20,000/$40,000 Eligible for 10 years.	$2,000/$4,000 contribution per year is deductible. Contribution limits increase based on inflation.
Kansas	$3,000/$6,000	$24,000/$48,000	$50,000	Contributions and interest income are tax deductible indefinitely.
Maryland	$5,000	$50,000	Principal and interest earned in a 10-year period.	Account can earn interest for 10 years. Both contributions and interest income are deductible.
Michigan[1]	$5,000/$10,000	$50,000	No limit	Contributions up to $5,000 per individual and interest are deductible.
Minnesota	$14,000/$28,000	$50,000/$100,000	$150,000	Interest income and dividends are deductible.
Mississippi	$2,500/$5,000	No maximum	No limit	Contributions up to $2,500/$5,000 are deductible.
Missouri	$1,600/$3,200	No maximum	No limit	50% of the contribution and all interest income are deductible.
Montana	$3,000	No maximum	No limit	Up to $3,000 per year and interest income are deductible.
Oklahoma	$5,000/$10,000	$50,000	$50,000	Contributions and interest income up to $50,000 are deductible.
Oregon[2]	$5,000/$10,000	$50,000	$50,000	Contribution and interest income up to $50,000 are deductible.
Virginia	No maximum	$50,000	$150,000	Interest income and capital gains are deductible.

SOURCE: Office of the State Auditor analysis of other state first-time homebuyer income tax deductions.

[1] Michigan's deduction is available through 2026.

[2] Contributions must be made into a first-time home buyer savings account opened before January 1, 2027 to qualify.

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

We did not identify any Colorado tax expenditures that are similar to the First-Time Home Buyer Deduction.

The Colorado Housing and Finance Authority (CHFA)—whose mission is "…to increase the availability of affordable, decent, and accessible housing for lower income Coloradans..."—offers down payment assistance grants to Coloradans based on income and location within the state. For first mortgages, CHFA offers down payment or closing cost assistance grants of up to 3 percent of the mortgage. The maximum loan amount is up to $647,200, meaning that some individuals could qualify for a little over $19,000 in down payment assistance.

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

We did not identify any data constraints during our evaluation of this deduction.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE EXTENT TO WHICH THE FIRST-TIME HOME BUYER DEDUCTION IS MEETING ITS PURPOSE AND COULD CONSIDER REPEALING IT OR MAKING CHANGES TO STATUTE TO INCREASE ITS USE. As discussed, we found that due to its limited usage and small tax benefit, this deduction has not met its purpose of encouraging saving for first-time home purchases. Moreover, the Department reported that the deduction is confusing to taxpayers, who often mistake it for a mortgage interest tax deduction and claim it improperly, and, additionally, that it is difficult to enforce the terms of the deduction. In Tax Year 2018, which was the only year of data available, only four taxpayers claimed the deduction, and at least one of those claims was an improper claim. Additionally, the deduction provides only a small tax savings to taxpayers, about $36 over a 2-year period for couples that save $50,000, the highest dollar amount allowed by statute. Furthermore, many individuals seeking to purchase a home

for the first time are likely to save less than the statutory maximum so the potential benefit they could receive from the deduction would also be less. Therefore, the General Assembly may want to review the deduction and could consider repealing it if it is not meeting its purpose to the extent intended.

Alternatively, the General Assembly could make changes to address the deduction's low usage and increase the benefit it provides. For example, we found that 11 of the 13 other states with a similar deduction allow eligible taxpayers to deduct the contributions they make to first-time home buyer savings accounts, not just the interest earned on the accounts. This type of change would significantly increase the deduction's benefit and its revenue impact to the State. For example, if an individual contributed $14,000 to an account and could deduct the full contribution, they could receive a $637 reduction in Colorado tax liability. By comparison, under the current deduction, a taxpayer would receive about a $6 reduction in tax liability for a $14,000 savings account that earns 1 percent interest over a 1-year period. However, Department staff reported that most taxpayers currently claim this deduction improperly; therefore, there is a risk that without additional oversight or controls over eligibility, an expansion of the credit could result in more taxpayers claiming it improperly.

IF THE GENERAL ASSEMBLY DOES NOT REPEAL THE DEDUCTION, IT MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH PERFORMANCE MEASURES FOR IT. Statute [Section 39-22-4702, C.R.S.] states that the purpose of this deduction is to "…encourage first-time home ownership through incentivizing saving for a down payment and closing costs…" However, statute does not provide performance measures for evaluating the effectiveness of the deduction. Therefore, based on the purpose outlined above, we developed a performance measure to assess the extent to which the deduction is meeting its purpose. However, if the General Assembly does not repeal the deduction, it may want to clarify its intent by providing performance measure(s) in statute. This would eliminate potential uncertainty regarding the deduction's effectiveness and allow our office to more definitively assess the extent to which it is accomplishing its intended goals.

Home Modification Tax Credit

OFFICE OF THE STATE AUDITOR
COLORADO

Tax Expenditure Evaluation • January 2023 • 2023-TE1

The Home Modification Tax Credit provides up to a $5,000 nonrefundable income tax credit to eligible taxpayers who modify an existing home to better accommodate a resident with an illness, impairment, or disability. Under statute, the credit's purpose is "to make retrofitting a residence for health, safety, and welfare more affordable."

The credit has made home modifications more affordable for those who have claimed it, but its impact has been limited because relatively few taxpayers have used it and many recipients are unable to claim the full credit amount.

- As of May 2022, the credits issued ranged between 4 percent and 100 percent of the total project cost. Over 40 percent of the credits issued covered more than half of the total project cost, and about one-third covered the entire project cost.

- Fewer taxpayers have been certified for the credit than expected. The fiscal note for the bill creating the credit anticipated an average of 260 credits would be issued each year compared to the average of 10 credits that the Department of Local Affairs has issued annually to date. It appears that a lack of awareness among potential beneficiaries has contributed to the credit's limited use.

- Only half of the taxpayers who received the credit in 2019 had sufficient tax liability to claim their full credit amount after 3 years. Some of these taxpayers may not have sufficient tax liability to use the remaining credit amount within its 5-year carryforward period and will not receive the full financial benefit of the credit.

Policy Considerations

The General Assembly may want to:

- Review the cost effectiveness of the credit.
- Consider making the credit refundable to make home modifications more affordable for taxpayers with lower incomes.

Tax Type:	**Income tax**	First Year Available:	**2019**
Expenditure Type:	**Credit**	Repeal/Expiration date:	**December 31, 2023**
Statutory Citation:	**Section 39-22-541, C.R.S.**	Revenue Impact:	**$76,400 (through Tax Year 2021)**

Purpose given in statute or enacting legislation? **Yes**

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Home Modification Tax Credit

Background

The Home Modification Tax Credit provides up to a $5,000 nonrefundable income tax credit to eligible taxpayers who modify an existing home to better accommodate a resident with an illness, impairment, or disability.

The amount of the credit is equal to the cost of the home modifications, up to $5,000. The credit is not refundable, but it can be carried forward for up to 5 years, after which time any unused amount expires. To be eligible for the credit, taxpayers must have a taxable family income at or below $153,000 in 2022, which is adjusted for inflation each year, and the home modifications must improve the ease of access to, safety of, and ability to age in place in the home for a taxpayer or their dependent who has an illness, impairment, or disability. The total amount of credits is capped at $1 million each year, which is awarded on a first-come, first-served basis. The credit was first available in 2019 and can be claimed through Tax Year 2023. In 2019, House Bill 19-1135 modified statute to allow taxpayers to claim the credit if they have a dependent who has a disability that necessitates a home modification.

The Department of Local Affairs (DOLA) is responsible for determining eligibility and awarding credit certificates. As part of the eligibility determination, a healthcare or social service provider must determine that the taxpayer or their dependent have an illness, impairment, or disability that necessitates the home modification. In addition, DOLA requires the residence being modified to:

- Exist before the work begins (i.e., the work may not be completed during initial construction of the residence).

- Be the residence of the qualified individual and the person for whom the retrofit is required.

- Be located in Colorado.

DOLA requires the applicant to provide evidence of the completed project, such as pictures, and may conduct an inspection, after which it issues a certificate to the taxpayer. Taxpayers provide the certificate number to the Department of Revenue when they claim the credit on their income taxes.

We considered the intended beneficiaries to be individuals who require home modifications due to illness, impairment, or disability, including conditions associated with older age. According to the U.S. Census Bureau, in 2021, 8 percent of the population under age 65 in Colorado had a disability, and 15 percent of the State's population was age 65 or older. These are two groups that are more likely to require home modifications in order to have improved functionality and physical access to the homes in which they reside. According to the U.S. Census Bureau, the average income of households in Colorado with individuals over age 65 was $69,900 in 2021. Approximately 15 percent of individuals with disabilities in Colorado had income below the poverty level, which was about $14,000 for an individual and $28,000 for a family of four. Based upon the applications for the tax certificate, retrofitting a residence costs about $15,700, on average, but ranged from about $750 to more than $130,000. Therefore, the cost of home modifications can constitute a significant portion of the income of some Coloradans who are eligible for the credit and it could be challenging for them to pay for home modifications without financial assistance.

There are six other states that offer a tax credit (Georgia, Maine, Missouri, Pennsylvania, and Virginia) or a deduction (Louisiana) similar to Colorado's Home Modification Tax Credit. Other states' credits or deductions range from $500 to $9,000.

According to statute [Section 39-22-541(1), C.R.S.], the purpose of the expenditure is "to make retrofitting a residence for health, welfare, and safety reasons more affordable."

We developed the following performance measures to evaluate the credit:

- The extent to which the credit made retrofitting a residence for health, welfare, and safety reasons more affordable.

- The extent to which the credit has been used by eligible taxpayers.

Evaluation Results

The credit has made home modifications more affordable for those who have claimed it, but its impact has been limited because relatively few taxpayers have used it and many recipients are unable to claim the full credit amount.

Between April 2019 and May 2022, DOLA issued 39 credits worth a total of about $179,000. The average credit issued was about $4,600, with the credits often offsetting a significant amount of project costs. For example, the credits issued ranged between 4 percent and 100 percent of the total project cost. Over 40 percent of the issued credits covered more than half of the total project cost, and about one-third covered the entire project cost. However, fewer taxpayers have been certified for the credit than expected at the time it was established. Specifically, the fiscal note for House Bill 18-1267, which created the credit, anticipated an average of 260 credits would be issued each year compared to the average of 10 credits that DOLA issued annually from 2019 through 2021.

It appears that a lack of awareness among potential beneficiaries has contributed to the credit's limited use. We contacted three groups that represent elderly and disabled Coloradans, and all three groups indicated that they were not actively promoting the credit and that awareness of the credit is probably low. DOLA also reported that, due to the COVID-19 pandemic, it has not conducted as much outreach to potential taxpayers in recent years and plans to conduct more in future years.

Additionally, **many credit recipients have not been able to claim the full value of the credit due to a lack of taxable income.** For the 15 taxpayers who received certification for a credit in 2019, we reviewed the recipients' annual income tax filings for Tax Year 2019 (the first year they could have claimed the credit) through Tax Year 2021 (the latest year they could claim the credit at the time of our evaluation). We found that only about half of the taxpayers had sufficient tax liability to claim their full credit amount after 3 years. Of the taxpayers who had not used their credits after 3 years, most had taxable incomes below $33,000, which would result in these taxpayers having, at most, $1,450 in potential state tax liability that could be offset by the credit. Due to their relatively low taxable incomes and the credit not being refundable, some of these taxpayers may not have sufficient tax liability to use the remaining credit amounts within the 5-year carryforward period.

Because many taxpayers have not been able to claim the full value of the credit, its revenue impact to the State has been less than the value of the total credits awarded by DOLA. Based on our review of credit recipients' income tax returns in the Department of Revenue's tax filing system, GenTax, as of May 2022, taxpayers claimed a total of $76,400, or about 60 percent of the total amount DOLA certified in 2019, 2020, and 2021. Exhibit 1 shows a breakdown of the total amounts certified and claimed each year.

Exhibit 1
Amount Certified, Taxpayers, and Credits Claimed
Calendar Years 2019 through 2021

Calendar Year	Credits Certified	Taxpayers Receiving Certified Credits	Credits Claimed
2019	$65,700	15	$26,900
2020	$18,600	4	$18,400
2021	$47,800	10	$31,100
Total	**$132,100**	**29**	**$76,400**

Source: Office of the State Auditor analysis of DOLA certification data and credit certificate recipients' income tax filings.

While taxpayers with lower incomes may not be able to use the full value of the credit, other state programs are available to help lower income Coloradoans with the cost of home modifications. The Department of Health Care Policy and Financing administers the Home Modification Benefit for Medicaid-eligible individuals enrolled in a Home and Community-Based Services (HCBS) waiver. If they are part of the HCBS Brain Injury; Spinal Cord Injury; Community Mental Health Supports; or Elderly, Blind and Disabled waiver, the lifetime maximum benefit is $14,000. If they are part of the HCBS Children's Extensive Support or Supported Living Services waiver, there is a $10,000 limit over the 5-year life of the waiver. To be eligible for Medicaid, an adult must also have an income that is less than 133 percent of the Federal Poverty Level, which roughly equals a monthly income of $1,500 per month or an annual income of $18,000 for an individual. Therefore, the HCBS Home Modification Benefit may be able to cover lower income residents who might not be able to use the Home Modification Tax Credit due to their lower tax liability.

Policy Considerations

The General Assembly may want to review the cost effectiveness of the credit. Currently, due to its limited use, the administration of the credit does not appear to be cost effective. DOLA reports that it spends approximately $55,000 per fiscal year administering the credit, which is about twice the financial benefit that taxpayers have received each year. According to DOLA, its administrative activities related to the credit include reviewing applications and awarding the credit, inspecting projects to ensure they meet the requirements for receiving the credit, and conducting outreach. However, if additional taxpayers claim the credit in future years due to increased outreach by DOLA or the credit being made refundable (see the policy consideration below), the administrative costs relative to the taxpayer benefit might decrease.

Additionally, to the extent that it encourages home modification projects that would not have otherwise occurred, the Home Modification Tax Credit may provide some additional financial benefits to the State. A 2017 academic study from New Zealand found that home modifications can reduce accidents that can result in additional medical care, such as emergency room visits, especially among those with a previous history of accidents. For individuals who are uninsured or participate in public insurance programs, the State might bear the cost of additional medical care. Therefore, helping taxpayers to pay for home modifications might reduce the State's costs for these programs, although we could not quantify this impact.

The General Assembly may want to consider making the credit refundable to make home modifications more affordable for taxpayers with lower incomes. As discussed previously, we found that taxpayers with lower incomes often lack sufficient tax liability to receive the full value of the credit. For example, a taxpayer who is eligible for a $5,000 credit would need to have a taxable income of roughly $114,000 to have enough tax liability to claim the full amount in 1 year. Exhibit 2 shows the credit amount a taxpayer could potentially claim in 1 year at different income levels,

which is equivalent to their tax liability based on Colorado's 4.4 percent income tax rate for Tax Year 2022 and assumes that they do not claim any other state tax credits.

Exhibit 2
Taxable Income Necessary to Claim a Tax Credit

Annual Taxable Income	Maximum Tax Credit that Could Be Claimed Per Year Based on Tax Liability
$22,700	$1,000
$45,500	$2,000
$68,200	$3,000
$90,900	$4,000
$113,600	$5,000

Source: Office of the State Auditor analysis of Colorado's individual income taxes.

Although taxpayers can carry forward the credit for up to 5 years, receiving the benefit at a later time likely reduces the credit's impact and some taxpayers may not be able to fully claim the credit. We found that about half of the taxpayers certified for a credit in Calendar Year 2019 had not fully claimed their credits after 3 years. Most of these taxpayers had taxable incomes under $33,000 and lacked sufficient tax liability to claim the full amount available. If the General Assembly made the credit refundable, it would allow taxpayers to claim the full amount of the credit in the first year and ensure they receive the full value of the credit. We identified one state, Missouri, that has a refundable home modification credit. However, making the credit refundable would likely increase its revenue impact. For example, about 40 percent ($55,700) of credits issued by DOLA were not claimed by taxpayers from 2019 through 2021; a significant portion of these unclaimed credits would likely have been claimed if the credit was refundable.

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AVIATION FUEL EXEMPTIONS

EVALUATION SUMMARY | APRIL 2022 | 2022-TE14

Expenditure	Jet Fuel Excise Tax Exemption	Aviation Gasoline Excise Tax Exemption
Tax Type	Excise	Excise
Year enacted	1988	1988
Repeal/Expiration date	None	None
Revenue impact (Tax Year 2019)	$16.7 million	$0
Number of taxpayers (Tax Year 2019)	Could not determine	None

KEY CONCLUSION: The Jet Fuel Excise Tax Exemption effectively defines the State's tax structure for aviation fuel, with commercial aviation operators commonly using it to avoid paying the excise tax on jet fuel and instead paying a jet fuel sales tax. However, we found that few, if any, aviation operators use the Aviation Gasoline Excise Tax Exemption.

WHAT DO THESE TAX EXPENDITURES DO?

Jet Fuel Excise Tax Exemption [Section 39-27-102.5(2.5)(a)(I), C.R.S.]—Provides scheduled air carriers and commuter air carriers that are exempt from the federal excise tax an exemption from the State's jet fuel excise tax ($0.04/gal)

Aviation Gasoline Excise Tax Exemption [Section 39-27-102.5(2.5)(a)(II) and (III), C.R.S.]—Provides commercial airlines, commuter air carriers, and public chartered flights with an exemption from the State's aviation gasoline excise tax ($0.06/gal).

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the exemptions do not explicitly state their purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of legislative audio, conversations with the Division of Aeronautics within the Colorado Department of Transportation, and statutory language, for the purposes of our evaluation we considered the following potential purpose: to exempt commercial aviation operators from the State's excise tax, since a majority instead pay the State's sales tax on jet fuel.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing a statutory purpose and performance measures for the exemptions.
- Consider repealing the Aviation Gasoline Excise Exemption.

AVIATION FUEL EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

In Colorado, sales of aviation fuel are subject to tax based on the type of fuel, which can either be jet fuel or aviation gasoline. According to Department of Transportation, Division of Aeronautics (Division) staff, more than 90 percent of aircraft use jet fuel, which is used for aircraft with turbo propeller or jet engines, such as large commercial aircraft, as well as smaller commuter and private aircraft. Aviation gasoline is used for small aircraft without turbo propeller or jet engines, such as airplanes used for private transportation, recreation, or aerial work. Colorado levies three taxes on aviation fuel: a $0.04 per gallon excise tax on jet fuel, a 2.9 percent sales tax on jet fuel, and a $0.06 per gallon excise tax on aviation gasoline. These taxes provide revenue to the Aviation Fund, which is administered by the Division to fund Colorado's aviation system.

This report covers the following two excise tax exemptions, referred to in this report collectively as the Aviation Fuel Exemptions:

JET FUEL EXCISE TAX EXEMPTION [SECTION 39-27-102.5(2.5)(a)(I), C.R.S.]—Provides commercial airlines and commuter air carriers with an exemption from the jet fuel excise tax. To qualify, the aircraft must provide regular scheduled air service or be a commuter air carrier eligible for the federal excise tax exemption on jet fuel.

AVIATION GASOLINE EXCISE TAX EXEMPTION [SECTION 39-27-102.5(2.5)(a)(II) and (III), C.R.S.]—Provides commercial airlines, commuter air carriers, and public chartered flights with an exemption from the aviation gasoline excise tax. To qualify, the aircraft must

provide regular scheduled air service or provide service as a public charter.

EXHIBIT 1 provides summary information on the State's aviation fuel taxes and the Aviation Fuel Exemptions.

EXHIBIT 1. AVIATION FUEL TAXES AND EXEMPTIONS		
JET FUEL		
Tax Type	Rate	Exemptions
Excise Tax	$0.04 per gallon	Jet Fuel Excise Tax Exemption: ▪ Scheduled air carriers (i.e., commercial airlines) ▪ Commuter air carriers exempt from the federal fuel excise tax (i.e., aircraft with 60 or less seats that provide regional air service)
Sales Tax	2.9% of retail price of purchase	None
AVIATION GASOLINE		
Tax Type	Rate	Exemptions
Excise Tax	$0.06 per gallon	Aviation Gasoline Excise Tax Exemption: ▪ Scheduled air carriers (i.e., commercial airlines) ▪ On-demand air carriers providing scheduled commuter flights (i.e., commuter air carriers, small non-turbo propeller or non-jet engine aircraft with 9 or less seats) ▪ Public chartered flights
SOURCE: Sections 39-26-715(1)(a)(I), and 102.5(a), C.R.S.		

The Aviation Fuel Exemptions were created in 1988 by House Bill 88-1250, which also established the jet fuel and aviation gasoline excise taxes. The bill made significant changes to the way the State funds its programs that support aviation, created the Aviation Fund, and repealed the ownership tax for aircraft and registration fee that existed at the time. Additionally, the bill established the Division and the Aeronautical Board (Board), which are tasked with managing the Aviation Fund, with the intent of "promot[ing] the safe operation and

accessibility of general aviation in the state …" Since they were established in 1988, the Aviation Fuel Exemptions have had one significant change with House Bill 03-1073, which clarified the definitions of the aviation operators who are eligible for the exemptions.

The Aviation Fuel Exemptions are applied by the fuel vendor by not collecting an excise tax when selling fuel to an exempt operator. Vendors record the amount of fuel purchased and the airport where the fuel was sold on the Distributor Schedule of Disbursements Worksheet (Form DR 7056) when selling to an exempt operator. If an operator is charged an excise tax on their fuel, they can apply for a refund under Section 39-27-103(2.5) C.R.S. by submitting a Gasoline/Special Fuel Tax Refund Permit Application (Form DR 7189) and accompanying Fuel Tax Refund Claim (Form DR 7118).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Based on the statutory language, operation of the tax expenditures, and discussions with the Department of Revenue (Department), the intended beneficiaries of the exemptions are commercial aviation operators, mainly those that provide regularly scheduled air transportation service. Commercial operators are the primary consumers of aviation fuel, mainly jet fuel, sold in the state, and pay most of the taxes collected on aviation fuel through the jet fuel sales tax.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation do not explicitly state the purpose for the Aviation Fuel Exemptions; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of legislative testimony, conversations with the Division, and the operation of the exemptions, we considered the following potential purpose: to exempt commercial aviation operators from the jet fuel and aviation gasoline excise taxes, since a majority pay the sales tax on jet fuel. As discussed, the General Assembly created the exemptions through House Bill 88-1250, which also established the excise taxes on

jet fuel and aviation gasoline. Therefore, it appears that the exemptions were intended to define the tax base for the newly created excise taxes as being limited to private, non-commercial aviation operators that do not provide regularly scheduled service. At the time the exemptions were created, most commercial aviation operators were already paying the jet fuel sales tax, which was created in 1963. Therefore, excluding commercial aviation operators that provide regularly scheduled service from the excise tax base appears to have been intended to ensure that commercial operators would only pay the jet fuel sales tax.

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

We could not definitively determine whether the Aviation Fuel Exemptions are meeting their purpose because no purpose is provided for them in statute or their enacting legislation. Based on the potential purpose we considered in order to conduct this evaluation, we found that the Jet Fuel Excise Tax Exemption is meeting its purpose because eligible aviation operators are aware of the exemption and use it to exempt their purchases of fuel from the jet fuel excise tax. However, the Aviation Gasoline Excise Tax Exemption is not meeting its purpose because it has limited applicability and has not been recently used.

Statute does not provide quantifiable performance measures for the exemptions. Therefore, we created and applied the following performance measure to determine if the exemptions are meeting the potential purpose we considered for this evaluation.

PERFORMANCE MEASURE: *To what extent are taxpayers using the Aviation Fuel Exemptions to avoid paying excise tax on eligible purchases?*

RESULTS: Based on information reported in the Division's 2020 *Aviation Economic Impact Study*, in Fiscal Year 2019 there were roughly 664 million gallons of jet fuel sold in the state, of which 94 percent (625 million gallons) qualified to be exempt from excise tax under the Jet Fuel

Excise Tax Exemption. Additionally stakeholders, including commercial airlines that purchase a majority of exempt jet fuel, indicated that industry members are aware of and use the Jet Fuel Excise Tax Exemption. Stakeholders did not identify any issues with the exemption's administration and indicated that purchases are exempted by vendors at the point of sale. They also indicated that a similar exemption is available in most states and that knowledge and use of these exemptions is widespread.

According to Department data, the Aviation Gasoline Excise Tax Exemption was not used in Calendar Year 2019, the only year with available data. According to Division staff, nearly all commercial aviation operators use aircraft that require jet fuel. Therefore, it appears that the exemption may not be used because there are likely few, if any, commercial aviation operators that would qualify for the exemption and who purchase aviation gasoline.

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

According to Department data, the Jet Fuel Excise Tax Exemption had a revenue impact to the State of about $16.7 million in Calendar Year 2019. As discussed, the Aviation Gas Excise Tax Exemption was not used in Calendar Year 2019 and it had no revenue impact. In comparison, in Fiscal Year 2019 the Department collected a combined $33 million from the State's aviation fuel taxes, with most of the revenue coming from the sales tax on jet fuel.

The Jet Fuel Excise Tax Exemption has the effect of reducing the after-tax cost of fuel purchased by commercial aviation operators while decreasing state revenue that would otherwise be available to fund aviation activities in the state. Specifically, aviation fuel taxes are distributed to the Aviation Fund, and the disbursements are managed by the Division and Board pursuant to Sections 43-10-110 C.R.S. Roughly two-thirds of the tax revenue from aviation fuel sales must be disbursed to the airport where the fuel sale occurred. Most of the remaining revenue is used for discretionary grants, which the Board

typically awards for projects at smaller airports that do not collect as much fuel tax disbursement revenue. Additionally, no more than 5 percent of the tax revenue is used to fund the administration of the Division.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

Eliminating the Aviation Fuel Exemptions would result in excise taxes of $0.04 or $0.06 per gallon being applied, respectively, to all purchases of jet fuel and aviation gasoline. As discussed, commercial aviation operators who are eligible for the exemptions typically only purchase jet fuel and do not use the Aviation Gasoline Excise Tax Exemption. Therefore, only the repeal of the Jet Fuel Excise Tax Exemption would have an impact on current beneficiaries. Eliminating this exemption would increase fuel taxes for commercial aviation operators by about $0.04 per gallon (i.e., the rate for the jet fuel excise tax), which would be levied in addition to the 2.9 percent jet fuel sales tax. As discussed, this exemption provided a $16.7 million benefit to aviation operators in Calendar Year 2019, which would no longer be available if it were repealed. Although jet fuel prices can fluctuate substantially based on market conditions, according to data from the U.S. Bureau of Transportation Statistics, commercial airlines paid an average of about $2 per gallon for jet fuel during Calendar Year 2021. Therefore, we estimate that if the exemption was not in place during 2021, commercial airlines would have paid about 2 percent more for jet fuel and Colorado's combined tax rate on jet fuel, including the sales tax, would have been 4.9 percent. Commercial aviation stakeholders mentioned that having to pay both taxes might influence their fuel purchasing decisions. For example, they might purchase and store less fuel at the State's airports if it was possible to purchase fuel at a lower after-tax cost in another state. However, considering that several other states with major airports tax jet fuel at rates higher than 4.9 percent and most aircraft are filled with enough fuel to meet their specific flight needs to maximize fuel efficiency, they would be limited to a certain extent in changing their purchasing decisions. It is also possible that commercial

air carriers would pass the increased after-tax fuel cost to their customers or absorb the additional cost to remain competitive, which is common when market prices for jet fuel fluctuate.

Additionally, if the exemptions were repealed, the State would be limited in how it could use the additional revenue. Under Article X Section 18 of the Colorado Constitution, the aviation fuel excise taxes can only be used for aviation purposes and the additional revenue would therefore increase the funds available in the Aviation Fund, most of which is disbursed to the airport where the fuel was sold.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

There are a variety of approaches across states regarding the taxation of aviation fuel. Aviation fuel purchases are typically assessed one or more of the following taxes or fees: excise tax, sales tax, environmental fee, and/or inspection fee. Overall, 38 states have either a tax/fee or a combination of an excise tax, environmental fee or inspection fee on aviation fuel and 38 states exempt the sales from sales tax.

Because Denver International Airport is ranked as the fifth busiest airport in the country based on Bureau of Transportation Statistics passenger data, we also compared the State's aviation fuel tax policies with those in states that have a similarly high level of commercial aviation. EXHIBIT 2 provides the tax policies for the states with one of the top five busiest airports in the country. As shown, most of these states apply a sales tax to the purchase of jet fuel, ranging from 2 percent in Georgia to 7.25 in California. Similar to Colorado, none of the states with jet fuel excise taxes levy the tax on commercial aviation operators, although three states charge an environmental fee in addition to the sales tax. Additionally, Texas does not apply any taxes to purchases of aviation fuel.

EXHIBIT 2. AVIATION FUEL STATE TAXES, FEES, AND EXEMPTIONS IN STATES
WITH THE TOP FIVE BUSIEST AIRPORTS IN THE U.S.

State (Airport)	Jet Fuel Excise Tax (per gallon)	Aviation Gasoline Excise Tax (per gallon)	Sales Tax Levied on Aviation Fuel?	Commercial Exemptions for Aviation Fuel?	Environmental or Inspection Fees
Georgia (ATL)	None	$0.01	Jet fuel only, 2%	None	Environmental Fee, $0.005/gallon
California (LAX)	$0.02	$0.18	Jet fuel only, 7.25%	Commercial aviation is exempt from the excise tax	Environmental Fee, $0.0215/gallon
Illinois (ORD)	None	None	Both jet fuel and aviation gasoline 5%	None	Environmental Fee, $.011/gallon, but commercial aviation is exempt
Texas (DFW)	None	None	No	None	None
Colorado (DIA)	$0.04	$0.06	Jet fuel only, 2.9%	Commercial aviation is exempt from the excise tax	None

SOURCE: Office of the State Auditor analysis of State Tax Policies and Energy Information Administration data.

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

We identified one state-level tax expenditure and several federal tax expenditures that may benefit aviation operators in the state:

AGRICULTURAL APPLICATOR AIRCRAFT FUEL TAX EXEMPTION [SECTION 39-27-103 (2.7)(d), C.R.S.]—Allows agricultural aviation operators to receive a 50 percent refund for any fuel excise taxes paid on the purchase of aviation fuel that is used for agricultural purposes.

FEDERAL AVIATION FUEL EXCISE TAX EXEMPTIONS—The federal excise tax for aviation gasoline is $0.194 per gallon and $0.219 per gallon for jet fuel. Commercial aviation operators pay a reduced jet fuel excise tax

rate of $0.044. Additionally, there are federal excise tax exemptions for aviation fuel when used in certain operations, including:

- Use on a farm for farming purposes
- Foreign trade
- Commercial aviation (aviation gasoline only)
- Exclusive use by a qualified blood collector organization
- Exclusive use by a nonprofit educational organization
- Exclusive use by a state, or political subdivision of a state
- In an aircraft owned by an aircraft museum
- In military aircraft.

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

We did not identify any data constraints that affected our evaluation.

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 AVIATION FUEL EXEMPTIONS. Statute and the enacting legislation for the exemptions do not state the exemptions' purpose or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of this evaluation we considered the following potential purpose: to exempt commercial aviation operators from the jet fuel and aviation gasoline excise taxes, since a majority pay the sales tax on jet fuel. We identified this purpose based on discussions with the Division, the operation of the exemption, and legislative testimony. We also developed a performance measure to assess the extent to which the exemption is meeting this potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).

THE GENERAL ASSEMBLY COULD CONSIDER REPEALING THE AVIATION GASOLINE EXEMPTION. As discussed, this exemption, which only applies to sales of aviation gasoline, but not jet fuel, was not used in Calendar Year 2019. Aviation gasoline accounts for less than one percent of all aviation fuel purchases, and according to Division staff, few, if any, of the commercial aviation operators that would qualify for the exemption use aircraft that require aviation gasoline. Instead, they typically only use aircraft that require jet fuel, which is exempt under the Jet Fuel Excise Tax Exemption. Therefore, it is likely that there are no eligible operators that use the Aviation Gasoline Exemption and the General Assembly may want to consider repealing it.

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