Colorado Office of the State Auditor

OSA

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TAX EXPENDITURES

COMPILATION REPORT

SEPTEMBER 2018

2018-TE

OFFICE OF THE STATE AUDITOR

STATE AUDITOR—DIANNE E. RAY, CPA

The OSA is required to evaluate Colorado's tax expenditures to determine if they are achieving the objectives that they are intended to achieve, including economic development, assisting beneficiaries, and promoting the health, safety, and welfare of the public. Statute defines a tax expenditure as "a tax provision that provides a gross or taxable income definition, deduction, exemption, credit or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue." [Sections 39-21-301 and 305, C.R.S.]

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TAX EXPENDITURES OVERVIEW

Senate Bill 16-203 (codified at Section 39-21-305, C.R.S.) requires the State Auditor to review all of the State's tax expenditures at least once every 5 years and to issue a report no later than September 14, 2018, and September 15 every year thereafter, that includes the tax expenditures reviewed during the preceding year. This report, the first issued under this requirement, contains all of the tax expenditure reviews completed through September 14, 2018.

WHAT IS A TAX EXPENDITURE?

Statute [Section 39-21-302(2), C.R.S.] defines a tax expenditure as "a tax provision that provides a gross or taxable income definition, deduction, exemption, credit, or rate for certain persons, types of income, transactions, or property that results in reduced tax revenue." Although tax expenditures are not subject to the State's annual budget and appropriations process, they are known as "expenditures" because they decrease available state funds similarly to appropriated expenditures, by reducing the amount of state revenue collected, as opposed to spending revenue that has been collected.

Taking into consideration the language used in Senate Bill 16-203, which directs the Office of the State Auditor (OSA) to conduct evaluations of all of the State's tax expenditures, the OSA interpreted the definition of tax expenditure to include four elements:

1 It must be a *state* provision, enacted by state law, not federal or local laws.

2 It must be a *tax* provision that provides a deduction, exemption, credit, rate, or taxable income definition, and not be related to a fee.

3 It must only apply to certain types of persons, types of income, transactions, or property, thereby appearing to confer preferential treatment to specific individuals, organizations, or businesses.

4 It must potentially result in reduced tax revenue to the State (i.e., the provision must affect state revenue, not just local government revenue); the State must legally be able to collect taxes from the person, or on the income, transaction, or property; and the provision must be administered outside of the State's annual budget, appropriations, and spending process.

Based on the OSA's interpretation of statute [Section 39-21-302(2), C.R.S.] and Senate Bill 16-203, the OSA did not consider the following provisions to meet its definition of a tax expenditure:

- Federal tax provisions and local tax provisions that are left to the discretion of local governments under current law (e.g., local sales, use, special district, income, and property tax ordinances).

- Provisions related to fees that operate similarly to a tax, but have not been considered taxes for purposes of the Taxpayer's Bill of Rights.

- The State's decision to use Federal Taxable Income as the basis for calculating state income tax since the use of Federal Taxable Income applies to all taxpayers. This decision effectively provides taxpayers with most federal deductions at the state level.

- Property tax exemptions created by the General Assembly that only apply to local governments.

- Colorado's Tribal Income Tax Exemption because federal law prohibits state taxation of tribal income.

EXHIBIT 1.1 provides information about the types of tax provisions included in the definition of tax expenditures.

EXHIBIT 1.1. EXAMPLES OF TAX EXPENDITURES

CREDIT Reduces tax liability dollar-for-dollar. Some credits are refundable, meaning that a credit in excess of tax liability results in a cash refund.		*Example: Taxpayers with children under age 13 may receive a credit for a percentage of childcare expenses.*
DEDUCTION Reduces gross income due to expenses taxpayers incur.		*Example: Taxpayers may be able to deduct from their income a percentage of the costs they incur for wildfire mitigation.*
INCOME DEFINITION Excludes certain income or benefits from the definition of gross income.		*Example: Employees do not pay taxes on contributions employers make to medical savings accounts.*
EXEMPTION Excludes certain types of income, activities, or transactions from taxes.		*Example: Alcoholic beverages produced for personal consumption are exempt from excise taxes.*
TAX RATE Reduces tax rates on some forms of income and other taxable activities and transactions.		*Example: Insurance companies with an office in Colorado may be eligible for lower insurance tax rates.*

SOURCE: Office of the State Auditor analysis of Colorado Revised Statutes and information from the U.S. Government Accountability Office, and the Tax Policy Center.

Tax expenditures may be enacted to achieve a variety of policy goals. For example, some tax expenditures, referred to in this report as "structural tax expenditures," are intended to establish the basic elements of a tax provision, avoid duplication of a tax, promote administrative efficiency, clarify the definition of the types of transactions or individuals who are subject to a tax, or ensure that taxes are evenly applied. A sales tax exemption for wholesale transactions is an example of a structural provision since it is intended to avoid the

repeated application of the sales tax to the same good as it moves through the supply chain (e.g., from manufacturer to wholesaler, or from wholesaler to retailer). In contrast, other tax expenditures may be intended to promote certain behaviors, promote fairness, or stimulate certain types of economic activity. For example, a tax credit for farmers who donate unsold crops to food banks may be intended to encourage farmers to donate crops.

The benefit, and therefore relative incentive, provided to taxpayers from each type of tax expenditure varies based on the operation of the tax expenditure and taxpayers' individual circumstances. Some key considerations include:

- **TYPE OF TAX EXPENDITURE.** The type of tax expenditure can have a large impact on the potential benefit to taxpayers. For example, deductions, which reduce taxpayers' taxable income, are most beneficial to taxpayers with higher incomes, whereas taxpayers who have taxable income that is already lower than the available deduction would see less benefit. Similarly, credits, which directly reduce the amount of tax owed, may be more beneficial to taxpayers with higher tax liabilities.

- **REFUNDABILITY.** Tax expenditures that are refundable, meaning that taxpayers can claim a refund for the amount that exceeds their tax liability, are generally more beneficial than non-refundable tax expenditures, especially when taxpayers otherwise owe less in taxes than the benefit provided by the tax expenditure.

- **CARRYFORWARDS.** Carryforward provisions allow taxpayers to apply unused portions of a tax expenditure to future years. Such provisions can increase the benefit to taxpayers who may not be able to claim the full value of the tax expenditure in one year.

- **TRANSFERABILITY.** Some tax expenditures allow taxpayers to sell the right to claim the tax expenditure to another person or business entity. Such provisions tend to be beneficial to taxpayers who have

an immediate need for funds or who would otherwise not be able to claim the full amount of the tax expenditure.

- **CAPS.** Some tax expenditures are capped, meaning that a taxpayer can only claim up to a specified amount. Caps limit the benefit provided to a taxpayer and tend to make tax expenditures relatively less attractive to taxpayers who have high incomes and high tax liabilities.

HOW DO TAX EXPENDITURES IMPACT COLORADO'S STATE AND LOCAL TAX SYSTEM?

Tax expenditures reduce both state and local tax revenues in Colorado and apply to most of the types of taxes levied by the State. In its 2016 Tax Profile and Expenditure Report and 2016 Income Tax Supplement Report, the Department of Revenue estimated that tax expenditures reduced state revenue by about $5.4 billion in Calendar Year 2013, the most recent year for which an estimate including income tax expenditures was available. EXHIBIT 1.2 provides a description of the different types of taxes levied by the State, the amount of state tax revenue generated by the taxes, and the number of tax expenditures we have identified related to each type of tax.

EXHIBIT 1.2. COLORADO TAX INFORMATION			
TAX	DESCRIPTION	2017 STATE REVENUE ASSOCIATED WITH TAX (PERCENT TOTAL)	NUMBER OF TAX EXPENDITURES
Income	Colorado levies individual income tax on Colorado residents, including part-time residents, estates, and trusts at a rate of 4.63 percent of their Colorado taxable income. The same rate applies to the Colorado taxable income of corporations doing business in Colorado.	$7,277,000,000 (64%)	91
Sales and Use	Colorado sales tax is required to be collected on the purchase price paid or charged on all retail sales and purchases of tangible personal property, unless specifically exempted by statute. Use tax is levied on retail purchases of tangible personal property that is stored, used, or consumed in Colorado when sales tax was not collected at the time of the purchase. The State's sales and use tax rates are both 2.9 percent.	$2,656,000,000 (23%)	70
Excise	Colorado levies excise taxes on a variety of goods and activities, including motor and aviation fuel, cigarettes and tobacco products, marijuana and marijuana products, liquor, gaming, and passenger miles. In contrast to a sales tax, the excise tax is not directly paid by the final consumer of the product; however, the retailer who ultimately sells the goods to the final consumer often builds the cost of the excise taxes into the purchase price of the goods. For excise taxes that are levied on activities such as gaming, the tax base is typically the gross, adjusted gross, or net proceeds from the activity. The State excise tax rate varies based on the type of good and the quantity purchased.	$1,089,000,000 (10%)	24
Insurance Premium	Insurance companies licensed and operating in Colorado are levied a tax on the gross amount of the premiums they receive from policyholders. The insurance premium tax rate is typically 2 percent.	$291,000,000 (3%)	14

EXHIBIT 1.2. COLORADO TAX INFORMATION			
TAX	DESCRIPTION	2017 STATE REVENUE ASSOCIATED WITH TAX (PERCENT TOTAL)	NUMBER OF TAX EXPENDITURES
Severance	Severance taxes are imposed on the extraction of certain non-renewable natural resources, including coal, molybdenum and metallics, and oil and gas. The tax base and rate vary depending on the type of resource extracted.	$11,000,000 (<1%)	15
Pari-Mutuel Racing	The Pari-Mutuel Racing tax is a tax levied on the gross receipts from wagers on horse and greyhound racing events. The tax rate varies based on the type of event and whether it is live or broadcast.	$1,000,000 (<1%)	0
Estate	Estate taxes are levied on the transfer of an estate of a deceased person. However, based on the interaction between federal and State law, Colorado's estate tax was effectively repealed in 2005.	$0 (0%)	3
TOTAL		$11,325,000,000	216
SOURCE: Office of the State Auditor analysis of C.R.S., and state revenue information provided by Legislative Council.			

LOCAL GOVERNMENT IMPACT

Because of the interplay between state and local sales and use tax laws, most state sales tax expenditure provisions also reduce the revenue collected by some local governments. Colorado has several types of local governments, including statutory cities and towns, home rule cities and towns, counties, and special districts. Statutory cities and towns are formed under the authority of state statutes, and their power is limited to that granted by state statutes, meaning that their sales and use tax laws must conform to the State's. Alternatively, the Colorado Constitution provides that cities and towns can adopt a home rule charter, which provides them with more authority to regulate local and municipal affairs independent from the State, including making their own local tax laws [Colorado Constitution Art. XX, Sect. 6]. Under Section 29-2-106, C.R.S., the Department of Revenue collects sales taxes for all non-home rule jurisdictions that have sales taxes and for some home rule jurisdictions that have elected to have the State collect

sales taxes on their behalf. Under Section 29-2-102, C.R.S., all of these state-collected local jurisdictions may set their own sales tax rate, but must otherwise conform to the State's tax laws regarding sales and use taxation and must apply all of the State's sales and use tax expenditures, with the exception of 17 sales tax exemptions specifically provided in statute [Section 29-2-105, C.R.S.]. For these 17 exemptions, Section 29-2-105(1)(d), C.R.S., provides that state-collected local governments are not required to apply the state exemption and must specifically adopt the exemption in its local municipal code if it wants to apply it. As a result, with the exception of these 17 exemptions, the State's sales tax expenditures also apply to the local tax revenues for all state-collected local governments.

Because local governments with state-collected local taxes are required to substantially conform to the State's sales and use tax laws, when possible, we estimated the revenue impact to local jurisdictions when evaluating sales tax expenditures that impact local governments' tax revenue. To assist in estimating the local revenue impact of sales tax expenditures, we calculated as of June 2018 a 1.8 percent average local sales tax rate (not including lodging taxes) for state-collected local jurisdictions, weighted by population, based on population data from the State Demographer's Office and local sales tax rate data from the Department of Revenue.

THE TAXPAYER'S BILL OF RIGHTS

The Taxpayer's Bill of Rights (TABOR) [Colo. Const. Art. X, Section 20] requires voter approval of all new taxes and tax increases in the State, as well as tax policy changes that result in increased state revenue. In addition, TABOR created a state spending cap, which is adjusted annually according to inflation and state population growth. If state revenue exceeds the spending cap, the State must refund the excess revenue or obtain voter approval to retain the revenue in excess of the cap. Tax expenditures interact with TABOR in two ways. First, some tax expenditures are only available to taxpayers in years where the TABOR spending cap is reached. In effect, these tax expenditures lower

the revenue collected by the State, which decreases the amount that must be refunded to taxpayers. Second, TABOR may restrict the General Assembly from repealing or modifying tax expenditures under some circumstances, although the law is unclear in this area. Specifically, TABOR requires voter approval of "tax policy changes directly resulting in a net tax revenue gain." It is unclear how this provision may limit the General Assembly's ability to change or repeal tax expenditures, when doing so results in a net revenue gain to the State. According to a 2018 Colorado Supreme Court ruling (TABOR Foundation v. Regional Transportation District), such changes are permissible when the underlying purpose of the change is not to increase tax revenue and the actual revenue increase is relatively small. However, the ruling does not indicate whether there are other circumstances under which such changes might also be permissible and whether changes to tax expenditures with the intent of increasing revenue would be considered as "*directly* [emphasis added] resulting in a net tax revenue gain." Furthermore, the General Assembly has repealed tax expenditures since TABOR was passed without seeking voter approval, and such changes have not faced a legal challenge.

HOW ARE TAX EXPENDITURES ADMINISTERED?

The Colorado Department of Revenue administers the State's tax laws, including most tax expenditures, and collects all taxes, with the exception of the Insurance Premiums Tax, which is administered by the Division of Insurance within the Department of Regulatory Agencies, as required by Section 10-3-209(1)(a), C.R.S. The Department of Revenue processes tax returns using GenTax, its tax processing and information system, and taxpayers submit most returns electronically. Typically, taxpayers claim tax expenditures through self-reporting. For some tax expenditures, taxpayers must provide the amount claimed when they file their state tax return forms, while for others, there is no reporting requirement or the Department of Revenue directs taxpayers to aggregate the expenditures with other figures, such as gross income or sales, before reporting. In some cases, the Department of Revenue does not require taxpayers to submit documentation that supports a transaction's eligibility for a tax

expenditure; however, it may require taxpayers to substantiate eligibility for tax expenditures as part of an audit.

In addition, some tax expenditures are administered by other state departments and agencies, in conjunction with the Department of Revenue. These tax expenditures typically require the other state departments to verify taxpayers' eligibility for a tax expenditure before taxpayers can claim it. For example, the Agricultural Lease Deduction [Section 39-22-104(4)(v), C.R.S.] is administered by the Colorado Agricultural Development Authority and taxpayers must first apply with the Colorado Agricultural Development Authority before they can claim the deduction. When tax expenditures are administered by an agency separate from the Department of Revenue, statute generally provides how the coordination between the agency and Department of Revenue should occur. For example, the other department or agency administering a tax expenditure may need to provide the Department of Revenue with a list of recipients of tax expenditures and the amount claimed or granted in order to verify that a taxpayer has properly claimed a tax expenditure. Similarly, in some instances, the administering agency may provide taxpayers with a certificate or other form of validation that they can attach to their tax returns.

HOW WAS EACH TAX EXPENDITURE EVALUATED?

As required by statute [Section 39-21-305, C.R.S.], each tax expenditure evaluation must include the following types of information, which are outlined in EXHIBIT 1.3, along with a general description of the OSA's evaluation approach.

EXHIBIT 1.3. TAX EXPENDITURE EVALUATION REQUIREMENTS AND OSA APPROACH

REQUIRED ELEMENTS	EVALUATION APPROACH
A summary description of the purpose, intent, or goal of the tax expenditure *The intended beneficiaries of the tax expenditure*	If the purpose and intended beneficiaries of the tax expenditure were directly stated in statute, we summarized this information in the report. If the statute did not state the intended purpose and/or beneficiaries, we inferred this information based on our review of the statute, the legislative history, communications with stakeholders, tax expenditures in other states, and principles of good tax policy.
Whether the tax expenditure is accomplishing its purpose, intent, or goal *An explanation of the performance measures used to determine the extent to which the tax expenditure is accomplishing its purpose, intent, or goal*	If performance measures were provided in statute, we used those to determine whether the tax expenditure was accomplishing its purpose, intent, or goal. If no performance measures were provided in statute, we inferred performance measures based on the purpose.
An explanation of the intended economic costs and benefits of the tax expenditure, with analyses to support the evaluation if they are available or reasonably possible	We included this information if it was provided in statute or inferable based on the overall purpose of the tax expenditure. We conducted an economic analysis, including an estimate of the revenue impact, to the extent possible based on the available information.
A comparison of the tax expenditure to other similar tax expenditures in other states	We provided this information to the extent we could identify other states with similar tax expenditures.
Whether there are other tax expenditures, federal or state spending, or other . . . programs to the extent the information is readily available. . .that have the same or similar purpose . . . how those all are coordinated, and if coordination could be improved, or whether redundancies can be eliminated	We reviewed and reported on this information if it was readily available. For example, we reviewed statute for similar state and federal tax expenditures, searched state and federal agency websites, and performed web-searches to identify potentially similar programs.
If the evaluation of a particular tax expenditure is made difficult because of data constraints, any suggestions for changes in administration or law that would facilitate such data collection	We reported data constraints whenever they limited our ability to evaluate a tax expenditure or may have had an impact on the accuracy and reliability of our evaluation.
To the extent it can be determined . . .(I) The extent to which the tax expenditure is a cost effective use of resources; (II) An analysis of the tax expenditure's effect on competition and on business and stakeholder needs; (III) Whether there are any opportunities to improve the effectiveness of the tax expenditure in meeting its purpose, intent, or goal; and (IV) An analysis of the effect of the state tax policies connected to local taxing jurisdictions on the overall purpose, intent, or goal of the tax expenditure	We provided this information whenever such analyses were relevant to the tax expenditure and possible based on the available information. Although our approach varied significantly for each tax expenditure, we searched for available information and considered whether it was possible to perform an analysis and draw conclusions in each of the areas listed.

SOURCE: C.R.S. and Office of the State Auditor tax expenditure evaluation methodology.

PRINCIPLES OF GOOD TAX POLICY

In conducting our evaluations, we often looked to sources such as the National Conference of State Legislatures, the Tax Policy Center, other states' tax expenditure reviews, and PEW Charitable Trusts to gather information on best practices related to tax policy. We used this information to help infer the intent of tax expenditures when such intent was not provided in statute, and also to identify relevant policy considerations for the General Assembly related to each tax expenditure. Based on a review of these sources, we identified the following criteria that we used to evaluate tax expenditures when relevant:

- **TRANSPARENCY.** Taxpayers and policymakers alike should be able to understand how the tax system works, including taxpayers' expected tax liabilities.

- **STABILITY.** Taxation should result in a predictable amount of revenue for the government, and taxpayers should be able to predict in advance how much they can expect to pay in taxes as the result of any given decision or transaction.

- **SIMPLICITY.** In order to assist taxpayers and policymakers in understanding the tax code, tax policy should be as simple as possible.

- **EASE OF ADMINISTRATION.** The tax system should be administered with as little difficulty and cost to taxpayers, tax professionals, financial intermediaries (such as banks), and the government as possible.

- **FLEXIBILITY AND RESPONSIVENESS TO COMPETITION.** Tax systems should be able to adapt to economic and technological changes that occur over time. Similarly, they should be responsive to the tax policies of other states and countries, to help ensure sufficient competitiveness in a global market.

WHAT LIMITATIONS DID THE OSA FACE IN EVALUATING TAX EXPENDITURES?

In this report, the OSA strived to present as complete and accurate an assessment of each tax expenditure as possible. However, there are some limitations implicit in the evaluations due to a variety of factors, including lack of available data, the nature of tax expenditures themselves, and general principles of economics. We discuss these limitations below.

LIMITATIONS ON DEPARTMENT OF REVENUE INFORMATION

We worked closely with the Department of Revenue to obtain information relevant to our tax expenditure evaluations and we appreciate the cooperation and assistance provided by the Department of Revenue throughout the review year. Despite working cooperatively with the OSA and making extensive efforts to provide the data we requested, for many of the tax expenditures we reviewed, the Department of Revenue was not able to provide any information or was only able to provide limited information. The reasons for this are due to the inherent limitations of a self-reported tax system and limitations in the information the Department of Revenue collects and stores in GenTax, its tax processing and information system. The most common issues we found included the following:

ISSUES INHERENT TO A SELF-REPORTED TAX SYSTEM

- **INACCURATE REPORTING BY TAXPAYERS.** Even when the Department of Revenue was able to extract relevant data from GenTax, this data likely included some degree of inaccuracy because taxpayers may not properly complete forms. For example, a taxpayer may enter an exemption on the wrong line of the form or misunderstand the information requested. Although these errors may have no impact on the amount of tax the State collects, they can impact the reliability of the information for the purposes of evaluating a tax expenditure.

Although these errors may be corrected if a taxpayer is audited by the Department of Revenue, not all taxpayers are audited.

- **TIMING OF RETURNS.** Taxpayers may file amended returns, request extensions to return filing deadlines, have returns on hold while being reviewed or audited by the Department of Revenue, and at times, file returns past required deadlines. As a result, data relevant to tax expenditures for any tax year (the year for which a taxpayer is filing taxes) or other relevant filing period may fluctuate substantially based on when it is pulled and as updated return filings are received by the Department of Revenue. According to the Department of Revenue, it can take several years for the relevant data to stabilize for some tax expenditures. As a result, information for tax expenditures for more recent tax years tends to be less reliable and it can be difficult to assess trends over time, especially for more recently enacted tax expenditures.

- **TIMING OF TAX EXPENDITURES.** Because taxpayers can carry forward some tax expenditures across multiple years and they do not always claim the full value of the tax expenditures they have qualified for, it can be difficult to estimate the revenue impact of some tax expenditures or perform analysis of trends over time.

LIMITATIONS DUE TO THE INFORMATION COLLECTED AND STORED BY THE DEPARTMENT OF REVENUE IN GENTAX

- **THE RELEVANT TAX EXPENDITURE INFORMATION IS NOT COLLECTED ON A DEPARTMENT OF REVENUE FORM.** According to the Department of Revenue, it does not collect some information that would be relevant to evaluating a tax expenditure, if that information is not necessary for the Department to administer the tax system or if another department has more direct authority over the tax expenditure (e.g., The Office of Economic Development and International Trade works more closely with taxpayers claiming enterprise zone credits). Because requiring more information increases the filing costs and burden for taxpayers and the Department of

Revenue's administrative costs, the Department typically attempts to collect only the information that is necessary for it to administer and enforce tax laws.

- **THE RELEVANT TAX EXPENDITURE INFORMATION IS COLLECTED ON A DEPARTMENT OF REVENUE FORM, BUT IS NOT CAPTURED BY GENTAX IN A MANNER THAT ALLOWS IT TO BE EXTRACTED.** This issue can take two forms: (1) a paper form is scanned and image data is stored, but the data is not captured in GenTax in a way that can be systematically retrieved without excessive manual labor; and (2) the form (whether filed online or on paper) data is captured, but GenTax would need to be programmed to pull comprehensive data. According to the Department of Revenue, it does not capture and program GenTax to pull all information reported by taxpayers on forms because it does not regularly use all of the information as part of its administration of taxes. In some cases, the information would only be useful if a taxpayer is audited, in which case, staff would be able to pull the relevant information for the relevant taxpayer, but pulling the information for all taxpayers who took a particular tax expenditure would not be possible.

- **THE RELEVANT TAX EXPENDITURE INFORMATION IS COLLECTED ON A DEPARTMENT OF REVENUE FORM, BUT IS AGGREGATED WITH OTHER INFORMATION.** In some cases, multiple tax expenditures are aggregated by taxpayers prior to reporting and are then combined on a single line on the Department of Revenue form. According to the Department of Revenue, it allows certain items to be aggregated to simplify the reporting process and avoid taxpayer confusion due to an excessive number of lines on forms. In addition, the Department of Revenue may not need disaggregated information to administer the applicable tax expenditures.

Although we reported on these issues whenever they had an impact on our ability to evaluate a tax expenditure, we did not make recommendations to the Department of Revenue regarding whether it should make changes to its reporting requirements and/or perform the

necessary programming in GenTax to make the information available for our reviews. We took a neutral approach on these issues because in each case, the General Assembly and Department of Revenue would need to weigh the relative benefits of having more information available to review, compared to the additional costs to the Department of Revenue and additional burden and cost to taxpayers if they have to report additional information. In order to provide a general estimate of the costs to make changes to the information it collects and captures in GenTax, the Department of Revenue provided the following information relevant to scenarios for addressing the most common data limitations we identified:

- **A NEW FORM WOULD NEED TO BE CREATED OR AN EXISTING FORM CHANGED.** The Department of Revenue would need to work with its vendor and the Department of Personnel & Administration, which is responsible for processing paper tax filings, to create the form. This cost is roughly $1,200 per page that is adjusted or created.

- **ADDITIONAL DATA WOULD NEED TO BE CAPTURED FROM PAPER FORMS.** The Department of Personnel & Administration prepares, scans, and performs data entry for paper tax forms for the Department of Revenue and bills for these services. The cost of capturing additional information from paper forms is highly variable based on the amount of data to be captured on each form and number of forms received and would be incurred on an ongoing basis. Collecting data on an entirely new form would be more expensive, for example, than adding a single line to an existing form.

- **GENTAX WOULD NEED TO BE UPDATED TO HOUSE, MAP, AND INDEX DATA NOT CURRENTLY CAPTURED.** This requires the Department of Revenue to work with its vendor to make the necessary programming changes and then perform testing to ensure that the changes operate properly. The costs for similar changes in recent years have ranged from about $9,000 to add a single reporting line to an existing form, to about $19,000 to create a new form, including programming and testing costs, though costs may be higher based on the specific changes.

It is important to note that depending on the tax expenditures and information needed, the Department of Revenue may incur the costs associated with one or all of scenarios described. Furthermore, these costs do not include Department of Revenue staff time to review taxpayer compliance with the new reporting requirements or additional programming that would be required to integrate controls, such as math verifications, to ensure accurate reporting. In addition, if a particular tax expenditure is reported across several forms, such as when it applies to several types of taxes or filers, the estimated costs would be multiplied for each change across forms. In addition to these direct costs, the Department of Revenue would also incur additional costs related to correcting errors on forms, answering questions, and working with the OSA to provide the necessary information.

Other limitations to our analysis

In lieu of actual tax return data from the Department of Revenue, we use other data sources to estimate the revenue impact of some tax expenditures. In general, the data sources include the following categories:

1. **Federal agencies**, including the U.S. Census Bureau, the Internal Revenue Service, the U.S. Department of Agriculture, and the U.S. Bureau of Economic Analysis.

2. **State agencies**, including Legislative Council, the Department of Agriculture, the Division of Insurance, the Secretary of State's Office, and State Demographer's Office.

3. **Local governments**, including statutory and home rule cities and towns, counties, and special districts.

4. **Research institutions**, including peer-reviewed professional publications, university publications, and reports published by reputable private research institutions.

5 **INDUSTRY AND STAKEHOLDER GROUPS,** including professional associations and other groups that are closely tied to industries relevant to a particular tax expenditure.

6 **MEDIA SOURCES,** including newspapers and trade publications.

7 **TAXPAYERS,** including surveys and interviews with taxpayers who may benefit from the tax expenditures.

Use of third-party data made the process of estimating the revenue impact of these tax expenditures significantly more difficult, in part, because this data may be less accurate than actual tax return data from the Department of Revenue and typically requires various adjustments in order to more accurately capture the effect of the tax expenditure in Colorado. In addition, the data from these sources was not always complete and the information provided was not always fully aligned with the information we needed for our evaluations (e.g., the definition of sales by "wholesalers" as used by the U.S. Economic Census in reporting sales figures may not encompass all sales that would be considered wholesale under the Colorado tax code.) As a result, in some cases, we made assumptions, as noted in the evaluations, based on the best information available, to complete our analysis.

HOW DID THE LIMITATIONS TO OUR ANALYSIS IMPACT OUR CONCLUSIONS?

We based our conclusions on the most reliable information that we identified, given the limitations to our analysis. However, each tax expenditure presents its own challenges and limitations with respect to estimating the number of taxpayers who use the tax expenditure, its revenue impact to the State and local governments, and its impact to beneficiaries and the State's economy. For this reason, we have provided information in each evaluation regarding the sources of information we used and the assumptions we made to come to our conclusions and the potential impact on our analyses. However, in general, due to the limitations of our information sources, readers are cautioned against

interpreting the estimates provided in our evaluations as exact, but should consider them as an indication of the magnitude of the impact of a given tax expenditure.

Furthermore, the revenue impact estimates provided in our evaluations should not be taken as equivalent to the amount of revenue that would be gained if the given tax expenditure were to be repealed, because the cumulative effects of repealing the tax expenditure are difficult to predict in advance. There are several reasons for this:

- A general principle of economics is that individuals and businesses typically spend their money and other resources in ways that will yield the highest return. Therefore, repealing a tax expenditure and thus, increasing the tax assessed on a particular item or activity may alter taxpayer behavior and change the associated tax revenue.

- Many tax expenditures overlap or interact with others, and we did not account for these interactions in our revenue impact estimates in most cases. For example, different statutes may include exemptions for the same products, as in the case of charitable organizations that are exempt from paying sales tax on items that they purchase for use in the course of their charitable activities and functions [Section 39-26-718(1)(a), C.R.S.]. Some of these eligible items that are purchased by charitable organizations may already be exempt from sales tax under other provisions, e.g., a charitable organization may purchase food for home consumption which is also exempt from taxation [Section 39-26-707(1)(e), C.R.S.]. Purchases of these items are included in the revenue impact estimate for the sales to charitable organizations exemption, but if this exemption were repealed, these items would still be exempt from sales tax under the food for home consumption exemption.

WHAT WERE THE RESULTS OF THE OSA'S EVALUATIONS?

EXHIBIT 1.4 provides a summary of the results of the OSA's 2018 tax expenditure evaluations.

EXHIBIT 1.4. SUMMARY OF THE OSA'S 2018 EVALUATION FINDINGS OLDEST TO MOST RECENT

Tax Expenditure Title	Statutory Reference (C.R.S.)	Year Enacted	Repeal/ Expiration Date	Estimated Revenue Impact[1]	Is the Tax Expenditure Meeting its Purpose?
Sacramental Wines Excise Tax Exemption	44-3-106(1)	1933	None	$2,600	Partially, because it is not applied to all sales
Occasional Sale of Liquor by Public Auction	44-3-106(3)(a)	1935	None	$0	No, because it is not being used
Wholesale Sales Exemption	39-26-102(19)(a)	1935	None	$4 billion	Yes
Sales to Charitable Organizations Exemption	39-26-718(1)(a)	1935	None	$45.5 million	Yes
Credit for Taxes Paid to Other States	39-22-108(1)	1937	None	$185 million	Yes
Newspaper sales Exemption	39-26-102(15)(a)(I)	1943	None	$2.7 million	Yes
Newsprint and Printer's Ink Sales Exemption	39-26-102(21)(a) 39-26-705(1)	1943	None	$500,000	Yes
Farm Close-Out Sales Tax Exemption	39-26-716(4)(a)	1945	None	Could not determine	Yes, with variable impact based on local taxes
Long-term Lodging Exemption	39-26-704(3)	1959	None	$12.3 million	Yes, but it may be applied inconsistently
Crop Hail Insurance Premium Tax Exemption	10-3-209(1)(d)(II)	1961	None	$0	No, because it is not being used
Sales to Residents of Bordering States Exemption	39-26-704(2)	1963	None	None	No, because it cannot be used
Crop and Livestock Contribution Corporate Income Tax Credit	39-22-301(3)	1982	None	Not reportable	No, because of its limited use
Hunger Relief Income Tax Credit	39-22-536	2014	December 31, 2019	$71,000	Yes, but the impact is relatively small
Biogas Production Components Exemption	39-26-724 (1)(c)	2014	July 1, 2019	$1.2 to $2.2 million	Yes, but to a limited extent
Agricultural Lease Deduction	39-22-304(3)(o)	2016	January 1, 2020	$0	No, because it has not been used

SOURCE: Office of the State Auditor evaluations of Colorado's tax expenditures.

[1] The year the estimated revenue impact applies to, varies by tax expenditure based on the availability of data. For more information, see the specific evaluation report.

AGRICULTURE-RELATED EXPENDITURES

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AGRICULTURAL LEASE DEDUCTION

EVALUATION SUMMARY — SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	2016
REPEAL/EXPIRATION DATE	December 31, 2019
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No, although it has only been available for 1 year.

WHAT DOES THIS TAX EXPENDITURE DO?

The Agricultural Lease Deduction allows taxpayers who lease their land or other agricultural assets to beginning farmers or ranchers to receive an income tax deduction equal to 20 percent of the resulting lease payments, up to a maximum of $25,000 per year, for a maximum of 3 years.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

The deduction is intended to provide an incentive for aging agricultural producers to lease their land and equipment to beginning farmers or ranchers to help them become established in the agricultural industry.

WHAT DID THE EVALUATION FIND?

The deduction is not yet meeting its purpose since no one applied to receive the deduction for 2017, the first year it was available.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider reviewing the administrative requirements for qualifying for the deduction and the amount of benefit it provides to taxpayers if it wants to encourage the deduction's use.

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AGRICULTURAL LEASE DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Agricultural Lease Deduction was created in 2016. It allows taxpayers who lease their in-state land or other agricultural assets (e.g., crops, livestock, farm equipment, etc.) to beginning agricultural producers for a period of 3 years or longer to deduct 20 percent of the resulting lease payments from their taxable income for state income taxes, up to a maximum deduction of $25,000 per year for 3 years.

According to Sections 39-22-104(4)(v) and 39-22-304(3)(o), C.R.S., to be eligible for the deduction, the leaseholder (i.e., the individual who the taxpayer leases the asset to) must:

- Be a full-time farmer or rancher.
- Have 10 years or less of agricultural experience.
- Have a net worth of less than $2 million.
- Provide the majority of the "daily physical labor and management" on the asset, or use the asset the majority of the time.

The deduction is administered by the Colorado Agricultural Development Authority (Authority), a statutory organization created to encourage investment in the agricultural industry, primarily through issuing tax-exempt bonds to lenders to make low interest loans available to first-time agricultural producers. Both the owner of the agricultural asset claiming the deduction and the leaseholder must apply to the Authority by March 31st of the year after the lease begins (e.g., March 31, 2018, for leases that began during Calendar Year 2017). In the

application, the asset owner must attach a copy of the lease that states the payment terms and a legal description of all rented assets, as well as a $50 application fee; the leaseholder must submit his/her federal Schedule F form, which denotes profit or loss from farming operations [Section 35-75-107(1)(u), C.R.S.]. In addition to these requirements, the leaseholder must have participated in a financial management education program approved by the Authority. The Authority is then responsible for issuing certificates to successful applicants who own the leased assets, which the applicants must then submit to the Department of Revenue when filing their income taxes. The Authority is also required to notify the Department of Revenue of all deductions awarded. A maximum of 100 asset owners can claim the Agricultural Lease Deduction each year [Section 35-75-107(1)(u), C.R.S.] and unused portions of the deduction cannot be carried forward to future tax years. The deduction expires at the end of Calendar Year 2019.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute mentions two key beneficiaries of the Agricultural Lease Deduction: (1) aging farmers and ranchers who own agricultural assets [Section 39-22-104(4)(v)(I)(D), C.R.S.], and (2) beginning farmers and ranchers [Section 39-22-304(3)(o)(I)(D), C.R.S.]. The Colorado agricultural industry has struggled to sustain the involvement of beginning farmers and ranchers in recent years. Specifically, according to the U.S. Agricultural Census, the number of farmers and ranchers with less than 10 years of experience has decreased from 29 percent of principal operators in 2007 to 24 percent in 2012. At the same time, according to the U.S. Agricultural Census, the average age of Colorado farmers and ranchers has risen from 50 years old in 1982 to 59 years old in 2012. This suggests that farmers and ranchers are working longer than in the past and that there may not be as many new farmers and ranchers ready to continue their operations as they retire.

For new farmers and ranchers, acquiring adequate land and equipment is often a key barrier to entering the industry. For example, in Colorado, the

National Agricultural Statistics Service estimates that between 1998 and 2017, the average cash rent for cropland increased from $56.30 to $73.50 per acre (an increase of 31 percent), and from $5 to $5.60 per acre for pastureland (an increase of 12 percent). Likewise, leases of agricultural equipment and machinery, which are typically the second-most costly agricultural lease expense behind land, are also becoming more expensive for new farmers and ranchers. For example, in 2008, the average farm/ranch paid $14,200 annually for leases of agricultural equipment and machinery, compared to $19,000 in 2012, a 34 percent increase. Additionally, U.S. Department of Agriculture Economic Research Service data indicates that beginning and younger farmers and ranchers often rely much more heavily on second, non-farm jobs to supplement their income than older and more experienced farmers and ranchers.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute states that the Agricultural Lease Deduction "is intended to be an incentive for aging farmers or ranchers to lease their agricultural assets to beginning farmers or ranchers in order to give the beginners a chance to get started in the industry" [Sections 39-22-104(4)(v)(I)(D) and 39-22-304(3)(o)(I)(D), C.R.S.]. Moreover, legislative committee testimony and interviews with the Executive Director of the Authority indicated that the bill sponsors primarily focused on incentivizing leases of agricultural land, which is the most expensive asset new farmers and ranchers must acquire.

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

We determined that the Agricultural Lease Deduction is not yet meeting its purpose because no taxpayers have applied for it. However, the deduction has only been available for 1 year, so it may be too early to fully assess its effectiveness and impact. 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 exemption is meeting its purpose:

PERFORMANCE MEASURE: *To what extent does the Agricultural Lease Deduction increase the amount of assets leased by agricultural producers nearing retirement to those beginning to farm or ranch?*

RESULT: As of March 31, 2018, the Agricultural Lease Deduction has not resulted in an increase in the amount of agricultural assets leased to new farmers and ranchers because no taxpayers have applied for the deduction. Specifically, although the Authority reported that it made efforts to communicate the deduction through radio and newspaper advertisements, and stakeholder outreach, no taxpayers applied for the deduction for Calendar Year 2017, the first year it was available.

Although interest in the Agricultural Lease Deduction could increase over time, it appears that the deduction may only act as a modest incentive for aging farmers and ranchers to lease assets to new farmers and ranchers. Specifically, in the case of a taxpayer who is eligible to claim the $25,000 maximum amount of the deduction, which requires an annual lease amount of $125,000 or more, their state tax liability would be reduced by about $1,160 ($25,000 multiplied by the 4.63 percent state income tax rate). While this reduction could act as a small incentive for some farmers and ranchers to lease their land, because this amount is only about 0.9 percent of the total lease value, other factors, such as the market price of their land and the potential lease income it can generate, are more likely to influence an aging farmer's or rancher's decision to lease land to a new farmer or rancher. In addition, stakeholders we interviewed indicated that although the deduction could be beneficial, many aging farmers and ranchers are already interested in seeing their operations continue after they retire and would seek out new farmers and ranchers to lease to, regardless of the deduction. Some of the stakeholders we contacted also indicated that many farmers and ranchers are not aware of the deduction, which has likely also contributed to the lack of applications for the deduction during its first year. This corresponded with a survey we conducted of

agricultural producers, in which 7 of the 26 respondents (27 percent) were familiar with the deduction.

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

Since no taxpayers have applied for and received the Agricultural Lease Deduction, there is no revenue impact to the State and no economic costs or benefits. However, the deduction has only been available to taxpayers for 1 year. Thus, its economic impact could grow over time as more taxpayers become aware of it. If the deduction were utilized to its fullest extent, with 100 taxpayers claiming the maximum possible benefit ($1,160 per year), the revenue impact to the State would be $116,000 annually.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Agricultural Lease Deduction would have a relatively small impact on the intended beneficiaries, even if it is used to the maximum amount allowed. Although there is no actual impact to beneficiaries because the deduction has not yet been used, if taxpayers do plan to use it in the future, the maximum impact would be $1,160 per year, per taxpayer on a $125,000 per year lease for 100 taxpayers.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Four other states have or have had tax expenditures similar to the Agricultural Lease Deduction—Nebraska, Iowa, Wisconsin, and Minnesota. Wisconsin's credit was phased out in 2013. EXHIBIT 1.1 compares the provisions of the expenditures in each state with Colorado's deduction.

EXHIBIT 1.1. DIFFERENCES BETWEEN STATES' BEGINNING FARMERS/RANCHERS AGRICULTURAL LEASE TAX EXPENDITURES

State	Type	Percent of Lease Amount	Lease Length	Max Net Worth of Beginning Farmer	Annual Max per Taxpayer	Annual State Cap on Expenditure	Business Course Required to be Eligible	Carry Forward Allowed
Colorado	Deduction	20%	3 years or longer	<$2 million	$1,160	$116,000	Yes	No
Nebraska	Credit	10% for cash rentals, 15% for crop share rentals	Exactly 3 years	<$200,000	None	None	Yes	No, but refundable
Iowa[1]	Credit	5% for cash rentals, 15% for crop share rentals	2-5 years	<$645,284	$50,000	$6 million	No	10 years
Wisconsin	Credit	15% of machinery, facility, and livestock leases	3 years or longer	<$200,000	None	None	No	No, but refundable
Minnesota	Credit	10% for cash rentals, 15% for crop share rentals	Not specified	None	$7,000 for cash rentals, $10,000 for crop share rentals	$5 million ($6 million in 2019-2023)	Yes	15 years

SOURCE: Office of the State Auditor analysis of similar tax expenditures in other states.
[1]Between 2013 and 2017, taxpayers could claim a credit equal to 7 percent of the lease amount for cash rent leases and 17 percent for crop share leases (for veterans, 8 percent and 18 percent, respectively), with an annual statewide cap of $8 million.

In addition to its agricultural lease program, Nebraska also offers beginning farmers and ranchers an exemption from the State's business personal property tax.

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

There are numerous other tax expenditures and programs available in Colorado that help new farmers and ranchers to afford the assets required to enter the agricultural industry. Specifically, we identified the following:

- **FINANCIAL PRODUCTS AND SERVICES.** There are a number of state and federal agricultural loan programs geared towards beginning farmers and ranchers. For example, the Authority primarily works on issuing tax-exempt bonds to lenders that significantly reduce the interest rates on loans to beginning agricultural producers. In addition, the U.S. Farm Credit System is a network of borrower-owned financial institutions that provide credit to agricultural producers whose mission it is to support agriculture and rural communities. According to the Farm Credit Administration, the federal agency that regulates the farm credit sector, the U.S. Farm Credit System made 74,000 new loans totaling $12.4 billion to farmers and ranchers with 10 years or less of experience nationwide in 2017, representing 23 percent of all new loans it made that year, and 16 percent by value. Moreover, the U.S. Department of Agriculture's Farm Service Agency provides low-interest financing to agricultural producers who cannot qualify for conventional loans, with applications from beginning farmers and ranchers receiving a significant preference. It also has other relevant programs, such as the Beginning Farmer and Rancher Individual Development Accounts Pilot Program, which offers matching funds set aside through savings accounts for new farmers and ranchers of limited means. Another is the Down Payment Loan Program, under which the Farm Service Agency acts as a joint-financer and loan-guarantor for beginning agricultural producers purchasing a farm or ranch. On certain occasions, the Farm Service Agency can additionally guarantee private land sales between retiring and beginning farmers and ranchers.

- **"LAND LINK" SERVICES.** These organizations work to connect established agricultural producers who are looking to lease some of their land and/or eventually sell it to beginning farmers and ranchers. Many also offer training and mentorship for the new farmer/rancher. Some examples of such services in Colorado include Guidestone Land-Link, Healthy Community Food Systems' Land Link, and LandShare Colorado.

- **INTERNSHIPS.** Many established farms and ranches have internship opportunities that give aspiring farmers and ranchers technical experience, while providing needed labor for the agricultural landowner. Senate Bill 18-042 created a 6-year trial agricultural workforce development program that allows qualified agricultural businesses to be reimbursed up to 50 percent of the cost of hiring qualified interns.

- **STATE SALES TAX EXEMPTION FOR FARM EQUIPMENT PURCHASES AND LEASES [SECTION 39-26-716, C.R.S.].** This tax expenditure exempts all purchases and leases of farm equipment with a fair market value of $1,000 or more from state sales tax.

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

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

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE APPLICATION OF THE STATUTORY REQUIREMENT THAT THE LEASEHOLDERS SUBMIT THEIR FEDERAL SCHEDULE F FORM IN ORDER TO QUALIFY FOR THE AGRICULTURAL LEASE DEDUCTION MAY MAKE IT DIFFICULT FOR MANY AGRICULTURAL PRODUCERS TO APPLY. Specifically, under Section 35-75-107(1)(u), C.R.S., leaseholders are required to submit a copy of their federal Schedule F form along with their application, although statute does not specify whether the form needs to be from the same tax year for which the deduction is claimed. For Calendar Year 2017, the Authority required leaseholders to provide the Schedule F form from their 2017 federal tax return (filed in 2018) with the asset owner's application, which was the same year that taxpayers would have been claiming the deduction. This means that leaseholders would have had to file their federal (but not state) income taxes before they or the asset owner could file their application with the Authority,

which was due March 31st, to qualify for the deduction. This may have limited the ability of those agricultural producers who normally file for extensions on their federal taxes to qualify, since they would not have completed their Schedule F prior to the March 31st application deadline. The requirement that leaseholders submit their Schedule F form appears to be intended to allow the Authority to verify that the leaseholders are agricultural producers and are not using the leased asset for other purposes. However, the General Assembly may wish to clarify how the Authority should verify that leaseholders are farmers or ranchers to allow more flexibility for farmers and ranchers who are interested in applying for the deduction. For example, the General Assembly could require that the Authority allow leaseholders to submit Schedule F forms from the year prior to the establishment of the lease or allow for alternative forms of documentation to show that they intend to use the leased asset for agricultural purposes. This would allow asset owners and leaseholders to submit applications before the March 31st deadline.

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE TAX BENEFIT PROVIDED BY THE AGRICULTURAL LEASE DEDUCTION TO DETERMINE WHETHER IT PROVIDES A SUFFICIENT INCENTIVE TO ACCOMPLISH ITS PURPOSE. Specifically, in the four other states with similar tax expenditures, the expenditures were structured to provide a more significant benefit for taxpayers. For example, the four other states have offered similar provisions as tax credits, which provide a direct reduction in income tax liability, as opposed to deductions, which instead reduce taxable income. In addition, they have offered higher caps on the amount each taxpayer can claim, which can also make these provisions more attractive to taxpayers. All four other states have also allowed taxpayers to either carry-forward (i.e., apply the tax benefit to later tax years) or obtain monetary refunds for the expenditures, which provides taxpayers with more flexibility to maximize the benefit they receive.

In at least three of the four states where these provisions are included, it appears that more taxpayers have taken advantage of these

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

CROP HAIL INSURANCE PREMIUM TAX EXEMPTION

EVALUATION SUMMARY SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1961
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No, because it is not being used

WHAT DOES THIS TAX EXPENDITURE DO?

Insurance companies selling policies in Colorado must pay a premium tax on the amount they collect for insuring in-state property or risks, including crops. Under the Crop Hail Insurance Premium Tax Exemption (Crop Hail Exemption), a portion of the premiums received on crop hail insurance sold by small-scale, member-owned insurers known as "mutual protective associations" is exempt from the premium tax.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. Based on statutory language, we inferred that its purpose is to improve the ability of farmers to obtain insurance on damage to their crops from hailstorms through mutual protective associations, which would be able to lower farmers' insurance premiums due to the tax savings.

WHAT DID THE EVALUATION FIND?

The exemption is not meeting its purpose since no companies are currently eligible to claim it.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may wish to consider either repealing the exemption, since it is not currently being used, or expanding the eligibility requirements for the exemption to increase the companies that may be eligible for it.

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CROP HAIL INSURANCE PREMIUM TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

In 1883, Colorado began levying a tax on insurance companies' in-state premium revenue, which is the revenue they collect from customers for writing insurance policies covering property or risks in the state. In 1961, Colorado created the Crop Hail Insurance Premium Tax Exemption (Crop Hail Exemption), which exempts certain insurers from paying the premium tax on a portion of the premiums they collect. Specifically, according to Section 10-3-209(1)(d), C.R.S., to be eligible to claim the exemption, an insurer must meet each of the following conditions:

A Be a "mutual protective association," which is a small-scale mutual insurance company owned entirely by its policyholders and authorized to sell them insurance policies covering in-state property or damages [Section 10-12-101(1), C.R.S.].

B Sell only crop hail insurance and not offer any other type of insurance to policyholders.

C Operate on an "advance premium basis," meaning that once the insurer sets the premium amount it cannot change during the policy period regardless of actual losses that may occur.

In addition, the exemption only applies to the "portion of the premium designated to the loss fund." The loss fund is the amount insurers must set aside in a given period in order to cover any payments on claims [Sections 10-12-101(3) and (4), C.R.S.]. Premiums collected and used to pay other expenses of the insurer, such as overhead and salaries, would therefore not be eligible for the exemption.

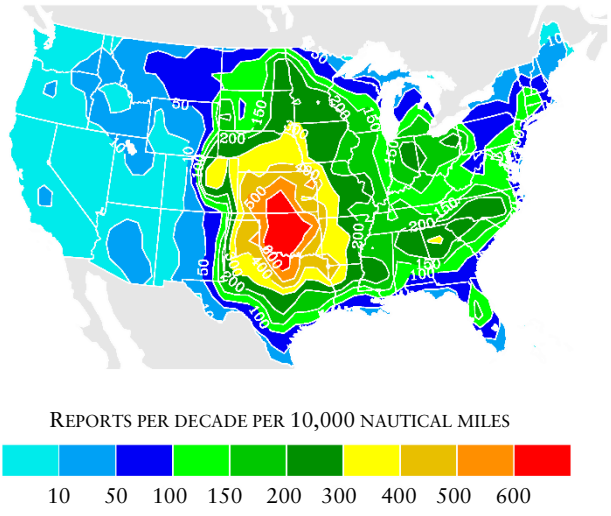
WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify intended beneficiaries for this exemption. Based on the language in statute and reports prepared by Legislative Council staff at the time the exemption was passed, the beneficiaries were intended to be eligible mutual protective associations and their policyholders, who were farmers in the state that would benefit from crop hail insurance.

According to the National Association of Mutual Insurance Companies, the number of mutual protective associations, which are more commonly known as "farm mutuals," peaked in 1925 at nearly 2,000 nationwide. As in much of the insurance industry, the following decades saw a large degree of consolidation among mutual insurers, leading to the creation of large companies which offer numerous different insurance products, including crop hail insurance.

In Colorado, crop hail insurance is often important to farmers because a hailstorm can be disastrous for a farmer's crops and Eastern Colorado lies within a region with frequent hail, known as "Hail Alley" (see EXHIBIT 1.1).

EXHIBIT 1.1. TOTAL HAIL REPORTS, 1955-2002



SOURCE: 2004 National Ocean and Atmospheric Administration report.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. We inferred, based on the language of the statute, and the environment surrounding the passage of the exemption, that its purpose was to improve the ability of farmers to obtain insurance on damage to their crops from hailstorms through mutual protective associations, which would be able to lower farmers' insurance premiums due to the tax savings. Specifically, according to a Legislative Council report prepared in 1960, at the time the exemption passed, high private hail insurance rates had historically been a concern in the state and the State's Crop Hail Insurance Program run by the Department of Agriculture was found to not be sufficiently addressing this issue because of low participation among farmers, and a competitive disadvantage with private insurers.

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

We determined that the Crop Hail Exemption is not meeting its purpose because no insurers are currently eligible to claim it. Statute does not contain a quantifiable performance measure for the Crop Hail Exemption. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its inferred purpose:

PERFORMANCE MEASURE: *To what extent does the Crop Hail Exemption increase the availability of crop hail insurance to farmers in the state?*

RESULT: The Crop Hail Exemption does not increase the availability of crop hail insurance in the state because no taxpayers are currently eligible to use it. Specifically, despite the continuing sale of crop hail insurance in the state, no insurers licensed in Colorado are mutual protective associations that only issue crop hail insurance, as required by the Crop Hail Exemption. Since 1979, there have not been any active

mutual protective associations in the state. Furthermore, all of the State's 351 providers of crop hail insurance offer other types of insurance, such as flood, lightning, livestock, and auto insurance. Insurance stakeholders we contacted reported that there are only a handful of insurers nationwide who solely issue crop hail policies, but none of them are located in Colorado.

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

Since no taxpayers are currently eligible to claim the Crop Hail Exemption, there is no revenue impact to the State and no economic costs or benefits associated with the exemption.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Crop Hail Exemption would have no impact on beneficiaries because it is not being used and there are no taxpayers eligible to use it.

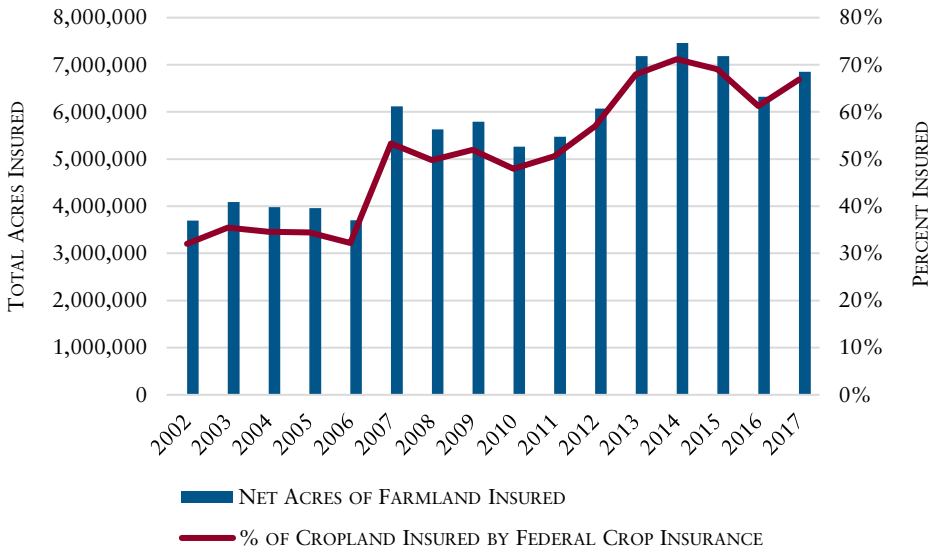
ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES OR OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

We did not identify any other states with a tax expenditure for crop hail insurance and there are no other state tax expenditures or programs in Colorado related to stand-alone crop hail insurance issued by a mutual insurance company.

Most cropland in Colorado is now covered by federal crop insurance, which may address the lack of affordable crop hail insurance that led the General Assembly to create the exemption. Federal crop insurance, which grew in popularity in the 1980s and 1990s, is a partnership between the U.S. Department of Agriculture's Risk Management Agency and private insurance companies to offer federally subsidized,

regulated, and guaranteed policies that insure against risks to crops, such as from fire, drought, and disease. These policies often provide limited high deductible hail insurance, though we lacked data to specifically quantify the percentage that include hail insurance. According to the National Crop Insurance Services, in 2017 Colorado farmers paid $181 million in federal crop insurance and $14 million in standalone crop hail premium. Colorado does not assess a premium tax on federal crop insurance and states are prohibited from doing so. Farmers are not required to purchase federal crop insurance, but most elect to do so. EXHIBIT 1.2 shows that the percentage of cropland in Colorado covered by federal crop insurance has increased since 2006, with 67 percent of cropland covered in 2017.

EXHIBIT 1.2. ACRES OF COLORADO CROPLAND COVERED BY FEDERAL CROP INSURANCE, CALENDAR YEARS 2002 -2017



SOURCE: Office of the State Auditor estimate based on U.S. Department of Agriculture Risk Management Agency and National Agricultural Statistics Service.

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

We did not identify any data constraints related to the evaluation of the Crop Hail Exemption.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider either repealing the Crop Hail Exemption or expanding the eligibility requirements for the exemption. Since there are currently no taxpayers who qualify for the exemption and the original purpose of the exemption may be fulfilled by other insurance products, the General Assembly may wish to consider repealing the Crop Hail Exemption. Alternatively, if the General Assembly would like to make the exemption available to more taxpayers to help reduce the cost of crop hail insurance in the state, it could change the eligibility requirements to include a broader range of beneficiaries, so that the exemption could be used to lower the overall cost of crop hail insurance. Despite the availability of crop hail insurance, Colorado farmers continue to pay significantly higher premium rates than farmers in most other states due to the higher risk of hail damage in Colorado compared to other states, which may reduce the number of insured farmers.

FARM CLOSE-OUT SALES TAX EXEMPTION

EVALUATION SUMMARY SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1945
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	Could not determine
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes, but with variable impact based on local taxes

WHAT DOES THIS TAX EXPENDITURE DO?

Sales of property used for farming or ranching by Colorado agricultural producers who are abandoning operations and holding a farm close-out sale, either by auction or private sale, are not subject to state sales tax and some local sales taxes under this exemption.

WHAT DID THE EVALUATION FIND?

The exemption appears to be meeting its purpose, primarily because it eliminates the local sales taxes that would otherwise apply to farm close-out sales in many local jurisdictions, although this impact varies widely depending on local tax policies. The exemption has a limited impact on state sales tax liability for most buyers because most of the transactions at farm close-out sales are now exempt from state sales tax under other tax provisions enacted since the Farm Close-Out Sales Tax Exemption was created.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Farm Close-Out Sales Tax Exemption. Based on statutory language, we inferred that the purpose was to encourage the purchase and transfer of used agricultural equipment and supplies from agricultural producers who are abandoning operations to new and ongoing agricultural producers by reducing the cost to buyers.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may wish to review this expenditure's exemption of on-road motor vehicles sold at farm close-out sales from sales tax, because this appears inconsistent with other tax expenditures that are intended to reduce the sales tax liability of farmers and ranchers.

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FARM CLOSE-OUT SALES TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Farm Close-Out Sales Tax Exemption [Section 39-26-716(4)(a), C.R.S.] was enacted in 1945 and exempts from sales tax all purchases made at "farm close-out sales," which are sales of an outgoing farmer's or rancher's tangible personal property, including equipment, vehicles, and other physical property, that is used to carry out agricultural operations [Section 39-26-102(4), C.R.S.]. The exemption applies to state sales and use tax and local sales and use taxes for local governments, such as cities and counties, for which the state collects sales tax. Home-rule jurisdictions established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes have the authority to enact their own tax policies and are not required to provide the exemption. To qualify for the exemption, the farmer or rancher must be attempting to dispose of all property used in their agricultural operation, which could include tractors, combines, grain handling equipment, sprayers, motor vehicles, or livestock, and abandoning the operation. Farmers and ranchers may retain their real and tangible nonagricultural property, such as their home and personal property, and still have the sale qualify for the exemption. Farm close-out sales can be made through auctions, estate sales or, beginning in 1964, private sales between farmers or ranchers and buyers.

The Farm Close-Out Sales Tax Exemption is typically applied at the point of sale and provides an exemption from the general requirement that sellers of tangible personal property collect and remit state sales tax from buyers. In most cases, sellers holding a farm close-out sale, which are typically the farmers or ranchers who own the property or auction firms that they hire to conduct the sale, are required to obtain a sales tax license and report the value of exempt sales to the Department of

Revenue using its Retail Sales Tax Return (Form DR 0100). The amount sellers report on this form is aggregated with several other sales tax exemptions and sellers are not required to report how much is attributable to this specific exemption. Outgoing farmers and ranchers privately disposing of agricultural items worth $1,000 or less in a given year are not required to obtain a sales tax license, but must still report state sales and use tax on Department of Revenue tax form DR 0100A. This form, which is used to report and remit state sales and use tax from occasional sales of $1,000 or less each year, also does not require the seller to specifically report the amount applied to the Farm Close-Out Sales Tax Exemption.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. Based on the statutory language, we infer that the intended beneficiaries of this exemption are farmers and ranchers who are abandoning their agricultural operations, and purchasers—primarily other farmers and ranchers—of tangible personal property from farm close-out sales. We could not identify statistics regarding the number and size of farm close-out sales that occur in the State. However, agricultural industry representatives and respondents to our survey of farmers and ranchers indicated that farm close-out sales are common within the agricultural industry, and the auction firms we spoke with reported that their practice is to apply the Farm Close-Out Sales Tax Exemption when they hold farm close-out auctions.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Based on the statutory language and its historical context, we inferred that the purpose was to encourage the sale and transfer of used agricultural equipment and supplies from farms and ranches that were closing to those with new and ongoing agricultural operations by reducing the cost to buyers purchasing such equipment and supplies. At the time of the

exemption's enactment in 1945, which was during the final months of World War II, the supply of new farm machinery could not keep up with the large demand for U.S. agricultural products from domestic and international buyers. Farm close-out auctions were likely an affordable means for farmers and ranchers to procure such equipment from those leaving the sector. Therefore, the General Assembly may have intended the expenditure to encourage these sales by reducing the after-tax cost of the equipment.

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

We determined that the Farm Close-Out Sales Tax Exemption is meeting its purpose, although its impact is primarily limited to taxing jurisdictions that apply a sales tax on farm equipment.

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

PERFORMANCE MEASURE: *Does the Farm Close-Out Sales Tax Exemption reduce the cost of purchasing agricultural equipment and supplies through farm close-out sales?*

RESULT: The Farm Close-Out Sales Tax Exemption likely provides a cost-savings to some farmers and ranchers who purchase agricultural equipment and supplies at farm close-out sales. However, most of the potential cost savings are due to a reduction in local, as opposed to state, sales and use taxes and the cost savings vary considerably based on the interplay between the applicable state and local tax provisions.

Most of the potential cost savings from the Farm Close-Out Sales Tax Exemption do not come from a reduction in state sales taxes because most purchases of equipment and supplies at farm close-out sales that

are to be used for agricultural purposes are also exempt from state sales tax under other state tax expenditure provisions. Specifically, Sections 39-26-102(19) and 716, C.R.S., provide broader exemptions from sales and use tax for purchases of most farm equipment and supplies, regardless of whether they occur at a farm close-out sale, at retail, or between individuals outside of a farm close-out sale. With the exception of sales tax exemptions for the sale of livestock, feed, seed, and orchard trees that were enacted along with the Farm Close-Out Sales Tax Exemption, these broader exemptions did not exist in 1945, when the Farm Close-Out Sales Tax Exemption was created. However, with the establishment of these broader sales tax exemptions for agricultural purchases, the impact of the Farm Close-Out Sales Tax Exemption, as it relates to the state sales tax paid by farmers and ranchers, has been significantly reduced. Instead, the unduplicated state sales tax cost savings provided by the Farm Close-Out Sales Tax Exemption is mainly limited to purchasers who do not intend to use the items for an agricultural purpose under Section 39-26-716, C.R.S., and purchasers of on-road motor vehicles, because such purchases do not fall under the other agricultural exemptions and would otherwise be taxed.

Despite its limited impact on farm close-out buyers' state sales tax costs, the Farm Close-Out Sales Tax Exemption may provide a significant cost savings in some local taxing jurisdictions. This is because under Section 29-2-105(1)(d), C.R.S., although the Farm Close-Out Sales Tax Exemption applies to the calculation of local sales taxes in all local jurisdictions for which the state collects sales taxes, the broader exemption for sales of farm equipment under Section 39-26-716, C.R.S., only applies to the local sales tax in these jurisdictions if they have specifically ratified a local provision to exempt farm equipment. Therefore, in state-collected jurisdictions that do not exempt farm equipment from sales and use tax, the Farm Close-Out Sales Tax Exemption continues to provide a significant cost savings on purchases of such equipment.

Based on our review of tax rate information published by the Department of Revenue, only 19 of the State's 64 counties have enacted the farm equipment sales tax exemption. An additional 10 counties do not have

any sales tax and two more are home-rule counties that are not administered by the State, leaving 33 counties where the Farm Close-Out Sales Tax Exemption provides an unduplicated cost savings on purchases of farm equipment. Similarly, 8 municipalities and 19 special districts that have their sales taxes collected by the State have farm equipment exemptions in place, leaving 143 municipalities and 12 special districts where the Farm Close-Out Sales Tax Exemption would provide an additional cost savings. These jurisdictions are distributed across the state and include many locations with significant agricultural economies. Based on our review of local sales tax rates, the population-weighted, average combined local tax rate in Colorado is 1.8 percent, excluding self-collected home-rule jurisdictions. Therefore, for some large purchases that would otherwise be taxed at the local level, the Farm Close-Out Sales Tax Exemption can provide a significant benefit to buyers. This benefit can vary widely based on the local tax rates, which can be as high as 7.5 percent or as low as 0.25 percent for the relevant locations. Overall, these tax benefits could provide a strong enough incentive to encourage some farmers and ranchers to participate in farm close-out sales, especially if they plan to purchase more expensive equipment. For example, a farmer purchasing a $50,000 used tractor at a farm close-out sale would save $900, based on the 1.8 percent average population-weighted local tax rate for state-collected local governments.

It is also important to note that neither the Farm Close-Out Sales Tax Exemption, nor any other exemption that may apply to a purchase at a farm close-out sale, necessarily applies to the local sales tax in home-rule taxing jurisdictions established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes. These 71 jurisdictions, which include all of the State's most-populated cities, set their own sales tax ordinances independent of state control. While some exempt purchases at farm close-out sales from sales tax, such provisions operate outside of the State's authority.

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

The Farm Close-Out Sales Tax Exemption has a relatively small impact on state revenue because most of the transactions that occur through farm close-out sales would likely be exempt from state sales tax because of other sales tax exemptions. However, the exemption likely results in some lost state revenue, in particular for motor vehicles and items that are sold to buyers who intend to use the items for a non-agricultural purpose. In addition, the exemption probably reduces the revenue of state-collected local taxing jurisdictions that do not otherwise exempt sales of farm equipment from sales taxes. This local impact is likely greatest in jurisdictions where agricultural operations make up a substantial part of the local economy.

Furthermore, the exemption likely provides a financial benefit to buyers, in particular those making purchases in local taxing jurisdictions that would otherwise levy a sales tax on the purchase, those who purchase motor vehicles, and those who do not intend to use the items purchased for an agricultural purpose. Overall, this financial benefit may increase interest and participation in farm close-out sales from these buyers, which would help sellers conducting farm close-out sales to find buyers and ease the process of winding down their agricultural operations. As discussed further below, we could not identify a reliable data source to quantify the sales volume and number of farm close-out sales that occur in Colorado, the types of items sold, or the buyers' intended use (i.e., agricultural vs. non-agricultural). Therefore, we were not able to quantify the potential economic costs and benefits.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Farm Close-Out Sales Tax Exemption would increase taxes for some buyers at farm close-out sales. It appears that buyers in certain local taxing jurisdictions that do not exempt farm equipment sales from tax, non-agricultural buyers, and motor vehicle buyers would

pay most of this additional tax, since the purchases of most agricultural buyers would otherwise already be exempt under other sales tax exemptions. Eliminating the exemption might also have a modest financial impact on farmers and ranchers who are closing out their operations, since the additional tax on buyers could reduce the number of participants at auctions or decrease the price buyers at private sales are willing to pay.

Eliminating the exemption would also change the administrative requirements for sellers. For example, auctioneers facilitating close-out sales would no longer need to verify and collect written declarations from outgoing farmers and ranchers that the items they sell were previously used as part of an agricultural operation and are therefore, exempt under the Farm Close-Out Sales Tax Exemption. On the other hand, sellers, including both auctioneers and farmers and ranchers making private sales, would need to verify that buyers intend to use the items purchased for an agricultural purpose in order to apply other available state sales tax exemptions. Further, some farmers and ranchers may face the additional requirement to obtain sales tax licenses if some items they sell at the farm close-out sale become taxable (e.g., equipment that will not be used for agriculture). However, it is unclear how much of an additional burden this would create since some farmers and ranchers conducting farm close-out sales already fall under this requirement if they sell some items as part of the sale that do not qualify for the exemption, such as personal property that was not used for their agricultural operation.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 other states and the District of Columbia that impose a sales tax, we identified five states that have a tax expenditure similar to the Farm Close-Out Sales Tax Exemption. These other states' expenditures are listed in EXHIBIT 1.1, along with comparisons to Colorado's exemption.

EXHIBIT 1.1. COMPARISON OF COLORADO'S FARM CLOSE-OUT SALES TAX EXEMPTION AND OTHER STATES' SIMILAR EXEMPTIONS

State	Type of Sales Tax Expenditure	Private Sales Covered?	Type of Eligible Items	Only Applies to "Close-Outs"[1]?	Must Take Place on Farm/Ranch?
Colorado	Exemption	Yes	Property used in agriculture	Yes	No
Minnesota	Exemption	No	Property used in agriculture Nonbusiness property (e.g., household goods)	No	No
Missouri	Exemption	Yes	All property except inventory	Yes	No
North Dakota	Exemption	No	All property	No	No
Washington	Exemption	No	Property (including household goods) used in agriculture Does not apply to property used in production of marijuana	No	Yes
Wisconsin	Exemption	No	Property used in agriculture, and household goods Does not apply to highway vehicles, boats, pets, and recreational animals not used in farming (e.g., racing, riding, or show animals)	No	No, but must take place "at a location where the auctioneer holds 5 or fewer auctions" per year

SOURCE: Source: Bloomberg BNA Tax and Accounting Center.

[1] "Close-Outs" refers to situations where the owner of the agricultural operation is planning to cease operations and is attempting to sell off their assets, with the exception of real estate and personal assets.

One reason that most other states do not have a farm close-out sales tax exemption is that other, broader exemptions for occasional or isolated sales likely cover the same transactions in those states, making such an exemption unnecessary. Specifically, 42 states and the District of Columbia exempt occasional sales and purchases from sales tax, which typically includes nonrecurring and infrequent sales of tangible personal property by an individual who is not in the business of selling that type of property. Many of the items sold through a farm close-out sale would likely fall under this type of exemption. However, Colorado does not

have a similar exemption for occasional sales, though, as mentioned above, it does not require a sales tax license for sellers that make occasional sales of $1,000 or less per year.

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

There are several other state tax expenditures that potentially exempt property sold through a farm close-out sale from sales tax. Unlike the Farm Close-Out Sales Tax Exemption, these expenditures require the purchaser to be engaged in an agricultural business and to use the property purchased for an agricultural purpose. Together, these expenditures exempt much of the equipment and supplies purchased by farmers and ranchers and likely overlap with most of the items sold at farm close-out sales.

Specifically, the following sales tax exemptions could apply to property sold at a farm close-out sale:

- **Livestock Exemption** [Section 39-26-716(4)(a), C.R.S.]. Established in 1943, this exempts most sales of livestock from state sales tax. The exemption includes most animals raised for commercial purposes, other than those being raised to be sold as pets.

- **Feed for Livestock, Seeds, and Orchard Trees Exemption** [Section 39-26-716(4)(b), C.R.S.]. Established in 1945, along with the Farm Close-Out Sales Tax Exemption, this exempts sales of feed, seeds, and orchard trees used for agricultural purposes.

- **Straw for Livestock and Poultry Bedding Exemption** [Section 39-26-716(4)(c), C.R.S.]. Established in 1961, this exempts agricultural purchases of straw used for animal bedding.

- **Farm and Dairy Equipment and Parts Exemption** [Sections 39-26-716(2)(b) and (3)(b), C.R.S.]. Established in 1999 and expanded in 2001, this exempts most purchases of equipment used for agricultural purposes from sales tax. However, it does not apply to

on-road motor vehicles which must be registered in the state, regardless of whether they are used for an agricultural purpose.

- **WHOLESALE ADJUVANTS, SEMEN FOR AGRICULTURAL PURPOSES, AGRICULTURAL COMPOUNDS, AND PESTICIDES EXEMPTION** [Section 39-26-102(19)(c) and (d), C.R.S.]. Originally, established in 1999 and expanded in 2012, this includes the sale of adjuvants, semen, agricultural compounds, and pesticides within the definition of wholesale sales, which are exempt from sales tax.

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

The Department of Revenue does not track farm close-out sales revenue, the amount of Farm Close-Out Sales Tax Exemption claimed, or the taxpayers who claim it, and we could not identify any other reliable source to obtain this information. Specifically, the Department of Revenue's Retail Sales Tax Return (Form DR 0100) does not contain a specific line for the Farm Close-Out Sales Tax Exemption and taxpayers must lump this expenditure's total into a line that includes all exemptions not specifically listed on the form. Since this line can encompass several different exemptions, the Department of Revenue does not capture this data point in GenTax, its tax processing and information system. If the General Assembly wants to know how many taxpayers claim the Farm Close-Out Sales Tax Exemption and how much they claim, it could require the Department of Revenue to add a specific line to the DR 0100 where taxpayers would be required to report this information and direct the Department of Revenue to capture the data in GenTax. However, this change would require resources for the Department of Revenue to update the form, provide new instructions, and make programming changes in GenTax to capture the information. (See the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and the potential costs of addressing these limitations.) Additionally, the change would increase the administrative burden on sellers who would be required to separately track and report exempt farm close-out sales.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

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

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HUNGER RELIEF INCOME TAX CREDIT & CROP AND LIVESTOCK CONTRIBUTION CORPORATE INCOME TAX CREDIT

EVALUATION SUMMARY SEPTEMBER 2018

THESE EVALUATIONS ARE INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

	HUNGER RELIEF INCOME TAX CREDIT CALENDAR YEAR 2016	CROP AND LIVESTOCK CONTRIBUTION CORPORATE INCOME TAX CREDIT CALENDAR YEARS 2012–2016
YEAR ENACTED	2014	1982
REPEAL/EXPIRATION DATE	January 1, 2020	None
REVENUE IMPACT	$71,000	Minimal
NUMBER OF TAXPAYERS	353	Too few to report
AVERAGE TAXPAYER BENEFIT	$201	Too few taxpayers to report
IS IT MEETING ITS PURPOSE?	Yes, but the impact is relatively small	No, because it has been used infrequently

WHAT DO THESE TAX EXPENDITURES DO?

The Hunger Relief Income Tax Credit (Hunger Relief Credit) allows a farmer or rancher to claim an income tax credit equivalent to 25 percent of the value of food donations to hunger relief organizations, up to a maximum of $5,000 per year.

The Crop and Livestock Contribution Corporate Income Tax Credit (Crop and Livestock Corporate Credit) allows agricultural C-corporations to claim an income tax credit of 25 percent of the value of food donations, up to a maximum of $1,000 per year.

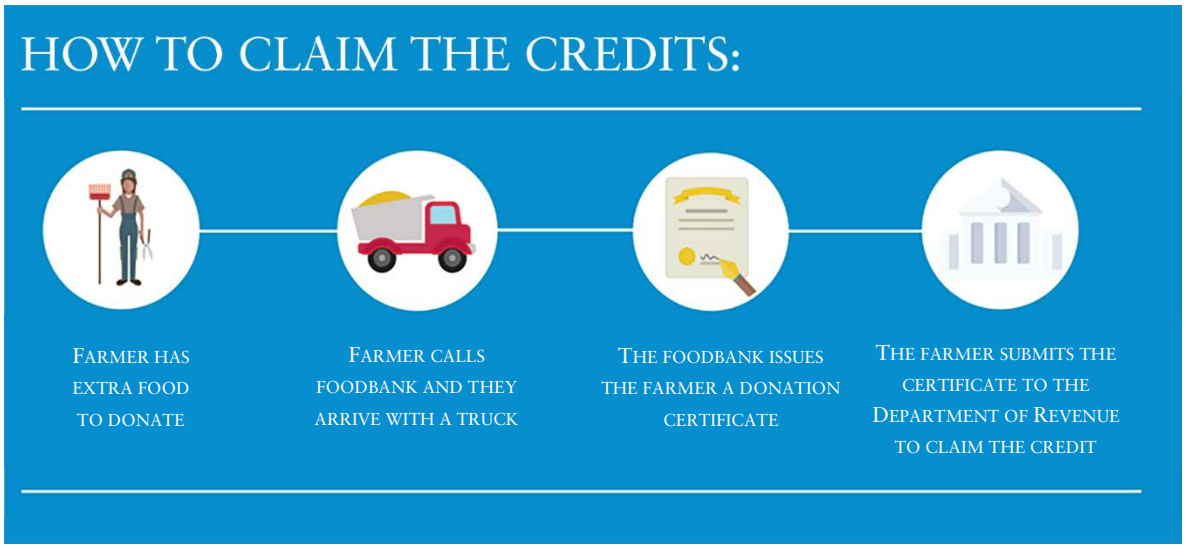
WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not explicitly state a purpose for either of the tax expenditures. However, we inferred that the purpose of the credits is to incentivize Colorado agricultural producers to donate more fresh produce, meat, dairy, and eggs to hunger relief organizations.

WHAT DID THE EVALUATION FIND?

The Hunger Relief Credit is meeting its purpose of providing an incentive for agricultural producers to donate food and may have resulted in a relatively small increase in food donations of healthy, fresh produce.

The Crop and Livestock Corporate Credit has only been used infrequently in recent years, and is doing little to meet its purpose.



WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

- Some non-corporate agricultural producers are unaware of the Hunger Relief Credit and therefore have not used it because it has only been available since Calendar Year 2015.

- Constraints, such as the cost to harvest crops, low tax liabilities among agricultural producers, and federal filing status, likely limit the financial incentive provided by the credits and the ability of some food donors to use them.

- The $1,000 annual cap on the Crop and Livestock Corporate Credit may be too low for it to provide an adequate incentive for C-corporations.

HUNGER RELIEF INCOME TAX CREDIT & CROP AND LIVESTOCK CONTRIBUTION CORPORATE INCOME TAX CREDIT

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

This report includes our evaluation of the two tax credits currently in place related to the donation of food by agricultural producers: the Hunger Relief Income Tax Credit (Hunger Relief Credit), which was created in 2014, and the Crop and Livestock Contribution Corporate Income Tax Credit (Crop and Livestock Corporate Credit), which has existed in its current form since 1987.

House Bill 14-1119 [Section 39-22-536, C.R.S.] created the Hunger Relief Credit, which was effective beginning in 2015 and allows farmers and ranchers who donate grains, fruits, vegetables, or other crops, as well as milk, eggs, livestock, or big game, to claim a credit against their state income tax liability. To qualify, taxpayers must donate the food to "hunger-relief charitable [organizations]" that "[use] food contributions for hunger-relief" in their communities (e.g., food banks, food pantries, soup kitchens, etc.). The bill permits all individuals or business entities, other than C-corporations or fiduciaries, to claim the credit, as long as they have filed a federal Schedule F tax form, which indicates profit or loss from agricultural operations. The amount of the credit is 25 percent of the value of their food donation, up to a maximum of $5,000 per year. If the credit exceeds a taxpayer's tax liability, it is not refundable; however, taxpayers may carryforward credits and apply them against their future tax liabilities for 5 years.

The Crop and Livestock Corporate Credit [Section 39-22-301(3), C.R.S.] was established in 1982 and was the State's first tax expenditure covering agricultural donations to qualified charities. Initially, it was available to all agricultural businesses, but in 1987, the General Assembly limited it to C-corporations. The Crop and Livestock Corporate Credit has a similar structure as the Hunger Relief Credit in that it provides a credit to taxpayers based on their charitable donations of food, but it has a more limited definition of what type of donations qualify. The Crop and Livestock Corporate Credit allows all of the same types of donations as the Hunger Relief Credit, with the exception of eggs, milk, and big game. Like the Hunger Relief Credit, the amount of the Crop and Livestock Corporate Credit is equivalent to 25 percent of the value of the food donation, but only up to an annual maximum of $1,000. It is also not refundable, but can be carried forward for 5 years to be applied against future tax liabilities.

To claim either credit, taxpayers must obtain a receipt from the charitable organization that confirms the donation. For the Hunger Relief Credit, taxpayers must submit the receipt to the Department of Revenue when filing their tax return and for the Crop and Livestock Corporate Credit, taxpayers must retain the receipt and provide it to the Department upon request. The taxpayer is then able to claim 25 percent of the donation's "most recent sale price" or "wholesale market price," as estimated by the taxpayer, as a credit on their state income taxes.

There is an interplay between the Hunger Relief Credit and the enhanced federal deduction for charitable contributions allowed by Section 170 of the Internal Revenue Code (for taxpayers who choose to itemize). Taxpayers making eligible food donations are allowed to take both the federal deduction and the state credit. However, to prevent "double dipping," when taxpayers complete their Colorado state tax return, they must add back an amount equal to the value of the donation for which they claimed the federal deduction to their federal taxable income, which is the starting point for calculating Colorado taxable income. Taxpayers also cannot claim both the Hunger Relief Credit and the state deduction for charitable giving for the same donation. None of these restrictions apply to the Crop and Livestock Corporate Credit.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

According to the legislative declaration in House Bill 14-1119, which established the Hunger Relief Credit, the intended beneficiaries of the credit are individuals who are experiencing food insecurity; hunger relief organizations, such as food banks and food pantries; and agricultural producers, including farmers and ranchers who file individual tax returns. Although the Crop and Livestock Corporate Credit does not include a similar legislative declaration, we inferred that it has a similar set of beneficiaries, with the primary difference being that it is intended to benefit agricultural producers who file as C-corporations, as opposed to individual filers.

According to the non-profit, Feeding America, as of 2016, over 627,000 Coloradans were experiencing hunger, which represents about 11 percent of all residents in the state. To help address this problem, a network of non-profit organizations operate in the state with the mission of encouraging food donations and distributing food to those in need. These organizations include Feeding Colorado, which coordinates the operations of five large food banks. These food banks handle a large volume of the food donated in the state and are a significant place for agricultural producers to donate food. In addition to receiving donations from agricultural producers, the food banks receive donations of food from individuals and food retailers, and also accept monetary donations which they use to purchase food. The food banks then distribute food into communities throughout Colorado through about 1,500 organizations, such as food pantries, churches, and community centers. This network of hunger relief organizations distributed 110 million pounds of food to Colorado residents in Calendar Year 2017. According to Feeding Colorado, the State's five food banks report that they, and the organizations they distribute food to across the state, are experiencing historic demand, which they are unable to keep up with—particularly for produce, meat, and dairy products.

According to the U.S. Department of Agriculture, the State's 34,000

agricultural producers (7 percent of which were C-corporations at the time of the most recent Colorado Agricultural Census in 2012) and are, according to Feeding Colorado, an important source of food donations because of the volume they can donate and because they can increase the supply of fresh, healthy food available to those needing food assistance. In addition to making donations based on a desire to help those in need, agricultural producers also have food available that cannot be sold, either due to a lack of demand or because of blemishes that make the food less marketable, though it is still healthy and suitable for consumption. The Food and Agriculture Organization estimates that 24 percent of all fruits and vegetables are wasted before they even reach the grocery store or restaurant. This includes food that is left in the field post-harvest and food that spoils or is unable to be sold by the agricultural producer. Food banks have been able to reduce this waste and obtain a source of healthy food, by accepting deliveries of excess food from producers, sending their own trucks to collect food from producers, and organizing volunteers to harvest excess crops that are left in the field post-harvest, a practice called "gleaning."

WHAT ARE THE PURPOSES OF THE TAX EXPENDITURES?

Statute does not explicitly state a purpose for the Hunger Relief Credit. However, based on the legislative declaration for House Bill 14-1119 [Section 39-22-536, C.R.S.], which established the credit, we inferred that the purpose of the credit is to:

- Incentivize Colorado agricultural producers to donate more produce, meat, dairy, and eggs to hunger relief organizations.

- Increase access to healthy, fresh foods, in greater variety for Coloradans who require food assistance.

Statute does not explicitly state a purpose for the Crop and Livestock Corporate Credit. However, given its similarity to the Hunger Relief Credit, we inferred the same purpose, limited to donations from C-corporations.

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

HUNGER RELIEF CREDIT

We determined that the Hunger Relief Credit is meeting its purpose, but the impact of the credit has likely been small. Specifically, we found that the Hunger Relief Credit may provide an additional incentive for some agricultural producers to donate healthy, fresh food. However, the extent to which the credit has driven increased food donations in recent years is unclear. Given national food donation trends, the relatively small size of the credits claimed, and information we received from stakeholders, it appears that the Hunger Relief Credit has had, at most, a relatively modest impact on food donations.

Statute does not provide quantifiable performance measures for this expenditure. Therefore, we evaluated the Hunger Relief Credit using the following performance measures that we inferred from the legislative declaration in House Bill 14-1119.

PERFORMANCE MEASURE #1: *The extent to which the Hunger Relief Credit has directly resulted in an increase in the total pounds of food donations from Colorado farmers and ranchers to food banks.*

RESULT: Agricultural food donations have increased significantly since 2014, when the Hunger Relief Credit was enacted, but only a small portion of the increase can potentially be attributed to the Hunger Relief Credit. The five major food banks in Colorado track how many pounds of produce, dairy, and meat have been donated by agricultural producers. The Calendar Years 2014 to 2016 totals for each food bank are shown in EXHIBIT 1.1.

EXHIBIT 1.1.
AGRICULTURAL FOOD DONATIONS TO FOOD BANKS
CALENDAR YEARS 2014-2016
(IN MILLIONS OF POUNDS)

FOOD BANK	2014	2015	2016	PERCENT CHANGE
Community Food Share (Louisville)	5.4	5.2	6.2	14%
Weld Food Bank (Greeley)	3.6	5.1	5.8	63%
Food Bank for Larimer County (Fort Collins)	2.0	2.3	2.6	26%
Care and Share Food Bank (Colorado Springs)	7.9	7.5	10.2	29%
Food Bank of the Rockies (Denver and Palisade)	4.9	7.0	10.3	109%
TOTAL	23.8	27.1	35.1	47%

SOURCE: Office of the State Auditor analysis of data provided by Feeding Colorado.

Agricultural food donations at the five food banks have increased by 47 percent, or 11.2 million pounds, from Calendar Years 2014, the year before the Hunger Relief Credit came into effect, and 2016. We found that this increase was consistent across food types: 47 percent for produce, 47 percent for dairy, and 52 percent for meat from Calendar Years 2014 to 2016.

Though the increase in total donations may suggest that the Hunger Relief Credit has increased donations from Colorado farmers and ranchers to in-state food banks, it is unclear to what extent the increase has stemmed from the credit. There are several indications that most of the increase is due to other factors. Specifically, according to Department of Revenue data, the total value of all of the credits taken for Calendar Year 2016 was about $129,000. Applying an average price of $0.34 per pound for the food donated, which we calculated based on receipts provided by the food banks, we estimate that approximately 1.5 million pounds of food were donated by taxpayers who claimed the credits in Calendar Year 2016. Therefore, given the 11.2 million pound increase in agricultural donations reported by the food banks, at most, only about 13 percent of the annual increase could be attributed to the Hunger Relief Credit. However, the true impact is likely less since some of the agricultural producers who took the credit may have donated the food regardless of the incentive provided by the credit.

We considered the following factors to further assess the potential incentive provided by the Hunger Relief Credit: (1) national food

donation trends, (2) the average amount of credit taken by taxpayers, and (3) information provided by food bank staff and agricultural industry representatives.

As shown in EXHIBIT 1.2, from Calendar Years 2014 to 2016, fresh fruit and vegetable distributions through the Feeding America charitable food distribution network rose by about 29 percent nationwide, despite the fact that only three other states and the District of Columbia created a similar credit during that time period. Therefore, it appears that factors outside of the Hunger Relief Credit are providing incentives to increase donations. Notably the federal deduction available for crop donations was increased in 2015, which could have increased donations nationwide.

EXHIBIT 1.2.
POUNDS OF FRESH FRUITS AND VEGETABLES SOURCED AND DISTRIBUTED ACROSS FEEDING AMERICA NETWORK OF FOOD BANKS
CALENDAR YEARS 2014-2016

YEAR	POUNDS OF PRODUCE[1]
2014	970 million
2015	1.1 billion
2016	1.25 billion
Percent Change 2014–2016	29%

SOURCE: Information obtained from Feeding America.
[1]Includes food obtained through donations and purchased by hunger relief organizations with monetary donations.

In addition, we found that the average value of the tax credits claimed was not high enough to provide a strong incentive to donate food. On average, taxpayers who took the credit in 2016 received an annual tax benefit of just over $200 and had a federal taxable income of about $58,000. This indicates that the credit may be enough to incentivize taxpayers to donate food in situations where the additional cost of doing so is low; for example, when a food bank offers to pick up excess crops (according to the food banks we interviewed this is a common service they offer). Furthermore, 28 percent of the taxpayers who took the credit in Tax Year 2015 or 2016 did not have sufficient tax liability to take the full amount available. This indicates that the credit's effectiveness in incentivizing larger donations is limited among the group who have claimed the credit, since taxpayers who have already

offset their entire tax liability would not be able to claim additional tax benefits even if they donated more crops.

Stakeholders from food banks, food pantries, and organizations representing agricultural producers generally indicated that the Hunger Relief Credit has only had, at most, a modest impact on food donations. Specifically, a representative from one food bank thought the credit may incentivize food donations of already harvested crops, but that it was not large enough to encourage farmers to go back and re-harvest their land. Other food bank and food pantry representatives indicated that they were unsure of whether the credit was providing any incentive at all, although some thought that could be due to lack of awareness of the credit. Representatives of agricultural producers and the farmers we spoke with also reported that many farmers would donate food regardless of the credit, in particular crops that were already harvested but not as marketable due to blemishes, though the credit could potentially provide an additional incentive in some cases.

PERFORMANCE MEASURE #2: *The proportion of food donations that were healthy, fresh food. We considered food to meet this standard if it was fresh produce, meat, eggs, or dairy.*

RESULT: The food donated by producers who took the credit was healthy and fresh. To determine the type of food donated to food banks, we reviewed donation receipts for Calendar Years 2015 and 2016 provided by the five major food banks in the state. Although this was not a complete set of all food donation receipts, it included all of the receipts maintained by the food banks and we considered it to provide a reliable sample of the types of donations received. Of the available 188 food bank receipts that contained descriptions of the items donated, almost all (98 percent) of the items donated were fruits and vegetables and the remaining donations were eggs and legumes. Many of these donations were not supermarket or restaurant-quality due to blemishes or size, and they were not always as fresh as supermarket goods. However, the food banks reported that the vast majority was of good quality and suitable for consumption.

CROP AND LIVESTOCK CORPORATE CREDIT

We determined that the Crop and Livestock Corporate Credit is not meeting its purpose. Specifically, we found that it is used too infrequently to have had any meaningful impact on food donations or the agricultural industry, with too few taxpayers taking the credit for us to be able to report the number who took the credit or the amount they claimed without compromising confidentiality of the taxpayers' data. Section 39-21-305(2)(b), C.R.S. requires us to maintain the confidentiality of taxpayer information.

Statute does not provide quantifiable performance measures for this expenditure. Therefore, we created and applied the same performance measures that we used to evaluate the Hunger Relief Credit.

PERFORMANCE MEASURE #1: *The extent to which the Crop and Livestock Corporate Credit has directly resulted in an increase in the total pounds of food donations from Colorado farmers and ranchers to food banks.*

RESULT: Due to its limited use, we found that the Crop and Livestock Corporate Credit has not resulted in a measurable increase in food donations.

PERFORMANCE MEASURE #2: *The proportion of food donations that were healthy, fresh food. We considered food to meet this standard if it was fresh produce, meat, eggs, or dairy.*

RESULT: We were not able to obtain information on the type of food donated for this credit.

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

HUNGER RELIEF CREDIT REVENUE IMPACT

The Hunger Relief Credit has directly reduced state tax revenue by an

average of about $71,000 annually and provided an average benefit of about $206 per year to taxpayers who used it. EXHIBIT 1.3 shows the number of taxpayers claiming the credit, the credit amount available, and the credits actually claimed for Calendar Years 2015 and 2016. The amount of credits used is less than those available because some taxpayers had tax liabilities less than the credit available during each year. These taxpayers may carry forward the credits for 5 years to offset future tax liabilities.

EXHIBIT 1.3.
HUNGER RELIEF CREDITS CLAIMED
CALENDAR YEARS 2015 AND 2016

	2015	2016
Total Credits Used	$71,000	$71,000
Total Credits Available	$118,000	$129,000
Average Credit Available	$351	$367
Average Credit Claimed	$211	$201
Total Taxpayers	337	353

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

As shown, the average total amount claimed has been about $71,000 per year. However, the revenue impact to the State may be less than the amount claimed because, according to Section 39-22-104(3)(j), C.R.S., to take the credit, taxpayers have to add back to their state taxable income any amount deducted on their federal return that was based on the same donation of food, which increases state revenue. Although we were unable to obtain federal taxpayer data due to federal confidentiality requirements, we estimate that if all of the taxpayers had to add back federal deductions, the revenue impact to the State would be $59,000 (i.e., approximately $12,000 would be added back to state revenues). If none of the taxpayers had to add back federal deductions, the revenue impact would be $71,000, or the total amount claimed for the credit.

Although the fiscal impact of the credit has been small, it is important to note that this amount could grow in future years if more taxpayers begin taking the credit. Based on our interviews with stakeholders and our survey of farmers and ranchers, most agricultural producers are not aware of the credit, especially since it had only been in place for 2 years

at the time of our review. Furthermore, the revenue impact could increase over time if more taxpayers apply unused credits from previous years.

IT IS UNCLEAR WHETHER THE HUNGER RELIEF CREDIT IS COST-EFFECTIVE. To assess the cost effectiveness of the credit, we calculated the potential cost per pound to the State of food donations attributable to the credit (i.e., the donations that would not have occurred but for the incentive provided by the credit). Because we did not have a source of data to determine what proportion of the donations were actually attributable to the credit, as opposed to other factors such as taxpayer altruism and the federal charitable deduction, in EXHIBIT 1.4 we provide several scenarios that assume varying percentages of donations being attributable to the credit.

For each scenario, we took the cost of the credits to the State (estimated at $211,000 based on the total credits available for Tax Years 2015 and 2016 and assuming 15 percent of available credits are never claimed) and calculated the pounds and cost per pound of donations attributable to the credit based on a total of about 2.9 million pounds of donations made using the credit in Calendar Years 2015 and 2016, which we estimated using food bank receipts.

EXHIBIT 1.4.
HUNGER RELIEF CREDIT SCENARIOS BY ADDITIONAL POUNDS DONATED IN CALENDAR YEARS 2015 AND 2016 AND DOLLARS-PER-POUND STATE IS "PAYING"

PERCENT OF DONATIONS INCENTIVIZED BY CREDIT	POUNDS DONATED ATTRIBUTABLE TO CREDIT	COST PER POUND TO THE STATE
5 Percent	146,000	$1.44
10 Percent	293,000	$0.72
20 Percent	585,000	$0.36
21 Percent	614,000	$0.34 (Break Even)
30 Percent	878,000	$0.24

SOURCE: Office of the State Auditor analysis of Department of Revenue data for Tax Years 2015 and 2016 and food bank receipts for Calendar Year 2015-2017.

As shown, the Hunger Relief Credit can be seen as more or less cost effective depending on the percentage of donations attributable to the credit, with the credit being more cost-effective the more it incentivizes donations. Based on the $0.34 per pound average fair market value of

the donations and the revenue impact to the State from the credit, we estimate that about 21 percent of the donations would need to be attributable to the credit in order for the State to be "breaking even." If a smaller proportion of donations are incentivized by the credit, then the State could potentially provide the same funds to food banks to use to purchase the food and achieve a greater impact. For example, if 5 percent of the donations, about 146,000 pounds of food, are incentivized by the credit, at a cost to the State of $1.44 per pound ($211,000 total), the State could potentially instead provide the equivalent funds to food banks who could purchase over 620,000 pounds of food at the $0.34 average fair market value. Although it is possible that the credit could be incentivizing a high enough proportion of the donations to be cost-effective, the true proportion could also be less and we lacked data to form a reliable conclusion in this regard.

Crop and Livestock Corporate Credit Revenue Impact

During Fiscal Years 2012 through 2016, C-corporations claimed too little under the Crop and Livestock Corporate Credit for us to report under Section 39-21-305(2)(b), C.R.S without compromising taxpayers' confidentiality. Due to the low usage of the credit, its economic impact is likely insignificant and we performed no further analysis.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

Eliminating the Hunger Relief Credit would have a relatively small impact on hunger relief organizations, food insecure households, and agricultural producers. The credit has incentivized, at most, about 1.5 million pounds per year in food donations, and likely less than that given the other incentives agricultural producers have to donate crops. By comparison, food banks report distributing about 110 million pounds of food (from all sources) to Coloradans in need during Calendar Year 2017. Similarly, the average tax credit taken was relatively small in comparison to the average income of the taxpayers who took it, about 0.3 percent of their federal taxable income for the

year. Further, an average of only 345 taxpayers took the credit for Tax Years 2015 and 2016, which is about 1 percent of the 34,000 agricultural producers in the state.

Eliminating the Crop and Livestock Corporate Credit would have no significant impact on beneficiaries because it has been very seldom used.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified similar expenditures in several other states, although we did not conduct a comprehensive review of all states. Specifically, California, New York, Iowa, Oregon, West Virginia, and Missouri have enacted similar income tax credits, while Virginia, Arizona, and Maryland have introduced similar income tax deductions. South Carolina also has a similar credit, but it only applies to packers, butchers, or processors of deer meat.

The percentage of the value of the donation (though calculated in different ways) that can be claimed as a tax credit or deduction ranges from 10 percent in California and Oregon to 100 percent in Arizona. The annual cap in other states ranges from $2,500 per taxpayer in Missouri to no cap in a number of states.

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

The enhanced federal deduction for charitable contributions provided under Section 170 of the Internal Revenue Code provides agricultural producers with a similar incentive to donate food. Though the incentive varies based on individual circumstances, this deduction allows many agricultural producers to deduct 50 percent of the market value of the donated food from their federal taxable income.

To illustrate the relative potential benefit provided by both the federal deduction and the Hunger Relief Credit (assuming eligible taxpayers would take both), EXHIBIT 1.5 provides information on tax incentives

for donating food for several hypothetical taxpayers. As shown, though the federal deduction is potentially more valuable for taxpayers with high taxable income amounts and very large donations (as illustrated by Taxpayer 4 in the table), the Hunger Relief Credit may be more valuable for other taxpayers with more typical income and donation amounts (in practice none of the donations we reviewed for 2015 and 2016 exceeded $35,000).

EXHIBIT 1.5.
EXAMPLE TAXPAYER BENEFIT FROM THE FEDERAL CHARITABLE DEDUCTION FOR FOOD DONATIONS AND THE HUNGER RELIEF CREDIT

	TAXPAYER 1	TAXPAYER 2	TAXPAYER 3	TAXPAYER 4
Federal Taxable Income	$10,000	$50,000	$100,000	$500,000
Donation Fair Market Value	$2,000	$10,000	$20,000	$100,000
Federal Deduction Tax Benefit	$100	$600	$2,200	$17,500
Hunger Relief Credit Tax Benefit[1]	$417	$2,084	$4,167	$4,537

SOURCE: Office of the State Auditor analysis.
1 The tax benefit of the Hunger Relief Credit is less than the available credit amount because taxpayers may not have sufficient tax liability to use the full credit amount, and because of the requirement that taxpayers add back to their state taxable income the amount they deducted on their federal returns that was related to the same donation.

As discussed previously, we were not able to obtain information on the number of taxpayers who claimed the federal deduction, or the total amount claimed.

In addition, in Colorado, the Supplemental Nutrition Assistance Program (SNAP), administered by the Department of Human Services serves a similar purpose of providing food to those in need. According to a 2014 survey of Feeding America food pantry recipients, 72 percent live in households with annual incomes at or below the federal poverty line, and 55 percent live in households currently receiving benefits from SNAP. A key difference between SNAP and food pantries is that SNAP has specific eligibility requirements and provides a consistent source of funds with which to purchase food. Conversely, food pantries generally do not have eligibility requirements (though some verify that recipients live in the area), but some may only operate a few days per week or even month.

Thus, they serve a broader population than SNAP and often act as a supplemental source of food for both SNAP recipients and those who may not qualify for SNAP, but who may periodically have difficulty affording adequate food. In comparison to the Hunger Relief and Crop and Livestock Corporate Credits, SNAP has a far larger fiscal impact on the State, $55 million in state administrative expenses and $728 million in benefits issued to recipients during Fiscal Year 2016, compared to the $71,000 average direct annual impact of the Hunger Relief Credit.

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

The Department of Revenue does not capture donation information for the Hunger Relief Credit in GenTax, its tax processing information system, in a format that allows for a comprehensive analysis. Specifically, the Department of Revenue requires taxpayers to submit donation certification forms that provide information relevant to the credit, including the amount and type of food donated, the market price, the hunger-relief organization receiving the donation, and donation date. The Department of Revenue maintains scanned images of the forms, which it can pull manually on a taxpayer-by-taxpayer basis; however, GenTax does not digitally capture the information from the form and does not clearly link the taxpayer's account to the form. As a result, the process to search and pull each form is time consuming. The Department of Revenue reported that it would take hundreds of hours to pull all of the forms for the 2 years included in our analysis, which was beyond the staff resources available.

We were able to conduct our analysis based on copies of donation receipts for the credits maintained by the food banks. However, these receipts did not cover all donations claimed by taxpayers and may include some donations for which taxpayers never actually claimed a credit. Therefore, our analysis was limited to estimating the type of food, and the average size and market price of the donations. With complete information from the certification forms received by the Department of Revenue, our analysis would be more reliable and could

include additional information, such as the distribution of donations to hunger relief organizations across the state and the timing of the donations. According to the Department of Revenue, GenTax would need additional programming to be able to capture the information from the donation certification forms in a format that would allow for a comprehensive analysis (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and potential costs of addressing these limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

MANY AGRICULTURAL PRODUCERS' STATE TAX LIABILITIES ARE TOO LOW TO BENEFIT FROM THE HUNGER RELIEF CREDIT. According to a 2015 study from the U.S. Department of Agriculture, 69 percent of all farms in the United States have operating profits that comprise less than 10 percent of their gross farm income, meaning that their federal and state tax liabilities may be low or negative. In addition, the Department of

Revenue's most recent data shows that in Tax Year 2013, the average Colorado taxpayer who reported a profit or loss from agricultural operations on their tax return reported a loss of almost $4,600. Although agricultural profits and losses can vary from year-to-year, based on this data, it appears that many agricultural producers in the state may not have any taxable income. Because the Hunger Relief Credit is not refundable, meaning the State will not issue a refund check to the taxpayer if the credit exceeds their state tax liability, individuals only receive a financial benefit from the credit to the extent that they have tax liability to offset.

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

THE CROP AND LIVESTOCK CORPORATE CREDIT, CAPPED AT $1,000, IS LIKELY TOO LOW TO PROVIDE A MEANINGFUL INCENTIVE TO C-CORPORATIONS. According to the most recent Colorado Agricultural Census, conducted in Calendar Year 2012, 7 percent of in-state agricultural operations are incorporated as C-corporations. Incorporating as a C-corporation has tended to be more beneficial for larger-scale agricultural operations, which might not be highly incentivized by a tax credit that is capped at only $1,000 per year, in comparison to the $5,000 cap for the Hunger Relief Credit. Further,

agricultural C-corporations tend to be more focused on growing grain and commodity crops, as opposed to food that is suitable for donation.

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

INCOME TAX-RELATED EXPENDITURES

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

CREDIT FOR TAXES PAID TO OTHER STATES

EVALUATION SUMMARY SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1937
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$185 million (CALENDAR YEAR 2015)
NUMBER OF TAXPAYERS	65,000 (CALENDAR YEAR 2015)
AVERAGE TAXPAYER BENEFIT	$2,846
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

Taxpayers filing as individuals, fiduciaries, or estates who are Colorado residents (collectively referred to herein as "residents") may subtract some or all of the income taxes they paid to other states on income earned in the other state from the taxes they owe to Colorado. Residents can claim a credit for the lessor of:

- The amount of tax paid to the other state(s), or
- A prorated share of the resident's income earned in the other state compared to the resident's Colorado taxable income.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state the purpose of the credit. We inferred the purpose to be to avoid double taxation for Colorado residents who earn income in and pay taxes to other states.

WHAT DID THE EVALUATION FIND?

The credit is generally accomplishing its purpose since taxpayers appear to be aware of and are using the credit to avoid double taxation on income earned in another state. Of the 43 states that have an income tax, 42 provide a credit for income taxes paid to another state.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations for this tax expenditure.

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

CREDIT FOR TAXES PAID TO OTHER STATES

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Statute [Section 39-22-108(1), C.R.S.] allows Colorado residents (residents) filing as individuals, fiduciaries, or estates, to claim a credit to offset their Colorado income tax liability in proportion to the amount of their income that was earned in and taxed by another state.

A version of this credit was created in 1937 and over time, the General Assembly has modified how the credit is calculated to account for changes in how Colorado establishes taxable income. The credit has existed in its current form since 1988.

To take the credit, resident taxpayers must include the amount of the credit in the combined total of all of the nonrefundable credits reported on their Colorado tax return, submit Department of Revenue Form 104CR, which is for reporting credits, and submit a copy of the tax return for the other state.

Residents can claim the lesser of:

- The amount of tax paid to the other state(s), or
- A prorated share of the resident's income earned in the other state compared to the resident's Colorado taxable income.

For example, a resident earned $100,000 in taxable income, $90,000 was earned in Colorado and $10,000 was earned in State A. The resident paid $500 in income taxes to State A on the $10,000 that was earned in that state. The Colorado credit would be calculated as follows:

- Colorado taxable income = Taxable income from all sources = $10,000 + $90,000 = $100,000

- Colorado income tax before credit = Colorado taxable income x 4.63% (Colorado's income tax rate) = $100,000 x 4.63% = $4,630

- Prorated share of Colorado income taxes attributed to State A income = Colorado Income Tax x State A Income/Colorado taxable income = $4,630 x $10,000/$100,000 = $463

- Credit available = lesser of the prorated Colorado tax liability ($463) or the amount of taxes paid to State A ($500) = $463

Because the credit only reduces residents' Colorado tax liability to the extent that out of state income is taxed in Colorado, residents who earn income in states with higher tax rates than Colorado receive credits less than the total tax they paid to the other state. Conversely, residents who earn income in states with lower tax rates than Colorado can only receive credits up to the amount they actually paid to the other states. If the resident in the above example had only been taxed $300 by State A, the available credit would be $300 (the lesser of $463 and $300). This prevents Colorado from subsidizing the taxpayer for the higher income tax they pay to other states and prevents taxpayers from receiving a windfall in excess of the taxes they actually pay to lower tax states.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this expenditure. Based on the statutory language of the expenditure and Colorado's tax structure, we inferred that the intended beneficiaries of this credit are primarily individuals who are Colorado residents and who earn taxable income in other states and pay income taxes on that income to the other states.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this expenditure. We inferred that the purpose is to avoid double taxation for residents who earn income in and pay taxes to other states.

To determine the purpose of the credit, we reviewed Department of Revenue taxpayer guidance documents, expenditure reviews conducted by other states, and secondary legal publications. These sources indicated the purpose of this type of credit as avoiding state-level double taxation.

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

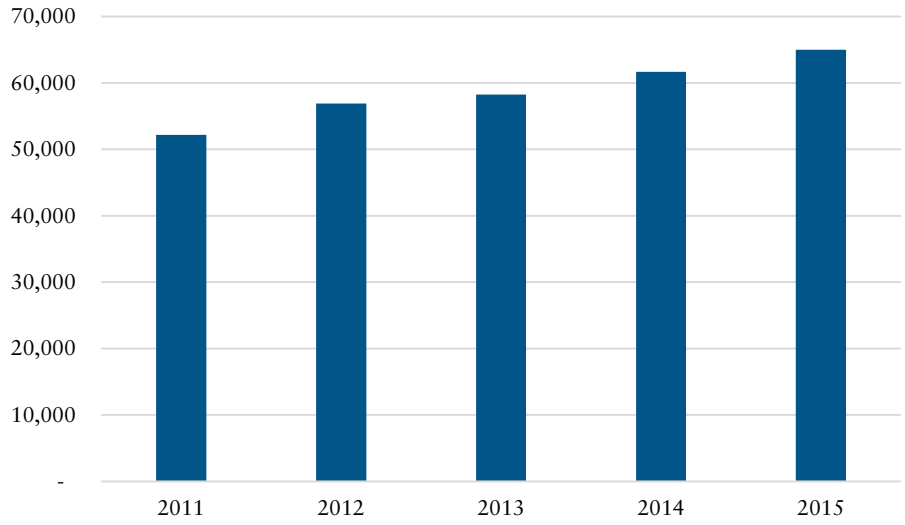
We determined that this credit is generally accomplishing its purpose since residents are aware of it and using it as intended to avoid double taxation on income earned in other states.

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 are Colorado taxpayers using the credit to avoid double taxation?*

RESULT: On average, between Tax Years 2011 and 2015, approximately 59,000 taxpayers claimed the credit annually. EXHIBIT 1.1 shows the number of residents claiming the credit each year, which has increased about 20 percent over the 5-year period.

EXHIBIT 1.1. TOTAL NUMBER OF RESIDENT TAXPAYERS CLAIMING CREDIT FOR TAXES PAID TO OTHER STATES TAX YEARS 2011-2015



SOURCE: Office of the State Auditor analysis of Department of Revenue individual taxpayer data for Tax Years 2011-2015.

Furthermore, it appears that eligible taxpayers are generally aware of the credit. According to representatives from the Colorado Society of Certified Public Accountants, taxpayers most commonly qualify for the credit because they paid taxes on business investment income, royalty income earned on mineral assets owned in another state, or income from property they rent or sold in another state or because they worked in another state while maintaining full time residency in Colorado. Tax preparers in the state are well aware of the credit, so eligible taxpayers who use a tax preparer are very likely to take advantage of the credit. Also, for taxpayers who prepare their own taxes, Department of Revenue forms provide clear notice of the availability of the credit and instructions for how to calculate and claim it. We attempted to determine the number of taxpayers who were eligible to claim the credit to assess how often it is being used. However, we did not identify adequate sources of data to reliably determine how many taxpayers could have claimed it.

Although the credit generally appears to be accomplishing its purpose, it may not eliminate double taxation in some situations. Specifically,

because the credit is limited to income taxes paid to another state from sources within that state, if a taxpayer has income that is not tied to a specific location, such as investment income, and is considered a resident of both Colorado and the other state, then both states could tax the income. Colorado statute defines a "resident individual" as a person domiciled in Colorado who maintains a permanent place of abode within this state and who spends more than 6 months of the taxable year in Colorado [Section 39-22-103(8), C.R.S.]. However, other states may have more inclusive residency laws, which could result in taxpayers with multiple states of residence. In practice, the Department of Revenue reports that taxpayers rarely have multiple states of residence, though specific data on Colorado residents who are also residents of other states were not available.

Additionally, the credit may not eliminate double taxation if differences exist regarding how Colorado determines where a taxpayer earned the income compared to how the taxing state determines location. According to state regulations, Colorado's determination of earning location controls for purposes of the credit. For example, State A may determine that $10,000 was earned within its borders, but under Colorado laws only $9,000 was earned in State A. Thus, the credit would be calculated based on the amount of taxes paid on $9,000, as determined by Colorado.

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

We estimate that beneficiaries of the credit saved, in total, about $176.4 million annually during Tax Years 2011 through 2015, or about $3,000 per taxpayer. The State incurred a direct revenue loss of the same amount. These estimates are based on Department of Revenue tax return data.

EXHIBIT 1.2 provides a breakout by year of the total amount of the credit claimed compared to the number of individual taxpayers who claimed the credit.

EXHIBIT 1.2. TOTAL AMOUNT CLAIMED AND NUMBER OF INDIVIDUAL CLAIMANTS
TAX YEARS 2011 TO 2015

	TOTAL AMOUNT CLAIMED	NUMBER OF CLAIMANTS	AMOUNT CLAIMED PER TAXPAYER
2011	$147,152,300	52,169	$2,821
2012	$193,675,200	56,921	$3,403
2013	$167,279,100	58,253	$2,872
2014	$189,019,900	61,666	$3,065
2015	$185,038,400	65,021	$2,846
Percent change 2011 to 2015	20%	20%	1%
Average 2011 to 2015	$176,433,000	58,806	$3,000

SOURCE: Office of the State Auditor analysis of Department of Revenue individual taxpayer data for Tax Years 2011 to 2015.

In addition, we estimate that the State receives approximately $1.1 million in additional sales tax revenue due to taxpayers spending the money they save by applying the credit. To calculate this estimate, we used data on average state sales taxes paid by taxpayers at various income levels from the Department of Revenue's *2016 Tax Profile and Expenditure Report*. We multiplied the total credit amounts for each taxpayer who took the credit by the average sales taxes paid (as a percentage of total income) for taxpayers with similar income and totaled the amounts to arrive at our estimate.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Federal law allows states to tax a resident's entire income no matter where the resident earns it and a nonresident's income if the individual has a connection (also known as a "nexus") to the state, such as the sale of goods or real estate located within the state. Therefore, Colorado would be permitted to tax income from other states under federal law.

If this credit were eliminated, a resident's income would be taxed in the state where the income was earned and by Colorado, creating an economic disincentive for residents to earn income outside the state and

remain Colorado residents. Based on our review of state taxpayer data, the average taxpayer who took the credit during Tax Years 2011 through 2015 had an average taxable income of about $332,130 and a total Colorado tax liability of about $12,600, before applying the average $3,000 credit. Thus, eliminating the credit would represent about a 31 percent Colorado tax increase for these residents.

Furthermore, the state-level taxes on the income earned in other states would increase sharply. To illustrate the potential impact, EXHIBIT 1.3 shows the state-level tax burden for several hypothetical resident taxpayers with and without the credit.

EXHIBIT 1.3. EXAMPLE STATE TAX LIABILITIES OF COLORADO RESIDENTS EARNING INCOME IN COLORADO AND STATE A

	TAXPAYER #1	TAXPAYER #2	TAXPAYER #3
Colorado Income	$0	$100,000	$200,000
State A Income	$50,000	$200,000	$100,000
Colorado Taxes[1]	$2,315	$13,890	$13,890
State A Taxes[2]	$2,393	$10,942	$5,242
Credit Amount[3]	$2,315	$9,260	$4,630
State-level Tax Liability with Credit	$2,393	$15,572	$14,502
State-level Tax Liability without Credit	$4,708	$24,832	$19,132
Percent State-level Tax Increase without Credit	97%	59%	32%

SOURCE: Office of the State Auditor analysis.
[1]Colorado income taxes for 2018 are 4.63 percent of Colorado and State A income combined.
[2]State A income taxes for non-residents in the examples above are based on Kansas income taxes of 5.7 percent of income above $30,000, plus $1,252.50 (totals in the exhibit are rounded to the nearest dollar).
[3]Credit amount is calculated as provided by Section 39-22-108, C.R.S. Because Colorado's effective tax rate is lower than State A for each taxpayer, the credit amount is equivalent to 4.63 percent of the State A income.

Since a taxpayer earning a greater percentage of their income in another state would be more severely impacted if the credit were eliminated, this may be an indication that this credit reduces potential disincentive for Colorado residents to work in other states by ensuring that taxpayers with a presence in another state are not subject to additional taxation.

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

Of the 43 states that impose income taxes, 42 offer a credit for income taxes paid to another state. States calculate the amount of the credit in one of three ways:

- Multiplying the resident's state tax liability by the ratio of income taxes by the other state to the resident's taxable income;
- Multiplying the income taxed by both states by the resident state rate on such income, as done in Colorado; or
- Determining the difference between the resident tax calculated by first including and then excluding the income subject to tax in both states.

A handful of states, such as California, Georgia, and Iowa, only allow this credit if the state where the income was earned also provides a credit.

We did not identify any other tax expenditures, federal tax provisions, or programs with a similar purpose.

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

The Department of Revenue was not able to extract and provide us with data for the fiduciaries and estates that claimed the credit. Currently, fiduciary and estate taxpayers provide the name of the other state, amount of the credit, and copy of the tax return submitted to the other state when claiming the credit. According to the Department of Revenue, although GenTax, its tax processing and information system, captures the amount of the credit and the name of the state, this information is difficult and time consuming to extract. Due to this limitation, our analysis and the figures provided on the number of taxpayers who took the credit and the revenue impact do not include fiduciaries and estates. However, programming GenTax to facilitate the

extraction of these data may not be a cost effective use of state resources since the fiduciary taxpayers comprise less than 1 percent of the State's tax collections, and estate taxpayers are not separately reported and would therefore have a small impact on our analysis (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to this tax expenditure.

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LIQUOR-RELATED EXPENDITURES

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

OCCASIONAL SALE OF LIQUOR BY PUBLIC AUCTION EXEMPTION

EVALUATION SUMMARY SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1935
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No

WHAT DOES THIS TAX EXPENDITURE DO?

This tax expenditure establishes an excise tax exemption for liquor, including beer, wine and spirits, sold through a public auction that came into the seller's possession under one of the following circumstances: (1) the seller possesses the liquor and the owner has failed to claim the liquor or furnish instructions for its disposition, (2) the seller obtains the liquor as part of the foreclosure of a lien, (3) the liquor has been salvaged or damaged in transit, or (4) the seller operates a charitable organization and receives the liquor as a donation. Typically, excise tax is paid by the entity with a Colorado liquor license at the time of first transfer within the state and this exemption relieves the seller from the requirement to be licensed and to pay the excise tax

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. We infer that the purpose is to simplify taxpayer compliance and decrease state administrative costs.

WHAT DID THE EVALUATION FIND?

Our evaluation found that the tax expenditure is likely not being used.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider repealing this exemption.

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OCCASIONAL SALE OF LIQUOR BY PUBLIC AUCTION EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The excise tax exemption for Occasional Sales of Liquor by Public Auction [Section 44-3-106(3)(a), C.R.S.] applies to auctions for the disposal of liquor, including beer, wine and spirits, that lawfully came into the possession of the seller under the following circumstances:

- Failure of the owner to claim the liquor or furnish instructions for disposition of it (e.g., if a deceased person did not include instructions in their will for who will inherit their wine collection).

- Foreclosure of lawful lien (e.g., if liquor is used as collateral on a loan, and the loan is not repaid).

- Salvage of the liquor or shipments damaged in transit (e.g., if the liquor's packaging is damaged so it is no longer saleable through retail but still has value).

- Lawful donation of liquor to a charity.

The Occasional Sales of Liquor by Public Auction Exemption was enacted in 1935 and it has remained largely unchanged since then, with the exception of expanding it in 1994 to include lawful donation of liquor to a charity. The seller is not required to pay excise taxes and is not subject to liquor licensing requirements for transactions covered by the exemption and likewise does not need to comply with the reporting requirements for licensed liquor distributors or retailers. However, statute [Section 44-3-106(3)(b), C.R.S.] requires that the "state

licensing authority" (i.e., the Division of Enforcement, within the Department of Revenue) "shall be presented records of all transactions" subject to the Occasional Sales of Liquor by Public Auction Exemption, though the process for such reporting is not defined by statute or the Department of Revenue. In addition, because the exemption applies to the excise tax but not to State sales tax, sellers and auctioneers who regularly conduct retail sales, and who are required to file sales tax returns, must report the value of the Occasional Sales of Liquor by Public Auction Exemption on Retail Sales Tax Return (Form DR 0100). Sellers whose only retail sales are occasional sales of liquor by public auction, may not be required to obtain a sales tax license [Section 39-26-103(6) C.R.S.] or file a Retail Sales Tax Return if their total sales do not exceed $1,000 annually [Section 39-26-103(9)(d), C.R.S.] but they must file an annual report of casual sales with their income tax return.

It is important to note that the Occasional Sales of Liquor by Public Auction Exemption is distinct from other provisions related to the auction of liquor. Specifically, public auctions related to tax compliance (e.g., when a business fails to pay its state or local taxes and its property is sold at auction) are covered under Section 39-21-114, C.R.S., and the exemption does not apply.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. We inferred that the intended beneficiaries are entities or individuals that come into possession of liquor under the specific circumstances identified in the exemption and the public who would purchase liquor through a public auction.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. Based on our review of tax policy best practices, we inferred that the purpose is to simplify taxpayer compliance and decrease state

administrative costs. According to the *Tax Policy Handbook for State Legislators, 3rd Edition,* published by the National Conference of State Legislatures, "A quality tax system facilitates taxpayer compliance by minimizing the time and effort necessary to comply with the law. It also minimizes the cost of the state administrative apparatus necessary to collect revenue, enforce the law, and audit to ensure compliance with the law." At the time it was created, the Occasional Sales of Liquor by Public Auction Exemption applied to limited sales by people or entities that did not typically sell liquor. Imposing an excise tax on these types of sales may have increased the State's administrative costs without a large increase in tax revenue. Thus, we inferred that this exemption was intended to increase the efficiency and effectiveness of the State's tax system by easing the compliance burden for taxpayers and decreasing administrative costs for the State.

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

We determined that the Occasional Sales of Liquor by Public Auction Exemption is not meeting its purpose because we were unable to find evidence that public auctions of liquor covered by the exemption are occurring.

Statute does not provide a quantifiable performance measure for this exemption. Therefore, we evaluated the Occasional Sales of Liquor by Public Auction Exemption using the following performance measure that we inferred based on general principles of an efficient tax system.

PERFORMANCE MEASURE: *Are taxpayers using this exemption to ease their administrative burden and avoid the excise tax on liquor?*

RESULT: It appears that taxpayers are not using this tax exemption. Because these sales are exempt from excise tax and liquor licensing requirements, there is not currently a Department of Revenue form to capture the amount of foregone excise tax. The sales tax from these sales

may be captured on the Retail Sales Tax Return form (DR 0100) but the sales tax form does not include a separate line for liquor sold at public auction and some sellers may not be required to file a sales tax return, and although there is a Retail Sales Tax Return for Occasional Sales (DR 100A) the data from this form is not captured by GenTax, we were not able to determine if any taxpayers have claimed this exemption. Therefore, we interviewed Department staff from the Division of Liquor Enforcement, which oversees the sale of liquor in Colorado, and the Division of Taxation, which oversees the State's sales tax system, and learned that the Department has no historic or current record of the exemption being applied to a sale. We also conducted some independent internet research, but were not able to identify any public auctions involving liquor that have occurred where this exemption would apply. Based on this information, it appears that sales that would qualify for the exemption are likely not occurring, or are rare.

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

We did not identify any economic costs or benefits to the exemption since it is likely not being used.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the exemption was eliminated, there would be little, or no, impact on the beneficiaries.

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

We were unable to identify any similar expenditures that apply only to sales of liquor in other states. Ohio, however, has an exemption for occasional sales conducted by an auctioneer.

In addition, we did not identify any similar tax expenditures or

programs in the state involving public auctions of liquor. Senate Bill 18-067, which went into effect on March 1, 2018, authorized the private auction sale of liquor by charities for fundraising purposes. However, the auctions authorized by the bill are different from those covered by the Occasional Sales of Liquor by Public Auction Exemption because they are private, as opposed to public. Additionally, Senate Bill 18-067 does not contain an excise tax exemption, though occasional sales by charities are exempt from sales tax by Section 39-26-718(1)(b), C.R.S.

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

The Department of Revenue does not have a form or other standard mechanism to allow for taxpayers to report the Occasional Sales of Liquor by Public Auction Exemption. Although statute requires taxpayers to report "records of all transactions" to which they applied the exemption, it does not specifically require the Department to create a reporting process. If the Department of Revenue created a reporting mechanism, such as a form, to facilitate the required reporting of sales subject to the exemption, some taxpayers may be more likely to report them if any are occurring, which would allow us to more reliably evaluate how frequently they occur, if at all. However, this may not be a cost-effective use of state resources since the Department of Revenue does not know of any sales that qualify for this exemption and creating a form would require additional staff time and resources (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of the Department of Revenue data and the potential costs of addressing these limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

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SACRAMENTAL WINES EXCISE TAX EXEMPTION

EVALUATION SUMMARY — SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1933
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$2,600 (CALENDAR YEAR 2017)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Partially, because it is not applied to all sales

WHAT DOES THIS TAX EXPENDITURE DO?

This expenditure excludes sacramental wines that are used for religious purposes from the liquor excise tax.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. We inferred that the purpose is to exempt wine used for religious purposes from liquor excise taxes to avoid taxing religious organizations.

WHAT DID THE EVALUATION FIND?

Although the Sacramental Wines Exemption is meeting its purpose for sales of sacramental wine from specialized sacramental wine distributors to religious organizations, it is likely not being applied to sales of sacramental wines from liquor stores. The exemption has a minimal economic impact.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider amending the Sacramental Wines Exemption to accommodate multiple distribution paths for sacramental wines and to ensure that all religious groups are treated equally.

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SACRAMENTAL WINES EXCISE TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Following the end of the Prohibition Era (1920–1933), Colorado was one of many states that legalized the production, sale, and use of liquor. With the legalization of liquor for consumption in 1933, Colorado created an excise tax on alcoholic beverages, which included a tax exemption for medicinal and sacramental liquors. Two years later, in 1935, the General Assembly amended the statute [Section 44-3-106(1), C.R.S.] to remove medicinal liquors and to limit the exemption to "sacramental wines sold and used for religious purposes." Statute has retained this wording ever since.

Excise taxes are taxes paid when purchases are made of a specific good and are often included in the price of the product and passed on to consumers. Liquor excise taxes are paid by distributors, manufacturers, and wholesalers the first time alcoholic beverages are sold or transferred within Colorado, which typically occurs when a licensed liquor distributor sells alcoholic beverages to a retailer or when a Colorado-based manufacturer sells alcoholic beverages to a distributor. The distributors, manufacturers, and wholesalers are required to report and remit the liquor excise taxes to the Department of Revenue using Form DR 0442 on a monthly basis. However, because the Sacramental Wines Exemption excludes wines used for religious purposes from the liquor excise tax and all related regulations, distributors and manufacturers are not required to apply the excise tax to these sales or report them to the Department of Revenue.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. We inferred, based on the legislative history and Colorado's tax structure, that the intended beneficiaries are religious organizations, because liquor excise taxes are typically passed on to final consumers in the form of higher prices. Producers of sacramental wine may also indirectly benefit if religious organizations decide to purchase greater quantities or more expensive sacramental wine due to the exemption. However, because the savings most religious organizations realize from the exemption are relatively small, it appears unlikely that the exemption would change their purchasing decisions enough to provide any significant benefit to producers.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. We inferred, based on the legislative history, Colorado's tax structure, and language in the exemption that the purpose is to avoid taxing religious organizations. Although statute does not limit the exemption to purchasers who are religious organizations, the excise tax on liquor and the Sacramental Wines Exemption were created at the end of Prohibition, during which time religious organizations were the only entities authorized to purchase sacramental wine under the Volstead Act, which enforced the 18th Amendment's prohibitions on liquor.

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

We determined that the Sacramental Wines Exemption is meeting its purpose for most sales of sacramental wine purchased by churches from religious supply stores, but may not be meeting its purpose for sales made through liquor stores.

Statute does not provide quantifiable performance measures for this expenditure. Therefore, we created the following performance measure based on the purpose we inferred, publicly available information on the typical practices related to the purchase of sacramental wine, and our discussions with stakeholders.

PERFORMANCE MEASURE: *Does the expenditure effectively exempt all purchases of wine for religious purposes from liquor excise taxes?*

RESULT: In practice, only certain purchases of sacramental wine are exempt from the liquor excise tax. According to our discussions with stakeholders, including representatives from religious organizations, sacramental wine producers, and liquor distributors and stores, this occurs because of varying practices for purchasing sacramental wines. Specifically, for Christian churches that use sacramental wine, most purchase the wine from religious supply stores in Colorado. Most of this wine comes from two out-of-state sacramental wine producers and based on discussions with representatives from these producers and the religious supply stores that sell sacramental wines, neither are paying the excise tax on sacramental wine sales made in Colorado. Therefore, Christian churches purchasing wine made by these producers from religious supply stores are not paying the tax through higher prices. However, there are many smaller producers of sacramental wines that sell directly to churches, religious organizations, and suppliers and we lacked sufficient data to determine the extent to which they also apply the exemption.

In contrast, sacramental wine purchased through liquor stores may include the excise tax. For example, this may occur with purchases of kosher wines, which are used for Jewish religious ceremonies. According to representatives from Jewish religious organizations, synagogues typically purchase kosher wines from liquor stores because they are not commonly sold through specialized religious supply stores similar to those that supply Christian churches. In addition, Jews who follow a kosher diet purchase kosher wines at liquor stores for home consumption. We contacted two liquor distributors in the state, who confirmed that, like all the wine they sell, the excise tax is applied to

their kosher wines and it would be difficult to apply the exemption because to do so they would need to determine which purchases would ultimately be used for religious purposes, as opposed to regular home consumption. They reported that these wines make up a small percentage of their overall sales, making the administrative costs of attempting to apply the exemption greater than the potential benefit.

We could not estimate the percentage of wine that qualifies for the exemption, but that may nevertheless be taxed, because sales of sacramental wines are not reported to the Department of Revenue and we could not identify a reliable source of information to estimate the amount of wine sold by liquor stores that is used for religious purposes.

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

The Sacramental Wines Exemption has very little impact on state revenue or the State's economy. Based on the limited data available to us, which was provided voluntarily by some wine producers, we estimate that the State lost about $2,600 in liquor excise taxes in 2017 as a result of the Sacramental Wines Exemption. Given the relatively small economic impact, it is unlikely that taxpayers are making decisions based on the existence of this expenditure and the economic costs and benefits are likely minimal.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating this exemption would likely have a small impact on the current beneficiaries. The excise tax on vinous liquor (i.e., wine) is about $.07 per liter, plus a $.01 surcharge and an additional excise tax of between $.01 and $.05 per liter, depending on the volume sold by the distributor. When all of the excise taxes and surcharges are combined, on average, a typical 750 milliliter bottle of wine is subject to about $.085 in excise tax. Therefore, a church that purchases 100 bottles of wine per year would incur additional expenses of about $8.50

if the full cost of the excise tax were transferred to the church through increased prices. In addition, distributors and manufacturers of sacramental wines would have to accommodate additional reporting and collection requirements required by the Department of Revenue.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

A tax expenditure for sacramental wine is available in 18 states. However, not all states provide an exemption from taxation at the initial point of sale like Colorado. Instead, some states require religious organizations to seek a refund from the state for taxes paid on sacramental wine.

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

We identified one other tax expenditure or program in the State with a similar purpose—the Sales to Charitable and Religious Organizations Sales Tax Exemption [Section 39-26-718(1)(a), C.R.S.], which exempts most religious organizations from paying sales taxes on all types of products normally subject to sales tax, including wine used for religious purposes. While the Sales to Charitable Organizations Exemption is broader than the Sacramental Wines Exemption and applies to a different type of tax, they both limit the tax burden on religious organizations for purchases of wine used for religious purposes.

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

The Department of Revenue does not collect any data and there is no other central source of data related to this exemption. Although the Department collects monthly reports from licensed liquor distributors on excise taxes through Form DR 0442, this form does not collect any information related to the Sacramental Wines Exemption and manufacturers and distributors of sacramental wine that do not sell other alcoholic beverages are not currently required to file excise tax reports with the Department of Revenue. The General Assembly could

amend statute to change the excise tax reporting requirements and direct the Department of Revenue to modify the form, and make changes in GenTax to collect data on the exemption, which would allow us to create a more accurate revenue impact estimate for the exemption and better identify the beneficiaries. However, this type of reporting may not be cost effective because it would impose an additional burden on distributors and manufacturers and would require additional resources at the Department of Revenue to cover programming costs and staff time, which would likely be larger than the exemption's revenue impact to the State (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and the potential costs of addressing these limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

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

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SALES TAX-RELATED EXPENDITURES

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LONG-TERM LODGING EXEMPTION

EVALUATION SUMMARY — SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1959
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$12.3 million (CALENDAR YEAR 2017)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes, but it may not be applied consistently

WHAT DOES THIS TAX EXPENDITURE DO?

The Long-Term Lodging Exemption excludes tax stays of 30 days or more at lodgings, such as hotels, home shares, and campgrounds from state sales.

WHAT DID THE EVALUATION FIND?

We determined that this exemption is likely accomplishing its purpose for a substantial portion of long-term stays; however, some lodging providers may not consistently apply the exemption.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider amending statute to clarify the exemption's eligibility requirements and clarify its applicability to third-party payers.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Because it was created at the same time that the State established a sales tax on lodgings, we inferred that the purpose was to establish the maximum length of stay for which lodging sales would be subject to the tax and ensure that individuals who purchase long-term housing from lodging providers, such as hotels or home shares, are treated the same as individuals who purchase long-term housing through traditional apartment or home lease agreements since these types of agreements are also not subject to state sales tax.

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LONG-TERM LODGING EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

In 1959, the General Assembly established a sales tax on temporary lodgings and created the Long-Term Lodging Exemption at the same time. The exemption has remained substantially unchanged since that time. According to Section 39-26-104(1)(f), C.R.S., sales of lodgings that are typically used for short-term stays, such as hotels, home shares, guesthouses, and trailer parks, are generally subject to state sales tax. However, under the Long-Term Lodging Exemption [Section 39-26-704(3), C.R.S.], sales of lodgings for stays of 30 consecutive days or more are tax exempt. In addition, eligible lodging purchases are exempt from local sales taxes, including lodging taxes, in cities and counties that have their local sales taxes collected by the State on their behalf. This is because statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that these local governments apply most of the State's sales tax exemptions, including the Long-Term Lodging Exemption. 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 and are not required to exempt long-term lodging from their local sales tax, although many choose to do so.

For a sale to be eligible for the exemption, there must be a written agreement for occupancy between the purchaser and lodging provider, which can include a receipt or a hotel registration, and the same payee must pay for the duration of the stay, which must be at least 30 consecutive days. If the price of the stay is not paid in full up-front, or is paid up-front but is refundable, Department of Revenue guidance indicates that lodging providers can either not collect the sales tax, in which case they would be liable for the sales tax if the customer does not complete at least a 30-day stay, or collect the tax and then refund it

after the customer has stayed at least 30 days. In some cases, the customer may have to apply to the Department of Revenue for a refund if they stay for at least 30 days, but the lodging provider collects the sales tax and does not refund it. Lodging providers must have a sales tax license and report the value of the Long-Term Lodging Exemption on the Department of Revenue's Retail Sales Tax Return (Form DR 0100) using the "other exemptions" line of the form's exemptions schedule. This line aggregates several exemptions that do not have a separate reporting line on the form.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. Based on the statutory language of the exemption, we inferred that the intended beneficiaries of this exemption are individuals and businesses who purchase long-term stays in lodgings, such as hotels, corporate housing, home shares (including online platforms such as Airbnb, Vacation Rentals by Owners (VRBO), and HomeAway), recreational vehicle parks, and campgrounds, which are typically subject to state sales tax. According to a 2006 study conducted by the U.S. Census Bureau, individuals who occupy hotels on a long-term basis do so for a variety of reasons, including, financial hardship that results in the loss of permanent housing, relocation by an employer on a temporary or permanent basis, loss of a home to fire or natural disaster, or a decision to live in high-end hotels to have access to luxury services. Some of these individuals choose hotels specifically designed and marketed for extended stays, but others stay in traditional hotels, some of which may offer low rates and flexible payment terms (e.g., discounted weekly rates, day-to-day payments) targeted to individuals experiencing financial hardship.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Because it was enacted in 1959, concurrently with the state sales tax on lodging,

we inferred that the purpose was to limit the state sales tax on lodging to individuals making short-term stays (less than 30 days) and provide parity in tax treatment between people who enter into residential leases for 30 days or more (which are not subject to sales tax) and people making long-term stays at lodging establishments which are more typically used for short-term stays by travelers.

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

We determined that this exemption is accomplishing its purpose for many long-term occupants of lodgings, but some lodging providers may not consistently apply 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 exemption is meeting its inferred purpose.

PERFORMANCE MEASURE: *To what extent are the amounts paid for long-term lodgings being exempted from sales tax?*

RESULT: Although we lacked adequate data to quantify the extent to which customers who make stays of 30 days or more in otherwise taxable lodgings are properly exempted from state and local sales tax, we determined that the exemption is likely applied to a substantial portion of lodging sales. Specifically, based on our analysis of Department of Revenue data and information from lodging providers, we estimate that the exemption was applied to $423 million (10 percent) of about $4.3 billion in total retail lodging sales in the state (see discussion below on how we arrived at our revenue estimates), which indicates that the exemption is frequently used. However, we did not have information on what percentage of stays were for 30 consecutive days or more, and therefore eligible for the exemption.

Despite evidence that the exemption is frequently used, we also found that lodging providers may not consistently apply the Long-Term

Lodging Exemption, which could reduce the extent to which long-term stays are exempted from sales tax. Specifically, we found the following based on our review of several types of lodging providers:

- **Traditional hotels.** We called a non-statistical sample of 20 Colorado hotels, including several large hotel chains, and customer service representatives at eight of the hotels indicated that they would not charge sales tax for a planned stay of 30 or more days (40 percent). Of the remaining 12 hotels that indicated that they would charge the sales tax, two stated that they would only apply the exemption for stays of 31 days or more and the other 10 did not seem to be aware of the exemption.

- **Extended stay hotels.** We reviewed the online booking systems of five extended stay hotels and found that three did not include sales taxes in their quoted price for a planned stay of 30 or more days, the other two included the sales tax in the quoted price. We contacted each hotel and staff at all five indicated that the tax would be refunded or credited to a guest's account after 30 days.

- **Corporate housing.** We interviewed representatives from two corporate housing providers that specialize in providing accommodations, such as furnished apartments, for long-term business travelers, and both indicated that they apply the exemption to stays of 30 or more days.

- **Home shares.** We reviewed the websites of Airbnb, VRBO, and HomeAway, the three largest home share platforms. We found that as of March 2018, Airbnb's website applies the exemption correctly to the quoted price of most long-term stays, although it appears to require a stay of 31 or more days before removing sales taxes. VRBO and HomeAway typically place the responsibility of sales tax collection and remittance on the lodging owners and there was no data available to determine the extent to which they apply the exemption.

Though our assessment of the practices of lodging providers suggests that some may improperly collect sales tax from customers making long-term stays, we did not inform the providers that we contacted that we would expect them to exempt long-term stays from sales tax. Thus, it is possible that if a customer knew that the exemption should apply and asked the lodging providers' customer service representatives to remove or refund the sales tax, the providers would do so. However, based on our limited survey of hotels in the state, it appears that lodging customers who are unaware of the exemption may be charged sales tax by some lodging providers.

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

We estimate that about $12.3 million in state revenue was forgone in Calendar Year 2017 as a result of the Long-Term Lodging Exemption. As shown in EXHIBIT 1.1, we calculated the revenue impact estimate separately for the hotel and corporate housing industry sectors due to different data sources for each sector.

EXHIBIT 1.1.
ESTIMATED REVENUE IMPACT OF THE LONG-TERM LODGING EXEMPTION
BY LODGING INDUSTRY SECTOR
CALENDAR YEAR 2017

	SALES ATTRIBUTABLE TO LONG-TERM STAYS (30 DAYS OR MORE)	STATE REVENUE IMPACT	LOCAL GOVERNMENT REVENUE IMPACT	TOTAL REVENUE IMPACT
Hotels and Home Shares[1]	$356 million	$10.3 million	$6.6 million	$16.9 million
Corporate Housing[2]	$67.3 million	$2 million	$1.3 million	$3.3 million
TOTAL	$423.3 million	$12.3 million	$7.9 million	$20.2 million

SOURCE: Office of the State Auditor analysis of data from the 2015 Department of Revenue reports, State Demographer data, Bureau of Economic Analysis data, and information published by industry associations.

[1] Data provided in the Department of Revenue 2015 Retail Sales Tax Reports.

[2] Data provided by Corporate Housing Providers Association. Assumes that all corporate housing stays are 30 days or longer.

To arrive at the revenue impacts, we first estimated the total taxable

revenue associated with long-term lodging stays of 30 days or more. We used data from the Department of Revenue's 2015 Retail Sales Tax Reports to determine that hotels and other types of accommodations, such as home shares, reported $450.6 million in tax exempt sales (the difference between net sales and taxable sales on their Retail Sales Tax Returns) in Calendar Year 2015 (the most recent year available), which includes exempt sales for lodging and other items, such as food. Although the Department of Revenue does not collect data specifically for the Long-Term Lodging Exemption on its Retail Sales Tax Return (Form DR 0100), our review of the State's sales tax exemptions indicates that this exemption is likely the most common exemption that would apply to sales of lodging. There are no other sales tax exemptions specifically targeted to the lodging industry and only a few other exemptions appear to potentially apply to the lodging providers, such as exemptions on food sold through vending machines (Section 39-26-714(2), C.R.S.), and food provided to restaurant staff (Section 39-26-707(2)(a), C.R.S). We attributed a factor of 25 percent to these nominal other exemptions. Therefore, we assumed that 75 percent of the tax exempt sales reported by lodging providers were due to the Long-Term Lodging Exemption. We multiplied this figure by the $450.6 million in reported exempt sales, to estimate $337.9 million in Long-Term Lodging Exemptions for Calendar Year 2015. We then increased this amount by 5.3 percent to account for growth in the hotel industry from Calendar Year 2015 to 2017, as reported by the U.S. Bureau of Economic Analysis, to arrive at our estimate of $356 million in exempted sales for the hotel and home share sector.

Because corporate housing providers may not be included with hotels and other types of accommodations in the Department of Revenue's retail sales tax reports, we obtained sales revenue data from the Corporate Housing Providers Association, which showed total U.S. corporate housing revenues of $3.2 billion in Calendar Year 2016. We multiplied this figure by 2.1 percent, which is the share of U.S. hotel sales that occurred in Colorado in 2012, which is the most recent year available, to estimate $65.9 million in Colorado corporate housing sales. We then increased this amount by 2 percent to account for industry growth and inflation from Calendar Year 2016 to 2017, as

reported by the U.S. Bureau of Economic Analysis, to arrive at our estimate of $67.3 million in Colorado corporate housing sales for Calendar Year 2017. We assumed that all of these sales were exempt under the Long-Term Lodging Exemption because according to the stakeholders we contacted, it is uncommon for corporate housing units to be used for shorter-term stays, though a few shorter term stays could be included in our estimate and cause a slight overestimate.

To estimate revenue impacts, we then applied the State's 2.9 percent sales tax rate and the Colorado population-weighted average local tax rate (including lodging taxes, if applicable) of 1.95 percent, which excludes self-collected home-rule cities, to our revenue estimates discussed above.

It is important to note that our estimated revenue impacts could double count the impact associated with corporate housing providers to some degree because we could not determine how corporate housing providers are typically categorized in the Department of Revenue's Retail Sales Tax Reports. Specifically, these reports rely on self-reported information from taxpayers based on the North American Industry Classification system. It is possible that some corporate housing providers could have selected industry categories that would have included them within the "Hotels and Other Accommodation Services" category in the Department of Revenue reports, the category we used to estimate the revenue impact from hotels and home shares, as opposed to other categories, such as the "Real Estate, Rental and Leasing." In this case, our estimate would likely double count the revenue impact.

The savings provided by the exemption may provide a significant benefit to some individuals, but likely has only a small impact on the lodging industry in general. Specifically, for some individuals, the combined state and local tax savings, which averages 4.85 percent and $20.2 million in total, or about $146 on a 30-day $100 per night hotel stay, may be significant enough to drive choices about where they make overnight stays. In particular, individuals who are staying in hotels due to economic hardship may choose or only be able to afford to stay in a hotel because

of the cost savings provided by the exemption. Further, in some local jurisdictions with higher tax rates on lodging, which can range up to 9.5 percent, the exemption may be more important to price-sensitive customers. In addition, for many individuals who choose to make long-term stays in hotels and other lodging establishments, other forms of housing, such as apartment or home leases, which are typically less expensive on a monthly basis, are impractical. This can be the case when individuals do not wish to enter into typical 6-month or 1-year lease terms, require hotel services and amenities, cannot pay the required up-front deposits that are often required for leases, or have poor credit.

For the lodging industry, the $20.2 million in estimated total cost savings to consumers represents about 0.5 percent of the $4.3 billion in total lodging sales in Calendar Year 2017. Therefore, the exemption likely has a relatively small impact on the lodging industry as a whole, since even if consumers used all of their cost savings on longer or more expensive hotel stays, it would represent a small increase in industry sales. However, the exemption may be more significant for businesses that specialize in long-term lodging, such as corporate housing providers, or extended stay hotels. In particular, because most states have a similar exemption, the Long-Term Lodging Exemption could also help keep long-term lodging providers in Colorado competitive for individuals who have the flexibility to choose which state to stay in.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the exemption could increase the cost of long-term lodging, result in unequal tax treatment of people depending on the type of long-term lodging they purchase, and negatively impact lodging providers who specialize in long-term accommodations. Specifically, without the exemption, the after-tax cost of long-term stays in non-home rule jurisdictions would increase, on average, by 4.85 percent due to state and local taxes. However, some lodging establishments could choose to offset part of this increase by reducing prices to remain competitive with establishments that are subject to lower taxes, since local tax rates for

lodging vary considerably across the state. In addition, individuals who reside in lodgings, such as hotels, corporate housing, and home shares, on a long-term basis would pay sales taxes that do not apply to individuals who enter into traditional residential leases. This could create a hardship for some individuals who cannot enter into traditional leases and could cause some businesses to choose alternative means of housing, such as renting apartments, for employees that need to make stays of over 30 days.

Several industry representatives we interviewed stated that the Long-Term Lodging Exemption is important to their businesses and to Colorado's lodging industry. Corporate housing providers reported that they are able to remain competitive with similar businesses and the hotel industry as a result of the exemption, and the same may be true for other lodging providers that rely on long-term occupants. Members of a lodging providers association predicted that eliminating the exemption would be damaging to their businesses and may have other adverse effects, such as driving up housing costs or causing some low-income residents to move to states where their dollar would stretch further.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

At least 46 states assess a sales or lodging tax on the price of temporary lodgings and at least 41 of these states provide an exemption for long-term lodgings. However, the minimum length of occupancy required to qualify for a "long-term" lodging exemption varies by state, and can be anywhere from 28 days to 185 days. The most common time period was 30 days, which is the requirement in Colorado.

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

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

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

The Department of Revenue does not track the amount of Long-Term Lodging Exemptions claimed by lodging providers. Specifically, the Department of Revenue's Retail Sales Tax Return (Form DR 0100), does not contain a specific line for long-term lodging sales, and lodging providers report the sales that qualify for this exemption as part of the "other exemptions" line on the form, which combines any exemption not specifically addressed elsewhere on the form. Since this line can encompass several different exemptions, the Department of Revenue does not capture this data point in GenTax, its tax reporting system. If the General Assembly wants to know the amount of the exemption claimed with a higher degree of reliability than the estimates provided in this evaluation, it could require the Department of Revenue to add a specific line to the DR 0100 where lodging providers are required to report this information and direct the Department of Revenue to capture these data in GenTax. However, this change could increase the administrative burden on lodging providers who would be required to separately track long-term lodging sales and the amount exempted. It would also require resources for the Department of Revenue to update the form, provide new instructions, and make programming changes in GenTax to capture the information (see the Tax Expenditures Overview section of thisCompilation Report for details on limitations of Department of Revenue data and potential costs for addressing them).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY COULD CONSIDER CLARIFYING WHETHER THE EXEMPTION SHOULD BE AVAILABLE TO THIRD-PARTY PAYERS. Statute specifies that the Long-Term Lodging Exemption is for sales that are made "to any occupant who is a permanent resident" of the lodgings [Section 39-26-704(3), C.R.S.]. Statute does not indicate whether this should apply to third-party payer situations, such as when a business pays for a room that is occupied by multiple employees over the length

of stay. However, the current Department of Revenue policy is to allow the exemption under such circumstances so long as the lodgings are paid for by the same payer for at least 30 consecutive days, regardless of whether the lodgings are actually occupied by the same person for that length of time. The Department of Revenue's policy likely decreases the administrative burden on lodging providers and taxpayers, but also allows for a broader application of the exemption than may have been intended and likely increases its revenue impact.

THE GENERAL ASSEMBLY COULD CONSIDER CLARIFYING WHETHER HOME-SHARES AND SIMILAR FORMS OF LODGING SHOULD QUALIFY FOR THE EXEMPTION. With the expansion of the home sharing industry, non-traditional temporary lodging options are growing. Although we found that, in practice, some home-share sales are being exempted from sales tax under the Long-Term Lodging Exemption, statute [Section 39-26-704(3), C.R.S.] does not specifically list "home-shares" or "private homes" as an exempted category of lodgings. Such sales could be interpreted as falling under categories that are listed, such as "guesthouse" or "lodging house," though it may not be clear to some taxpayers how to interpret these terms.

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

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1876

NEWSPRINT & PRINTER'S INK, AND NEWSPAPERS EXEMPTIONS

EVALUATION SUMMARY SEPTEMBER 2018

THESE EVALUATIONS ARE INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

	Newsprint & Printer's Ink Exemption	Newspapers Exemption
Year enacted	1943	1943
Repeal/Expiration date	None	None
Revenue impact	$500,000 (Calendar Year 2017)	$2,700,000 (Calendar Year 2017)
Number of Taxpayers	Could not determine	Could not determine
Average taxpayer benefit	Could not determine	Could not determine
Is it meeting its purpose?	Yes	Yes

WHAT DO THESE TAX EXPENDITURES DO?

The Newsprint & Printer's Ink Exemption exempts newspaper publishers and commercial printers from paying state sales and use tax on their purchases of the two primary tangible inputs of print newspapers, newsprint and printer's ink.

The Newspapers Exemption excludes the sale of newspapers from state sales and use tax.

WHAT DID THE EVALUATION FIND?

The exemptions are generally meeting their purpose since retailers, newspaper publishers, and commercial printers are aware of them and use them regularly and newspaper customers are not charged a sales tax on their purchase of newspapers.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURE?

Statute does not explicitly state a purpose for either of the tax expenditures. However, in the legislative declaration for the 1943 bill that created these exemptions, the General Assembly stated that its intention was to clarify that it never intended to tax newspaper sales and that, in practice, such sales had not been taxed. Therefore, we inferred that the purpose of the exemptions was to clarify the definition of the types of purchases that are subject to the state sales tax. Most states with sales taxes do not tax sales of newsprint and printers ink because these goods are considered to be inputs to a the final product sold

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider clarifying the publications that are eligible for the Newspapers Exemption and whether it should apply to digital editions of newspapers.

to a consumer and sales taxes are typically intended to only tax the final purchase of a good by the consumer. Furthermore, because states have traditionally considered newspapers as serving an important role in informing the public and a forum for legal notices, excluding the sale of newspapers from sales tax is a common provision across states with a sales tax.

NEWSPRINT & PRINTER'S INK, AND NEWSPAPERS EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

This evaluation covers two sales and use tax exemptions that apply to the newspaper industry for: (1) newsprint and printer's ink purchased and used by newspaper publishers and commercial printers (Newsprint & Printer's Ink Exemption); and (2) the sale and distribution of newspapers (Newspapers Exemption). Colorado enacted a sales tax in 1935 and a use tax in 1937. Both exemptions were created in 1943, and the use tax exemption was added to the Newsprint & Printer's Ink Exemption in 1945.

Under the Newsprint & Printer's Ink Exemption, newspaper publishers and commercial printers are exempt from paying state sales and use tax on newsprint and printer's ink because these sales are deemed to be wholesale sales, which are exempt from Colorado sales and use tax [Sections 39-26-102(19)(a), 102(21), and 705(1), C.R.S.]. Retailers and wholesalers that sell newsprint and printer's ink subtract the exempt sales from their net sales on the Retail Sales Tax Return (Form DR 0100) by including the amount exempted on the "other exemptions" line on the form, which aggregates several exemptions that do not have specific reporting lines.

The Newspapers Exemption exempts purchases of newspapers from state sales and use tax [Section 39-26-102(15), C.R.S.]. Department of Revenue guidance states that digital copies of newspapers are exempt in the same manner as printed newspapers. Newspaper publishers who do not sell other products are exempt from retail sales tax reporting requirements and therefore, are not required to report newspaper sales to the Department of Revenue. However, if a publisher sells other products

that are subject to sales tax, then they must apply for a retail sales tax license and would be required to report newspaper sales, along with the other sales, and report the amount of the exemption on their Retail Sales Tax Return (form DR 0100) on the "other exemptions" line.

In addition, sales of newsprint and printer's ink to newspaper publishers and commercial printers and sales of newspapers are exempt from local sales taxes for purchases made in local governments, such as cities, towns, and counties, that have their local sales taxes collected by the State on their behalf. Statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that these local governments apply most of the State's sales tax exemptions, including the Newsprint & Printer's Ink Exemption and Newspapers Exemption. Home rule municipalities established under Article XX, Section 6 of the Colorado Constitution that collect their own taxes have the authority to set their own tax policies independent from the State and are not required to exempt such sales from their local sales tax. Based on our review of the 15 most-populated home rule cities, all exempt both newsprint and printer's ink from sales tax, and only Denver and Broomfield impose a sales tax on newspapers.

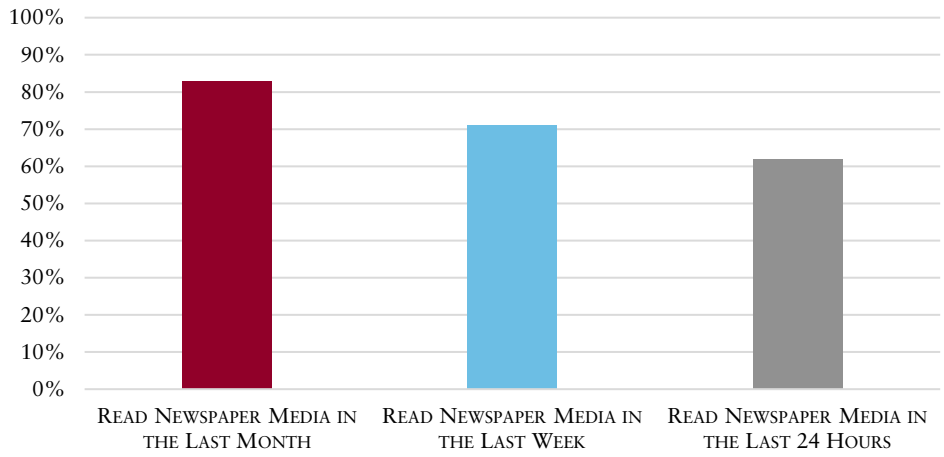
WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not explicitly identify the beneficiaries of the Newsprint & Printer's Ink Exemption or the Newspaper Exemption. We inferred that newspaper publishers and commercial printers are the intended beneficiaries of the Newsprint & Printer's Ink Exemption since they are the only parties eligible for the exemption. Newspaper purchasers are also indirect beneficiaries of the Newsprint & Printer's Ink Exemption because, by not paying tax on inputs, newspaper publishers' printing costs are lower and, therefore, some of the savings may be passed on to purchasers through lower retail prices.

We inferred that the beneficiaries of the Newspapers Exemption are newspaper purchasers and newspaper publishers, including publishers of free newspapers since they would be responsible for paying use tax if

the exemption did not exist. More than half of Coloradans access newspaper media in some format and thus, benefit from the exemptions. In 2017, Pulse Research, a newspaper market research company, conducted a survey to measure Colorado newspaper readership and found that most Coloradans read newspapers on a regular basis (though the survey did not measure how many of them pay for newspapers). This information is summarized in EXHIBIT 1.1. Additionally, in the survey, 22 percent of participants reported reading the newspaper in print format only, 28 percent reported reading it in both digital and print formats, and 33 percent reported reading it in digital format only.

EXHIBIT 1.1. COLORADO NEWSPAPER READERSHIP IN 2017



SOURCE: Pulse Research Colorado Readership Survey, 2017.

WHAT ARE THE PURPOSES OF THE TAX EXPENDITURES?

NEWSPRINT & PRINTER'S INK EXEMPTION

Statute does not explicitly state a purpose for the Newsprint & Printer's Ink Exemption. We inferred that the purpose of this exemption is to define the types of sales subject to state sales tax and avoid charging sales taxes on the production inputs of newspapers and commercial printers. Based on our research of other states' tax expenditures, this is a typical structural tax expenditure in most states with sales taxes. According to tax policy guidance prepared by the National Conference

of State Legislatures, many economists believe that sales and use taxes should not apply to transactions in which the purchaser is not the final consumer of the goods sold.

NEWSPAPERS EXEMPTION

Statute does not explicitly state a purpose for the Newspapers Exemption. Based on the legislative history of the provision, we inferred that its intended purpose was to clarify which purchases were intended to be taxed under the State's sales tax, enacted in 1935. Specifically, the legislative declaration for House Bill 43-155 that created the exemption, states that it was always the General Assembly's intent to exempt newspapers in their entirety from sales and use tax and that, in practice, they had never been taxed. This policy is consistent with other states with a sales tax provision, most of which have historically exempted newspapers from sales taxes because of their importance in fostering a more informed public and serving as a forum for posting required legal notices. Department of Revenue guidance states that another reason newspapers may have been exempted from sales and use tax was due to the difficulties related to collecting a penny or two on each sale, particularly when sold through coin-operated machines.

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

We determined that the Newsprint & Printer's Ink Exemption and Newspapers Exemption are both meeting their purposes. Specifically, newspaper publishers, commercial printers, and newspaper retailers are aware of the exemptions and both exemptions generally appear to be applied to applicable sales.

Statute does not provide quantifiable performance measures for these tax expenditures. Therefore, we created and applied the following performance measure to determine the extent to which the exemptions are meeting their inferred purpose.

PERFORMANCE MEASURE: *The extent to which sales of newsprint and printer's ink purchased by newspaper publishers and commercial printers, and newspapers purchased by consumers are being exempted from state sales and use tax.*

RESULT:

NEWSPRINT & PRINTER'S INK EXEMPTION. Although we lacked data to quantify the proportion of sales of newsprint and printer's ink sold to newspaper publishers and commercial printers to which the exemption has been applied, we interviewed representatives from 23 Colorado newspapers, and all of them reported that they have not paid state sales or use tax on newsprint and printer's ink. Two of the stakeholders that we interviewed also oversee substantial newspaper printing businesses in Colorado. Both stated that newsprint and printer's ink have continuously and consistently been exempted from Colorado sales and use tax. In some instances, stakeholders reported that they periodically must provide their printer's ink suppliers or distributers with documentation, such as an affidavit, attesting that the printer's ink is being used to print newspapers.

NEWSPAPERS EXEMPTION. The newspaper representatives we contacted reported that retail sales of their publications are also consistently exempted from sales and use tax. The Department of Revenue has issued guidance to retailers, which provides that sales of newspapers should not be subject to state sales tax.

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

NEWSPRINT & PRINTER'S INK EXEMPTION

We estimate that the Newsprint & Printer's Ink Exemption reduced state tax revenue by about $500,000 in Calendar Year 2017. We derived our estimate from Colorado newsprint annual demand data and annual

average newsprint price data available from the Pulp and Paper Products Council and from financial data provided to us in stakeholder interviews. Specifically, we obtained data from the Pulp and Paper Products Council, a trade group representing paper products manufacturers, on the volume of newsprint sold and the average price of newsprint in Colorado in 2017. Using that data, we estimated that approximately $16.7 million in newsprint sales occurred in Colorado in 2017, though it is important to note that this may overestimate eligible sales because some of these purchases may not have been made by newspaper publishers and commercial printers. We were unable to identify a source to directly obtain data on total printer's ink sales in Colorado; however, we obtained data from two substantial newspaper printers in Colorado and used that data to create an average ratio of the cost of printer's ink compared to newsprint, which was about $.06 for every $1.00 of newsprint sales. We used the ratio to estimate that there were about $1 million in printer's ink sales in Colorado in 2017. We then multiplied the printer's ink and newsprint sales estimates (totaling $17.7 million) by the State sales tax rate of 2.9 percent.

We also estimated that the exemption reduced local government revenue by about $300,000 in Calendar Year 2017. To estimate this amount, we used the same sales revenue estimate arrived at for calculating the state revenue impact ($17.7 million), but applied the population-weighted average local sales tax rate, excluding home rule jurisdictions with self-collected local sales taxes, of 1.8 percent.

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

NEWSPAPERS EXEMPTION

We estimate that the Newspapers Exemption reduced State tax revenue in calendar year 2017 by about $2.7 million. This estimate was calculated using U.S. Census Bureau Economic Census data for newspaper publishers in Colorado, which reports $85.2 million in sales and subscriptions of general and specialized newspapers in 2012 in Colorado. We then increased the sales reported by the U.S. Census Bureau by about 7 percent using national newspapers sales trends information from a 2018 report issued by the Pew Research Center to arrive at an estimate of $91.4 million in newspaper sales for Calendar Year 2017. We then multiplied this figure by the State sales and use tax rate of 2.9 percent.

Our estimates have the following limitations:

- The data is from the 2012 Economic Census, which was the most recent data available, and accounts for print sales and subscriptions only. The estimate does not include online sales and subscriptions to newspapers because we were unable to identify a reliable source of data regarding online sales and subscriptions.

- The estimate does not account for forgone use tax from newspapers that are distributed for free.

We also estimate that the exemption reduced local government revenue by $1.7 million in Calendar Year 2017. To estimate this amount, we used the same revenue estimate arrived at for calculating the state revenue impact ($91.4 million), but applied the average population-weighted local sales tax rate, excluding home rule jurisdictions with self-collected sales taxes, of 1.8 percent.

It is important to note that unlike the Newsprint & Printer's Ink Exemption, the revenue impact of the Newspapers Exemption does not appear likely to decline over time, despite the decrease in print circulation. Specifically, the Pew Research Center report indicates that when digital sales are included, the total circulation revenue of

newspapers has been increasing moderately in recent years (7 percent between 2012 and 2017). However, according to the report, advertising revenue, which is not subject to sales tax, has decreased significantly during that period, which appears to be a key contributor to the financial issues faced by newspaper publishers in recent years.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

The elimination of these exemptions would increase costs for newspaper publishers and/or readers since one or both of the groups would need to pay the increased tax cost for newspapers. Specifically, we estimate that by including both state and local sales taxes, eliminating the Newsprint & Printer's Ink Exemption would increase the cost of producing a newspaper and eliminating the Newspapers Exemption would increase the cost of purchasing a newspaper by about 4.7 percent, including state and local taxes. Newspapers could either pay the additional tax on newsprint and printer's ink without increasing retail newspaper prices or pass it on to customers in the form of higher prices. Similarly, newspaper publishers could respond to a sales and use tax on newspapers by making no adjustment to their prices, meaning customers would pay the cost of the additional tax, or by lowering prices to compensate for the sales tax.

If the increased cost is absorbed by newspapers, then the newspaper would need to offset that cost by decreasing its other expenses. The stakeholders that we interviewed, primarily newspaper publishers, emphasized that they would have difficulty with any additional expenses, especially those that are outside of their control. Many stated that the imposition of a sales and use tax on newspapers could result in their newspaper, or other newspapers, experiencing continued declines in revenue, layoffs, or closure due to small profit margins. This is consistent with data compiled by Dun & Bradstreet, a business data and analytics company, on the newspaper industry, which indicates that newspapers' net income is typically 3 to 3.4 percent of their net sales depending on the size of the company. Furthermore, between 2015 and

2017, print circulation fell by just over 13 percent in Colorado and the number of reporters and correspondents decreased by about 15 percent. This suggests that some newspapers are already having difficulty generating enough revenue to remain financially viable, and would likely have difficulty absorbing additional sales tax costs. As a result, they would need to pass at least some of the costs on to customers.

However, some newspaper customers may be sensitive to increases in price and may purchase fewer newspapers if prices increased. For example, according to one stakeholder we interviewed who represents three newspapers circulated in low income communities, many residents in those communities might no longer be able to afford to purchase a subscription to the newspaper if the price increased to reflect additional taxes. Some of these communities are in remote areas of the state that do not have internet access, and the residents rely on their local printed newspaper to stay informed.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 other states that impose a retail sales or similar tax, all but one (Hawaii), provides an exemption for newsprint and printer's ink, either by exempting them specifically or because they are considered to be component parts of a manufactured product, which are also typically exempt from sales tax.

In addition, of these 44 states, 28 generally exempt newspapers from sales and use tax. Eight additional states exempt newspapers in certain circumstances, such as only subscription sales, only street vendor and rack sales, or only newspapers distributed free of charge. Eight states and the District of Columbia generally impose a sales and use tax on newspapers.

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

We did not identify any other tax expenditures or programs with a similar purpose.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE EXPENDITURES?

We were unable to obtain data on the revenue impact of the sale of newsprint, printer's ink, or newspapers from the Department of Revenue due to limitations in how it collects data and the sales tax licensing requirements for newspapers. Specifically, retailers and wholesalers that sell newsprint, printer's ink, and newspapers subtract the exempt sales from their net sales on the Colorado Retail Sales Tax Return (Form DR 0100). These exemptions are typically reported on the "other exemptions" line on the form, which aggregates several exemptions that do not have specific reporting lines. To collect the data needed to calculate a more accurate estimate of the newspapers, newsprint, and printer's ink sales in Colorado, the Department of Revenue would need to add a separate reporting line to the Retail Sales Tax Return (Form DR 0100) and capture the data on that line for later extraction, which would require staff time and resources to create the form and program GenTax, the Department of Revenue's tax processing system, to capture the information (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and the potential cost of addressing them).

In addition, newspaper publishers that do not sell other products are exempt from retail sales tax reporting requirements altogether, and therefore, are not required to report newspaper sales and distributions of free newspapers to the Department of Revenue, nor are they required to report the amount of the Newspaper Exemption they applied to customer purchases. Thus, to collect sales and use tax information on newspapers, the Department of Revenue would need to modify its licensing regulations to require all newspapers to obtain retail licenses. This would increase administrative costs for both the newspapers who would need to comply with licensing and reporting requirements, and for the Department of Revenue to change its regulations and ensure compliance for these new retailers.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

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SALES TO CHARITABLE ORGANIZATIONS EXEMPTION

EVALUATION SUMMARY — SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1935
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$45.5 million (CALENDAR YEAR 2016)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

This tax expenditure exempts charitable organizations from paying state sales tax on purchases related to their charitable activities and functions. Before claiming the exemption, a charitable organization must apply for a certificate of exemption from the Department of Revenue and present this certificate to retailers when making purchases for the sale to be exempt from tax. The exemption is typically applied at the time of sale, but an organization can also pay the sales tax and later apply for a refund from the Department of Revenue.

WHAT DID THE EVALUATION FIND?

The exemption is meeting its purpose and is likely used widely by charitable organizations in the state.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. We inferred that the purpose is to exempt charitable organizations from taxation because historically, governments, including the State of Colorado, have considered charitable organizations to be beneficial to the public and to reduce the need for government services. Because the expenditure was created concurrently with the establishment of the State's sales tax, it appears that the exemption was not intended to provide new tax benefits for charitable organizations, but instead to define which entities and individuals would be subject to the sales tax.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

Charitable organizations we surveyed reported some administrative difficulty in claiming the exemption due to some retailers refusing to apply the exemption and differences between state and home rule city local sales tax requirements.

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SALES TO CHARITABLE ORGANIZATIONS EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

In 1935, the General Assembly enacted the Emergency Retail Sales Tax Act, which established Colorado's retail sales tax and created the Sales to Charitable Organizations Exemption. The General Assembly made the sales tax and this exemption permanent in 1937, and the exemption has remained largely unchanged since that time.

According to Section 39-26-718(1)(a), C.R.S., charitable organizations are not required to pay state sales and use tax on purchases related to their charitable activities and functions. In addition, charitable organizations are not required to pay local sales taxes for purchases made in local taxing jurisdictions, such as statutory cities and counties, which have their local sales taxes collected by the State on their behalf, because statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that these local governments apply most of the State's sales tax exemptions, including the Sales to Charitable Organizations Exemption. 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 and are not required to exempt charitable organizations from their local sales tax, although many choose to do so.

A charitable organization is defined in statute [Section 39-26-102(2.5), C.R.S.] as "any entity organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international sports competition…, or for the prevention of cruelty to children or animals," and new legislation, House Bill 18-1218, includes veterans' organizations in this definition as

well. Additionally, to qualify as a charitable organization, none of the organization's income may benefit a private individual directly, nor can the organization substantially participate in lobbying activities, or intervene in the campaigns of political candidates. The State's definition of a charitable organization substantially follows the federal definition provided in Section 501(c)(3) of the Internal Revenue Code.

To claim this exemption, an organization must apply to the Department of Revenue to verify its eligibility and receive a certificate of exemption (Form DR 0715). The organization must present the exemption certificate to retailers to claim the exemption when making purchases. Retailers are responsible for verifying an organization's tax exempt status and maintaining records of sales to charitable organizations, including the organizations' Colorado certificate of exemption numbers, the dates of the sale, descriptions of the items purchased, and the organizations' names and addresses. In addition to the certificate of exemption, charitable organizations may provide retailers with a Standard Colorado Affidavit of Exempt Sale Form (DR 5002) that contains these details about the organization and transaction as a courtesy to retailers. This form is intended to help retailers accurately calculate their monthly or quarterly sales tax remittance, but retailers are not required to submit this form to the Department with their Retail Sales Tax Returns (Form DR 0100). Retailers are required to report exempt sales to charitable organizations on their Retail Sales Tax Returns; these sales are combined on a single line with sales to government entities, which are also exempt from sales tax. If a retailer is unsure whether a transaction qualifies for the exemption or questions the authenticity of an organization's documents, the retailer may refuse to accept the certificate of exemption and collect and remit sales tax on the transaction. If this occurs, charitable organizations have to pay the tax in order to complete the sale, but may submit a claim for a refund to the Department of Revenue (Form DR 0137B).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of this exemption. We infer that the main beneficiaries of this exemption are charitable organizations and Coloradans that utilize the services, products, or experiences that charitable organizations provide. According to Internal Revenue Service data, there are more than 21,000 charitable organizations qualifying under Section 501(c)(3) of the Internal Revenue Code in Colorado. Charitable organizations serve many groups in the state and exist for a wide variety of purposes, including religion, arts, education, health care, human services, research, emergency relief, animal welfare, and the environment. As a result, the benefit these organizations receive from the exemption can vary based on the volume and type of retail purchases they make. According to our survey of charitable organizations, the items most frequently purchased using the exemption are office supplies and equipment, items consumed in the course of providing direct programming, and catering for programs and events.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this tax expenditure. We inferred based on the enactment date and statutory language that the purpose is to exempt charitable organizations from taxation. Because the expenditure was created concurrently with the establishment of the State's sales tax, it appears that the exemption was not intended to provide a new tax benefit for charitable organizations, but instead to define which entities and individuals would be subject to the sales tax.

In the United States, there is a well-established history of providing preferential tax treatment to charitable organizations because governments, including the State of Colorado, have considered them to be beneficial to the public and to help reduce the need for government services and resources. Therefore, tax exemptions for charitable organizations are a common structural element within many states' tax codes.

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

We determined that the exemption is meeting its purpose because charitable organizations are widely using it to avoid paying sales taxes. 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 exemption is meeting its inferred purpose.

PERFORMANCE MEASURE: *To what extent has the Sales to Charitable Organizations Tax Exemption been used by charitable organizations?*

RESULT: We found that the exemption is likely being used by most charitable organizations who make otherwise taxable purchases. Although data constraints prevented us from quantifying how many organizations benefited from the exemption and by how much, we conducted a survey of a non-statistical sample of charitable organizations based in Colorado to assess the extent it is being used and obtain input from those organizations using it on its impact on their organizations and its overall administration. Of the 152 survey respondents that answered the question in our survey, 124 (82 percent) reported that their organization uses this exemption approximately 75 percent or more of the time that it makes otherwise sales-taxable purchases.

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

We estimate that this tax expenditure resulted in $45.5 million of forgone state revenue in Calendar Year 2016 and a corresponding tax savings to charitable organizations. In addition, because the local governments that rely on the State to collect their sales taxes must also apply the exemption to their local sales taxes, we estimated the revenue impact to local jurisdictions. Home rule jurisdictions that self-collect their sales taxes are not included in this estimate because they set their

tax policies independently from the State. The revenue impact estimates are summarized in EXHIBIT 1.1.

EXHIBIT 1.1. REVENUE IMPACT ESTIMATES FOR THE SALES TO CHARITABLE ORGANIZATIONS EXEMPTION FOR STATE AND LOCAL JURISDICTIONS CALENDAR YEAR 2016 (IN MILLIONS)

	REVENUE IMPACT
State	$45.5
Local Jurisdictions	$28.4
TOTAL	$73.9

SOURCE: Office of the State Auditor analysis of Secretary of State, Internal Revenue Service, Guidestar, Department of Revenue, and survey data.

Because the Department of Revenue was unable to provide data specific to the amount claimed for this exemption, we used publicly-available IRS financial data for charitable organizations registered with the Colorado Secretary of State and survey responses from eligible organizations to estimate these figures. First, we estimated total expenses for charitable organizations for 2016 using expenses they reported on their IRS Form 990 for Calendar Years 2009 through 2016, which is publicly available for active organizations, adjusting 2009 through 2015 to 2016 dollars using the Consumer Price Index for the Denver-Aurora-Lakewood metropolitan area, prepared by the Bureau of Labor Statistics. Because we had less information for the smallest organizations and religious places of worship, we excluded them from our IRS Form 990 analysis, but made a small (about 2 percent) adjustment to our estimate to account for them, using a subset of IRS data on charitable organizations with gross receipts of less than $25,000 from Form 990-N filers, which is for charitable organizations with gross receipts of $50,000 or less, and Department of Revenue data on registered places of worship to estimate their expenses.

Using this information, we estimated that charitable organizations in Colorado had $15.1 billion in expenses for Calendar Year 2016. Because the reported expenses include many expenses, such as staff salaries and overhead costs that would not be subject to sales tax regardless of the exemption, we used information provided by our survey respondents to estimate that, on average, 10.4 percent of

charitable organizations' expenses would be subject to sales tax without the exemption. We then used this rate to estimate that without the exemption, $1.6 billion of the organizations' expenses would be subject to sales tax. We applied Colorado's 2.9 percent sales tax rate to these otherwise taxable expenses to calculate the total forgone state sales tax revenue. For the local government revenue impact estimate, we used the same method, but applied an average local sales tax rate (combining city and county tax rates and excluding home rule jurisdictions with self-collected sales taxes) of 1.8 percent, which we weighted based on the population of each local government.

With the passage of House Bill 18-1218, which expanded the definition of a "charitable organization" to include veterans' organizations, the revenue impact to the State for the Sales to Charitable Organizations Exemption is expected to increase slightly after July 1, 2018, when this law takes effect. Legislative Council staff estimated the annual revenue impact specifically related to the inclusion of veterans' organizations as charitable organizations under the exemption to be approximately $60,000 per year.

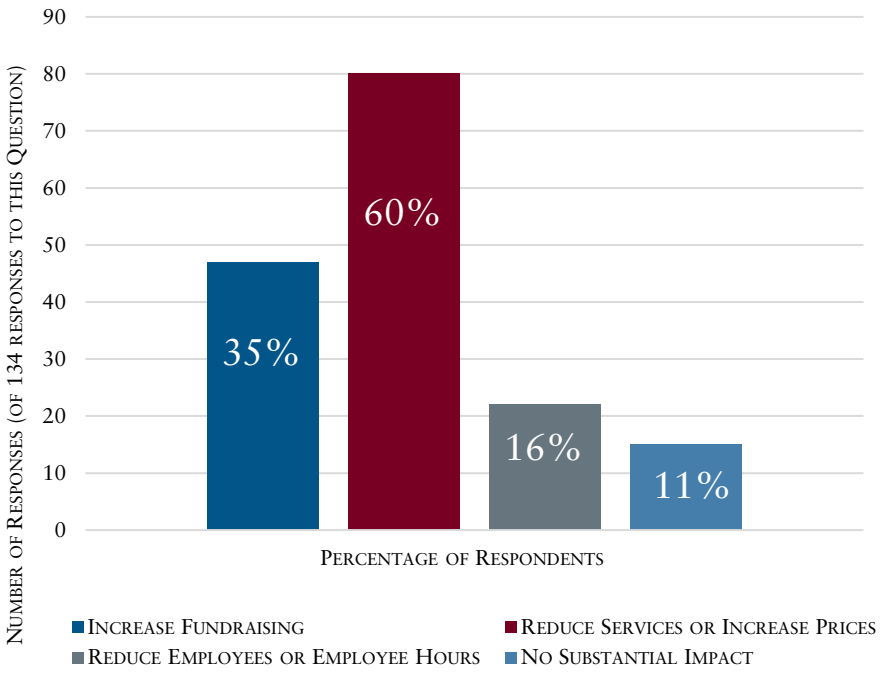
In addition to the direct impact of the exemption on state revenue, we estimate that the exemption reduces the tax burden on charitable organizations by about $73.9 million per year, including both state and local tax reductions and using the same analysis as above. There are several economic benefits that may result from this reduction in costs. For example, although we lacked data to quantify the number of jobs and wages supported by the savings realized by charitable organizations, 16 percent of organizations responding to our survey indicated that the exemption helps them retain additional paid staff. Therefore, the exemption may increase personal income in the state and state income tax collections, potentially offsetting some of the reduction in sales tax collections. In addition, about 60 percent of our survey respondents indicated that the exemption helps them sustain the quantity of services they provide. These services overlap with a number of state programs, including those aimed at providing food, housing, education, and recreation. Therefore, the exemption may also decrease the need for or

supplement government services, although we lacked data to reliably estimate this impact. Furthermore, the exemption may encourage charitable organizations to make additional retail purchases due to the lower after-tax cost, although this impact is likely limited by the organizations' need for goods and supplies to support their activities.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If this exemption was eliminated, it would increase operating costs for many charitable organizations and could cause some of them to compensate by providing fewer services, products, and experiences; increasing fundraising; or decreasing staffing. Based on our analysis of charitable organizations' expenses, we estimate that including the impact of both the state and local sales tax reduction, on average, the exemption provides a less than 1 percent reduction in the organizations' total expenses ($73.9 million compared to total expenses of $15.1 billion). However, for specific organizations, the impact can vary, depending on the proportion of the organization's expenses that come from otherwise taxable purchases. The organizations responding to our survey indicated that the exemption is significant to them. Specifically, 86 percent stated that the sales and use tax exemption was moderately or extremely important to their organization, and 97 percent stated that they believe the exemption is moderately or extremely important to the nonprofit sector in Colorado. The survey respondents provided a variety of comments explaining the impact that eliminating the exemption could have on their operations, which we categorized and summarize in EXHIBIT 1.2.

EXHIBIT 1.2. REPORTED IMPACT OF REMOVING THE SALES TO CHARITABLE ORGANIZATIONS EXEMPTION



SOURCE: Office of the State Auditor analysis of responses to survey of Colorado charitable organizations conducted by the Office of the State Auditor in March 2018.

Although most organizations indicated that the exemption provides them with an important benefit, approximately 11 percent of the organizations that participated in our survey reported that this exemption does not have a substantial impact on their operations. Specifically, some organizations reported that they do not regularly purchase large amounts of tangible personal property because they are service-based organizations, or they mostly purchase items that are already exempt from sales tax under other provisions of statutes. For example, many human services organizations reported that they frequently purchase food that is classified as food for home consumption, which is already exempt from state sales and use tax [Section 39-26-707(1)(e), C.R.S.].

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 other states that impose a sales and use tax, 27 offer a broad

sales and use tax exemption for charitable organizations that is similar to Colorado's exemption. Eight additional states offer a limited sales tax exemption for some charitable organizations; in these states, the exemption is typically limited to a few statutorily-listed organizations or specific types of organizations (e.g., nonprofit hospitals, relief organizations, churches). Nine states and the District of Columbia do not have a general sales tax exemption for charitable organizations, though some of these jurisdictions allow for minor exceptions. Aside from North Carolina and Utah, which require taxpayers to claim the exemption through a refund, all of the states that have a broad exemption apply it at the point of sale.

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

There are several other tax expenditures in Colorado that reduce the amount of taxes a charitable organization may pay. For example, Colorado does not impose an income tax on most income earned by charitable organizations [Section 39-22-112(1), C.R.S.], and occasional sales by charitable organizations are not subject to sales tax under certain circumstances [Section 39-26-718(1)(b), C.R.S.]. The Colorado Constitution [Article X, Section 5] also exempts real and personal property used exclusively by charitable organizations from local property taxes. Additionally, charitable organizations may benefit from other more specific sales and use tax exemptions, such as:

- Food for home consumption [Section 39-26-707(1)(e), C.R.S.].
- Prescription drugs and certain medical equipment, devices, and supplies [Section 39-26-717, C.R.S].
- Sales of tangible personal property that becomes an ingredient or component part of a product or service being manufactured, compounded, or furnished [Section 39-26-102(20)(a), C.R.S.].
- Tangible personal property for use in food manufacturing when the

property becomes an integral part or constituent part of the food product [Section 39-26-102(20)(b), C.R.S.].

- Sales from wholesalers to retailers or other wholesalers (if an organization makes purchases of items for resale) [Section 39-26-102(19)(a), C.R.S.].

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

We lacked sales tax return data necessary to precisely calculate the amount of the exemption claimed and the number of organizations claiming it. Although the Department of Revenue collects data on retail sales made to charitable organizations and governments on its Retail Sales Tax Return form DR 0100, the form includes a single line to report these sales, and retailers must combine the total sales from each category when filing. This information cannot be disaggregated and is not captured by GenTax, the Department of Revenue's tax processing system. In addition, the Department of Revenue does not capture the amount of refunds issued specifically under the exemption. If the Department of Revenue modifies its Retail Sales Tax Return form DR 0100 to include a separate reporting line for sales to charitable organizations, programs GenTax to capture this information from the return, and begins tracking refunds issued under the exemption, we would be able to more reliably report the revenue impact to the State. However, this would require additional resources and staff time for the Department of Revenue and would create additional tracking and reporting requirements for retailers (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and potential costs for addressing them).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

Although most charitable organizations reported that they use the exemption, they also reported that administrative issues can make it

difficult to claim under certain circumstances. Specifically, almost one-third of the respondents to our survey reported that they find this exemption to be very or somewhat difficult to claim. Respondent comments suggest that the difficulty arises during the retail transaction process, specifically because:

- There is not a consistent process applied by all retailers regarding which documents need to be provided by the charitable organization and whether the retailer stores the organization's information for future use or if the organization has to provide its documentation on each separate occasion.

- Some retailers do not understand how the exemption works and who is eligible for it.

- Many checkout staff have not been trained by retail management on how to apply the exemption during a transaction.

- It is time-consuming and difficult for some retailers to verify in advance of a purchase that an organization is eligible for the exemption.

- Some retailers decline to apply the exemption, though they do not always provide a reason.

- Some retailers are not aware of the exemption.

Further, these issues are complicated by Colorado's laws regarding local government taxes, which may result in confusion for retailers in applying the exemption. Specifically, the State's 71 home rule, self-collected municipalities have the authority [Colorado Constitution, Article XX, Section 6] to decide whether to exempt purchases made by charitable organizations from their local sales and use taxes and to create a separate local charitable organization exemption certificate application process. We reviewed the tax regulations for the fifteen most populous home rule, self-collected cities and found that they all provide

some type of sales tax exemption for charitable organizations, but the requirements vary among cities and are not always the same as those for the state sales tax exemption. For example, seven home rule, self-collected cities provide a blanket exemption for charitable organizations without a separate application process, eight require a separate application and certificate, and one limits which charitable organizations qualify for the exemption based on their annual gross revenue. In addition, organizations located, or making purchases, in some home rule cities must often present two charitable certificates, one for the State and one for the city, when making purchases. Although the state exemption should be applied to the state sales tax regardless of local tax laws, the variation between locations can create uncertainty among retailers and charitable organizations regarding which documents are required in order to apply the exemption, and some charitable organizations reported difficulty using the exemption under these circumstances.

When a retailer refuses to apply the sales tax exemption, the charitable organizations holding a certificate of exemption can apply for a refund of the sales taxes paid from the Department of Revenue. However, while 24 percent of our survey respondents reported that retailers have refused to honor their exemption, 6 percent reported applying for a refund, which may indicate that charitable organizations do not have the resources to apply for refunds or that applying for refunds is not a cost-effective use of staff time, especially if they must apply separately for a state refund and a city refund in the case of a home rule, self-collected municipality. Additionally, this can be a financial burden on charitable organizations since, according to Department of Revenue staff, refunds typically take between 6 and 9 months to process. Having to issue refunds also places additional administrative burden on the Department of Revenue.

SALES TO RESIDENTS OF BORDERING STATES

EVALUATION SUMMARY SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1963
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	None
NUMBER OF TAXPAYERS	None
AVERAGE TAXPAYER BENEFIT	None
IS IT MEETING ITS PURPOSE?	No, because it likely cannot be used

WHAT DOES THIS TAX EXPENDITURE DO?

This tax expenditure creates a sales tax exemption at the time of sale for residents of adjoining states that do not impose a retail sales tax. The sale must occur within 20 miles of the Colorado border, and be made by an individual for the sole purpose of making purchases and not as a tourist.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state the purpose of the sales tax exemption. We inferred the purpose to be to eliminate the disincentive to making purchases in Colorado for residents of states with no sales tax.

WHAT DID THE EVALUATION FIND?

Currently, all states bordering Colorado impose a retail sales tax or an equivalent tax on retail sales; thus, this exemption is most likely no longer applicable and its purpose no longer exists.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider repealing or clarifying the applicability of this exemption.

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SALES TO RESIDENTS OF BORDERING STATES EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Statute [Section 39-26-704(2), C.R.S.] created the Sales to Residents of Bordering States Exemption to exempt from sales tax retail sales to residents of adjoining states that do not impose a retail sales tax. The sale must occur within 20 miles of the Colorado border, and be made to a non-corporate resident of an adjoining state that does not impose a retail sales tax who is in Colorado for the sole purpose of making purchases and not as a tourist. The consumer need not take any affirmative steps to obtain the exemption. If the retailer determines the purchaser qualifies for the exemption, then the retailer would not charge Colorado state sales tax. This exemption was enacted in 1963 [House Bill 63-157] and has remained substantially unchanged since that time.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the sales tax exemption. Based on the statutory language of the expenditure and Colorado's tax structure, we inferred that the intended beneficiaries of this exemption were retailers located near the Colorado border, specifically the Colorado-Nebraska border. Nebraska did not have a sales tax when this expenditure was enacted.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. We inferred that the purpose is to remove the disincentive to making

purchases in Colorado that would otherwise exist for residents of bordering states with no retail sales tax.

To determine the purpose of the exemption, we researched retail sales tax provisions in states bordering Colorado (i.e., Wyoming, Nebraska, Kansas, Oklahoma, New Mexico, Arizona, and Utah), the legislative history of the exemption, and similar sales tax exemptions in other states. We found that at the time the exemption was enacted, all the bordering states had a retail sales tax, or an equivalent tax, with the exception of Nebraska, which did not impose a sales tax, therefore we infer that the exemption was likely targeted to businesses within 20 miles of the Colorado-Nebraska border.

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

We determined that this exemption is not meeting its inferred purpose since all of the states bordering Colorado currently impose a sales tax, or an equivalent tax on retail sales, and retailers likely do not receive a financial benefit from the exemption.

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 inferred purpose:

PERFORMANCE MEASURE: *Does the Sales to Residents of Bordering States Exemption provide a financial benefit to Colorado retailers located near Colorado's border?*

RESULT: When this exemption was first enacted in 1963, only one bordering state, Nebraska, did not impose a retail sales tax. At that time Colorado sales tax would have been an added cost and disincentive for Nebraska residents to make purchases in Colorado. However, in 1967, Nebraska began assessing a retail sales tax and all other adjoining states

have continued to assess a retail sales tax, or equivalent taxes, which include a transactional privilege tax in Arizona and gross receipts tax in New Mexico. Therefore, it appears that the exemption is likely not providing a financial benefit to retailers located near the Colorado border.

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

We did not identify any economic costs or benefits of the exemption since Colorado retailers have most likely not been able to apply it for the past 51 years.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the exemption were eliminated there would be very little, if any, impact on beneficiaries.

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

Of the 44 other states that have a sales tax, only 13 states share a border with a state that does not have a sales tax. Therefore, this type of expenditure is not applicable to most states. Although we did not complete an extensive analysis of other states with similar exemptions, we did identify one state that has a similar exemption. Washington, which shares a border with Oregon that does not have a state sales tax, has a provision that is available to residents of *any* State or Canadian province, with a sales tax of less than 3 percent. Washington's Joint Legislative and Audit Review Committee performed an assessment of the provision in 2011 and determined that the exemption was meeting its inferred purpose of encouraging nonresidents from regions with low or no retail sales tax (particularly Oregon) to make retail purchases in Washington. Thus, it appears that this type of exemption is potentially effective, when there are bordering states that do not impose a tax on purchases of tangible personal property.

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

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

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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

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

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WHOLESALES EXEMPTION

EVALUATION SUMMARY — SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	1935
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$4.0 billion (CALENDAR YEAR 2017)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

This tax expenditure provides an exemption from Colorado's retail sales tax for wholesale transactions. Wholesale transactions are any sales for which the purchaser is not the final consumer, such as when a distributor sells an item to a retailer for purposes of resale.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. We inferred that the purpose is to ensure that the sales tax is only applied to purchases made by the final consumer, which helps maintain fair competition among businesses and transparency in the tax system.

WHAT DID THE EVALUATION FIND?

We determined that the exemption is likely accomplishing its purpose because it appears to be widely used.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Wholesales Exemption.

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WHOLESALES EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Wholesales Exemption exempts wholesale transactions from state retail sales tax [Section 39-26-102(19)(a), C.R.S.]. The exemption was part of the 1935 legislation that first imposed a retail sales tax in Colorado, and the statutory language of the exemption has remained unchanged. A sale of tangible goods is considered to be wholesale if the items are being purchased for purposes of resale. In addition, eligible wholesale transactions are exempt from local sales taxes in statutory cities and counties, which have their local sales taxes collected by the State on their behalf. This is because statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that these local governments apply most of the State's sales tax exemptions, including the Wholesales Exemption. Home-rule cities established under Article XX, Section 6 of the Colorado Constitution, which have the authority to set their own tax policies independent from the State, are not required to exempt wholesales from their local sales tax. However, the 15 most populous cities in Colorado, which are all home rule cities, also exempt wholesale sales from local sales tax.

All Colorado retailers and wholesalers are required to obtain a sales tax license, which serves as proof that a business can collect retail sales tax and make tax-exempt wholesale purchases for resale. Both retailers and wholesalers use the Department of Revenue's Retail Sales Tax Return (form DR 0100) to report sales on a monthly, quarterly, or annual basis, depending on their sales tax liability. The form includes a separate line for reporting any wholesale transactions that have been exempted from retail sales tax.

According to Department of Revenue Regulations [1 CCR 201-4], vendors making a wholesale sale must confirm that the purchaser

intends to resell the items being purchased and is therefore, eligible for the exemption. There are several mechanisms available for the vendor to verify and document that the purchaser is making a wholesale purchase, including:

1. Reviewing and retaining a copy of the purchaser's sales tax license.

2. Verifying the purchaser's sales tax license number with the Department of Revenue either online, or by phone.

3. Retaining a statement signed by the purchaser confirming that the purchase is for resale.

Out-of-state purchasers do not need a Colorado sales tax license to qualify for the Wholesales Exemption. For these purchasers, the seller can accept a sales tax license or sales tax exemption certificate issued by another state as proof that the purchaser is eligible to make wholesale purchases. The seller's verification, record keeping, and reporting requirements are the same regardless of whether the purchaser is located in-state or out-of-state. Finally, if items purchased at wholesale are later withdrawn from inventory for the purchasing entity's own use, the entity is then liable for use tax on the items.

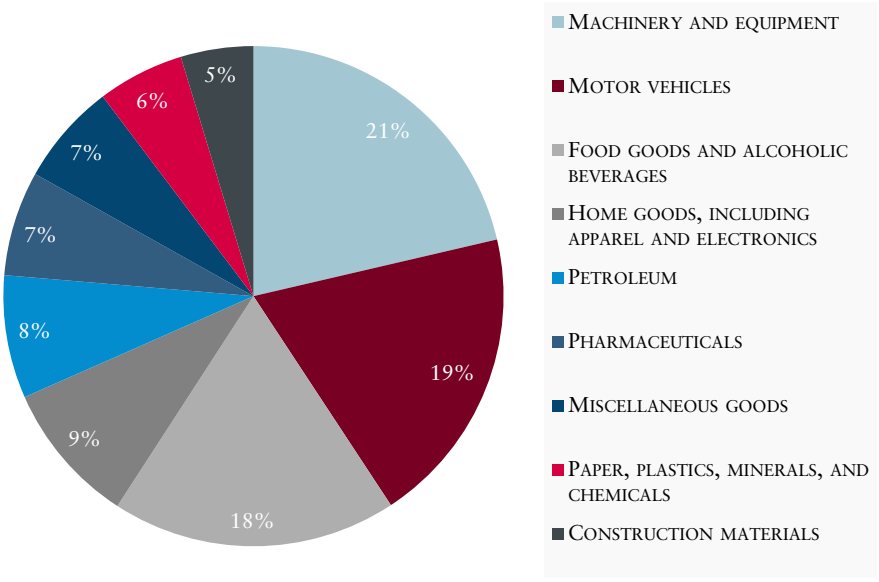
WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the Wholesales Exemption. We inferred that the intended direct beneficiaries are manufacturers, wholesalers, distributors and other entities that make purchases for resale. We also inferred that consumers indirectly benefit from this exemption since it likely reduces the effective tax rate on tangible goods.

Wholesale businesses are often a key part of the products distribution chain, as products move from manufacturers, to distributors, and to retailers and wholesale transactions are common across many

industries. According to U.S. Census Bureau 2016 County Business Patterns Survey data, Colorado has approximately 7,300 wholesale businesses. Based on data from the U.S. Bureau of Economic Analysis, we estimate that there were about $139 billion in wholesale transactions in Colorado in 2017 (see analysis below for more information on our estimate). Economic Census data from 2012 shows that wholesale sales occurred in a variety of industries, with the three largest being machinery and equipment, motor vehicles, and food and alcoholic beverages. EXHIBIT 1.1 contains a breakdown by industry group of wholesale sales in Colorado.

EXHIBIT 1.1. WHOLESALE INDUSTRY SALES BY INDUSTRY SUBCATEGORY



SOURCE: Office of the State Auditor analysis of U.S. Census Bureau, 2012 Economic Census.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this exemption. Based on our review of statute, the legislative history, and other states' tax expenditure provisions, we inferred that the purpose is to ensure that sales taxes are only applied to purchases made by final consumers. Specifically, the exemption, which is a common structural provision in states with sales tax, ensures that the sales tax is only applied once,

instead of at multiple steps through a product's distribution chain. This helps maintain fair competition among businesses and ensure transparency in the tax system by disclosing to consumers the full sales tax that is included in a product's cost, since it would be hidden from consumers if businesses increased prices to account for sales taxes at earlier steps in the distribution chain.

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

We determined that this exemption is likely accomplishing its purpose. Statute does not provide a quantifiable performance measure for this exemption, and there is limited data available to assess its effectiveness. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its inferred purpose.

PERFORMANCE MEASURE: *To what extent does the Wholesales Exemption exempt wholesale transactions from Colorado's retail sales tax?*

RESULT: Overall, we found evidence that the Wholesales Exemption is being frequently applied to transactions in the wholesale and manufacturing industries, both of which tend to have a high volume of wholesale transactions. However, we lacked data to quantify the proportion of eligible transactions that it was applied to. Specifically, we reviewed retail sales tax reports prepared by the Department of Revenue for Calendar Year 2015 (the most recent full year available) and found that wholesalers and manufacturers who completed sales tax returns, reported gross sales (which includes both wholesale and retail sales) of $76.3 billion for the year and retail sales of $30.3 billion. The difference, $46 billion (60 percent of gross sales), could be attributable to wholesale sales that would qualify for the exemption. However, the difference could also be attributable to other types of sales that would not be exempt under the Wholesales Exemption, but that are deducted from gross sales in order to calculate retail sales, such as service sales,

sales to government entities, and nonprofits. We found that for wholesalers and manufacturers, the difference between the amounts reported for gross sales and retail sales was much larger than the difference between the amounts reported for other industries. For example, the retail trades industry reported only a 10 percent difference between gross sales and retail sales, compared to the 60 percent difference for wholesalers and manufacturers. This indicates that most of the difference for the wholesalers and manufacturers is likely attributable to wholesale sales that would qualify for the exemption. Therefore, it appears that the Wholesales Exemption is being frequently applied within the wholesale and manufacturing industries.

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

We estimated that about $4.0 billion in state revenue was forgone in Calendar Year 2017 as a result of this exemption. EXHIBIT 1.2 provides the estimated state and local revenue impacts of the tax expenditure for Calendar Year 2017.

EXHIBIT 1.2. WHOLESALES EXEMPTION
ESTIMATED 2017 STATE AND LOCAL REVENUE IMPACT

Estimated wholesale industry sales, 2017	$139.4 billion
Estimated state revenue impact, 2017	$4.0 billion
Estimated local government revenue impact, 2017	$2.5 billion
TOTAL REVENUE IMPACT	$6.5 billion

SOURCE: Office of the State Auditor analysis of data from the 2012 Economic Census and the Bureau of Economic Analysis.

Because Department of Revenue data was not available to measure the revenue impact of this exemption, we used data from the U.S. Census Bureau and the Bureau of Economic Analysis to develop our estimates. Specifically, we used data from the 2012 Economic Census indicating that about $113.8 billion in wholesale transactions occurred in Colorado during Calendar Year 2012. We then increased that amount based on Bureau of Economic Analysis data showing 22.5 percent in combined wholesale industry growth and inflation from Calendar Year 2012 to 2017 to arrive at our estimate of $139.4 billion in wholesale sales for

2017. We multiplied this amount by the state tax rate of 2.9 percent and the average population-weighted local tax rate for state-collected local governments of 1.8 percent to estimate the revenue impacts.

The revenue impact estimate in EXHIBIT 1.2 should be viewed as a general indicator of the scale of the Wholesales Exemption rather than as an exact figure because 2012 U.S. Census Bureau data may not include all wholesale sales in Colorado and may include some sales that would not qualify for the exemption. Specifically, the U.S. Census Bureau reports sales figures based on North American Industry Classification System (NAICS) codes, which categorize all United States businesses according to their function. However, businesses self-select their NAICS codes and it is unclear whether businesses have selected the best or most accurate code to describe their activities. Furthermore, the U.S. Census Bureau's definition of "wholesale" may not fully capture all wholesale sales since it focuses on the industry rather than the transaction. For instance, if a retailer makes a one-time sale to another retailer, that sale may qualify as a wholesale sale under Colorado law if the purchaser was not the final consumer. However, it is unclear if this sale would be captured by the U.S. Census Bureau data that relies on industry codes rather than the intent of the seller. Conversely, if a wholesaler sells products directly to a final consumer, then these sales could be included in the data, though the sales would not qualify for the exemption.

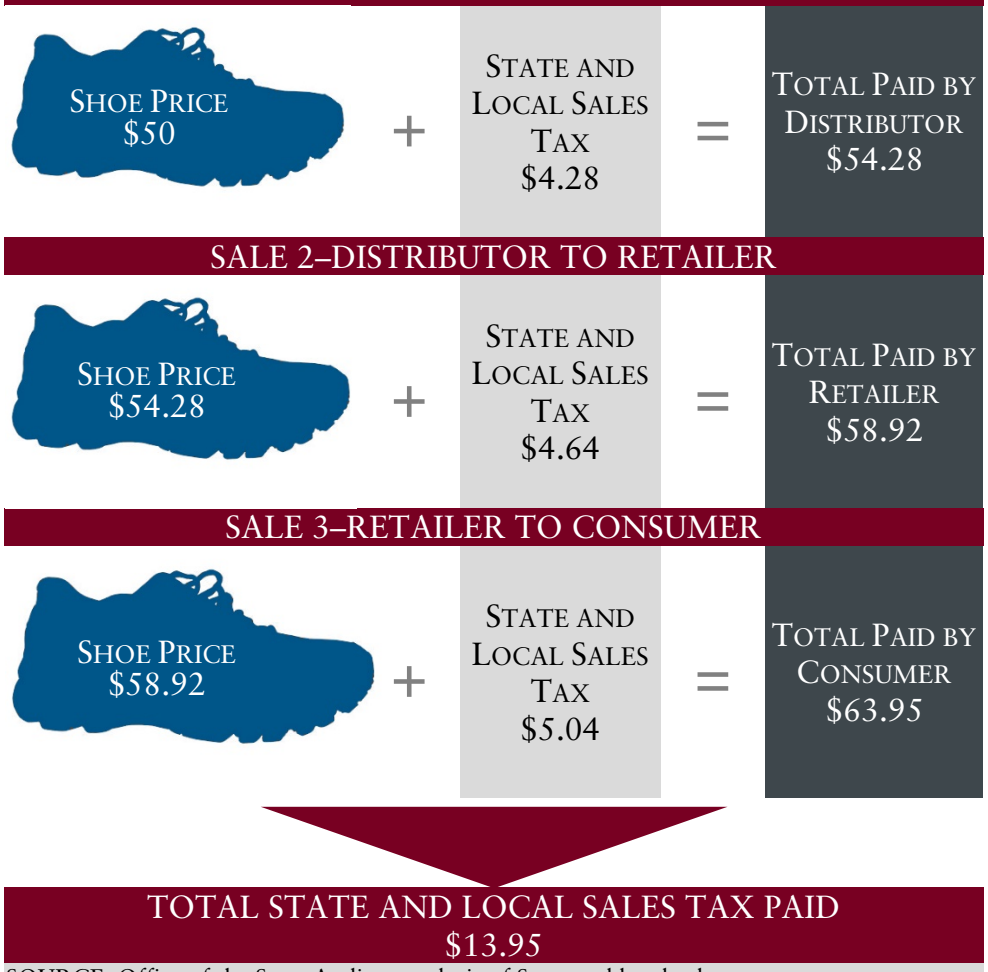
WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Wholesales Exemption would cause a very large increase in the sales taxes paid by wholesalers, distributors, and retailers and would have wide ranging impacts to the State's economy. Specifically, according to information provided by Legislative Council, the State collected about $2.7 billion in sales taxes and $11.3 billion from all taxes during Fiscal Year 2017. Therefore, based on our estimate of $4.0 billion in forgone sales taxes due to the Wholesales Exemption, eliminating the exemption would effectively increase state sales taxes by about 148 percent and total state taxes by about 35

percent. Because retailers would likely adjust prices to cover the additional tax costs incurred through the distribution chain, all, or a portion, of the increased taxes would be passed on to consumers.

The large impact of eliminating the Wholesales Exemption is due to the "pyramiding" effect of applying a sales tax to every transaction through a product's distribution chain, which causes the effective tax on the product to increase dramatically. EXHIBIT 1.3 demonstrates this effect for a product manufactured and sold in Estes Park, Colorado, a statutory town, where the combined state and local municipal sales tax rate was 8.55 percent as of 2018. To focus the analysis on the effect of the sales tax alone, the hypothetical example also assumes that the businesses would not increase the price at each step to make a profit, but only enough to cover the additional tax cost and avoid a loss. To the extent that businesses increase sales prices to cover non-tax expenses and make a profit, the impacts shown here would be amplified.

EXHIBIT 1.3.
HYPOTHETICAL EXAMPLE OF THE SALE OF SHOES IF THE WHOLESALE EXEMPTION WERE ELIMINATED



SOURCE: Office of the State Auditor analysis of State and local sales tax rates.

In this example, the effective tax rate for the shoes would increase from 8.55 percent to 27.91 percent (increasing the after tax cost from $54.28 to $63.95) if the Wholesales Exemption were eliminated. Wholesalers, distributors, manufacturers, retailers, and any other entities making wholesale purchases would either need to pay the tax themselves, thereby cutting into their profit margins, or they would pass the cost of the tax on to their customers by increasing the price of the product. In addition to increasing costs, because retail prices would not specify the taxes that would effectively be passed on to consumers, a pyramiding method of applying the sales tax would be less transparent than applying the tax once to the final consumer purchase.

In addition, the pyramiding effect that would occur if the Wholesales Exemption were eliminated puts businesses that sell products with a longer distribution chain (i.e., more sales transactions between wholesale businesses before product is sold to a consumer) at a competitive disadvantage to manufacturers that sell products directly to consumers. Using the example above, if another shoe manufacturer handled its own distribution and retail stores, its shoe would only be taxed once, allowing it to offer the shoe at a substantially lower price to consumers ($54.28 compared to $63.95, including taxes). The Wholesales Exemption is in place to avoid such market distortions and ensure that each final retail purchase is subject to the same tax rate.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

The exemption of wholesale transactions from retail sales taxes is commonplace in the United States. Of the 44 other states that assess a retail sales tax or similar tax on sales of tangible personal property, 43 provide an exemption for wholesale sales. Hawaii does not exempt wholesale purchases from its general excise tax, which is assessed on most sales in the state, but it does assess the tax at a much lower rate on wholesale transactions (0.5 percent for wholesales compared to 4 percent on retail).

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

There are several other retail sales tax exemptions that are closely related to the Wholesales Exemption. These exemptions include:

- Ingredients and component parts that are incorporated into a manufactured product that is then resold [Section 39-26-102(20), C.R.S.]

- Newsprint and printer's ink [Section 39-26-102(21)(a), C.R.S.]

- Certain agricultural compounds [Section 39-26-102(19)(c), C.R.S.]

Sales of these items are explicitly defined as "wholesale" transactions and therefore exempt from sales tax. Additionally, we identified 66 other tax exemptions related to sales taxes that could also apply to the items sold through wholesale transactions.

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

Although the Department of Revenue's Retail Sales Tax Return (Form DR 0100) contains a separate line for reporting exempt wholesale transactions, it is not stored in a format that GenTax, the Department's tax processing and information system, can readily pull data from. Therefore the Department of Revenue was unable to provide us with data showing the amount of Wholesales Exemptions claimed. This data would enable us to provide a more accurate and reliable estimate of the exemption's revenue impact to the State, and potentially identify the location of wholesale transactions in the State to better assess the local impact of the Wholesales Exemption. Therefore, if the General Assembly determined that a more accurate estimate is necessary, it could direct the Department of Revenue to make changes in GenTax to allow it to pull data on wholesale transactions reported on the Retail Sales Tax Return. However, according to the Department of Revenue, this would require additional resources to complete the necessary programming in GenTax (see the Tax Expenditures Overview section of this 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?

We did not identify any policy considerations related to the Wholesales Exemption.

BIOGAS PRODUCTION COMPONENTS SALES TAX EXEMPTION

EVALUATION SUMMARY SEPTEMBER 2018

THIS EVALUATION IS INCLUDED IN COMPILATION REPORT SEPTEMBER 2018

YEAR ENACTED	2014
REPEAL/EXPIRATION DATE	July 1, 2019
REVENUE IMPACT	$1.2 to $2.2 million (BETWEEN MAY 2014 AND JULY 2018)
NUMBER OF TAXPAYERS	Could not determine
AVERAGE TAXPAYER BENEFIT	Could not determine
IS IT MEETING ITS PURPOSE?	Yes, but only to a limited extent

WHAT DOES THIS TAX EXPENDITURE DO?

The Biogas Production Components Sales Tax Exemption (Biogas Exemption) exempts the sale, storage, and use of components used in biogas production systems from state sales and use tax. To be eligible for the exemption, the biogas produced must be (1) sold to a power generator, (2) used as a transportation fuel, or (3) converted into renewable natural gas.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. We inferred that the purpose is to encourage the development of projects that produce biogas-derived energy from renewable sources in Colorado.

WHAT DID THE EVALUATION FIND?

We determined that the Biogas Exemption is meeting its purpose, but only to a limited extent. Specifically, we found that the exemption may provide a small additional incentive to develop biogas facilities in the state, but likely has not caused a significant increase in biogas energy production capacity.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider expanding the Biogas Exemption to include biogas used to produce electricity and heat that is consumed on site.

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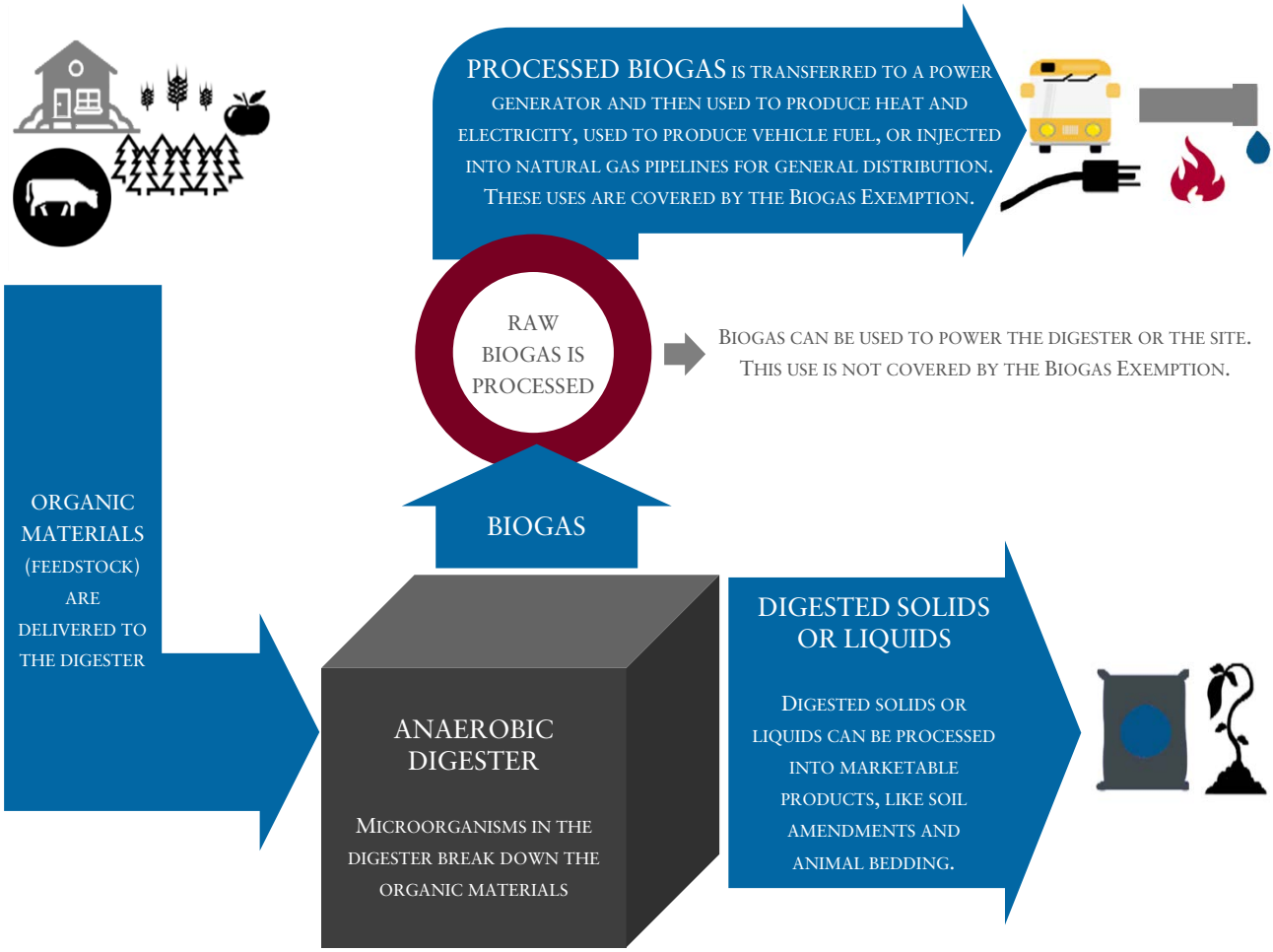
BIOGAS PRODUCTION COMPONENTS SALES TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Biogas Production Components Sales Tax Exemption (Biogas Exemption) excludes the sale, storage, and use of components found in biogas production systems from state sales and use tax [Section 39-26-724(1)(c), C.R.S.]. Biogas is one end-product of anaerobic digestion, which occurs when microorganisms break down organic waste feedstock (e.g., manure, municipal solid waste, food waste, or crop residue) in the absence of oxygen. Biogas is composed primarily of methane (60 to 70 percent) and carbon dioxide (30 to 40 percent) and can be processed for use as fuel for heat and/or electricity generation, or converted into renewable natural gas, which is similar to natural gas derived from fossil fuel sources and can be upgraded for use as transportation fuel. Other byproducts of anaerobic digestion include a fibrous solid that can be used as animal bedding or a soil amendment, and a nutrient rich liquid that can act as a soil amendment. Often, biogas systems are constructed onsite at agricultural or industrial operations or at waste management facilities, although they can also be stand-alone commercial operations that process organic waste from other nearby sources. EXHIBIT 1.1 shows the biogas production process.

EXHIBIT 1.1. BIOGAS PRODUCTION SYSTEM



SOURCE: Office of the State Auditor created diagram explaining the anaerobic digestion and biogas generation process based on information from the American Biogas Council, the Environmental Protection Agency and Section 39-26-724(1)(c), C.R.S.

Biogas production facilities can sell the solid and liquid by-products and the biogas, use the biogas to heat or power their buildings, and/or collect fees from third parties that use the biogas production system to dispose of their waste. Additionally, if the biogas production system processes waste that is produced onsite and would otherwise need to be landfilled, the system's owners may benefit from reduced waste transportation costs and disposal fees.

The exemption was created by House Bill 14-1159 in 2014 and has remained unchanged since its initial enactment. To be eligible for the exemption, the biogas produced must be: (1) sold to a power generator,

(2) used as a transportation fuel, or (3) converted into renewable natural gas. Statute [Section 39-26-724(2)(a)(I), C.R.S.] defines the components used in biogas production systems as "all tangible personal property used in connection with the production of biogas and related solid by-products and liquid by-products," including but not limited to anaerobic digestion systems, biogas upgrade systems, and digested solids systems. Statute [Section 39-26-724(2)(a)(1)(A) through (C), C.R.S.] also provides a non-exhaustive list of specific items of tangible personal property that comprise anaerobic digestion systems, biogas upgrade systems, and digested solids systems and are covered under the exemption. The Biogas Exemption has been available since May 17, 2014, and it has a scheduled repeal date of July 1, 2019.

To apply the exemption, biogas components suppliers must include the exempt sale amount on the Department of Revenue's Retail Sales Tax Return (Form DR 0100) on the renewable energy components line of the Exemptions Schedule. Alternatively, purchasers of qualifying components who are charged sales tax at the time of purchase can apply to the Department of Revenue for a refund of the sales taxes they paid.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute did not explicitly identify the intended beneficiaries of this exemption. We inferred that the intended beneficiaries are companies, project developers, and investors that finance, build, or operate biogas production systems since these entities benefit from lower capital costs on some components of biogas projects due to the exemption. Indirect beneficiaries of the Biogas Exemption could be industries and facilities that produce organic material waste, such as the agricultural industry, the restaurant and hospitality industry, landfills, and wastewater treatment facilities, since biogas facilities can potentially accept this waste at a lower cost.

Currently, the biogas industry in Colorado is small and produces less than 1 percent of Colorado's renewable electric energy. Based on

information provided by stakeholder organizations, we identified 25 biogas production facilities in the state that are currently operating, were recently operating, or were in development as of July 2018. Of these 25 biogas production facilities, it appears that a maximum of five facilities could be eligible for the exemption, as shown in EXHIBIT 1.2.

EXHIBIT 1.2. COLORADO BIOGAS PRODUCTION FACILITIES CURRENTLY OR RECENTLY OPERATIONAL, OR CURRENTLY IN DEVELOPMENT, AS OF JULY 2018

BIOGAS PRODUCTION FACILITY TYPE	NUMBER OF FACILITIES IDENTIFIED	ABLE TO BENEFIT FROM THE EXEMPTION? WHY?
Municipal waste water treatment facilities	20	No. Municipalities are already exempt from state sales tax on all sales taxable purchases under Section 39-26-704(1), C.R.S.
Facilities located onsite at an agricultural or industrial operation	3	Possibly. These facilities typically use biogas for purposes not covered under the exemption, such as powering or heating their own buildings, but they may also use biogas for a qualifying purpose.
Stand-alone facilities	2	Yes. These facilities are constructed for the primary purpose of producing biogas from organic waste produced by third parties nearby and are therefore likely to sell the biogas for one of the three exempt purposes.

SOURCE: Office of the State Auditor analysis of data from news sources, the American Biogas Council and Resource Recovery Data.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for this exemption. Based on the legislative history, the statutory language of the exemption, and other states' evaluations of similar exemptions, we inferred that the purpose is to encourage the development of projects that produce biogas-derived energy from renewable sources in Colorado. This purpose is consistent with the original legislative declaration for the 2007 bill that created a similar renewable energy exemption, which is located in the same statutory section [Section 39-26-724, C.R.S.] as the Biogas Exemption. Specifically, the legislative declaration of House Bill 07-1279 stated 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." Biogas is a form of renewable energy, according to the U.S. Energy Information Administration, and can be used to produce electricity for use

onsite, which is not a use covered by the exemption, or sold to a power generator, which is covered by the exemption.

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

We determined that the Biogas Exemption is meeting its purpose, but only to a limited extent. Specifically, we found that the exemption may provide a small additional incentive to develop biogas facilities in the state, but likely has not caused a significant increase in biogas energy production capacity.

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 inferred purpose.

PERFORMANCE MEASURE: *To what extent has the Biogas Exemption incentivized the development of biogas production systems?*

RESULT: The Biogas Exemption may have provided a small additional incentive to develop biogas production systems in the state since its enactment in 2014. Specifically, of the five facilities that we identified as possibly benefiting from the exemption, two were constructed or planned for construction from 2014 to 2018 for the purpose of producing biogas as an energy source. One of these facilities, located in Weld County, was large (the largest biogas production facility in North America according to media sources); however, in part due to odor and permitting concerns, the Weld County Board of Commissioners ordered the facility to suspend operations in December 2016, and the facility continues to be closed. The other facility, located in Yuma County, was still in the planning phase, as of July 2018. Neither of the two facilities was in full operation prior to the exemption's enactment in 2014. However, the Weld County facility had been in the planning phase since 2009, 5 years prior to the enactment date of the exemption. Therefore, it appears unlikely that the

exemption drove the decision to go forward with the project. Industry representatives we interviewed stated that the exemption is helpful in providing some financial support for biogas projects and could help attract investment in projects, especially if investors are choosing between states. However, they also indicated that it does not provide a sufficient financial incentive to be a decisive factor in whether to develop and construct a biogas production system in Colorado.

To quantify the potential incentive provided by the Biogas Exemption, we assessed the taxpayer savings that could be realized under several hypothetical biogas production facility projects. We developed these scenarios based on industry reports and stakeholder feedback, indicating that anaerobic digestion projects typically cost between $1 million and $30 million, and between 40 percent and 75 percent of this cost is attributable to components in the biogas production system that may be eligible for the Biogas Exemption. EXHIBIT 1.3 uses these figures to calculate the estimated cost to taxpayers for a small, onsite anaerobic digester (the low end of the range of project expenses) and a large, stand-alone biogas production facility (the high end of the range of project expenses). To calculate the taxpayer savings we multiplied the estimated expenses eligible for the exemption under each scenario by the state sales tax rate of 2.9 percent.

EXHIBIT 1.3. ESTIMATED TAXPAYER SAVINGS FOR PROJECT SCENARIOS

PROJECT COST RANGE	TOTAL INCURRED CAPITAL EXPENSES	PERCENTAGE OF CAPITAL EXPENSES ELIGIBLE FOR EXEMPTION	EXPENSES ELIGIBLE FOR EXEMPTION	TAXPAYER SAVINGS
SCENARIO 1: Small, Onsite System	$1,000,000	40%	$400,000	$11,600
SCENARIO 2: Small, Onsite System	$1,000,000	75%	$750,000	$21,750
SCENARIO 3: Large, Stand-alone System	$30 million	40%	$12 million	$348,000
SCENARIO 4: Large, Stand-alone System	$30 million	75%	$22.5 million	$652,500

SOURCE: Office of the State Auditor analysis of industry reports and stakeholder feedback.

Overall, our analysis shows a typical taxpayer savings rate of about 1.16 to 2.18 percent of the project's total capital costs. Though this savings could be significant enough to encourage developers to invest in projects where the decision of whether to go forward is very close, in most cases, it would likely only provide a modest additional incentive rather than drive a decision.

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

We estimate that the revenue impact to the State was between $1.2 million to $2.2 million, in total, for May 2014 through July 2018. To develop this estimate, we used newspaper articles that reported the estimated project costs for the facility we identified as having been built after the exemption went into effect, as well as feedback from industry representatives estimating that no less than 40 percent and up to 75 percent of a typical biogas project's costs are attributable to biogas production components that would likely be eligible for the exemption. Although there may have been some additional revenue impact from smaller facilities that existed at the time the exemption was created, the additional revenue impact from these facilities would be due to component parts that were used for repairs or expansion of existing biogas systems, this would likely have a relatively small impact. EXHIBIT 1.4 provides more detailed calculations of the revenue impact based on this estimate of the minimum and maximum costs of eligible biogas production components.

EXHIBIT 1.4. ESTIMATED IMPACT TO STATE REVENUE, THROUGH JULY 2018

TOTAL PROJECT COST	$102 MILLION
Minimum estimated amount spent on biogas production components (40 percent of total project cost)	$40.8 million
Maximum estimated amount spent on biogas production components (75 percent of total project cost)	$76.5 million
Colorado retail sales tax rate	2.9%
Minimum revenue impact resulting from exemption	$1.2 million
Maximum revenue impact resulting from exemption	$2.2 million

SOURCE: Office of the State Auditor analysis of estimated project costs reported in news articles and legal filings.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

The Biogas Exemption is scheduled for repeal on July 1, 2019. Allowing the exemption to expire would increase the cost of components used in the production of biogas by a minimum of 2.9 percent and present a modest financial barrier for those seeking to develop biogas production systems in Colorado. The additional cost to the taxpayer from eliminating the exemption depends on the total estimated project costs, as well as the percentage of total costs that would be eligible for the exemption. In addition, the exemption covers eligible replacement parts that may need to be purchased after a project's initial development. Allowing the exemption to expire would also increase the total incurred costs of these replacement parts. Although the impact of eliminating the exemption appears to be modest, stakeholders reported that since there are comparatively few financial incentives for biogas systems in Colorado, this exemption is one of the few tools the biogas industry can use to help convince investors to provide financial backing for these projects.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We examined the tax expenditures that are, or have recently been, available for biogas production systems in states with at least 10 non-municipal biogas production facilities. Because other types of feedstock (e.g., organic landfill waste and solid waste) tend to be associated with municipal operations, we limited our analysis to biogas production facilities that use agricultural and/or food waste as their primary feedstock. According to data from the U. S. Environmental Protection Agency, there are nine states with more than 10 facilities that use agricultural and/or food waste as their primary feedstock. We examined the state tax laws of these nine states, and found that six currently offer a tax incentive for biogas projects. EXHIBIT 1.5 summarizes the tax expenditures currently and previously available in these states.

EXHIBIT 1.5. STATES WITH 10 OR MORE NON-MUNICIPAL BIOGAS PRODUCTION SYSTEMS USING AGRICULTURAL, AND/OR FOOD WASTE AS FEEDSTOCK AND TAX EXPENDITURES AVAILABLE IN THESE STATES		
STATE	NUMBER OF SYSTEMS	TYPE OF TAX INCENTIVE
Wisconsin	44	Sales tax exemption
California	37	Sales tax exemption
New York	37	Property tax exemption
Pennsylvania	34	Income tax credit (expired 2016)
Vermont	22	Sales tax exemption Income tax credit (expired 2016)
Ohio	14	Sales tax exemption Property tax exemption
Missouri	13	Sales tax exemption (for all power plants)
North Carolina	12	Income tax credit (expired 2016)
Indiana	10	None identified
TOTAL	223	7 current, 3 expired

SOURCE: Office of the State Auditor analysis of EPA anaerobic digestion facilities data and other state tax laws.

In addition, we identified four states bordering Colorado and/or in the Rocky Mountain region that currently offer tax incentives for biogas production facilities: Arizona, Montana, New Mexico, and Utah. In total, there are eight biogas production facilities that use agricultural and/or food waste as their primary feedstock in these four states.

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

We identified the following state programs and tax incentives, and one federal tax incentive that could potentially apply to biogas projects.

- **ADVANCED INDUSTRY TAX CREDIT.** This tax expenditure is administered by the Governor's Office of Economic Development and International Trade (OEDIT) and provides an investor in an advanced industry business with an income tax credit of up to 30 percent of the qualified investment and is capped at $50,000 for each qualified investment. Colorado has seven statutorily recognized advanced industries: advanced manufacturing; aerospace, bioscience, electronics, energy and natural resources, infrastructure engineering, and information technology [Section 24-48.5-117(2)(a), C.R.S.]. Biogas projects, which may be considered part of the bioscience or

energy and natural resources industries, could be eligible for this tax credit if they meet the following criteria—less than $10 million received from third party investors since the business was formed, less than $5 million in annual revenues, and the investor cannot have held more than 30 percent of the voting power before the investment and must hold less than 50 percent of the voting power after the investment, and are approved by OEDIT. According to OEDIT, it granted one Advanced Industry Tax Credit in the amount of $25,000 to an investor for its investment in a biogas project in 2014.

- **Advanced Industry Grants.** OEDIT also offers several advanced industry grants, some of which biogas projects would be eligible to apply for, including grants for early stage capital, retention, infrastructure, and proof of concept. However, the eligibility requirements for each of these grants are very specific, and the grants are competitive. OEDIT staff reported that it receives approximately 100 applications for each grant cycle, and it is only able to provide grants to approximately 10 to 15 percent of applicants; each grant is generally around $250,000. OEDIT awarded an Advanced Industry Grant to one research-oriented biogas project in Fiscal Year 2017. Since 2013, there have been four other grant applications for biogas projects, and none of them have been awarded a grant.

- **Federal Energy Credit.** Some biogas projects may be eligible for the Federal Energy Credit [26 USC 48]. However, the federal credit is limited to certain types of energy property, and the only biogas-related eligible property is combined heat and power property, which is not one of the three statutorily-required uses of biogas to be eligible for the Biogas Exemption in Colorado.

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

The Department of Revenue could not provide data on the total amount of Biogas Exemptions that have been claimed. Sales covered by the Biogas Exemption are reported on the Colorado Retail Sales Tax Return (Form

DR 0100) on the line for "Renewable energy components," which aggregates the sale of biogas components with other renewable energy components exempt under Section 39-26-724(1)(a), C.R.S. The Department of Revenue does not currently capture this data in an extractable format in GenTax, its tax processing and information system, and would need to make programming changes to capture and retrieve the data going forward, as well as add a separate line to disaggregate the biogas component sales from other renewable energy component sales. Additionally, the renewable energy component sales reported on DR 0100 may not include some exempt sales of biogas components, if those exemptions were claimed as a refund rather than taken at the time of sale. As a result, we could not determine the amount claimed for the Biogas Exemption using Department of Revenue data.

Further, the Department of Revenue lacked additional data from exemption beneficiaries, such as total project costs, cost and type of components purchased under the exemption, and the projects' expected biogas production and use, which would also be useful to evaluate the effectiveness of the Biogas Exemption. However, collecting this information would require the Department of Revenue to create a new form, which would require additional resources, and would increase the burden and reporting requirements for taxpayers claiming the exemption (see the Tax Expenditures Overview section of this Compilation Report for details on the limitations of Department of Revenue data and the potential costs of addressing these limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider expanding the Biogas Exemption to include electricity and heat produced and consumed on site. Statute [Section 39-26-724(1)(c)(I), C.R.S.] designates three permissible uses for biogas that is produced in order for the biogas production components to be exempt from sales tax: (1) for sale to a power generator, (2) used as a transportation fuel, and (3) turned into renewable natural gas. This list does not include heat and electricity

produced on site, and it is unclear whether on site electricity production from biogas is covered by another tax expenditure, the Alternating Current Exemption authorized in Section 39-26-724(1)(a), C.R.S., which provides that components used in the production of alternating current electricity from a renewable energy source are exempt from sales tax. However, interviews with stakeholders, as well as additional research into uses of biogas, indicated that on site heat and electricity production is also a common usage of biogas. Therefore, the General Assembly could consider expanding the eligibility requirements for the Biogas Exemption to include biogas systems that are used to generate heat or electricity on site or clarifying whether biogas production systems that are used to produce alternating current electricity, either entirely or partially, are exempt from sales and use tax under the Alternating Current Exemption. If implemented, this change would potentially increase the revenue impact of the exemption and may incentivize smaller scale production facilities than what may have been originally intended.