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MEMORANDUM

January 3, 2013

TO: Interested Persons

FROM: Ron Kirk, Economist, 303-866-4785

SUBJECT: State Tax Expenditures; Sales and Use Tax Exemptions and Income Tax Credits

Summary

This research provides information on Colorado's tax expenditures. It lists state sales and use tax exemptions and state income tax credits for corporations and individual taxpayers. These tax incentives reduce the amount of state sales and use and income taxes that would otherwise be paid by taxpayers.

Table 1 lists state sales and use tax exemptions and their *estimated* General Fund revenue impact. For FY 2010-11, the total revenue impact for these exemptions is estimated at \$2.0 billion. Estimates are based on data from the Colorado Department of Revenue. It is important to note that these impacts are estimates and may differ from a staff analysis for fiscal note purposes.

Tables 2 and 3 list state income tax credits for FY 2010-11 and FY 2011-12. The total General Fund revenue impact for FY 2011-12 is \$358.0 million, up 50.7 percent from \$237.5 million in the prior fiscal year. The increase in the use of credits is likely tied to the economic recovery as individuals and businesses are making more investments that qualify for these tax incentives.

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Tax Expenditures

Tax expenditures include any reductions in income tax or other tax liabilities resulting from special tax provisions or regulations that provide tax benefits to particular taxpayers. Generally, these provisions take the form of exemptions, tax credits, deductions, or exclusions from taxable income. These provisions reduce the taxes paid by taxpayers and reduce General Fund revenue.

It is important to note that tax expenditure estimates in this memo are not the same as a revenue estimate that would be prepared for a fiscal note. Unlike revenue estimates, tax expenditure estimates do not incorporate any behavioral response of taxpayers or changes in the timing of tax payments. This research lists *estimated* expenditure estimates for state sales and use tax exemptions and actual revenue amounts for state income tax credits claimed by taxpayers based on actual economic activity. It is important to note that these impacts, whether estimates or actual numbers for a given year, will likely differ from a staff analysis for fiscal note purposes. The difference results because a more in-depth analysis would likely be performed on a bill proposal.

State sales and use tax exemptions. Table 1 lists state sales and use tax exemptions that were enacted since 1935. The effect of these tax mechanisms is to exempt certain goods from state sales taxes that would otherwise be taxed. The estimated expenditure impact for these exemptions was about \$2.0 billion in FY 2010-11.

Research on state tax structures from the National Conference of State Legislatures has evaluated state sales tax exemptions.¹ Ultimately, these are policy decisions that lawmakers have made regarding state sales taxes. Research indicates that many of these policy decisions were passed to avoid multiple taxation, as a response to a federal law, to make sales taxes less regressive or have less of an impact on persons with lower income, or to stimulate the economy by offering business incentives.

State income tax credits. Tables 2 and 3 list state income tax credits for individual and fiduciary returns, and corporate taxpayers. The effect of these tax mechanisms is to provide incentives for certain types of business investment and rewards certain taxpayer behavior by reducing the amount of income taxes owed to the state. The expenditure impact for income tax credits was \$358.0 million in FY 2011-12. Figure 1 shows the amount of tax credits claimed by corporations and individual/fiduciary taxpayers since 1987, when Colorado changed its income tax system from a graduated tax rate to a flat rate. The change was triggered by the 1986 federal tax reform and effort by the state to simplify its tax structure.

Corporate tax credits slowly trended upward from 1987 to 1995, averaging about \$15.8 million in credits claimed each year. Tax policy changes increased the amount of credits claimed in the late 1990s and early 2000s. The first recession of the 2000s slowed investment and resulted in a significant decline in credit utilization. The amount claimed for corporate credits has trended upward since the most recent recession.

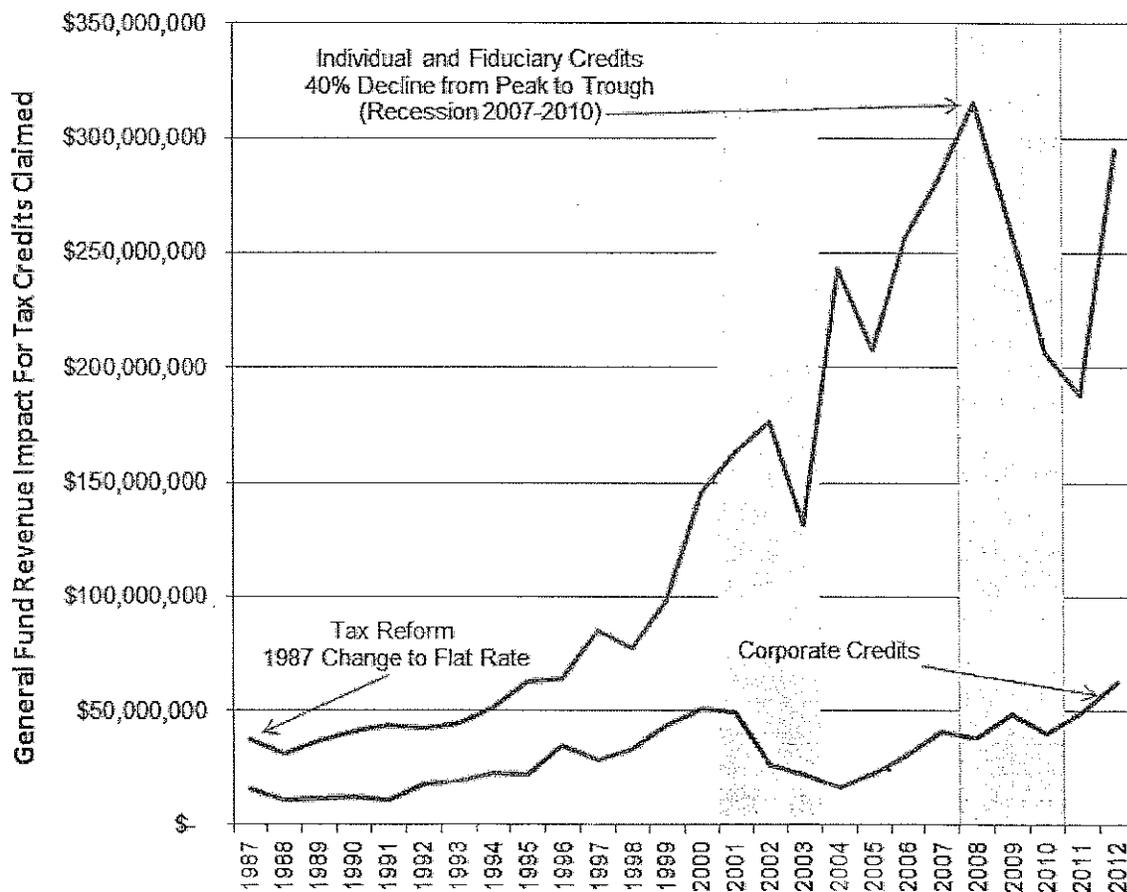
Similar to corporate income tax credits, Figure 1 shows that individual and fiduciary credit utilization also trended upward from 1987 through the late 1990s, but rose at a faster

¹*Principles of a High-Quality State Revenue System*, Third Edition, July 1999, National Conference of State Legislatures.

rate than corporate credits after 1998. The amount claimed for individual income tax credits was more volatile in the 2000s. In most years, the revenue impact of individual and fiduciary credits was much larger than the impact of corporate credits. For example, in 2002, \$176.5 million in individual credits were claimed, compared to \$26.3 million in corporate credits. Ten years later, in 2012, \$295.2 million was claimed in individual income tax credits, whereas corporate credits were \$62.8 million.

The difference is attributed to the greater number and larger aggregate tax liability of individual taxpayers relative to corporate taxpayers. For example, net individual income tax collections were over \$5.0 billion compared to \$486.5 million in corporate income tax collections. There are also a greater number of tax incentives available to individual taxpayers (see Tables 2 and 3).

**Figure 1: State Income Tax Credits
"1987-2012"**



Source: Colorado Department of Revenue.

Table 1: State Sales and Use Tax Exemptions¹

Statute Citation	Year Enacted	Tax Expenditure Description	CY 2009 Revenue Impact	CY 2011 Revenue Impact
§39-26-102(20)(a)	1935	Ingredients and component parts	\$519,298,000	\$601,482,000
§39-26-715(1)(a)(I)	1935	Gasoline and special fuel	\$181,780,000	\$276,632,000
§39-26-102(21)	1937	Energy used for industrial, manufacturing, and similar purposes (Temporary repeal in effect for 2011)	\$14,985,000	N/A
§39-26-704(1)	1937	Sales to governmental entities	\$123,436,000	\$130,384,000
§39-26-718(1)(a)	1937	Sales to charitable organizations	\$37,269,000	\$39,367,000
§39-26-102(15)	1943	Newspapers	\$5,785,000	\$5,918,000
§39-26-102(21)	1943	Printers ink and newsprint	\$1,266,000	\$1,344,000
§39-26-716(3)(a) & (4)(a)	1943	Certain livestock	\$154,896,000	\$223,583,000
§39-26-716(4)(b)	1943	Feed for livestock, seeds, and orchard trees	\$47,136,000	\$58,612,000
§39-26-716(4)(a)	1945	Farm auction close-out sales 5/		
§39-26-704(3)	1959	Lodging for permanent residents	\$180,000	\$185,000
§39-26-716(4)(c)	1961	Straw for livestock and poultry bedding 4/		
§39-26-704(2)	1963	Sales to residents of bordering states that do not impose a sales tax 2/		
§39-26-717(1)(a)	1965	Prescription drugs	\$49,127,000	\$53,389,000
§39-26-717(1)(f)	1965	Prosthetic devices 4/		
§39-26-704(4)	1969	Sales to public schools	\$25,274,000	\$26,697,000
§39-26-716(4)(a)	1970	Fish for stocking	\$57,000	\$64,000
§39-26-712(1)(a) & (b)	1976	Commercial trucks and trailers licensed out-of-state	\$5,702,000	\$5,992,000
§39-26-102(10)(f)	1977	Transfers of assets 2/		
§39-26-113(5)(a)	1977	Sales of motor vehicles for use by nonresidents outside Colorado	\$2,312,000	\$2,477,000
§39-26-710(1)(a)	1977	Construction materials for use by a common carrier by rail	\$1,238,000	\$1,273,000
§39-26-713(1)(c)	1977	Testing property used for short-term out-of-state testing 2/		
§39-26-716(2)(a)	1977	Special fuel for farm vehicles	\$3,250,000	\$4,946,000
§39-26-717(1)(b)	1977	Insulin	\$1,267,000	\$1,377,000
§39-26-707(1)(c) & (d)	1978	Sales of certain items provided with food and beverage items	\$2,028,000	N/A
§39-26-707(2)(a)	1978	Food service employer-provided meals	\$214,000	\$445,000
§39-26-713(1)(b)	1978	Complimentary marketing property to out-of-state vendors	\$73,000	\$73,000
§39-26-707(1)(e)	1979	Food for home consumption (candy and soft drinks exemption repealed in 2010)	\$227,355,000	\$229,361,000
§39-26-708(1)	1979	Construction and building materials used by contractors on public works projects, tax-exempt organizations, and public schools	\$69,704,000	\$74,088,000
§39-26-709(1)(a)(II)	1979	Machinery or machine tools used in manufacturing process	\$53,673,000	\$54,245,000
§39-26-715(1)(a)(II)	1979	Fuel for residential heat, light, and power	\$91,214,000	\$99,717,000
§39-26-717(1)(c)	1979	Glucose for treatment of insulin reactions and insulin measuring and injecting devices	\$881,000	\$877,000
§39-26-717(1)(d)	1979	Urine- and blood-testing kits and materials 4/		
§39-26-717(1)(e)	1979	Insulin measuring and injecting devices 4/		
§39-26-717(1)(g)	1979	Oxygen delivery equipment and related supplies 4/		

Table 1: State Sales and Use Tax Exemptions¹

Statute Citation	Year Enacted	Tax Expenditure Description	CY 2009 Revenue Impact	CY 2011 Revenue Impact
§39-26-717(1)(h)	1979	Supplies related to incontinence, infusion, enteral nutrition, ostomy, urology, diabetic care, and wound care 4/		
§39-26-717(1)(i)	1979	Equipment and accessories for sleep therapy, inhalation therapy, and electrotherapy 4/		
§39-26-717(1)(j)	1979	Durable medical equipment and mobility enhancing equipment	\$11,609,000	\$11,562,000
§39-26-721(1)	1979	Factory built housing	\$2,734,000	\$2,693,000
§39-26-717(1)(k)	1980	Nonprescription drugs or materials when furnished by a licensed provider as part of professional services 4/		
§39-26-717(1)(l)	1980	Corrective eyeglasses, contact lenses, or hearing aids 4/		
§39-26-102(20)(b)	1982	Ingredients and component parts, food manufacturing	\$7,899,000	\$9,252,000
§39-26-102(21)	1982	Gas and electric services when deemed a wholesale sale 2/		
§39-26-706(3)	1982	Certain materials used in the manufacturing or processing of iron, steel, and uranium-vanadium ores	\$7,000	\$8,000
§39-26-711(1)(a)	1984	Aircraft used in interstate commerce by commercial airlines 5/		
§39-26-102(15)	1985	Preprinted newspaper supplements	\$335,000	\$372,000
§39-26-714(1)	1986	Certain personal property sold through vending machines 2/		
§39-26-707(1)(a)	1987	Food purchased with food stamps	\$17,260,000	\$22,784,000
§39-26-707(1)(b)	1987	Food purchased with funds from the supplemental food program for women, infants, and children (WIC)	\$1,207,000	\$1,475,000
§39-26-102(15)	1990	Direct mail advertising materials (repealed in 2010)	\$1,430,000	N/A
§39-26-711(1)(b)	1991	Aircraft component parts used in interstate commerce by commercial airlines	\$630,000	\$641,000
§39-26-102(19)	1992	Materials used in the printing process	\$7,000	\$6,000
§39-26-710(1)(b) & (c)	1992	Railroad capital equipment 4/		
§39-26-718(1)(b)	1995	Occasional sales by charitable organizations 4/		
§39-26-202(1)(c)	1996	Wireless telecommunications equipment	\$1,601,000	\$1,490,000
§39-26-706(2)(a)	1998	Internet access service	\$7,056,000	\$7,034,000
§39-26-713(1)(d)	1998	Donations of component parts to tax-exempt organizations	< 500,000 5/	< 500,000 5/
§39-26-402(1)	1999	Biotechnology equipment	\$629,000	\$637,000
§39-26-706(4)	1999	Coins and precious metal bullion	\$687,000	\$1,159,000
§39-26-714(2)	1999	Food sold through vending machines	\$9,993,000	\$10,413,000
§39-26-716(2)(b) & (3)(b)	1999	Farm equipment	\$5,672,000	\$5,949,000
§39-26-716(2)(d)	1999	Agricultural compounds and bull semen	\$1,593,000	\$838,000
§39-26-716(2)(e)	1999	Pesticides	\$3,115,000	\$1,420,000
§39-26-718(1)(a)	1999	Special events sales by veterans' organizations	\$1,137,000	\$1,201,000
§39-26-719(1)	1999	Low-emitting vehicles	< 100, 3/	< 100, 3/
§39-26-716(2)(b) & (3)(b)	2000	Farm parts used in the repair or maintenance of farm equipment 4/		

Table 1: State Sales and Use Tax Exemptions¹

Statute Citation	Year Enacted	Tax Expenditure Description	CY 2009 Revenue Impact	CY 2011 Revenue Impact
§39-26-716(2)(b) & (3)(b)	2001	Dairy equipment	\$70,000	\$74,000
§39-26-720(1)	2001	Bingo and raffle equipment	\$120,000	\$122,000
§39-26-104(1)(c)(I)	2002	Interstate telephone services 2/		
§39-26-722(1)	2007	Machinery that comprises a cleanroom 3/		
§39-26-724(1) (a)	2007	Components used in the production of electricity from a renewable energy source 2/		
§39-26-711.5 (1)	2008	New or used aircraft to a non resident	\$591,000	\$286,000
§39-26-718(1)(c)	2008	Sale by an association or organization of parents and teachers of public school students that is a charitable organization 4/		
§39-26-723(1)	2008	Wood from salvaged trees killed or infested in Colorado by mountain pine beetles	\$1,615,000	\$1,703,000
§39-26-725(2)	2008	Sales that benefit Colorado schools	\$193,000	\$218,000
§39-26-113.5	2009	Sales tax refund for commercial vehicles used in interstate commerce	N/A	\$9,000
§39-26-403	2009	Clean technology and medical devices 3/		
§39-26-726	2010	Medical marijuana to indigent patients 2/		
Totals			\$ 1,696,590,000	\$ 1,973,874,000

Data Source: Colorado Department of Revenue, December 2012.

Document by Legislative Council Staff, December 2012.

1/ All expenditures in this category are estimates and may differ from estimates prepared for a fiscal note.

2/ Not available.

3/ Only available as a refund of sales tax paid if the total general fund for a particular fiscal year will be sufficient to increase the total general fund appropriations by 6% over such appropriations for the previous fiscal year.

4/ Amount combined with another exemption.

5/ Non-disclosable.

N/A = Not applicable.

Table 2: State Income Tax Credits, Individual and Fiduciary
Fiscal Years 2011¹ and 2012

Tax Credits	FY 2010-11¹	FY 2011-12
Enterprise zone investment credit	3,682,339	7,696,044
Enterprise zone commercial vehicle investment credit	N/A	298,584
Enterprise zone new business facility employee credit	607,355	873,385
Enhanced rural enterprise zone new business facility employee credit	219,230	287,750
Enterprise zone agricultural employee processing credit	7,950	20,594
Enhanced rural enterprise zone agricultural employee processing credit	7,859	24,288
Enterprise zone employee health insurance credit	100,825	89,175
Contribution to enterprise zone administrator credit	3,555,267	5,392,343
Research and development enterprise zone credit	N/A	67,453
Rehabilitation of vacant commercial buildings enterprise zone credit	N/A	294,201
Job training program enterprise zone credit	N/A	214,780
Enterprise zone credits carried over 2/	5,960,604	4,134,834
Other enterprise zone credits 3/	1,504,900	1,252,873
Child care credit	3,457,508	3,245,984
Alternative fuel credit 4/	6,314,402	5,244,175
Gross conservation easement credit	41,319,911	49,142,712
Credit for taxes paid to another state	94,234,882	187,435,021
Plastic recycling investment credit	14,296	1,795
Colorado minimum tax credit	2,931,531	3,675,783
Historic property preservation credit	1,009,333	950,995
Child care investment credits 5/	937,406	601,500
School-to-career investment credit	34,377	6,985
Colorado works program credit	37,791	NR
Child care contribution credit	15,938,871	16,710,320
Rural technology enterprise zone credit 6/	NR	30,895
Long term care insurance credit	3,646,924	3,563,958
Contaminated land redevelopment credit	NR	134,653
Low-income housing credit 6/	6,519	1,500
Aircraft manufacturer new employee credit	NR	NR
Colorado innovation investment tax credit	46,130	360,158
Job growth incentive tax credit	12,644	168,416
Other credits 7/	2,441,330	3,319,352
TOTAL	\$188,030,184	\$295,231,134

Data Source: Colorado Department of Revenue, December 2012.

Document by Legislative Council Staff, December 2012.

1/ Beginning in FY 2011 the Colorado Integrated Tax Architecture, which houses Colorado Income Tax data, provides information specific to the income tax credits listed above.

2/ Applies to 2010 and prior income tax years and includes enterprise zone credits carried over from previous tax years.

3/ Applies to 2010 and prior income tax years and includes the research and development enterprise zone credit, the rehabilitation of vacant commercial buildings enterprise zone credit, and the job training program enterprise zone credit.

4/ Includes refundable and non refundable alternative fuel vehicle credits and alternative fuel refueling facility credit.

5/ Includes investment credits for licensed child care centers, family care homes, and employers providing licensed child care facilities.

6/ Includes credits carried forward only. See FYI 36 for rural technology enterprise zone credit and FYI 46 for low income housing credit.

7/ Applies to 2010 and prior income tax years and includes credits for: taxes paid to another state, plastic recycling investment, previous year minimum tax, historic property preservation, child care center investment, employer child care facility investment, school-to-career investment, Colorado works program, child care contribution, rural technology enterprise zone (carry forward), long term care insurance, contaminated land redevelopment, low-income housing, weather related livestock sale (carry forward), aircraft manufacturer new employee credit, job growth incentive, and credits from fiduciary and partnerships returns.

NR = Nonreleasable data due to confidentiality requirements.

N/A = Data not available for the fiscal year.

The information on this page reflects individual, partnership, and fiduciary income tax transactions that occurred during the fiscal year but not limited to credits claimed on current year, amended returns, and/or corrected returns previously in error. The information may encompass transactions over multiple years. This information is different from data by income tax year.

Table 3: State Income Tax Credits, Corporate
Fiscal Years 2011¹ and 2012

	FY 2010-11 ¹		2012 Amount
Enterprise zone investment	22,340,344		37,610,093
Commercial vehicle investment credit	N/A		NR
Enterprise zone employee	2,014,639		383,970
Enterprise zone contribution credits	528,447		457,842
Enterprise zone building rehab credit	N/A		3,796
Enterprise zone research credit	N/A		927,797
Enterprise zone job training credit	N/A		2,551,337
Rural technology enterprise zone credit carryforward	N/A		195,573
Other enterprise zone credits 1/	3,352,100	1/	9,338,172
New investment tax	456,263		1,252,786
Alternative fuel credit 2/	\$16,388	2/	5,337,347
Gross conservation easement credit	1,654,158		969,552
Old investment tax credit	N/A		39,742
Crop and livestock contribution credit	N/A		0
Historic property preservation credit	N/A		NR
Child care contribution credit	N/A		386,401
Child care investment credits 3/	N/A		NR
School-to-career investment credit	N/A		0
Colorado works program credit	N/A		0
Contaminated land redevelopment credit	N/A		0
Low-income housing credit	N/A		0
Aircraft manufacturer new employee credit	N/A		0
Job growth incentive credit	N/A		312,561
Other credits 4/	19,110,538	4/	2,956,675
TOTAL	\$49,472,877		\$62,751,054

Data Source: Colorado Department of Revenue, December 2012.

Document by Legislative Council Staff, December 2012.

1/ Applies to income tax years 2009 and prior and includes enterprise zone vacant commercial building rehabilitation credit, enterprise zone research and experimental credit, enterprise zone job training credit, and rural technology enterprise zone credit.

2/ Includes credit amounts for the purchase of alternative fuel vehicles and investment in alternative fuel refueling facilities.

3/ Includes investment credits for licensed child care centers, family care homes, and employers providing licensed child care facilities.

4/ Applies to income tax years 2009 and prior and includes credits for: old investment tax, crop and livestock contribution, historic property preservation, child care contribution, child care center - family care home investment, employer child care facility investment, school-to-career investment, Colorado works program, contaminated land redevelopment, low-income housing, and aircraft manufacturer new employee.

NR - Not Releasable

N/A - Not Available

The information on this page reflects corporate income tax transactions that occurred during the fiscal year but not limited to credits claimed on current year, amended returns, and/or corrected returns previously in error. The information may encompass transactions over multiple years. This information is different from data by income tax year.