Colorado
Legislative
Council
Staff

ISSUE BRIEF

Number 12-39 | A Legislative Council Publication | November 20, 2012

SALES TAX PRIMER

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Colorado's sales tax is the state's second largest General Fund revenue source, generating $2.1 billion in FY 2011-12, 27.0 percent of all General Fund tax revenue. Along with property taxes, sales tax revenue is also one of the largest revenue sources for local governments like cities, counties, and special districts. This *issue brief* discusses the sales and use tax in Colorado.

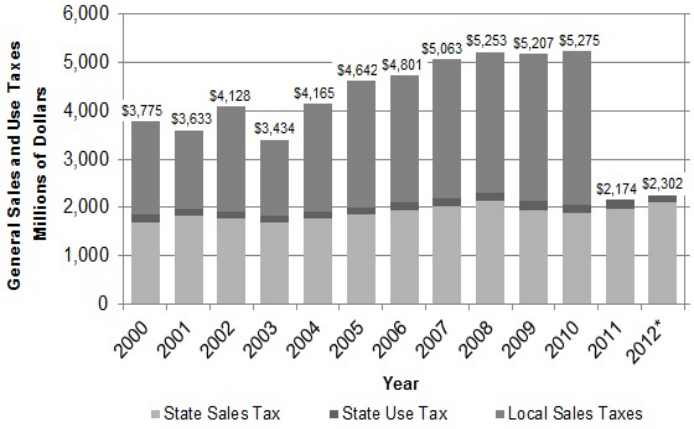
Background on Consumption Taxes

Colorado has had a sales tax since 1937, when it was created to help make up for revenue shortfalls during the Great Depression.

The sales tax is a form of consumption tax, as opposed to an income tax or a property tax. The basis for a consumption tax is to tax the final consumption of a good or service. Some of the major advantages of consumption taxes is that there is a large tax base and consumers have the ability to pay. In general, a large base is an advantage for a tax because it allows for the generation of revenue with a low rate. A low tax rate minimizes economic distortions caused by the tax. Consumers pay the tax as they purchase goods and services, so it is typically paid in frequent, small amounts rather than at a single given time. Other forms of consumption taxes include the value-added tax and excise taxes.

Historically, sales taxes in Colorado have been established in a way that avoids tax pyramiding and the taxation of necessary purchases. Tax pyramiding occurs when goods and services are taxed multiple times during the chain of production of the good. This can cause distortions in the allocation of resources and the choice of inputs that may not be economically efficient. Also, tax pyramiding conflicts with the goal of taxing final consumption. Policymakers have also historically chosen not to tax necessary consumer goods like food, heat, and health care.

Figure 1
History of State and Local Sales and Use Tax Collections, 2000 to 2012



Source: Colorado Department of Revenue, U.S. Census Bureau, State and Local Government Finances.

** No data for local sales taxes is shown in Figure 1 because they have not yet been published for 2011 and 2012.*

The state tax rate is 2.91 percent on the retail price of taxable goods and services, and local taxing jurisdictions can levy an additional tax rate. In Colorado, the local sales tax increases the overall sales tax rate to about 7.75 percent

of the purchase price of taxable goods and services, but it varies by location and the type of good purchased. Tangible personal property is subject to the sales tax unless it is specifically exempt, and services are exempt unless specifically included.

The tax is collected by the retailer at the time of purchase from the consumer. The retailer remits the tax to the state. Colorado has a complementary use tax that is required to be paid by the consumer directly to the state when no sales tax was collected, but would have been due.

The largest exemptions in the Colorado sales tax are aimed at addressing tax pyramiding and taxing necessary goods. Table 1 shows the ten largest sales and use tax exemptions and where they can be found in statute.

Table 1
10 Largest Sales Tax Exemptions

Sales Tax Exemption	Statutory Citation
Goods Used in Manufacturing	Section 39-26-102(20)(a), C.R.S.
Food for Home Consumption	Section 39-26-707(1)(e), C.R.S.
Gasoline and Fuel	Section 39-26-715(1)(a), C.R.S.
Fuel for Residential Heat	Section 39-26-715(1)(a)(II), C.R.S.
Construction Materials Sold to Contractors	Section 39-26-708(1), C.R.S.
Machinery and Tools Used in Manufacturing	Section 39-26-709(1), C.R.S.
Sales to Government	Section 39-26-704(1), C.R.S.
Sale of Livestock for Breeding	Section 39-26-716(3)(a) and (4)(a), C.R.S.
Prescription Drugs	Section 39-26-717(!)(a), C.R.S.
Energy Used for Manufacturing	Section 39-26-102(21), C.R.S.

Source: Colorado Department of Revenue.

Trends in the Sales Tax Base

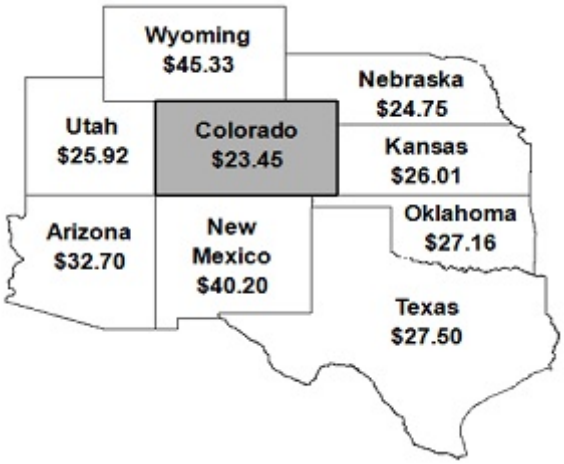
The sales tax base has not changed much since the sales tax was enacted in 1937, even as the economy has changed. In the 1970s, Colorado's economy started to transition to a service economy, meaning that more consumption was in the form of services than retail goods. The sales tax base includes only services that are enumerated in statute, as opposed to goods, which are included unless they are specifically exempt.

In addition to consumption shifting towards services, technology is affecting the sales tax base. The Internet has made purchasing goods from out-of-state retailers easier and has created digital goods. Out-of-state retailers do not always collect sales taxes, and many consumers are unaware that they need to pay use taxes on some of these purchases. As the share of services, out-of-state purchases, and digital goods grows relative to the sales tax base, a smaller share of consumption is taxed.

Other States

Colorado is one of 45 states with a sales tax. In general, states with a state sales tax also have local sales taxes. The federal government does not have a sales tax, instead leaving broad-based consumption taxes to the states. Unlike the individual and corporate income tax, states do not have a federal framework on which to base the sales tax, so there is quite a bit of variation in sales taxes among the states. Figure 2 shows the state and local sales taxes paid per $1,000 in personal income in Colorado and surrounding states for FY 2008-09, the most recent year for which local data is available.

Figure 2
Total State and Local Sales Tax Collections per $1,000 in Personal Income
Colorado and Surrounding States, FY 2008-09



Source: U.S. Census Bureau.