



FOOD FOR HOME CONSUMPTION & RETIREMENT COMMUNITIES EXEMPTIONS

EVALUATION SUMMARY | APRIL 2021 | 2021-TE11

TAX TYPE	Sales and use	REVENUE IMPACT	\$333.6 million (TAX YEAR 2019) - combined
YEAR ENACTED	1979 and 2016	NUMBER OF TAXPAYERS	Could not determine
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The exemptions appear to be effective at exempting food for home consumption and food sold to residents of retirement communities from sales and use tax.

WHAT DO THE TAX EXPENDITURES DO?

The Food for Home Consumption Exemption [Sections 39-26-707(1)(e) and (2)(d) and 714(2), C.R.S.] exempts from sales and use tax most food that is purchased for home consumption and consumed off the premises where the purchase was made. The Food for Retirement Communities Exemption [Section 39-26-707(1)(f)(I)(A) and (2)(e)(I)(A), C.R.S.] exempts food and food packaging from sales and use tax if it is consumed by residents on the premises of a retirement community.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURES?

Statute and the enacting legislation for the Food for Home Consumption Exemption do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the exemption, we considered a potential purpose: to avoid applying sales and use tax on purchases of basic necessities, which are commonly exempted in Colorado and other states.

The legislative declaration for the Food for Retirement Communities Exemption states that its intended purpose “is to clarify that food purchased and provided as part of a meal plan to residents of a retirement community is exempt from sales and use tax as food for domestic home consumption, and clarifying that the packaging used in presenting that food to a resident of a retirement community is exempt from sales and use tax under the existing exemption for food packaging.”

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider establishing a statutory purpose and performance measures for the Food for Home Consumption exemption.

FOOD FOR HOME CONSUMPTION & RETIREMENT COMMUNITIES EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers two sales tax provisions related to food sold to consumers, as follows:

FOOD FOR HOME CONSUMPTION EXEMPTION [SECTIONS 39-26-707(1)(e) AND (2)(d) AND 714(2), C.R.S.]—Statute exempts from sales and use tax most food that is purchased for home consumption and consumed off the premises where the purchase was made. Although food sold at restaurants is not eligible for the exemption regardless of where it is to be consumed, food sold by all other types of vendors, such as grocery stores, convenience stores, gas stations, and vending machines, is exempt if it falls within the statutory definition of exempt food, specified in Sections 39-26-102(4.5), 707(1)(e) and 707(2)(d), C.R.S., which ties to items eligible for the federal Supplemental Nutrition Assistance Program, but makes a number of exclusions for state sales tax purposes. EXHIBIT 1 provides a summary of items that are exempt and non-exempt, according to statute and Department of Revenue guidance.

**EXHIBIT 1. EXAMPLES OF EXEMPT AND
NON-EXEMPT FOOD ITEMS UNDER THE FOOD FOR HOME
CONSUMPTION EXEMPTION**

EXEMPT	NON-EXEMPT
<ul style="list-style-type: none"> ▪ Meats and vegetables ▪ Infant formula ▪ Dairy products, such as milk and cheese ▪ Baked goods, such as bread and cakes ▪ Snacks, such as chips, nuts, and granola bars ▪ Frozen meals 	<ul style="list-style-type: none"> ▪ Foods to be eaten in the store, such as hot sandwiches ▪ Deli trays, prepared salads, and cold sandwiches ▪ Soft drinks and candy ▪ Seeds and plants used to grow food ▪ Alcohol and tobacco ▪ Medicine and vitamins

SOURCE: Office of the State Auditor analysis of statute, federal law and rule, and Department of Revenue guidance.

Additionally, under Section 29-2-105(1)(d)(I)(C), C.R.S., statutory and home-rule local governments that have their sales taxes collected by the State may choose whether to apply the exemption to their local sales taxes, which most have chosen to do. The Colorado Constitution [Article XX, Section 6] allows home-rule cities and counties to set their own tax policy. Of the 10 most populous home-rule cities and counties, six have adopted an exemption for food for home consumption and one taxes food at a lower rate than other types of items. In addition, one of the six home-rule cities also exempts food sold through vending machines from local sales and use tax.

The exemption was enacted in 1979 by House Bill 79-1611. Starting in 2000, House Bill 99-1015 established that sales of food from vending machines are eligible for the exemption, using the same definition of food, and in 2010, House Bill 10-1191 excluded candy and soft drinks from the list of eligible food, regardless of where they are sold.

The exemption is typically applied by vendors at the time food is sold. Food vendors report the exemption on their Retail Sales Tax Return (Form DR 0100) using Line 1 of Schedule B.

FOOD FOR RETIREMENT COMMUNITIES EXEMPTION [SECTION 39-26-707(1)(f)(I)(A) AND (2)(e)(I)(A), C.R.S.]—Statute also exempts food and

food packaging from sales and use tax if it is consumed by residents on the premises of a retirement community, which includes assisted-living residences, nursing-care facilities, and independent-living facilities that serve as the primary residence for people age 55 and older. In this context, exempt food includes prepared foods, such as salads and sandwiches, in addition to the foods exempted by the Food for Home Consumption Exemption. The Food for Retirement Communities Exemption was enacted in 2016 with House Bill 16-1187 and has remained unchanged since.

Statute [Section 29-2-105(1)(d)(I), C.R.S.] requires local governments whose sales taxes are collected by the State to also exempt food for retirement communities from their sales and use taxes. Article XX, Section 6 of the Colorado Constitution allows self-collected home-rule cities and counties to set their own tax policy. Of the 10 most populous home-rule cities and counties, none have adopted an exemption that specifically excludes food sold to residents of retirement homes from local sales and use tax; however, it is possible that some of these local governments interpret an exemption for food sold for home consumption to include food sold to residents of retirement homes as well.

Food vendors, typically operators of eligible retirement communities, claim the exemption on their Retail Sales Tax Return (Form DR 0100) using Line 12 of Schedule A.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not directly state the intended beneficiaries of either exemption. Based on its operation and eligible food items, we considered the intended beneficiaries of the Food for Home Consumption Exemption to be individuals who purchase food from retailers, such as grocery stores, to consume at home. In addition, we determined that indirect beneficiaries are the retailers that sell food for

home consumption, since consumers may purchase additional food due to the reduced after-tax cost of food provided by the exemption.

Based on its operation and legislative testimony at the time it was established, we considered the intended beneficiaries of the Food for Retirement Communities Exemption to be individuals who reside in eligible retirement communities. In addition, we determined that indirect beneficiaries are the facilities in which eligible elderly individuals reside. These facilities benefit administratively by not having to collect and remit state sales tax on sales of food to their residents.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for the Food for Home Consumption Exemption do not state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the Food for Home Consumption Exemption, we considered a potential purpose: to avoid applying sales and use tax on purchases of basic necessities, which are commonly exempted in Colorado and other states. Other necessities, such as energy used at a residence and prescription drugs, are also exempt from sales tax. Further, based on our review of tax policy literature, sales tax exemptions for basic necessities are commonly intended to avoid placing a disproportionate sales tax burden on individuals with lower incomes, since these individuals tend to spend a larger share of their income on these items.

The legislative declaration for the Food for Retirement Communities Exemption states that its intended purpose "is to clarify that food purchased and provided as part of a meal plan to residents of a retirement community is exempt from sales and use tax as food for domestic home consumption, and clarifying that the packaging used in presenting that food to a resident of a retirement community is exempt from sales and use tax under the existing exemption for food packaging." According to the legislative declaration, at the time the bill was enacted, retirement communities had not typically been charging

sales tax on the food they provided to residents, but the Department of Revenue had issued a private letter ruling indicating that the items were subject to sales tax.

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

We could not definitively determine whether the Food for Home Consumption Exemption is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that it is meeting the potential purpose we considered in order to conduct this evaluation because food vendors are aware of the exemption and apply it to eligible sales. In addition, we found that the Food for Retirement Communities Exemption is meeting its purpose because it is likely applied as intended to treat eligible sales in retirement communities the same as food purchased for home consumption.

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

PERFORMANCE MEASURE: To what extent are sales of food purchased for home consumption and sales of food provided to by retirement communities to their residents exempt from state sales and use tax?

RESULT: Department of Revenue data indicate that the Food for Home Consumption Exemption was applied to about \$11.5 billion in food sold by eligible taxpayers, including grocery and convenience stores, in Calendar Year 2019. Although we lacked data to estimate the proportion of all eligible sales made in the state to which the exemption was applied, stakeholders indicated that food retailers are generally aware of the exemption and apply it to most eligible sales. Specifically, we spoke with a food industry association representative who had contacted four grocers of different sizes as part of their preparation for our interview. We also spoke with a representative for a

gas/convenience store association that represents approximately 1,700 stores in Colorado. The representatives reported that grocers, convenience stores, and gas stations are aware of the exemptions and rely on their point-of-sale systems to ensure the correct items are exempt. Larger retailers typically have staff who are responsible for programming their systems to not collect state and/or local sales taxes, when applicable. Smaller grocery stores will typically contract with a point-of-sale provider who is responsible for ensuring the grocer is compliant with state and local sales tax laws as part of their contract. We also spoke with a vending machine association that represents vending machines operators and a large wholesaler of vending machine products in the state that reported its members are aware of the exemption and apply it to eligible items that they sell.

In addition, we spoke to a stakeholder representing most of the retirement communities in the state who indicated that retirement communities exempt eligible sales from tax as intended. Although we could not determine that all retirement communities are aware of the exemption, it appears likely that most eligible beneficiaries receive the exemption, as intended, because the legislative history and declaration for the exemption indicate that, at the time the exemption was created, it was not a common practice to collect sales tax on meals (and packaging included with meals) provided to residents of retirement communities.

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

The Department of Revenue reported that in Tax Year 2019 the Food for Home Consumption Exemption resulted in about \$333.6 million in foregone revenue to the State. Although, the Department of Revenue reported that a portion of this revenue impact, which is drawn from the amount taxpayers reported on their Sales and Use Tax Return, is likely attributable to the Food for Retirement Communities Exemption, it was not able to provide data necessary to separate out the revenue impact for the two exemptions. However, based on information provided by

stakeholders, we estimate about \$2.9 million of the \$333.6 million (0.9 percent) of foregone revenue was due to the Food for Retirement Communities Exemption. Specifically, stakeholders estimated that nursing homes and assisted living facilities spent about \$100 million annually on food for their residents, which we multiplied by the 2.9 percent state sales tax rate.

In addition, home-rule and statutory cities and counties that have their sales taxes collected by the State have the option of taxing food that is exempt from state sales tax. According to the Department of Revenue, 76 counties, municipalities, and special districts have adopted the Food for Home Consumption Exemption, though only 37 exempt vending machine sales. We estimated that the local governments that have adopted the Food for Home Consumption Exemption collected \$31.9 million less in sales taxes in Tax Year 2019 as result of the exemption. We developed this estimate by multiplying the estimated \$11.5 billion of food sales eligible for the Food for Home Consumption Exemption by the 1.32 percent average population-weighted sales tax rate of local governments that had adopted the exemptions. However, the actual impact is probably slightly less because the amount includes food sold through vending machines, which, as noted above, not all local governments exempt, and food sold in retirement communities. However, we did not have data to determine what portion is attributable to each of these types of food sales.

Further, home-rule cities and counties that collect their own sales tax are not required to apply the Food for Home Consumption Exemption and Food for Retirement Communities Exemption. We reviewed the sales taxes of the 10 largest home rule cities and counties and found that six exempt food from sales tax, one taxes food at a lower rate, and three do not provide a similar exemption. We also found that none of the home-rule cities and counties explicitly exempt meals that retirement communities provide to residents; however, it is possible that some local governments consider food sold to residents of retirement communities as food for home consumption. Sales tax rates in the cities that tax food for home consumption ranged from 2.25 percent to 8.6 percent,

indicating that consumers in some areas of the state pay sales taxes on food purchases despite the State's exemption.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

FOOD FOR HOME CONSUMPTION EXEMPTION—If this exemption were eliminated, it would result in an increase of 2.9 percent in the after-tax price of eligible food products for consumers. Since food for home consumption is a necessity, the increase would impact most Coloradans. However, according to U.S. Department of Agriculture estimates, households in the lowest 20 percent income group spend 36 percent of their income on food compared to 8 percent for households in the highest 20 percent income group. Therefore, eliminating the exemption would likely have a more significant impact on households with lower income. The average low-income household spends about \$4,400 on food per year, which would increase by about \$128, to \$4,528, if the State eliminated the exemption.

FOOD FOR RETIREMENT COMMUNITIES EXEMPTION—If this exemption were eliminated, nursing facilities, assisted-living centers, and facilities serving as a permanent residence for people 55 and older that provide food for their residents would be required to assess and remit the state sales tax of 2.9 percent on the sales of prepared and unprepared food. According to an association that represents these facilities, elderly residents who pay for their own care would likely see a corresponding increase in the amount they are charged for food. However, facilities would have to absorb the additional cost for residents whose care is paid for by Medicaid, which accounts for about 65 percent of residents, since Medicaid pays a pre-determined, fixed amount for each resident's care. Similar to the Food for Home Consumption Exemption, the impact of eliminating the exemption would likely be more significant for residents of retirement communities that have lower incomes.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Forty-five states, including Colorado, have sales and use tax. Of these 45 states, 32 have an exemption for food for home consumption. Other states' statutes are not always explicit about whether food from vending machines are part of food for home consumption exemptions, but we identified 16 states that specifically exempt sales of food from vending machines. In addition, similar to Colorado, 26 states with a sales tax exempt food sold by retirement communities.

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

FEDERAL SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP) AND WOMEN, INFANTS, AND CHILDREN (WIC) PROGRAM—SNAP and WIC provide beneficiaries with food stamps/vouchers they can use to purchase food for home consumption from food retailers, such as grocery or convenience stores, or at assisted living communities, such as retirement homes and drug and alcohol rehabilitation centers, where they are residents. According to the Colorado Department of Human Services, Coloradans were issued \$1.05 billion in SNAP benefits in Calendar Year 2020 and, according to the Colorado Department of Public Health and Environment, Coloradans spent \$48.2 million in WIC benefits in Calendar Year 2020. Federal law requires all sales of food made under these programs to be exempt from sales tax and Colorado has codified this requirement in Section 39-26-707(1), C.R.S. We estimate that the exemption of SNAP/WIC from state sales taxes reduced food costs for program recipients in 2020 by about \$31.9 million, which we estimated by multiplying the \$1.1 billion in total SNAP/WIC benefits in Colorado by the State's sales tax rate of 2.9 percent. Although this exemption generally overlaps with the Food for Home Consumption Exemption, SNAP/WIC allow program recipients to purchase some food items, such as prepared sandwiches, salads, soft drinks, and candy, which would not be exempt from sales tax under the Food for Home Consumption Exemption, but that must be exempted under the federal law and Section 39-26-707(1), C.R.S.

Although this provision is similar to the Food for Home Consumption Exemption, because federal law requires the State to exempt these purchases, we did not consider this provision to be a tax expenditure for the purposes of our evaluations (see the Tax Expenditures Overview Section of the Office of the State Auditor’s *Tax Expenditures Compilation Report* for additional details on how we determined which provisions are tax expenditures).

FOOD & BEVERAGE PACKAGING EXEMPTION—Section 39-26-707(1)(c) and (2)(b), C.R.S., provides a sales and use tax exemption for essential food packaging that is provided to the consumer as part of the sale of food, so long as the purchase is subject to sales tax and the seller does not separately charge for the food packaging. Essential packaging includes items such as plates, cups, bowls, vending machine cups, disposable containers (i.e. pizza boxes), and clamshells for carry out. Nonessential items are assessed sales tax, with retailers paying the tax if they provide the items to the customers free of charge, and include utensils, skewers, napkins, serving trays, grocery bags, straws, cup sleeves, and single serving condiments offered at convenience counters.

FOOD SERVICE EMPLOYER-PROVIDED MEALS SALES TAX EXEMPTION—Section 39-26-707(2)(a), C.R.S., provides a sales tax exemption for restaurant meals when the meal is provided to an employee of the restaurant or is provided to the employee at a discount.

INGREDIENTS AND COMPONENT PARTS FOR FOOD MANUFACTURING EXEMPTION—Section 39-26-102(20)(b), C.R.S., exempts ingredients and other materials, such as molds, casings, and chemicals, used in processing or manufacturing food products, which will later be sold to consumers, from state sales and use tax.

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

The Department of Revenue could not provide data showing the revenue impact for the Food for Retirement Communities Exemption

because retirement communities typically report the sales that qualify for the exemption on the same line as other sales and use tax exemptions. Specifically, they report these sales on Schedule A, Line 12 of the Department of Revenue's Retail Sales Tax Return (Form DR 0100). This line is also where retailers report over a dozen other exempt sales and this information cannot be disaggregated for analysis. Further, according to the Department of Revenue, some taxpayers may have reported qualifying sales on Line 1 of Schedule B of Form DR 0100, which is the same line used to report the Food for Home Consumption Exemption and these amounts cannot be disaggregated for the purposes of analysis. If the General Assembly wants additional information on the exemption, it could consider instructing the Department of Revenue to add a reporting line for the expenditure to the Retail Sales Tax Return form. GenTax, the Department's tax processing and information system, would also have to be reconfigured to collect and extract this data; however, according to the Department of Revenue, this type of change would require additional resources to develop the form and complete the necessary programming in GenTax (see the Tax Expenditures Overview Section of the *Office of the State Auditor's Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE FOOD FOR HOME CONSUMPTION EXEMPTION. As discussed, statute and the enacting legislation for the exemption do not state the exemption's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered the following potential purpose: to avoid applying sales and use tax on purchases of basic necessities, which are commonly exempted in Colorado and other states. For example, other necessities, such as energy used at a residence and prescription drugs, are also exempt from

sales tax. Further, based on our review of tax policy literature, sale tax exemptions for basic necessities are commonly intended to avoid placing a disproportionate sales tax burden on individuals with lower incomes since these individuals tend to spend a larger share of their income on these items. We also developed one performance measure to assess the extent to which the exemption is meeting its potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).