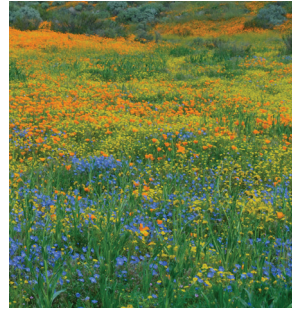


Tax Expenditures **Compilation Report 2025**



OFFICE OF THE STATE AUDITOR

C O L O R A D O

Working to improve government for the people of Colorado.

Office of the State Auditor

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Tax Expenditure Compilation Report

Overview

Section 39-21-305(1)(e), C.R.S., requires the Office of the State Auditor (OSA) to publish a report of the evaluations we conducted of the State's tax expenditures by June 30 of each year. The report must be published on the General Assembly's website and we must provide copies of the report to the Joint Budget Committee and the Finance Committees of the Senate and the House of Representatives. This report compiles all of the tax expenditure reports the OSA issued during State Fiscal Year 2025—July 1, 2024 to June 30, 2025. This is the first compilation report issued under the requirements of House Bill 24-1053, which made several changes to the scope of the OSA's work on tax expenditures. Specifically, the bill gave:

1. Our office flexibility to consider when sufficient data is expected to be available when scheduling our reviews of new tax expenditures while still endeavoring to review the oldest tax expenditures first, and issue reports on expiring expenditures in the year before they are set to expire so evaluations are available for the legislative session before the expenditure(s) expire.
2. Our office discretion in deciding (1) whether to reevaluate a tax expenditure after it has been reviewed once and (2) the timing of the subsequent review.
3. The Legislative Oversight Committee Concerning Tax Policy (Committee) the option to select three additional expenditures for our office to review before June 30 of the following year.

Section 39-21-403(2)(c)(I), C.R.S., requires the Committee to consider our tax expenditure evaluation reports' policy considerations. However, Senate Bill 25-199 suspended the Legislature's interim committees—including the Committee—for 2025. As a result, the Committee will not consider the policy considerations in the tax expenditure evaluations included in this compilation report until 2026 and will not be able to assign our office additional expenditures to review before June 30, 2026.

Below, we provide more information on the reports we completed during Fiscal Year 2025 under each of the requirements noted above.

Tax Expenditures Reviewed

Exhibit 1 provides a list of the expenditures and the reason we reviewed each expenditure this year, such as being statutorily required, OSA selected, or Committee selected.

Exhibit 1

Tax Expenditures Reviewed During Fiscal Year 2025

Expenditure	Reason for Review
Agricultural Applicator Aviation Fuel Tax Refund	We started this review prior to the passage of HB 24-1053 and completed it during Fiscal Year 2025.
Manufacturing Sales Tax Exemptions	We started this review prior to the passage of HB 24-1053 and completed it during Fiscal Year 2025.
Colorado ABLE Savings Account Contribution Deduction	We were statutorily required to review the expenditure before it was scheduled to expire on December 31, 2025.
Early Childhood Educator Credit	We were statutorily required to review the expenditure before it was scheduled to expire on December 31, 2025.
Rural Jump-Start Tax Expenditures	We selected these expenditures for review because the Rural Jump-Start grants, which were created since our last review, expired in 2025. These grants were not available when we conducted our last review in 2020.
Essential Hygiene Products Exemptions	We selected these expenditures for review because the General Assembly added an exemption for period products and incontinence products in 2022, which was after our last review of the Medical Supplies Sales Tax Exemptions. We focused our review on the additional exemptions.
Regional Home Office Insurance Premium Tax Rate Reduction	We selected this expenditure for review because the General Assembly changed the criteria to receive the reduction starting in 2022. Our office published our last review of the reduction in 2020.
Sustainable Aviation Fuel State Incentives ¹	The Committee selected the expenditures related to this topic for review in October 2024.
Oil and Gas Severance Tax Deduction	We selected this expenditure for review because the General Assembly changed what expenses can be claimed as a deduction starting in 2022. We published our last evaluation of the deduction in 2020.
Senior Housing Income Tax Credit	We selected this expenditure for review, because the General Assembly originally established the credit just for Tax Year 2022, and then reinstated for the credit for Tax Year 2024. We reviewed the 2022 version of the expenditure because data was available for that year, but not for 2024. We conducted the review so the General Assembly will have information on its effectiveness if it would like to reinstate the credit again in future years.
Software Sales Tax Exemption ¹	The Committee selected this expenditure for review in October 2024.

¹Notes: The Legislative Oversight Committee Concerning Tax Policy did not select a third expenditure for our office to review in Fiscal Year 2025.

In addition to the changes to our tax expenditure evaluations, including the interim Committee's ability to select up to three tax expenditures for our review, House Bill 24-1053 also (1) allowed the Committee to select two specific, discrete topics related to existing tax policy for the OSA to report on and (2) required that we annually report on the impact of the State's policy of using federal taxable income as the basis for Colorado taxable income, including any changes to federal tax law regarding taxable income that may significantly impact the State's tax base or taxable income. Because these reports are not tax expenditure evaluations, they are not included in this tax expenditure compilation report and will be published separately.



Agricultural Applicator Aviation Fuel Tax Refund



OFFICE OF THE STATE AUDITOR

Tax Expenditure Evaluation • August 2024 • 2024-TE7

C O L O R A D O

Aerial application is the process of applying pesticides, fertilizers, and seeds over crop land via aviation services. The Agricultural Applicator Aviation Fuel Tax Refund is a fuel excise tax refund available for aviation gasoline and jet fuel that is used to propel Colorado-licensed aircraft that (1) perform aerial application services and (2) exclusively use a private aviation facility. Based on the Refund's legislative history, it appears that legislators intended to give a refund of the excise taxes that were paid by these operators and were allocated to public airports because these operators do not use public airports.

The Applicator Fuel Refund is meeting its purpose for the businesses that claim it, but not all operators are aware of the Refund.

- Only half of the stakeholders who provided feedback were aware of the Refund.
- The Refund provides a relatively small financial benefit to eligible businesses, and its impact on State revenue is minimal.

Policy Considerations

We did not identify any policy considerations for the Agricultural Applicator Aviation Fuel Tax Refund.

Tax Type:	Fuel excise	Year Enacted:	1988
Expenditure Type:	Refund	Repeal/Expiration date:	None
Statutory Citation:	Section 39-27-103(2.7)(d), C.R.S.	Revenue Impact:	No more than \$27,000

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



Agricultural Applicator Aviation Fuel Tax Refund

Background

Aerial application, also known as “crop dusting,” is the process of applying pesticides, fertilizers, and seeds over crop land via aviation services. **The Agricultural Applicator Aviation Fuel Tax Refund (Applicator Fuel Refund) is a fuel excise tax refund available for aviation gasoline and jet fuel that is used to propel Colorado-licensed aircraft that (1) perform aerial application services and (2) exclusively use a private aviation facility rather than a public airport.**

Colorado's legislature enacted the Applicator Fuel Refund along with the aviation fuel excise tax in 1988. The fuel excise tax is imposed on jet fuel at the rate of 4 cents per gallon and on aviation gas at the rate of 6 cents per gallon. In this report, we use the term “aviation fuel” to refer collectively to aviation gasoline and jet fuel. All revenue from aviation fuel taxes is allocated to the Aviation Fund, which Article X, Section 18 of the Colorado Constitution requires be used exclusively for aviation purposes. The majority of the excise tax revenue—all revenue from the jet fuel excise tax and two-thirds of the revenue from the aviation gas excise tax—is allocated to Colorado's public airports. Based on legislative audio recordings from committee hearings for the enacting legislation, **it appears that legislators intended to give a refund of the excise taxes allocated to public airports and paid by aerial application operators that fly exclusively from private aviation facilities because these operators do not use public airports.**

The amount of the Refund is 50 percent of the fuel excise taxes paid on the fuel used for crop dusting purposes, including travel to and from the site where the services are performed. Eligible taxpayers must obtain a Gasoline/Special Fuels Refund Permit from the Department of Revenue (Department) and submit a claim in order to receive the Refund. There is also a federal excise tax on aviation fuel, the full amount of which may be refunded or credited by the federal government if the fuel is used for farming purposes.

According to the U.S. Department of Agriculture, there were about 11 million acres of cropland in Colorado as of 2017, the most recent year for which data is available. About 28 percent of harvested cropland is treated with aerial application services. Of the 36 other states that impose an excise tax on jet fuel, we identified 12 states that provide an exemption for fuel used in agricultural aerial application.

In order to determine whether the Refund is meeting its purpose, we assessed the extent to which agricultural applicator operators are aware of and claiming the Applicator Fuel Refund and, therefore, avoiding paying for public airports that they do not use.

Evaluation Results

The Applicator Fuel Refund is meeting its purpose for the businesses that claim it, but not all operators are aware of the Refund.

Only half of the stakeholders who provided feedback were aware of the Refund. We reached out to 27 stakeholders from the aerial application industry in Colorado and received responses from eight operators, only four of whom were aware of the Applicator Fuel Refund and reported claiming the Refund. The other four operators reported that they were not aware of the Refund or were unsure whether they had received it.

The Refund provides a relatively small financial benefit to eligible businesses, and its impact on State revenue is minimal. The Department is not able to provide the amount of refunds that businesses claimed because the Refund is claimed using the same form as several other fuel refunds, which are combined in the Department's database and cannot be disaggregated for analysis. We used stakeholders' estimates of their operations' total annual fuel usage and the jet fuel excise tax rate of 4 cents per gallon to estimate that the aerial application operators we spoke with receive a refund between \$150 and \$640 per year. We used the jet fuel excise tax rate because stakeholders reported that most operators now use jet fuel rather than aviation gasoline. We also used this information to estimate that the maximum total revenue impact of the Refund for all operators is about \$27,000 per year based on all 42 operators in the state claiming a \$640 refund each year. However, because we know that some operators are not claiming it, the actual revenue impact is probably less.

Exhibit 1

The Applicator Fuel Refund provides a relatively small financial benefit to eligible businesses, and its impact on State revenue is minimal.

Estimated annual benefit per operator	\$150 - \$640
Estimated maximum total annual revenue impact	\$27,000

Source: Section 39-27-102(1)(a)(IV)(A), C.R.S., and aerial application operators' estimates of their operations' total annual fuel usage.

Policy Consideration

We did not identify any policy considerations for the Applicator Fuel Refund.

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Manufacturing Sales Tax Exemptions



OFFICE OF THE STATE AUDITOR

Tax Expenditure Evaluation • December 2024 • 2024-TE8

C O L O R A D O

This report covers three sales and use tax exemptions that apply to purchases by manufacturers:

- The Machinery Exemption can be claimed for purchases over \$500 of machinery, machine tools, and machine parts that are used in manufacturing.
- The Component Parts Exemption applies to manufacturers' purchases of tangible personal property that is incorporated into a final manufactured product.
- The Industrial Energy Exemption treats sales of energy used for industrial and manufacturing purposes as exempt wholesale sales.

The Machinery Exemption appears to have been intended to encourage the purchase of machinery for manufacturing. The Industrial Energy and Component Parts Exemptions ensure that sales tax is only applied to purchases made by final consumers and avoid taxing businesses' inputs used to manufacture products.

We found the following:

- Although the Machinery Exemption may help reduce manufacturers' costs to a relatively small degree, it is unlikely that the exemption encourages manufacturers to invest in additional machinery, and it is sometimes applied to ineligible machinery.
- Although we were unable to determine how many manufacturers are using the Component Parts Exemption, it is likely that the exemption is well-known and commonly claimed by eligible purchasers.
- The Industrial Energy Exemption is likely commonly claimed, but some businesses may not be aware of it.

Policy Considerations

Since the Machinery Exemption is likely not meeting its original presumed purpose of encouraging manufacturers to purchase machinery, the General Assembly may want to assess whether the exemption is serving a different purpose and, if so, amend statute to establish a purpose statement for the exemption. The General Assembly could also consider simplifying the eligibility requirements for the Machinery Exemption.

	Machinery Exemption	Component Parts Exemption	Industrial Energy Exemption
Tax Type:	Sales and use	Sales and use	Sales and use
Expenditure Type:	Exemption	Exemption	Exemption
Statutory Citation:	Section 39-26-709, C.R.S.	Sections 39-26-102(20)(a) and 39-26-713(2)(b)(I) and (2)(e)(I), C.R.S.	Sections 39-26-102(21)(a) and 39-26-715(2)(b)(I), C.R.S.
Year Enacted:	1979	1935	1935
Repeal/Expiration Date:	None	None	None
Revenue Impact:	Up to \$28 million (2021)	About \$795 million (2021)	Up to \$104 million (2021)
Purposes given in statute or enacting legislation? No			



Manufacturing Sales Tax Exemptions

Background

This report covers three sales and use tax exemptions that apply to purchases by manufacturers, which we refer to collectively as the Manufacturing Exemptions.

First, the Exemption for Machinery Used in Manufacturing (Machinery Exemption) can be claimed for purchases over \$500 of machinery, machine tools, and machine parts that are used in manufacturing. Exhibit 1 summarizes the main requirements for a purchase to qualify for the exemption.

Technical Note

Unless otherwise stated, we use the term “machinery” in this report to refer collectively to machinery, machine tools, and parts of these items that are eligible for the Machinery Exemption.

Exhibit 1 Summary of Eligibility for the Machinery Exemption¹

- (1) The machinery must be used in Colorado.
- (2) The machinery must be used **directly** in manufacturing, which is defined as the production of a new product that is different from raw or prepared materials. This includes any machinery used from the point at which raw material is moved from inventory to the point at which the raw material has been altered to its completed form, including packaging.
- (3) The machinery must be used **predominantly** in manufacturing. If a machine has any other uses in addition to its manufacturing use, the manufacturing use must be at least 50 percent of all use.
- (4) The machinery must be depreciable and have a useful life of at least 1 year. If the purchaser fully expenses the machinery and recovers the full cost in 1 year, the machinery is not eligible for the exemption.
- (5) The purchase must qualify for the Section 38 federal investment tax credit as it existed prior to the Tax Reform Act of 1986.

Source: Section 39-26-709, C.R.S.; 1 CCR 201-4, Rule 39-26-709; and Department of Revenue taxpayer guidance documents.

¹The exemption is also available for machinery used to produce electricity “in a facility for which a long-term power purchase agreement was fully executed between February 5, 2001 and November 7, 2006, whether or not such purchases are capitalized or expensed” [Section 39-26-709(1)(a)(IV), C.R.S.]. The Department of Revenue reports that some businesses might still be eligible for the exemption under this provision, but the number is likely to decrease over time.

Second, the Component Parts Exemption applies to manufacturers’ purchases of tangible personal property that is incorporated into a final manufactured product, treating them as wholesale sales that are exempt from Colorado’s sales and use tax. For example, purchases of raw materials that become part of a final product—such as wood, fiberglass, and metal used to

manufacture skis; or aluminum used to manufacture cans—are covered by the exemption. Containers, labels, and shipping cases are also eligible types of component parts for purposes of this exemption. According to data from the U.S. Census Bureau, there were about 5,100 manufacturing firms in Colorado in 2021, all of which may be eligible for the Component Parts and Machinery Exemptions.

Third, the Energy Used for Industrial and Manufacturing Purposes Exemption (Industrial Energy Exemption) treats sales of energy used for industrial and manufacturing purposes as wholesale sales that are exempt from Colorado’s sales and use taxes. Exhibit 2 summarizes the types of energy that are eligible for the exemption and the industrial purposes for which exempt energy can be used.

Exhibit 2

Summary of Eligibility for the Industrial Energy Exemption

Eligible Types of Energy	Eligible Industrial Uses	
• Electricity • Gas • Coal and coke • Fuel oil • Steam¹ • Nuclear fuel¹	• Processing • Manufacturing • Mining • Refining • Irrigation • Construction	• Telephone and radio communication • Street and railroad transportation services • Gas and electricity production

Source: Section 39-26-102(21)(a), C.R.S., and 1 CCR 201-4, Rule 39-26-102(21).

¹Nuclear fuel was not used in Colorado as of 2022, the most recent year with data available, and we did not identify any data on the use of steam for energy in Colorado.

Only energy used for industrial purposes is eligible for the Industrial Energy Exemption. For example, energy used to run manufacturing machinery, produce food for consumption in a restaurant, or to light an industrial plant is eligible for the exemption; energy used to provide services, light stores, or operate an office is not eligible. Therefore, a manufacturer may use some energy that is eligible for the exemption, but still be liable for sales tax on the portion of their energy that is not used for industrial purposes. We provide more information on the methods for claiming the exemption in the evaluation results section. According to data from the U.S. Energy Information Administration (EIA), there were about 15,300 industrial consumers of electricity in Colorado in 2021, all of whom may be eligible for this exemption.

While statute does not state a purpose for the Manufacturing Exemptions, based on our review of their operation and legislative history, we considered them to have the following purposes:

- **The Machinery Exemption appears to have been intended to encourage the purchase of machinery for manufacturing.** When the exemption was established in 1979, legislators based

eligibility for the Machinery Exemption on whether a given purchase would have been eligible for a federal investment credit, which was enacted in the 1960s to encourage investment in capital assets. This suggests that the exemption was also intended to encourage this type of investment, specifically in machinery. In addition, the exemption may also avoid imposing a tax that could be passed on to consumers in the form of higher prices. Our review of tax policy publications indicates that minimizing the taxation of business-to-business transactions in this way is generally considered to be good tax policy; however, it is unclear whether Colorado's General Assembly had this purpose in mind when enacting the exemption.

- **The Industrial Energy and Component Parts Exemptions ensure that sales tax is only applied to purchases made by final consumers.** Sales of these items are defined in statute as wholesale sales, which are sales that are made to a business for purposes of resale. Wholesale sales are exempt from state sales and use tax under Colorado statute. Such exemptions are intended to ensure that sales tax is only applied once, to purchases made by final consumers, and to avoid “tax pyramiding,” an effect that can occur when sales tax is applied to products and the inputs necessary to manufacture them multiple times before the final finished product is sold to the consumer. Tax pyramiding can result in hidden taxes being passed on to consumers in the form of higher prices and can put businesses that sell products with longer supply and distribution chains at a relative disadvantage.

We developed the following performance measures in order to evaluate the Manufacturing Exemptions:

1. To what extent does the Machinery Exemption encourage manufacturers to purchase machinery used for manufacturing?
2. To what extent do the Industrial Energy and Component Parts Exemptions prevent the imposition of sales tax on inputs necessary for manufacturing and, in the case of the Industrial Energy Exemption, on energy used for industrial and manufacturing purposes?

Evaluation Results

Although the Machinery Exemption may help reduce manufacturers' costs to a relatively small degree, it is unlikely that the exemption encourages manufacturers to invest in additional machinery. Additionally, the exemption is sometimes applied to ineligible machinery. In our last evaluation of this exemption, published in January 2021, we found that the Machinery Exemption is well-known among manufacturers, routinely applied by machinery vendors, and may help Colorado to stay competitive when compared with other states with a similar exemption. Out of the 44 other states plus the District of Columbia that levy sales tax, only 8 do not offer any type of exemption for machinery, with 34 offering a full exemption and 3 providing a partial exemption.

We estimate that the Machinery Exemption reduced state revenue by between \$3.9 million and \$28 million in 2021 and provided a corresponding tax benefit to manufacturers. Because it appears that machinery vendors may not consistently report this exemption, we could not provide a precise estimate of its revenue impact. Specifically, the exemption is itemized on the Department of Revenue's (Department) sales tax return, meaning it has its own reporting line, and Department data indicate that the exemption reduced state revenue by about \$3.9 million in 2021. This amount would correspond to about \$133 million in machinery sales in the state. However, we compared the amount claimed to data from the U.S. Census Bureau Annual Survey of Manufactures (ASM), which indicates that manufacturers in Colorado purchased closer to \$964 million in machinery in 2021, in which case the exemption would reduce state revenue by about \$28 million if all purchasers received it. Thus, it seems the exemption is likely underreported on the Department's sales tax return.

Although we were unable to determine why this is the case, it is likely that some exempt purchases of machinery are being reported on other lines of the Department's sales tax return, such as the wholesales line or the line for other exempt sales. Although this would not impact the amount of tax the State collects, it prevents the Department from collecting complete data on the exemption. Additionally, manufacturers that purchase exempt machinery from another state and bring it into Colorado are not required to report the amount exempt from use tax under this exemption. The exemption also may not be claimed by all eligible taxpayers, although we were unable to determine the extent to which this may be the case.

Although the exemption seems to be widely used, a 2.9 percent sales tax exemption may not provide a significant incentive for manufacturers to purchase additional machinery. Manufacturers we contacted reported that sales and use taxes are one factor among many that manufacturers consider when making investment decisions, so the exemption is most likely to have an impact in cases when a purchase is almost, but not quite, financially viable. Additionally, in some areas of Colorado, there are no corresponding local sales tax exemptions to help reduce the cost of the purchase, which reduces the effectiveness of the State's exemption as an incentive. Our previous report found that most purchases of manufacturing equipment in Colorado are subject to local sales taxes because home rule and statutory municipalities—both of which have the option to tax or exempt purchases of machinery—commonly elect to tax these purchases. According to the Tax Foundation, Colorado has the third highest average local sales tax rate in the United States, at about 4.9 percent.

Additionally, vendors frequently apply the exemption to ineligible machinery. As discussed, the exemption is only available for machinery purchases that would have qualified for the federal investment tax credit in Section 38 of the Internal Revenue Code of 1954 as it existed just prior to the Tax Reform Act of 1986. According to the Department, "[t]he statute's reliance on a federal law repealed more than 30 years ago is problematic. Copies of the federal law from that time are not readily available and, even if taxpayers and tax practitioners can find them, the text is voluminous and complex." For example, among other things, the federal investment credit:

- Was limited to \$25,000 plus 85 percent of the taxpayer's net federal income tax liability that exceeded \$25,000. This limitation varied for married couples filing separately, controlled groups, and estates and trusts.
- Was not permitted for certain types of property, such as certain boilers fueled primarily by petroleum and natural gas.
- Was limited to \$150,000 of used property.

Since eligibility for Colorado's Machinery Exemption is dependent in part on eligibility for this federal investment credit, all of these qualifications also apply to the Machinery Exemption (as well as to the Enterprise Zone Machinery Exemption, another exemption for machinery that references the Machinery Exemption eligibility and is available in certain economically distressed areas of the state). The exemption is typically applied at the point of sale by machinery vendors, who are unlikely to be aware of some of these requirements or be able to determine, for example, whether a given purchase of machinery would have resulted in the purchaser's federal investment credit exceeding the allowable cap. According to the Department, "[v]endors frequently do not apply this exemption correctly, do not have sufficient documentation, or do not exercise due diligence in verifying that a sale is exempt." We provide some options for the General Assembly to address this issue in the Policy Considerations section below.

If a vendor does not apply the exemption to a machinery purchase, the purchaser may submit a claim to the Department for a refund. However, the Department reported that purchasers frequently submit ineligible claims for the exemption. In these instances, "[t]he Department encounters claims for property that does not qualify for the [exemption]. For example, the...exemption is often claimed for items that are not machines, machine tools, or machine adjuncts or attachment[s] or for items that are not used directly and predominantly in manufacturing tangible personal property."

It is likely that the Component Parts Exemption is well-known and commonly claimed by eligible purchasers. We reached out to 37 stakeholders about the Component Parts Exemption, and the two stakeholders who responded indicated that manufacturers are generally aware of and claim the exemption. Additionally, all states and the District of Columbia that have a sales tax provide an exemption or a reduced tax rate for component parts. Therefore, businesses that operate in other states in addition to Colorado are probably familiar with these types of exemptions. We were unable to determine how many manufacturers are using the Component Parts Exemption because it is not itemized on the Department's sales tax return, so the Department could not provide data on its use. However, ASM data indicates that Colorado manufacturers spent about \$27.4 billion on components and packaging in 2021. We multiplied this by the state sales tax rate of 2.9 percent to estimate that the Component Parts Exemption may have reduced state revenue by about \$795 million in 2021.

The Industrial Energy Exemption is likely commonly claimed, but some businesses may not be aware of it. In our previous report on the exemption, published in July 2019, stakeholders reported that the Industrial Energy Exemption is important to businesses in a variety of industries and is particularly impactful in industries that use more energy as an input, that operate with lower profit margins, or in which products are sold at fixed market prices. We also found that both industrial businesses and restaurants are generally aware of and claim this exemption. However, during our previous evaluation of this exemption, stakeholders indicated that smaller businesses may not be aware of the exemption, and one industrial business who spoke with us this year had not heard of the exemption.

We estimate that the Industrial Energy Exemption reduced state revenue by about \$104 million in 2021. To prepare our estimate, we used the EIA's State Energy Data System data to determine that the industrial sector—including manufacturing, mining, construction, and other industries eligible for the exemption—and the electricity generation sector spent approximately \$3.5 billion on energy sources in Colorado in 2021, which would result in \$104 million being exempt from sales tax. Because data on eligible versus non-eligible uses was not available, our estimate assumes that all energy used by the industrial sector was eligible. However, the actual amount is likely somewhat lower than our estimate because not all gas and electric energy used by industrial facilities is eligible for the exemption, and some eligible taxpayers may not claim the exemption. The Department could not provide the total number of claims or amount claimed by taxpayers for exempt coal, fuel oil, or most gas and electricity because, with the exception of amounts claimed by restaurants, the exemption is not itemized on the Department's sales tax return. Department data indicates that about 2,800 restaurants claimed the exemption for gas and electricity in 2021 for a total of \$1.4 million.

The method to claim the exemption varies by the taxpayer's industry and how much of the energy use is exempt. Exhibit 3 provides the methods for claiming the exemption and the estimated amount claimed through each method.

Exhibit 3

Methods of Claiming the Industrial Energy Exemption

Claim Method	Type of Energy	Information Provided to Department of Revenue	2021 Estimated Revenue Impact <i>Percentage of Total</i>
1. Utility Company Method Businesses that use at least 75 percent of their energy for exempt purposes must file an affidavit with their utility company, which then applies the exemption to all of the business' energy use. The business is then required to remit sales tax on the non-exempt portion of their energy use to the Department.	Electricity and gas purchased by the industrial sector	Businesses are not required to submit supporting documentation establishing the percentage of their exemption to either the utility company or the Department. When remitting sales tax on the non-exempt portion of their energy use, there is no separate line for reporting these purchases, so the number of taxpayers and amount remitted to the State is not known.	\$50 million ¹ 48%
2. Refund Method Businesses that use less than 75 percent of their energy for exempt purposes must submit a claim for refund to the Department.	Primarily electricity and gas, but could be used for coal and fuel oil	Businesses submit a claim for refund form to the Department and provide supporting documentation that establishes the percentage of their exemption. Department staff review this documentation before granting the refund.	At most \$250,000 (2019 ²) Less than 0.5%
3. Restaurant Method Restaurants must file for the exemption using a separate form.	Electricity and gas used by restaurants	In addition to filing information with the Department on a separate form, restaurants report the amount of their exemption on a separate line of the sales tax return.	\$1.4 million 1%
4. Point of Sale Method Coal and fuel oil that are sold directly to industrial consumers ³ , as well as all energy sold to electricity producers, are exempt from sales tax at the time of purchase.	Coal and fuel oil, as well as gas purchased by electricity producers	These sales are not reported to the Department on a separate line of the sales tax return.	\$53 million 51%
Total Revenue Impact			\$104 million

Source: Office of the State Auditor analysis of U.S. Energy Information Administration data, Department of Revenue data and forms, and input from Department of Revenue staff.

¹This may overestimate the actual revenue impact of the utility company method of claiming the exemption because we were unable to quantify the extent that industrial businesses use less than 100 percent of their energy for eligible uses and are remitting sales tax on the nonexempt portion to the Department.

²This is the most recent year with data available for the refund method of claiming the exemption.

³All coal and fuel oil sold to industrial businesses are typically fully exempt from sales tax because these sources of energy are exclusively used for exempt purposes by industrial users. The exemption is applied at the time of sale.

The Manufacturing Exemptions have a significant impact on state revenue and are a common feature of most states' sales tax systems. Exhibit 4 summarizes the Manufacturing Exemptions' impact on state revenue in 2021, and Exhibit 5 shows the number of states with exemptions similar to the Manufacturing Exemptions.

Exhibit 4

Estimated Impact of the Manufacturing Exemptions on State Revenue, 2021

Machinery Exemption ¹	Up to \$28 million
Industrial Energy Exemption ²	Up to \$104 million
Component Parts Exemption	About \$795 million
Total for All Manufacturing Exemptions	Up to \$927 million

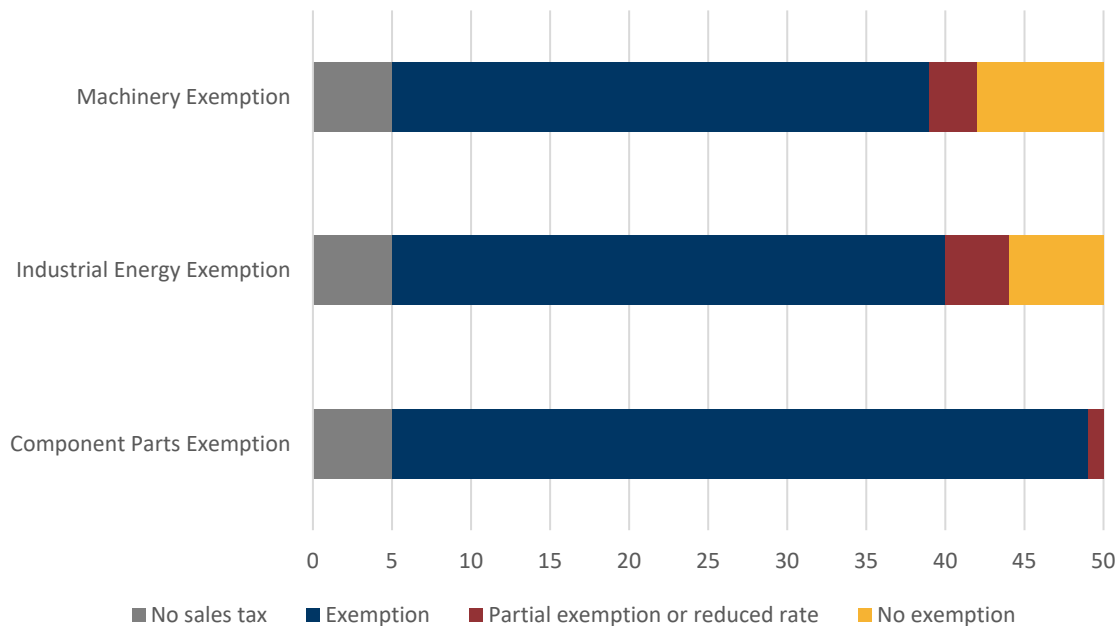
Source: Colorado Office of the State Auditor analysis of data from the Department of Revenue, the U.S. Census Bureau Annual Survey of Manufactures (ASM), and the U.S. Energy Information Administration State Energy Data System.

¹ ASM data on capital expenditures for equipment may include some sales that are not eligible for the Machinery Exemption, such as purchases of office equipment and purchases of \$500 or less. Therefore, this estimate may overstate the impact of this exemption to some extent.

² The industrial and electricity generation sectors consumed about \$3.5 billion in energy in 2021. However, for industrial consumers, only the portion of electricity and gas used for manufacturing or industrial processes is eligible for the exemption. Our estimate calculates the maximum possible revenue impact by assuming that 100 percent of the electricity and gas used by the industrial sector was eligible for the exemption.

Exhibit 5

Manufacturing Exemptions in Other States¹



Source: Colorado Office of the State Auditor analysis of data from Bloomberg Law and other states' statutes.

¹This exhibit includes the 44 other states with a sales tax, along with the District of Columbia, and the five states that do not impose a sales tax. Colorado is not included.

Policy Considerations

The General Assembly may want to assess the Machinery Exemption and amend statute to define its purpose. Neither the exemption's enacting legislation nor statute establishes a purpose statement for the Machinery Exemption, but the fact that legislators designed the exemption's eligibility to be dependent on a federal credit specifically intended to encourage investment suggests that the original purpose of the exemption was to encourage investment in manufacturing machinery. As discussed, we found that the exemption, which provides a 2.9 percent reduction in the cost to purchase eligible machinery, is unlikely to be large enough to motivate manufacturers to purchase additional machinery in most cases.

However, the exemption likely serves other purposes that the General Assembly may deem to be worthwhile, such as avoiding the imposition of a tax that could be passed on to consumers in the form of higher prices. Taxing business-to-business transactions can result in tax pyramiding, in which sales taxes are applied multiple times before a product is sold, and sales taxes from earlier transactions can end up being built into the final price of the product. The extent to which taxes are passed on to the consumer in this manner depends on a variety of factors. For example, manufacturers that produce products with longer supply chains and multiple manufacturing stages may have more business-to-business sales transactions during the production process. These manufacturers would face a higher increase in production costs if their business-to-business sales were taxed and, thus, may be more likely to pass these costs on to consumers. However, manufacturers in highly competitive markets or that manufacture products for which consumer demand is more price-sensitive may have less ability to pass sales tax costs on to consumers and might instead accept reduced profits or look for other ways to reduce production costs. Therefore, different manufacturers would likely respond in different ways to any increase in costs that result from imposing sales tax on business-to-business transactions.

Finally, the exemption may allow Colorado to stay competitive with other states, since the majority of states have a similar exemption. Specifically, we found that 34 other states provide an exemption for manufacturing machinery, and an additional 5 states do not impose state sales tax.

The General Assembly could consider simplifying the eligibility requirements for the Machinery Exemption. As previously discussed, the qualification requirements for the Machinery Exemption are unnecessarily complex as a result of Colorado statute's reference to the federal investment credit in Section 38 of the Internal Revenue Code of 1954, and this exemption is frequently applied incorrectly. If the General Assembly decides to simplify eligibility requirements for this exemption, the simplest approach would be to remove the statutory reference to Section 38 of the Internal Revenue Code of 1954. Other states with a similar exemption take a variety of approaches in determining eligibility for their respective exemptions, but in most states, the exemption is available only for machinery that is directly and primarily (or exclusively) used to manufacture tangible personal property that is new and different from the original inputs. Colorado's statutes already stipulate that purchased machinery meet these requirements irrespective of the reference to Section 38 of the Internal Revenue Code of 1954, so if the General Assembly decides to take action on this policy consideration, simply removing the reference to the Internal Revenue Code may be sufficient.

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Colorado ABLE Savings Account Contribution Deduction



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Tax Expenditure Evaluation • January 2025 • 2025-TE1

The Colorado ABLE Savings Account Contribution Deduction (ABLE Deduction) allows individuals, estates, and trusts who contribute to Colorado ABLE accounts in Tax Years 2023 through 2025 to deduct their contributions up to established limits from their Colorado income. An ABLE account is a savings and investment account that allows certain individuals with disabilities to save money and pay for qualified disability expenses. For our evaluation, we considered two potential purposes for the deduction: (1.) To provide support to individuals with disabilities and their families in saving money to pay for qualified disability expenses, and (2.) To create an additional incentive for contributing to ABLE accounts not already created by other state or federal programs.

The ABLE Deduction provides a modest support for individuals with disabilities and their families; however, it likely provides only a small incentive to contribute to ABLE accounts and there are other, more significant incentives for making contributions.

- Based on the \$3,650 average amount contributed to ABLE accounts during the first year the deduction was available, the deduction would have provided an average tax benefit of about \$161, which would be split among all contributors to the account, based on the State’s income tax rate of 4.4 percent that year.
- Stakeholders reported that the end of Medicaid Recovery, which ended Colorado’s practice of recapturing funds in the ABLE accounts of those Medicaid recipients who have died, serves as a bigger incentive to contribute to ABLE accounts than the deduction.

Policy Considerations

If the General Assembly extends the ABLE Deduction, it could consider adding a purpose statement to statute.

Tax Type:	Income	Year Enacted:	2022
Expenditure Type:	Deduction	Repeal/Expiration date:	December 31, 2025
Statutory Citation:	Section 39-22-104(4)(i)(II)(B), C.R.S.	Revenue Impact:	Could not determine
Purpose given in statute or enacting legislation? No			



Colorado ABLÉ Savings Account Contribution Deduction

Background

The federal Achieving a Better Life Experience (ABLE) program [Internal Revenue Code, Section 529A] allows states to sponsor state-operated savings and investment accounts (ABLE accounts) to assist individuals with disabilities to save for qualifying expenses. In Colorado, the ABLE program is administered by CollegeInvest, a State enterprise within the Department of Higher Education that also administers the State's 529 college education savings program. Prior to the establishment of the ABLE program, individuals with a disability were limited in their ability to save to pay for expenses without losing eligibility for federal benefits programs such as Medicaid and Supplemental Security Income (SSI), which require that single beneficiaries have no more than \$2,000 in assets and joint-filing beneficiaries have no more than \$3,000 in assets [42 USC 1382]. Under the ABLE program, individuals with a disability can save up to \$100,000 in ABLE accounts without having those assets counted for the purposes of determining eligibility. Parents can also establish ABLE accounts to save money for their children's disability expenses and anyone can contribute funds to an ABLE account, regardless of whether they are the account holder or beneficiary of the account. Currently, ABLE accounts must benefit individuals whose disabilities began before age 26; this age limit will rise to 46 after December 31, 2025. Individuals can only use funds saved in ABLE accounts for qualifying expenses, which include housing, transportation, employment training or supports, education, and assistive technologies.

Federal law [26 USC 529A(b)(2)(B)] imposes a limit on the total contributions that can be made to an ABLE account each year. The limit, which is adjusted every year based on inflation, was \$17,000 for 2023. As part of the Tax Cuts and Jobs Act of 2017, federal law [26 USC 529A(b)(2)(B)(ii)] expanded the limit to allow ABLE account beneficiaries who have earned income to contribute an additional amount above the standard federal ABLE limit under a program known as ABLE-to-Work. In 2023, this expansion allowed an ABLE beneficiary to contribute an additional amount of \$13,590 to their own account, for a total potential contribution of \$30,590 for the year.

Contributions to ABLE accounts are not deductible for federal tax purposes. However, under federal law [26 USC 529A(c)(1)], funds distributed from ABLE accounts are excluded from federal income for federal income tax purposes as long as all funds distributed from the account are used for qualified expenses.

The Colorado ABLE Savings Account Contribution Deduction (ABLE Deduction) allows individuals, estates, and trusts to deduct their contributions to ABLE accounts from their

Colorado Income. The ABLE Deduction was created by House Bill 22-1320 in 2022, and was first available to taxpayers beginning in Tax Year 2023. It is set to expire at the end of Tax Year 2025. For Tax Year 2023, statute [Section 39-22-104(4)(i)(II)(B), C.R.S.] allows taxpayers to deduct the amount they contribute to ABLE accounts up to \$20,700 per beneficiary for single taxpayers and \$31,000 per beneficiary for joint filers; these amounts are adjusted annually. The ABLE Deduction is modeled after and located in the same statute as the deduction for contributions to 529 college education savings accounts (529 Deduction). As a result, the ABLE Deduction and the 529 Deduction share the same annually adjusted per beneficiary cap, which is higher than the federally imposed limit on the total contributions that can be made to an ABLE account for Tax Years 2023 through 2025. Therefore, most contributions to ABLE accounts will not reach the State’s statutory cap on the deduction. However, ABLE account beneficiaries who qualify for the ABLE-to-Work expansion would potentially be able to deduct up to the statutory cap if they contribute amounts above the standard federal limit on ABLE account contributions. Any qualified taxpayer can claim the deduction, regardless of whether they are the account holder or beneficiary. For example, individuals who contribute to an ABLE account benefiting a family member can also claim the deduction. However, the federal cap on ABLE accounts is an annual per account limit, so all contributors to an ABLE account are collectively constrained to that limit and would need to coordinate (to the extent possible) to make sure they do not exceed the cap. CollegeInvest reported that additional contributions to accounts that have hit their limit for the year are rejected. Statute [Section 39-22-104(4)(i)(I)(B), C.R.S.] also allows a deduction for both interest earned on ABLE accounts and distributions made for qualified purchases to the extent they are included in federal taxable income. However, since Colorado uses federal taxable income as the starting point for determining Colorado income, interest earned on Colorado ABLE accounts and distributions made for qualified purchases are effectively exempt from state income tax already since these amounts are already deductible for federal tax purposes.

Statute does not provide a purpose for the ABLE Deduction and we were not able to clearly determine its purpose based on its construction and legislative history. For our evaluation, we considered two potential purposes for the deduction:

- **To provide support to individuals with disabilities and their families in saving money to pay for qualified disability expenses.** We inferred this purpose based on the statutory purpose of the ABLE program, which provides, “The general assembly...finds, determines, and declares that the establishment of a savings program that qualifies under section 529A of the internal revenue code will...Assist individuals and families in saving money for the purpose of supporting individuals with disabilities in maintaining health, independence, and quality of life...”
- **To create an additional incentive for contributing to ABLE accounts not already created by other state or federal programs.** During legislative hearings for House Bill 22-1320, the bill sponsors stated that in creating the ABLE Deduction, they intended to provide the same tax treatment for contributions to ABLE accounts that is provided to 529 education savings

accounts. Statute provides that the purpose of the 529 Deduction is “to create additional incentives for saving for college tuition not already created by other state or federal law.”

We inferred that the intended beneficiaries of the deduction are taxpayers who make contributions to ABLE accounts and receive a reduction in their taxable income. These taxpayers could be the account owner and/or beneficiary, family or friends, or any other individual who provides support through contributions to the account. If the deduction has an additional incentivizing impact, secondary beneficiaries could be those account owners who receive additional contributions.

To determine if the deduction is meeting these potential purposes, we developed the following performance measures:

- **To what extent does the ABLE Deduction support individuals with disabilities and their families in saving money to pay for qualified disability expenses?**
- **To what extent does the ABLE Deduction provide an additional incentive to contribute to ABLE accounts?**

Evaluation Results

The ABLE Deduction provides a modest support for individuals with disabilities and their families; however, it likely provides only a small incentive to contribute to ABLE accounts and there are other, more significant incentives for making contributions. We were not able to determine the extent to which eligible contributors actually claimed the deduction because the Department of Revenue cannot provide taxpayer data on the ABLE Contribution Deduction for Tax Year 2023—the first year the Deduction was available—until January 2026. However, CollegeInvest data shows that in 2023, there were 2,982 ABLE accounts and total contributions of about \$10.9 million to these accounts, or an average of about \$3,650 contributed to each account. CollegeInvest reported that due to the federal Right to Financial Privacy Act, they are restricted from sharing information about individual ABLE account contributions, so could not provide data on the number of individuals who contributed to each account or the amount each individual contributed. Additionally, contributors can, but are not required to, report whether they are Colorado taxpayers or not. Therefore, we could not determine the potential tax benefit each contributor could have received. To estimate the total potential benefit that contributors may have received, we multiplied the \$3,650 average contribution amount by the 2023 state income tax rate of 4.4 percent to determine that, on average, the individuals who made eligible contributions to an ABLE account would collectively have received an average tax benefit of about \$161, assuming that they had Colorado taxable income in 2023. This is a relatively small tax benefit, especially if it is split among several taxpayers.

However, for some taxpayers, the total tax benefit from the ABLE Deduction could be more significant. In 2023, the federal ABLE contribution limit was \$17,000; if a single Colorado taxpayer

contributed this amount to a Colorado ABLE account, the tax benefit would be around \$750, assuming they had enough taxable income to use the entire deduction. According to CollegeInvest data, 83 accounts (out of a total of 2,982) hit the annual contribution limit in 2023. However, because we only had data on total contributions made to accounts and not individual contribution or contributor data, we were unable to determine whether a single contributor provided the entire \$17,000, or if multiple contributors provided smaller amounts to reach the \$17,000 cap for those accounts, in which case the tax benefit per contributor would be less than \$750.

Additionally, ABLE account beneficiaries could receive a larger benefit. As discussed above, under the federal ABLE-to-Work program, eligible ABLE account beneficiaries can make contributions to their own accounts in excess of the standard federal ABLE contribution limit. Therefore, account beneficiaries who contributed the first \$17,000 and the additional \$13,590 permitted under the ABLE-to-Work program in 2023, and filed jointly, could deduct up to \$30,590, which would provide a tax benefit of \$1,346, assuming they had enough taxable income to use the entire deduction. According to CollegeInvest, as of 2024, there were 82 accounts with authorized ABLE-to-Work expansions. However, we were unable to determine whether any of those account owners contributed the full amount they are allowed to contribute.

Six stakeholders working in the disability support services industry and one stakeholder that works with Colorado ABLE clients responded to our outreach. Three stakeholders who had experience with Colorado ABLE account beneficiaries said that the deduction has little impact in incentivizing contributions, especially when compared to other factors, such as the ability to save a larger amount of resources and still qualify for federal programs. One stakeholder reported that the deduction “very rarely helps if the disabled person is contributing their own money.” This may be the case because individuals must have lower incomes to qualify for federal programs such as Medicaid and SSI, so they may not have the taxable income to take advantage of the deduction. For those contributing to someone else’s ABLE account, stakeholder feedback indicated that the tax deduction is helpful to offset the extra expenses associated with disability care, but it is mostly viewed as a “bonus” that is secondary when compared to the ability to save beyond \$2,000 for a single individual or \$3,000 for joint filers and to receive gifts from family members without threat to losing one’s Medicaid and other means-tested benefits.

The same legislation that created the ABLE Deduction (House Bill 22-1320) also ended Colorado’s practice of recapturing funds in the ABLE accounts of those Medicaid recipients who have died, a process commonly referred to as Medicaid Recovery. Prior to this legislation, under Medicaid Recovery, the State could recover certain Medicaid benefits paid on behalf of a Medicaid enrollee from a Colorado ABLE account. This change now allows the surviving families of account beneficiaries the opportunity to inherit any remaining ABLE account funds when the account beneficiary passes. The end of Medicaid Recovery, as an incentive, likely has a larger impact than the deduction since it can be accessed by non-state residents and the overall value can be much higher. One stakeholder who works directly with current and eligible ABLE beneficiaries and their families

explained that the end of Medicaid Recovery could, for example, result in a family inheriting amounts such as \$50,000, while the deduction's value, and thus incentivizing effect, is much smaller.

The number of ABLE accounts in Colorado and amounts contributed to these accounts has increased steadily in recent years. Exhibit 1 shows the number of open ABLE accounts on the last day of the year, along with the total value of ABLE contributions for account beneficiaries for Calendar Years 2019 through 2023.

Exhibit 1
Colorado ABLE Accounts and Contribution Values
Calendar Years 2019 through 2023

Calendar Year	ABLE Accounts	Percentage Change in ABLE Accounts	Total Value of ABLE Contributions	Percentage Change in Total Value of ABLE Contributions
2019	949	N/A	\$3,890,869	N/A
2020	1,349	42%	\$5,405,285	39%
2021	1,843	37%	\$7,398,460	37%
2022	2,322	26%	\$7,519,157	2%
2023	2,982	28%	\$10,895,210	45%

Source: Office of the State Auditor analysis of CollegenInvest data for Calendar Years 2019 through 2023.

Based on the \$10,895,210 contributed in 2023, if all contributions were eligible for the ABLE Deduction and taxpayers claimed a deduction for the entire amount they contributed, the maximum revenue impact to the State would be just under \$500,000. However, it is likely that the actual revenue impact was less due to contributors not claiming a deduction for the entire amount contributed. For example, only Colorado taxpayers are eligible for the ABLE Deduction and some of the contributions likely came from residents of other states. It is also likely that some taxpayers who made contributions were unable to claim the full amount of the deduction because they lacked sufficient taxable income to use it. Additionally, some eligible taxpayers might not be aware of the deduction. The majority of stakeholders we spoke with were aware of the ABLE program, but only one stakeholder was aware of the deduction. Most of these stakeholders reported that while they provide information about the ABLE program to clients who might be eligible, their organizations were either unaware of the deduction or not likely to provide information about the deduction due to concerns about it being perceived as offering tax guidance.

Some research has found that states that offer income tax incentives for contributing to ABLE accounts have higher rates of ABLE account use. National research conducted by the Social Security Administration found that the states with the highest rates of ABLE account participation in 2021 were those that either offered some form of tax incentive to contributors or

had no state income tax. However, despite Colorado's lack of a contribution tax incentive at that time, Colorado's ABLE account participation rate was double the national average and in the top 15 among states. Therefore, the creation of the deduction might not significantly impact the number of ABLE accounts in Colorado.

Forty-five states and the District of Columbia offer an ABLE program and the majority of these allow enrollees from other states. As of 2024, there are 40 other states and the District of Columbia that impose an income tax; of those, 23 states (56 percent) offer some form of tax expenditure for contributions made to ABLE accounts. Twenty-one (91 percent) of these tax expenditures are structured as deductions. Although the value of a state's deduction is dependent on the specific income tax structure and rates used, Colorado offers the highest deduction cap. Similar to Colorado, four other states (17 percent) also allow their tax expenditures to be claimed on a per beneficiary basis. Of the other 22 states that have an ABLE program and offer a tax expenditure, 13 have also ended Medicaid Recovery practices.

Policy Consideration

If the General Assembly extends the ABLE Deduction, it could consider adding a purpose statement to statute. Statute [Section 39-21-304(1)(a), C.R.S.] provides that any bill that “extends an expiring tax expenditure must include a tax preference performance statement [i.e., a purpose statement] as part of a statutory legislative declaration.” As discussed, we were not able to definitively determine the purpose for the ABLE Deduction. We inferred two purposes based on the statutory purpose for the ABLE program and legislative testimony from the bill sponsors that created the ABLE Deduction. Adding a purpose statement to statute would eliminate potential uncertainty regarding the deduction's purpose and allow our office to more definitively assess the extent to which it is accomplishing its intended goal(s) if the deduction is extended.

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Early Childhood Educator Credit

Tax Expenditure Evaluation • February 2025 • 2025-TE3

The Early Childhood Educator Income Tax Credit (Credit) allows qualified early childhood education professionals (Educators) who obtain an Early Childhood Professional Credential (ECPC) to claim a refundable income tax credit. Under statute, Educators must obtain an ECPC, work for a state-licensed child care provider for at least 6 months of the year, and have an adjusted gross income (AGI) of \$75,000 or less for single filers, or \$150,000 or less for joint filers. The credit is currently available for Tax Years 2022 through 2025—expiring January 1, 2026—and in Tax Year 2022, prior to inflation adjustments, Credit amounts ranged from \$750 to \$1,500, depending on the ECPC Level of the Educator.

The General Assembly established the Credit to incentivize Educators who work at state-licensed child care providers to obtain an ECPC, or to increase their ECPC Level, in order to increase quality of care. Additionally, the General Assembly intended for the Credit to provide tax relief for these Educators, citing its concern with low industry wages leading to turnover, lower quality care, and scarcity of care.

Overall, we found that the Credit is likely meeting its purposes because most of the eligible population has used the Credit, and it provides a financial benefit to Educators. This financial benefit appears to be an incentive for Educators to obtain or retain their ECPC or increase their ECPC Level, but recent growth in the Educator workforce and Educators who hold an ECPC may also be due to broader state efforts to strengthen the workforce in recent years.

- Department of Revenue data for Tax Year 2022, the most recent year available, shows that 11,400 tax returns claimed the Credit. This represents a majority of Educators that Department of Early Childhood data shows also held an active ECPC for the year.
- Educators reported that the Credit ranged from a small incentive to obtain or increase their ECPC Level to a very strong incentive, with about 10 percent reporting the Credit as the only reason they pursued or renewed their credential. About 29 percent reported it did not have an impact on their decision. However, many stakeholders reported that the financial benefit was important to maintaining their current ECPC and provided Educators with a sense of validation and recognition for their job.
- Because the Credit is refundable, it is available to people who qualify, regardless of their tax liability. The Credit provides an average of \$1,200 to Educators, which may help Educators pay down debt, increase savings, or cover costs for additional training and education.

Policy Considerations

If the Credit is renewed, the General Assembly may want to consider amending the AGI limitations to adjust annually with inflation so Educators with wages close to the maximum do not become ineligible for the Credit.

Tax Type:	Income tax	Year Enacted:	2022
Expenditure Type:	Credit	Repeal/Expiration date:	2025
Statutory Citation:	§ 39-22-547, C.R.S.	Revenue Impact (2022):	\$14.2 million
Purpose given in statute or enacting legislation? Yes			



Early Childhood Educator Income Tax Credit

Background

The Early Childhood Educator Income Tax Credit (Credit) allows qualified early childhood education professionals (Educators) who obtain an Early Childhood Professional Credential (ECPC) to claim a refundable income tax credit.

To be eligible for the Credit, Educators must obtain an ECPC, work for an eligible child care provider (i.e., a state-licensed provider that meets state quality rating minimums) for at least 6 months of the year, and have an Adjusted Gross Income (AGI) of \$75,000 or less for single filers, or \$150,000 or less for joint filers. The annual Credit amount available is based on the level of ECPC the Educator obtains, and is adjusted each year based on inflation. In Tax Year 2024 the Credit amount ranged from \$852 to \$1,705.

According to statute, the General Assembly established the Credit to incentivize early childhood educators who work at state-licensed providers to obtain an ECPC, or to increase their ECPC level, in order to increase quality of care. Additionally, the General Assembly intended for the Credit to provide tax relief for these early childhood educators, citing its concern with low industry wages leading to turnover, lower quality care, and scarcity of care. [Section 39-22-547(1)(a) and (b), C.R.S.; House Bill 22-1010, Section 1 (Legislative Declaration)].

The legislative declaration for the enacting bill [House Bill 22-1010] cited the importance of investing in the early childhood educator workforce to provide quality education and care for children, and to enable parents to work. Educator workforce data from the Department of Early Childhood (CDEC) and University of Denver's Colorado Evaluation and Action Lab shows that, while the industry has suffered from recruitment, retention, and professional development barriers due to low wages and job demands for many years, the COVID-19 pandemic greatly increased these issues and resulted in several thousand professionals leaving the early childhood workforce, impacting quality of care and access to care across the state, especially in rural counties. Having early childhood education professionals with more education, experience, and skills can lead to better quality of care for children, which yields positive impacts on the children's health, safety, and development and provides stability for parents who need child care to maintain employment. Therefore, the General Assembly intended to create a financial incentive for Educators to increase

their skills and obtain a state-issued ECPC, or increase their ECPC Level (i.e., higher levels require more experience, education, and demonstrated skills), and to recruit and retain more Educators.

In addition to encouraging Educators to obtain or increase their credentials, in order to promote quality child care, the legislative declaration also cited the importance of tax relief for Educators due to low wages in the industry, impacting primarily women and women of color, which makes it difficult for these groups to achieve economic stability—one of the most common reasons Educators leave the early childhood workforce. According to the legislative declaration, early childhood educators earn less than half the salary of kindergarten teachers, their counterparts in elementary education. According to a study from the University of California Berkeley (U.C. Berkeley) Center for the Study of Child Care Employment, the poverty rate for early childhood educators in Colorado in 2022 was about 13 percent, which is significantly higher than the State’s overall poverty rate of 5.8 percent. Therefore, the General Assembly declared that “supporting the early childhood workforce with a targeted tax credit can support stability in the industry and, in turn, support working families, child development, and economic growth.”

Only two other states have a similar income tax credit for early childhood educators. Both Louisiana and Nebraska offer tax credits to early childhood educators to expand and retain the workforce in their states and increase the quality of child care. Louisiana’s tax credit is part of a broader package of tax incentives for early childhood professionals, child care facilities, families, and businesses and has been available since 2008. Nebraska’s credit was enacted in 2024, and similar to Louisiana’s credit, is part of a broader tax incentive policy that also provides credits to child care centers that participate in the State’s quality rating and child care subsidy program.

Credential Administration

The Colorado Department of Early Childhood (Department) manages the ECPC. To apply for the ECPC, individuals use the Department’s Professional Development Information System (PDIS), a workforce registry and professional development tool available to anyone in the early childhood workforce, to receive training and apply for job-related credentials. For the ECPC, the PDIS awards points based on four components (formal education, experience, ongoing professional development, and demonstrated competencies) to award a final score. Individuals must achieve a minimum score to receive the ECPC and are assigned an ECPC Level based on their score. The ECPC is valid for 3 years, after which an Educator must reapply for the ECPC. However, an individual may increase their Level at any given time while their ECPC is valid by submitting additional documentation of training, education, or experience. There are six ECPC Levels, with Level 6 being the most advanced. Exhibit 1 shows the components, point levels, and final ECPC Level assigned based on the combination of these factors.

Technical Note:

Prior to 2022, the Department of Education with oversight from the Office of Early Childhood within the Department of Human Services managed the Early Childhood Professional Credential system. However, in July 2022, the Department of Early Childhood was established as a new department, and began managing the Early Childhood Educator Credential (ECPC) and Professional Development Information System (PDIS).

Exhibit 1**Early Childhood Professional Credential Components and Scoring Guide**

Components	Component Description	Maximum Points
Formal Education	= Based on degree, area of study, ECE coursework, and Trainings of Special Recognition.	50
Ongoing Professional Development	= One point per clock hour for the training hours and/or CEUs earned in the last 3 years.	30
Experience	= One point for every year (1,820 hours) worked in the early childhood field.	20
Demonstrated Competencies	= Received qualifying score from an observation with an approved observation tool.	10

Credential Levels

Level 1	Level 2	Level 3	Level 4	Level 5	Level 6
10-20 points At least 2 components	21-35 points At least 2 components	36-50 points At least 3 components	51-60 points At least 3 components	61-70 points At least 3 components	71+ points At least 3 components

Source: Colorado Department of Early Childhood.

Credit Administration

The ECPC Levels determine the amount of the Credit that an individual is eligible to receive, with Educators at higher levels receiving larger credits. Exhibit 2 shows the Credit amounts for each ECPC Level for Tax Years 2022, 2023, and 2024. Amounts for Tax Year 2025 have not been calculated as of the date of this publication, and the Credit is currently set to expire January 1, 2026.

Exhibit 2**Credit Amounts by Early Childhood Professional Credential (ECPC) Level by Year**

Credential Level	2022	2023	2024
Level 1	\$750	\$850	\$852
Level 2	\$1,000	\$1,080	\$1,136
Level 3, 4, 5, and 6	\$1,500	\$1,620	\$1,705

Source: Statute Section, 39-22-547(3)(a) and (b) C.R.S., and Department of Revenue information on credit amounts adjusted for inflation.

In addition to obtaining their ECPC, to receive the Credit, Educators must work for a Department-licensed early childhood education provider. Licensed providers include child care facilities, preschools, and in-home care (i.e., family care homes), with some exceptions. Special schools or classes for single skill-building or religious instruction; short-term care for less than 3 hours; and in-home family child care that serves four or fewer unrelated children, with no more than two of the children under the age of two, are all legally exempt from licensing; Educators employed in unlicensed child care settings are not eligible for the Credit.

The Department annually provides the Department of Revenue (Revenue) with a list of all the individuals who have an ECPC and, therefore, are potentially eligible for the Credit. Individuals claim the Credit by completing the Early Childhood Educator Income Tax Credit form (Form DR 1703), which requires them to attest that they met each of the requirements to be eligible for the Credit.

Statute provides the following performance measures to evaluate whether this credit is meeting its purposes:

- The number of Credits claimed.
- A comparison of the number of ECPCs at various levels before and after the Credit became available.

In addition to the statutory performance measures, to evaluate whether the Credit is meeting its purposes we also measured the effectiveness of the Credit at incentivizing early childhood education professionals to obtain an ECPC, or to increase their credential level.

Evaluation Results

The Credit is likely meeting its purposes because eligible individuals are aware of and claiming the Credit, and it provides a benefit to Educators who obtain an ECPC or increase their ECPC Level. Some stakeholders also reported that the Credit is a valuable incentive that encourages Educators to obtain their ECPC or increase their ECPC Level. Overall, the number of Educators obtaining an ECPC has increased since the Credit became available; however, the State's broader efforts to stabilize and grow the early childhood education workforce coincide with the Credit, so the extent to which the incentive of the Credit has driven growth in ECPCs is not clear.

Uptake of the Credit is high among the eligible population. Based on Revenue data for Tax Year 2022, between 11,400 and 14,300 individuals claimed the Credit for a total benefit of about \$14.2 million and a corresponding revenue impact to the State. We could not determine precisely how many individuals claimed the Credit because joint filers claim the Credit using the same reporting line on their return, making it impossible to determine if the amount claimed on some

forms was for one or two individuals (e.g., two \$750 Credits or one \$1,500 Credit). However, the Credit usage appears to indicate a relatively high uptake of the Credit among eligible Educators. Although we lacked data necessary to determine the exact number of eligible individuals because we did not have the license number of the individuals' employers and could not validate employment, based on PDIS data for 2022, there were 24,800 Educators with an ECPC, of which 15,400 provided employment information in the PDIS that indicated they likely worked for a licensed provider and would be eligible for the Credit; assuming they worked for at least 6 months and did not exceed the Credit's income limitations. The remaining 9,400 Educators who held an ECPC were also potentially eligible for the Credit, but did not submit their employment information in the PDIS; employment information is not a requirement to obtain an ECPC. It is likely that some of these Educators did not work for a licensed provider and so were not eligible for the Credit. While data for Tax Year 2023 is not yet available, preliminary figures from Revenue suggest that the number of tax returns claiming the Credit has increased by about 2,000 tax returns from Tax Year 2022.

After speaking with the Department and surveying stakeholders, we found that awareness of the Credit is generally very high, as the Department, child care providers, and industry organizations were aware of and publicize the Credit. The Department includes information on the tax credit on its website and in its newsletter to people who have an account in the PDIS. Additionally, we surveyed individuals with a PDIS account about their knowledge of the Credit. Of the 87 respondents to our survey, 80 were aware of the Credit prior to our survey, and 58 had reported claiming the Credit. In addition to the high awareness of the Credit, its design as a refundable income tax credit allows all eligible taxpayers to claim the Credit regardless of their income tax liability.

In general, the Credit provides tax relief to qualified Educators, increasing their after-tax income by about \$1,200, on average. According to Revenue data for Tax Year 2022, about 11,400 returns claimed the Credit, for an average benefit per return of about \$1,245. According to a study from the Center for the Study of Child Care Employment (U.C. Berkeley), using data from the U.S. Census Bureau, as of 2022, the median hourly wage of a child care worker in Colorado was \$15.06; adjusted to an annual salary, the median annual wage was \$31,325. Therefore, the average Credit would have resulted in a tax benefit equivalent to a wage increase of about 4 percent, or about \$.60 per hour for a full-time child care worker. The actual benefit of the Credit varies based on the taxpayer's annual income, with the majority of taxpayers claiming the Credit as single filers with an AGI between \$20,000 and \$50,000; joint filers generally had an AGI between \$75,000 and \$150,000. These figures suggest that the average Credit amount claimed in 2022 could provide a monetary benefit of just under 1 percent up to 6 percent of annual income for the majority of taxpayers that claimed the Credit.

Additionally, in 2024, the Department contracted with a research organization to conduct focus groups with Educators who had claimed the Credit. The results from the focus groups showed that the Credit provided some financial relief for Educators, allowing focus group participants to pay off

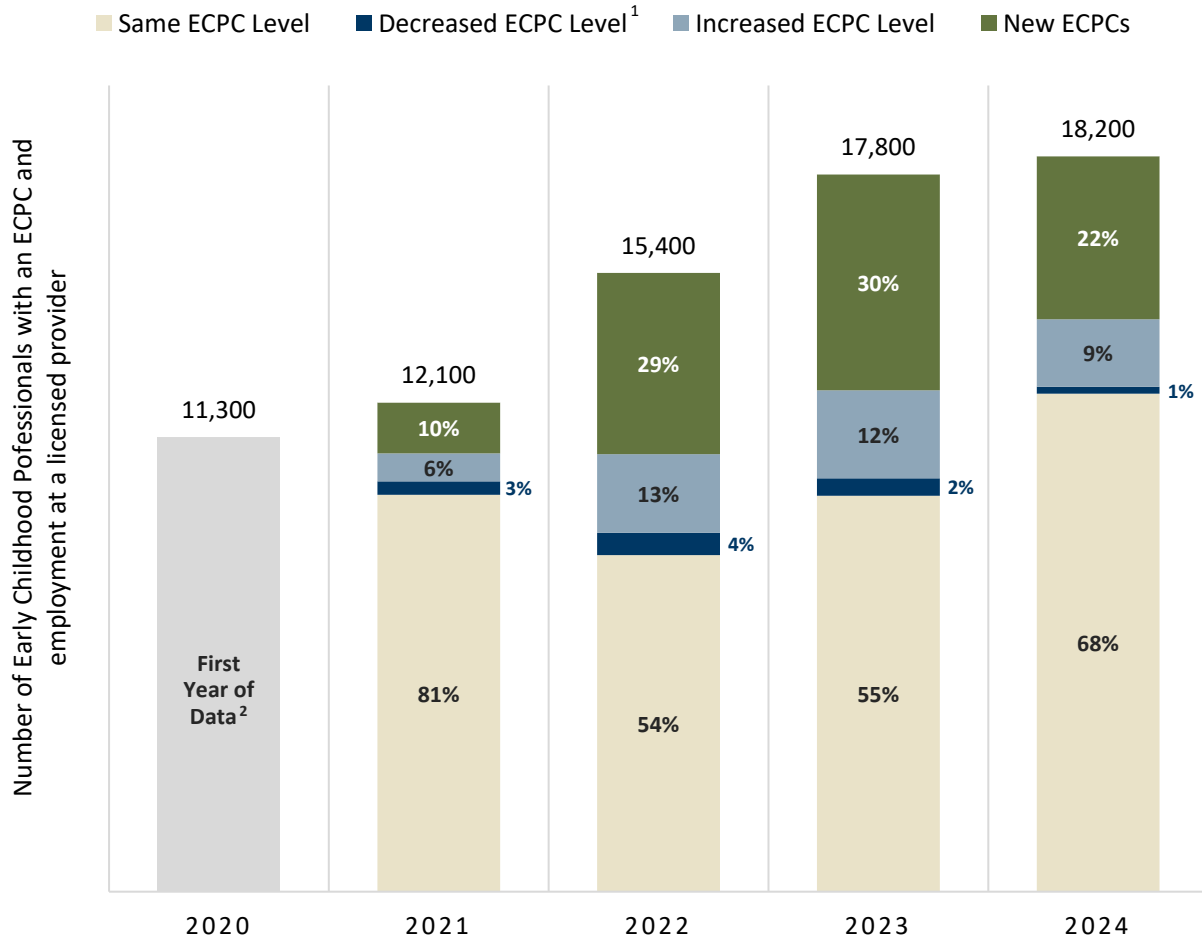
personal debt, increase their savings, afford basic needs like groceries, and pay for additional education. The study concluded that the Credit provides Educators with a sense of validation and recognition, having both a professional and emotional impact that can support overall job satisfaction.

Overall, the Credit provides some financial relief to Educators; however, it is not sufficient on its own to resolve low wages in the field that contribute to high turnover rates. For example, according to the Center for the Study of Child Care Employment (U.C. Berkeley) study, in Colorado a child care worker making the median wage of \$31,325, with no dependents, would fall short of a livable wage by about \$3 an hour. This gap between the median wage and livable wage increases to nearly \$23 an hour for an individual with a dependent. While the Credit provides a benefit, Educators still lack economic stability and opportunity due to low wages, which may continue to impact retention, especially for individuals who are in entry level positions and have the lowest wages and generally the lowest Credit amount.

There has been an overall increase in Educators who have obtained ECPCs, and the Credit appears to be an incentive for most Educators. However, broader state efforts to increase the size and quality of the early childhood workforce are also likely driving the increase. We found that between Tax Year 2021, the year before the Credit became available, and Tax Year 2024, the number of Educators who worked for a licensed provider and obtained an ECPC increased by about 50 percent. Additionally, there was an increase in the number of Educators who increased their ECPC Level from the previous year. Specifically, about 6 percent of Educators with ECPCs working for licensed providers increased their ECPC Level in 2021, compared to 13 percent in 2022 and 12 percent in 2023. Exhibit 3 shows the annual number of Educators who both held an ECPC and submitted employment information in the PDIS, and whether they earned their ECPC or maintained, decreased, or increased their ECPC Level.

Exhibit 3

Overall Increase in Educators with ECPC, January 2020 through October 2024, and Change in Educators Increasing ECPC Level Versus New ECPCs



Source: Office of the State Auditor analysis of Colorado Department of Early Childhood PDIS data for all Educators with an approved ECPC between January 2020 and October 2024, and who reported employment data.

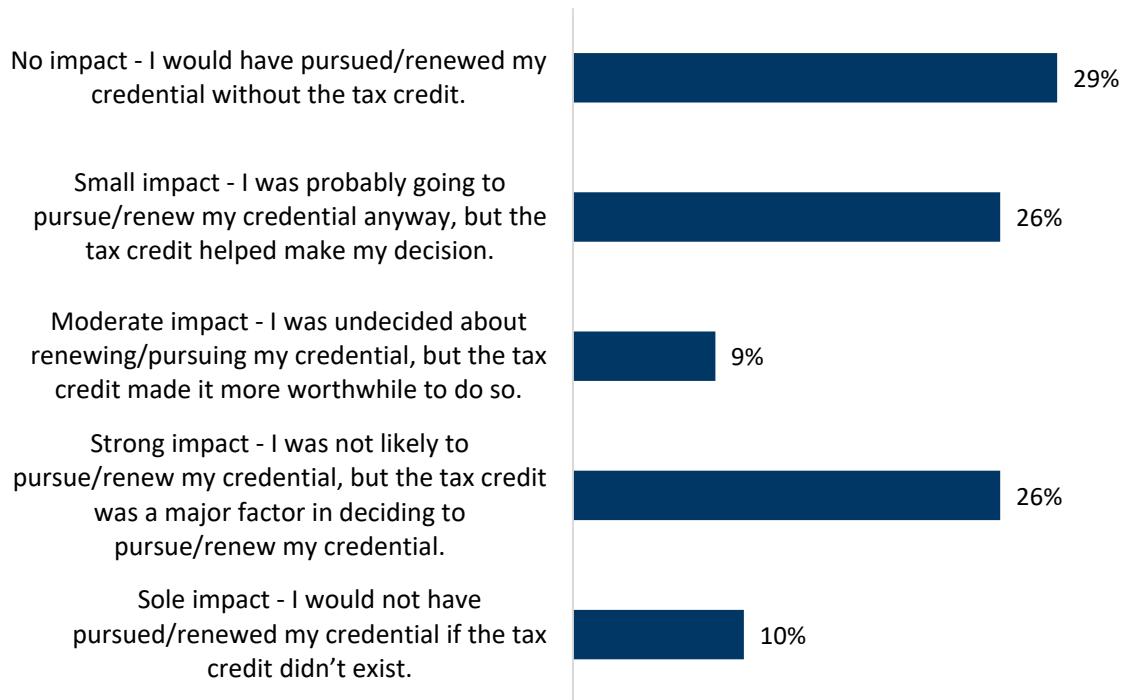
¹ ECPC's are valid for 3 years, at which point an Educator must reapply for the ECPC. Based on PDIS scoring factors an Educator's re-certification could result in a decreased ECPC Level.

² The 2020 data serves as a baseline year to measure changes in Educators' ECPC Levels and new ECPCs in the following years; therefore, a total count is provided but there are no changes to measure.

To determine whether the Credit acted as an incentive for Educators to obtain an ECPC or increase their ECPC Level, we surveyed Educators and received responses from 87 individuals, 58 of whom claimed the Credit. While the Credit at least partially incentivized most individuals who claimed it, about 29 percent reported that they would have pursued or renewed their ECPC without the Credit. Additionally, some of these respondents stated that their job required an ECPC, but the Credit was beneficial and acted as compensation to keep their credential current. Exhibit 4 shows the breakdown of responses to our survey question regarding the extent to which the Credit incentivized individuals' decisions to pursue or renew their ECPC.

Exhibit 4**Survey Response Results**

Survey Question: “To what extent did the credit incentivize you to pursue or renew your Early Childhood Education Professional Credential?”



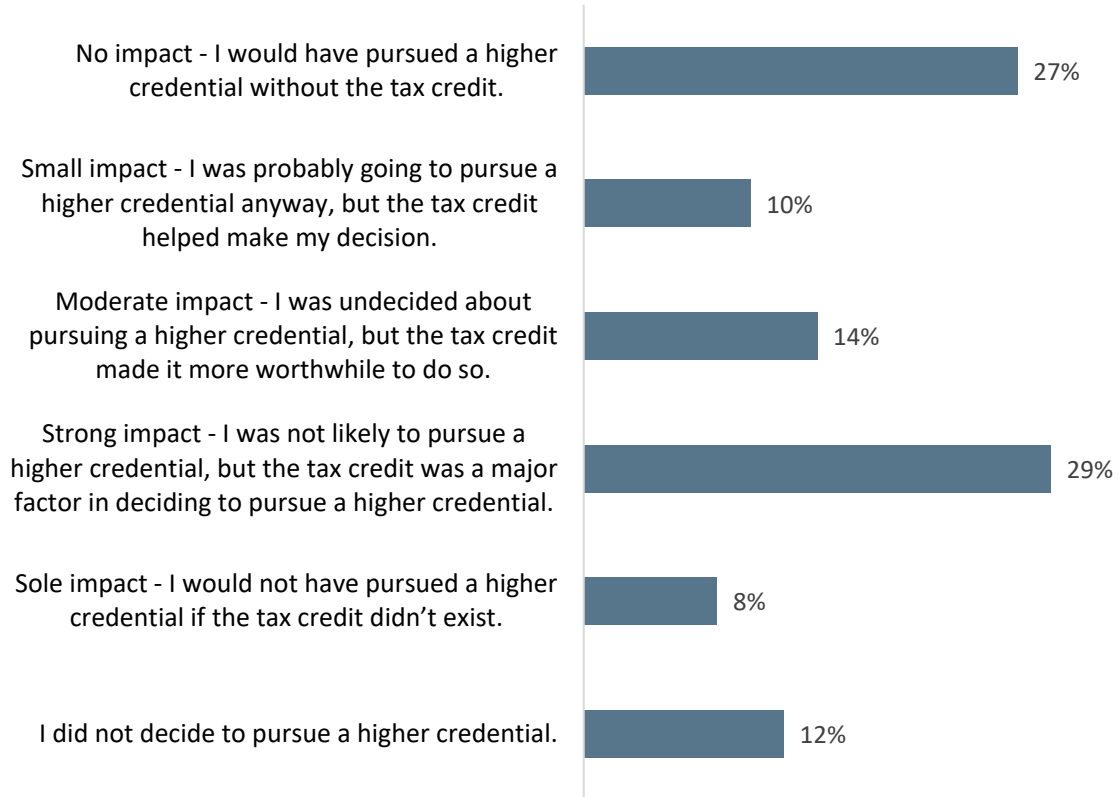
Source: Office of the State Auditor survey of early childhood education professionals, Fall 2024. There were 58 total survey respondents who reported claiming the Early Childhood Educator Tax Credit.

Additionally, for eligible individuals who were not at the highest ECPC Level (Level 6) and claimed the Credit, the Credit appeared to be a strong incentive for many of them to increase their credential level, with 29 percent stating that the Credit had a strong impact on their decision to pursue a higher credential level and another 8 percent saying the Credit was the sole reason they pursued a higher credential level. However, 27 percent reported that they would have pursued a higher credential level regardless of the Credit. Exhibit 5 provides a breakdown of responses to our survey question regarding the Credit's impact on individuals' decisions to pursue a higher ECPC Level.

Exhibit 5

Survey Response Results

Survey Question: “If the amount of the tax credit influenced you to pursue a higher credential level, how strongly would you say the additional tax credit amount influenced your decision?”



Source: Office of the State Auditor survey of early childhood education professionals, Fall 2024. There were 49 total survey respondents who reported claiming the Early Childhood Educator Tax Credit and would be able to increase their credential level (i.e., were not at a Level 6).

In addition to our survey, the Department’s recent focus group study reported that the Credit was a valuable tool to motivate Educators to apply for an ECPC or increase their credential level, especially since increasing skillsets do not always result in an increase in wages.

While the incentive provided by the Credit may have driven the increase in the number of Educators with ECPCs working for licensed providers to some extent, there are several other workforce and retention programs targeted at increasing and stabilizing the early childhood education workforce that may have also contributed to the increase. First, in recent years the Department has invested staffing and resources to improve its PDIS, promote the ECPC, and process applications faster. Since 2022, when the Department became responsible for the ECPC, the overall number of applications approved has increased significantly. In 2021, the Department of Education

(Education) approved about 1,500 ECPCs, and since 2022, when the Department became responsible for the credentialing process, the number of applications processed has grown from almost 9,000 in 2022 to almost 13,000 in 2024. These increases are reflective of both an increase in overall applications and the Department's application approval process improvement efforts, which has reduced approval time from a maximum of 2 months, down to 2 weeks. Second, it is possible that at least part of the increase in overall ECPCs may be attributed to already qualified Educators completing the application process. Data on whether an ECPC represents an Educator obtaining new skills, thereby increasing quality of care, versus obtaining a formal credential for skills and education they already possess is not available. Therefore, we could not conclude on the Credit's direct impact on improving the quality of child care in the state.

In addition to efforts to increase awareness of the ECPC and to process applications, the State has invested in multiple programs to address recruitment, retention, and training in the early childhood workforce. Using federal and state COVID-19 stimulus funds and block grants (e.g., American Rescue Plan Act, Coronavirus Response and Relief Supplemental Appropriations, State and Local Fiscal Recovery Funds, Child Care and Development Fund), the General Assembly appropriated almost \$750 million to address recovery and strengthen Colorado's early childhood sector. The Department has administered this funding since 2022 while convening multiple working groups to identify and implement strategies to strengthen the workforce, including:

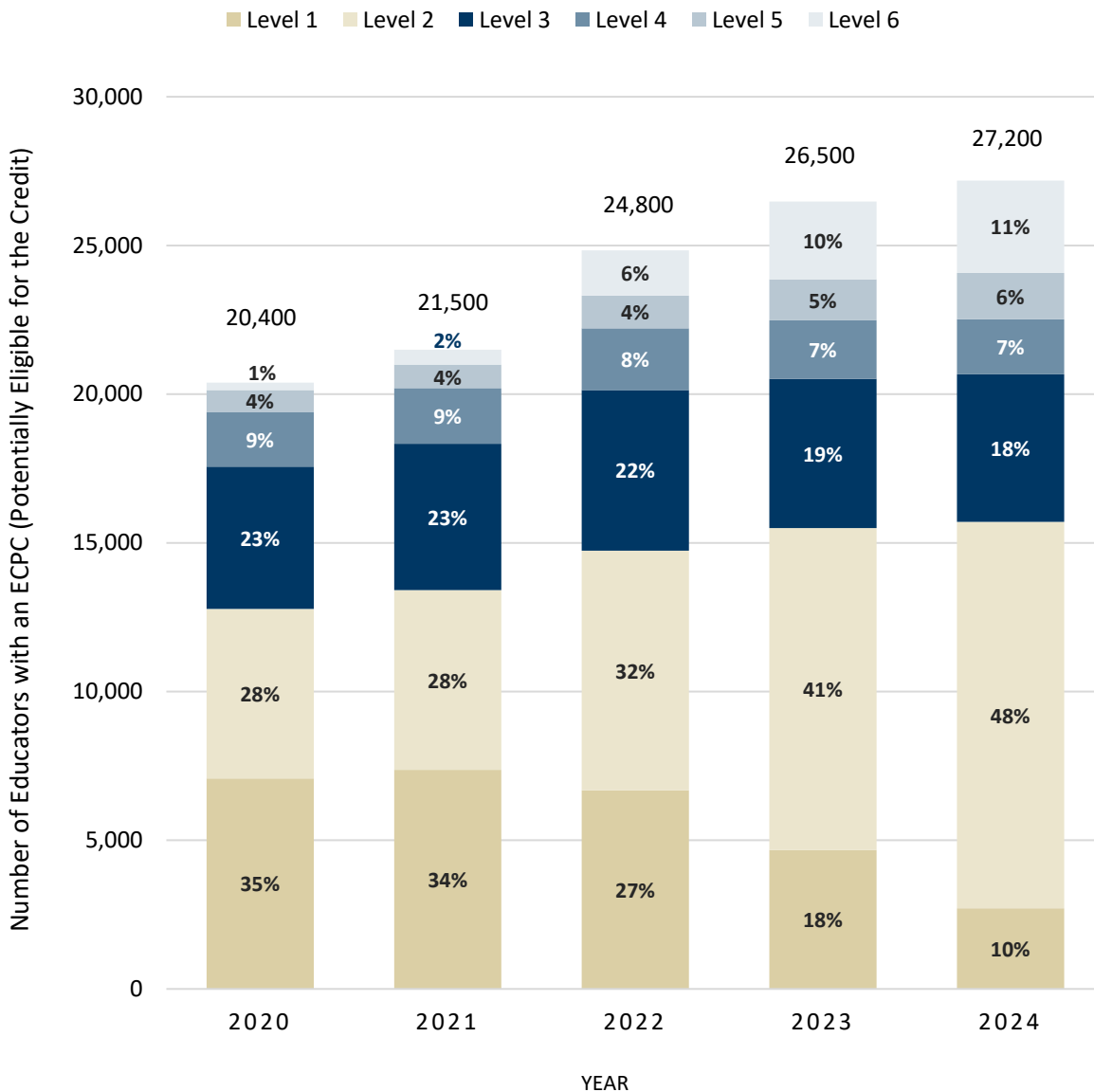
- Providing workforce stabilization grants to child care programs to invest in training programs, benefits, bonuses, and other support programs for their employees;
- Creating an apprenticeship program;
- Providing peer mentorship training;
- Providing financial support to the Child Development Associate Support Specialist program, an alternative to traditional higher education requirements in the workforce;
- Providing free training through the PDIS;
- Providing business training to center directors and family child care home providers to support business practices;
- Funding scholarships for higher education and providing loan forgiveness;
- Subsidizing access to substitute teachers to support time for educators to access professional development; and
- Piloting a program for wage increases for early childhood teachers and assistant teachers.

These investments, paired with the Credit, may help drive industry recruitment and retention. A University of Virginia study in 2020 found that providing cash grants to teachers significantly

reduced employment turnover in early childhood centers. In our survey to Educators, of the 87 responses, about 34 percent reported that they received some sort of financial assistance (e.g., partial tuition waivers, grants, scholarships) to pursue higher education or additional training aside from the Credit. The Department reports that since losing nearly 7 percent of professionals in the early childhood workforce during the COVID-19 pandemic, the workforce has begun to grow, reaching approximately 27,200 professionals who hold an ECPC, as of October 2024. Exhibit 6 shows the change in the number of Educators holding an ECPC, by Level, from January 2020 through October 2024. Overall, the number of Educators with an ECPC has increased by about 33 percent over the last 5 years, and a larger proportion of Educators with an ECPC have a Level 2, Level 5, or 6 than in 2020.

Exhibit 6

Summary of All Educators with an ECPC Between January 2020 and October 2024



Source: Office of the State Auditor analysis of Colorado Department of Early Childhood PDIS data for all Educators with a verified ECPC between January 2020 and October 2024.

Additionally, the General Assembly established the Qualified Care Worker Tax Credit in House Bill 24-1312, which will be available for Tax Years 2025 through 2028. This credit provides a benefit up to \$1,200 per taxpayer to child care workers who work at least 720 hours during the tax year and are registered in the PDIS; child care workers are eligible whether they work for a licensed provider or in an informal care setting such as family, friend, or neighbor child care. Although the credit's impact is not reflected in the data available for our current review, it could support efforts to increase recruitment and retention of early childhood educators in future years. However, this new credit does not provide an incentive for early childhood educators to obtain or increase their ECPC Level like the Early Childhood Educator Credit. Therefore, if the Early Childhood Educator Credit is not renewed, the number of Educators with an ECPC, or a higher Level ECPC may not be sustained. Additionally, the AGI limitation on the Care Worker Credit for joint filers is \$100,000, lower than the \$150,000 for the Early Childhood Educator Credit. Therefore, some joint filers who are currently eligible for the Early Childhood Educator Credit will not be eligible for the Care Worker Credit. The Care Worker Credit is also available to other direct care workers in long-term care settings, such as individuals employed in nursing facilities or home-based care.

Policy Considerations

If the General Assembly chooses to renew the Credit, it could consider amending the AGI cap to adjust with inflation. Currently, the maximum AGI limit to be eligible for the Credit is set at \$75,000 for single filers or \$150,000 for joint filers. While this is generally higher than the wages of most Educators, there are some instances when Educators' AGI, especially those who are married filing jointly, may exceed these AGI limits and the Educators may, therefore, become ineligible for the Credit. While data on the population of Educators who would be eligible but exceed the AGI limit is not available, 13 of the 87 taxpayers (15 percent) who responded to our survey noted that they could not claim the Credit because they were ineligible due to income limitations, and several noted that their joint filing status and partner's income made them ineligible for the Credit. When we spoke with stakeholders about these limitations, many recognized that funding for the Credit is limited, and therefore it should be prioritized towards Educators who are paid lower wages to address the economic stability of those most in need. However, the recent years of inflation and cost-of-living increases in Colorado may mean that some Educators may become ineligible for the Credit as their income increases and exceeds the AGI limitations, even though their wages relative to costs have remained the same. Therefore, the General Assembly may want to assess whether the current AGI limit continues to reflect the population that should be eligible for the Credit, and consider adjusting AGI limits for inflation if it decides to renew the Credit.

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Rural Jump-Start Tax Expenditures



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Tax Expenditure Evaluation • February 2025 • 2025-TE2

The Rural Jump-Start Program (Program) is a business incentive program originally established in 2016 to attract new businesses to rural, economically distressed counties known as Rural Jump-Start Zones (RJS Zones). The Program provides tax benefits to qualifying new businesses and qualifying New Hires that locate in Rural Jump Start Zones, including:

- A business income tax credit equivalent to 100 percent of businesses' tax liability (New Business Credit),
- A state sales and use tax refund on business purchases of goods used inside the RJS Zone (Sales Tax Refund),
- An income tax credit for RJS employees paid above the average county wage equivalent to 100 percent of the employees' tax liability (New Hire Credit),
- The full elimination of local property taxes on business tangible personal property, and
- Grant funding to qualifying businesses to cover operating expenses and new hire wages, available from Fiscal Year 2022 to 2025.

According to statute and committee legislative testimony, the Program's purpose is to attract new businesses to economically-distressed rural areas in the state to create or retain higher-paying jobs, spur economic growth, and address the still significant contraction of these local economies.

In general, the Program is meeting its purpose as it has attracted some new businesses and higher-paying jobs to some RJS Zones. However, the tax expenditures associated with the Program are largely underutilized and are not effective at retaining businesses in RJS Zones or creating higher-paying jobs. Additionally, businesses that have sustained jobs have mainly been concentrated in the most populous RJS Zones, while other economically distressed areas continue to struggle to attract and retain businesses.

- From the start of the Program in 2016, through June 2024, 32 of the 42 counties that met the statutory definition of "distressed" had formed a RJS Zone; during that time only 16 of those RJS Zones had a participating new business. As of June 2024, there were 28 participating businesses in 13 RJS Zones.
- A total of 56 businesses were approved to participate in the Program from 2016 to June 2024, however most businesses did not claim the New Business Credit, and it appears that none of the businesses claimed the Sales Tax Refund. Many businesses did not generate income to be able to use the New Business Credit, and the RJS Tax Expenditures do not appear to be support the long-term retention of most participating businesses. Of the 56 approved businesses, only 7 have completed at least one full, 4-year term and met the Program requirements, and 25 companies were approved but failed to meet Program requirements, closed, or left the Program. A total of 24 are active and still in their first 4-year term with the Program.
- The RJS Program assisted in the creation of a total of 836 new jobs in RJS Zones between 2017 and 2023, an average of about 119 jobs per year, generally concentrated in Mesa and Delta counties. However, with some businesses closing, experiencing turnover, or leaving the Program, only 374 of the 836 total jobs continued to be supported by the Program at the end of 2023. Additionally, wages for the majority of new jobs created did not exceed the county average wage, and for those jobs that did exceed county average wages such that the employees were eligible for the New Hire Credit, less than half of the eligible employees claimed the credit.

Policy Considerations

- The General Assembly may want to assess whether the New Business Income Tax Credit is sufficiently meeting the General Assembly's expectations for the Rural Jump-Start Program even though it is currently providing a limited benefit to taxpayers.
- The General Assembly could consider eliminating the New Business Sales and Use Tax Refund since it is not being used.
- The General Assembly could consider eliminating the New Hire Credit, since it does not seem to be incentivizing businesses to create many new, higher-paying jobs or helping to retain employees.

	New Business Tax Credit	New Hire Tax Credit	New Business Sales and Use Tax Refund
Tax Type:	Corporate/Individual Income	Individual Income	Sales and use
Expenditure Type:	Credit	Credit	Refund
Statutory Citation:	Section 39-30.5-105(1) C.R.S.	Section 39-30.5-105(2) C.R.S.	Section 39-30.5-105(3) C.R.S.
Year Enacted:	2015	2015	2015
Repeal/Expiration Date:	January 1, 2031	January 1, 2031	January 1, 2031
Revenue Impact:	\$184,825 (2022)		\$0 (2021)
Purposes given in statute or enacting legislation? Yes			

Rural Jump-Start Tax Expenditures

Background

The Rural Jump-Start Program (Program) was established in 2016 to attract new businesses to rural, economically distressed counties designated as Rural Jump-Start Zones (RJS Zones).

The Program provides tax benefits to qualifying new businesses and qualifying employees that locate in RJS Zones and, since 2021, has provided grant funding to qualifying businesses to assist with operating expenses and employee wages.

According to statute, the Program’s purpose is to “create or retain jobs in order to help address the still significant contraction of local economies in certain areas of the state” and “...by attracting businesses that are completely new to Colorado, economic growth will occur in distressed counties without negatively impacting other areas of the state.” [Section 39-30.5-102(2)(b) and (3), C.R.S.]

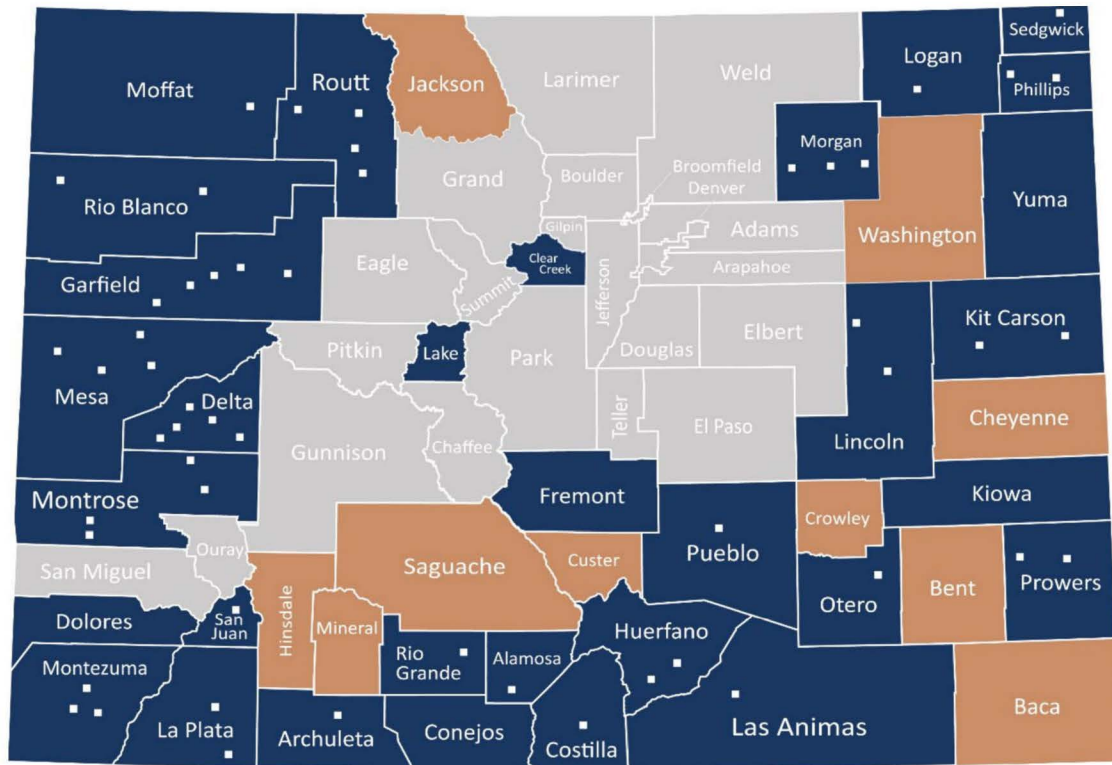
The Office of Economic Development and International Trade (OEDIT) and the Economic Development Commission (Commission) jointly administer the Program. Under statute, the Commission determines the rural counties in Colorado that are “distressed” and therefore, can apply for RJS Zone designation based on statutory criteria (see Technical Note). A distressed county must partner with a local “sponsoring entity,” which must be either a designated state institution of higher education (DIHE) or an approved economic development organization (EDO), to apply to the Commission to become a designated RJS Zone. Municipalities located within a RJS Zone (i.e., participating county) may choose to participate in the Program, but they are not automatically eligible just because they are located in a RJS Zone. As part of the Zone formation process, counties and municipalities that participate in the Program must agree to either eliminate the business personal property tax (e.g., local taxes on the value of business equipment, machinery, security systems, furnishings) for all participating Rural Jump-Start businesses, or agree to eliminate the tax for specific participating businesses (i.e., on a case-by-case basis). Counties and municipalities participating in the Program have the option to provide additional incentives to approved businesses, such as local sales tax exemptions. Once the Commission approves the county and participating municipalities as a RJS Zone, new businesses within the RJS Zone are eligible to apply for the Program.

Technical Note:

According to statute, a county is considered “distressed” if it has a population of less than 250,000 and reflects specified indicators of economic distress, such as per capita income substantially below the statewide average, unemployment levels during the last 5 years that are substantially above the statewide average, a net loss of people of workforce age during the last 5 years, or failure to recover from a loss of workforce over the last 10 years [Section 39-30.5-103(4), C.R.S.].

As of June 2024, 42 of Colorado’s 64 counties (66 percent) have been designated as “distressed” and 32 have formed RJS Zones. Within the RJS Zone counties, 53 municipalities are participating in the Program. Exhibit 1 shows the current counties that are designated as “distressed,” the counties that are approved RJS Zones, and the municipalities in the RJS Zones that are participating.

Exhibit 1

Designated Rural Jump-Start Counties and Participating Municipalities¹ as of June 2024

■ RJS Zones

■ Economically-distressed rural counties that have not formed RJS Zones

County	Municipality	County	Municipality
Alamosa	■ Alamosa	Mesa	■ De Beque
Archuleta	■ Pagosa Springs		■ Fruita
Clear Creek	○		■ Grand Junction
Conejos	○		■ Palisade
Costilla	■ San Luis	Moffat	■ Craig
Delta	■ Delta	Montezuma	■ Cortez
	■ Cedaredge		■ Dolores
	■ Hotchkiss		■ Mancos
	■ Orchard City	Montrose	■ Montrose
	■ Paonia		■ Naturita
Dolores	○		■ Nucla
Fremont	○		■ Olathe
Garfield	■ New Castle	Morgan	■ Brush
	■ Glenwood Springs		■ Fort Morgan
	■ Parachute		■ Wiggins
	■ Rifle	Otero	■ La Junta
	■ Silt	Phillips	■ Haxtun
Huerfano	■ La Veta		■ Holyoke
	■ Walsenburg	Prowers	■ Granada
Kiowa	○		■ Lamar
Kit Carson	■ Burlington	Pueblo	■ Pueblo
	■ Vona	Rio Blanco	■ Meeker
Lake	○		■ Rangely
Las Animas	■ Trinidad	Rio Grande	■ Monte Vista
La Plata	■ Durango	Routt	■ Hayden
	■ Ignacio		■ Oak Creek
Lincoln	■ Hugo		■ Steamboat Springs
	■ Limon		■ Yampa
Logan	■ Sterling	San Juan	■ Silverton
		Sedgwick	■ Julesburg
		Yuma	○

Source: Office of the State Auditor analysis of designated Rural Jump-Start Zones from the Office of Economic Development and International Trade.

¹A dash indicates a county without a participating municipality.

To qualify for program benefits, a “new business” must apply to a sponsoring entity (i.e., a DIHE or EDO) to participate in the Program. If the sponsoring entity agrees to work with the business, the new business then submits a Program application and a memorandum of understanding with the sponsoring entity to the Commission for approval. For the purposes of the Program, statute outlines that at a minimum a new business “is not operating in the state at the time it submits its application...to participate in the [Program],” [39-30.5-103(7)(a), C.R.S.]. OEDIT's program guidelines outline that the business must be:

- A startup not yet operating;
- A business based outside of Colorado, not currently operating in Colorado;
- A new joint venture between companies; or
- A newly created division of a company. The company may or may not be operating in Colorado at the time it creates the division.

To qualify for the Program, a business must also add to the local economic base and export goods and services outside of the RJS Zone (i.e., it must sell goods and services outside of the zone, thereby bringing additional dollars into the local economy); cannot be moving existing jobs in the State into the RJS Zone; and cannot be substantially similar in operation to or directly compete with the core function of a business operating in the same, or an adjacent, economically-distressed county, even if that county is not a designated RJS Zone.

Once a business has been approved for the Program and is participating, it must do the following to remain in the Program:

- Employ a minimum number of individuals who work full-time; are employed with the business for at least 6 months; work in the RJS Zone at least 80 percent of the time; and have annual wages that meet or exceed the average wages for the county. These individuals are defined as “New Hires” and businesses are required to employ at least one New Hire by the end of the business’s first year in the Program.

New Hires —If the business is located in a county with a population of at least 100,000 people, the business must employ at least three New Hires by the end of its second year, and at least five New Hires by the end of its third year. If the business is located in a county with a population of less than 100,000 people, it must employ at least two New Hires by the end of its second year, and at least three New Hires by the end of its third year.

- Submit an annual report to the Commission by the last day of February of the current year that provides required information about the prior year’s business operations and eligible New Hires.

The Program has three state-level tax expenditures, which are the focus of this evaluation, referred to collectively in this report as the RJS Tax Expenditures. Qualifying businesses can claim the New Business Income Tax Credit and New Businesses Sales and Use Tax Refund, while qualifying New Hires are eligible to claim the New Hire Income Tax Credit. Each of the RJS Tax Expenditures is available for 4 consecutive tax years and taxpayers can receive an additional 4-year extension with Commission approval (i.e., a business can participate in the Program for eight years total).

1. **New Business Income Tax Credit (New Business Credit):** Participating businesses receive an income tax credit equal to 100 percent of their annual state income tax liabilities for business activities that occur in the RJS Zone. New businesses benefit directly from this credit with their employees and the local

communities where the new businesses locate possibly receiving an indirect benefit to the extent that the credit encourages businesses to create new jobs and increase economic activity within the area they locate.

2. **New Business Sales and Use Tax Refund (Sales Tax Refund):** Participating businesses can apply for a refund of all state sales and use taxes paid on purchases of goods that are used solely within the RJS Zone. Participating businesses benefit directly from this credit, along with their employees, the local communities where the businesses locate, and vendors possibly receiving an indirect benefit to the extent that the refund encourages businesses to create new jobs, increase economic activity in RJS Zones, and make additional purchases.
3. **New Hire Income Tax Credit (New Hire Credit):** Qualifying New Hires are eligible for an income tax credit equal to 100 percent of the New Hires' annual income tax liability on wages earned from the participating businesses. New Hire employees, which may include the owners of the business, are the direct beneficiaries of this credit with the new businesses being indirect beneficiaries to the extent that the credit helps attract and retain employees. There is a cap of 200 credit certificates that OEDIT can issue to New Hires employed by all new businesses in each RJS Zone per year, although starting in 2024 the Commission has the discretionary authority to increase this to 600 credit certificates per year.

In addition to the RJS Tax Expenditures, participating businesses are also eligible for Program grant funding; OEDIT was appropriated \$3 million for Program grants for Fiscal Years 2022 through 2025. Specifically, new businesses can be awarded:

- **Working Capital Grants** for establishing operations in a RJS Zone. OEDIT awards grants of up to 25 percent of the business's documented operating expenses. Businesses can receive a maximum of \$20,000 in grants, unless they are operating in a "tier one transition community," (see technical note) in which case businesses are eligible for \$40,000 in grant funding.
- **New Hire Grants** for each new employee who qualifies as a New Hire (i.e., works in the RJS Zone at least 80 percent of the time, has been employed by the business in the RJS Zone for at least 6-months, is employed full-time, and is paid an annual salary above the county average wage). OEDIT awards grants based on the number of New Hires a business reports for the year. Businesses can receive a maximum of \$2,500 in grants per New Hire, unless they are operating in a "tier one transition community," in which case businesses are eligible for \$5,000 per New Hire. In contrast to the New Hire Credit, which directly benefits the newly hired employee, the New Hire Grants directly benefit the business. A business can receive the grant for any individual, qualified New Hire; there is no hiring threshold that must be met, as is the case for the business to qualify for the New Business Credit.

Technical Note:

Statute defines "Tier One Transition Communities" as communities that have been determined to be experiencing significant economic disruptions due to the contraction of the coal power industry [Section 39-30.5-103(12), C.R.S.].

Participating businesses can receive Working Capital Grant funds as soon as they submit proof of expenses to OEDIT; however, in order to receive New Hire Grants, or any of the RJS Tax Expenditures, businesses must wait until February of the following year, when they submit their annual report to the Commission confirming they have met Program requirements documenting business operations, including the number of employees hired and their wages. OEDIT staff and the Commission then review the report to determine whether the business qualifies for Program benefits. Upon approval by the Commission, OEDIT then issues credit

certificates to the business and any qualified New Hires. OEDIT provides the Department of Revenue (Department) with an electronic report of each new business that has been approved for credits for the preceding calendar year. Taxpayers must fill out a Rural Jump-Start Zone Credit Schedule to determine the amount of income tax credits they can claim and attach the credit certificates when they file their tax returns with the Department. To receive the Sales Tax Refund, participating businesses must submit directly to the Department proof of sales and use tax paid and a refund form.

The Office of the State Auditor (OSA) last conducted an evaluation of the RJS Tax Expenditures in 2019 and published the evaluation in 2020. We concluded that the expenditures were likely meeting their purpose to some extent, although their impact on distressed counties in the State was limited. At the time, only Mesa County had any businesses approved and operating in the Program, which limited its impact on distressed counties statewide. Since then, the General Assembly has made several significant changes to the Program with the goal of expanding participation. These changes include the addition of the business grants, the addition of an FTE for OEDIT to manage the Program and conduct outreach, and changes to allow businesses to participate in the Program if they do not compete with another local business or a business in an adjacent, distressed county, regardless of whether the adjacent county is a designated RJS Zone (prior to the changes, businesses had to show that they would not compete with an established business *anywhere* within Colorado).

Additionally, during the 2024 Legislative Session, the RJS Tax Expenditures' expiration dates were extended from the end of Tax Year 2025 to the end of Tax Year 2030, the Program grants were extended through the end of Fiscal Year 2025, and the General Assembly reduced the number of qualified New Hires a business must employ from five to three if they are operating in a county with a population under 100,000 people; of the counties participating in the Program as of June 2024, all of them except Mesa and Pueblo had a population under 100,000 people. Based on interviews with OEDIT staff, the requirement of five New Hires was a significant challenge for new businesses operating in more rural areas. This report does not include an evaluation of the impact of these changes, as they occurred during our evaluation of the RJS Tax Expenditures and not enough time has passed to assess their effects.

Rural Economic Challenges and Other Programs in the State

According to the Economic Innovation Group, a bipartisan economic development policy organization, rural areas lag behind non-rural areas on nearly every measure of economic well-being from poverty rates to labor force participation. In general, many rural areas have been experiencing population decline following the Great Recession due to a natural decrease in population (fewer births and more deaths), as well as greater rates of out-migration compared to in-migration. Technological automation has also reduced employment in agricultural, manufacturing, and mining industries, which have long been more prevalent in rural economies. A shrinking labor pool is less attractive to outside firms scouting locations, and shrinking job opportunities can drive more out-migration of rural workers. One strategy to counter this cycle is to focus, as the Program does, on developing entrepreneurship and startups in these locations. According to the Federal Reserve, entrepreneurship, or the rate of self-employed business proprietors, is highest in the most remote rural communities.

New businesses and startups are generally associated with regional economic growth and significant levels of job creation relative to other businesses. However, rural areas pose a number of challenges for new businesses and startups, such as difficulty accessing funds and business services, both of which are generally concentrated in urban centers; higher costs for transportation and communication; and insufficient workforce in terms of numbers and/or skill or education level of potential employees. Rural areas also experience difficulty in

developing innovative and specialized businesses, which are more likely to yield economic growth. Entrepreneurs tend to start new businesses in their current location and within industries in which they already have experience. Therefore, rural entrepreneurs are more likely to create businesses in industries that already have a presence in the local economy, which are in turn less likely to be high-growth, innovation-oriented industries and are more likely to serve local needs rather than exporting goods or services outside of the area.

Another type of “new business” the Program attempts to incentivize to locate in RJS Zones are existing, larger businesses that are opening a new division or relocating to Colorado. According to OEDIT, while these businesses represent a smaller number of the businesses participating in the Program, they have had an outsized impact on job creation and tax expenditures claimed.

OEDIT reports that the Rural Jump-Start Program is one of several programs providing financial assistance and business development tools to address the contraction of the state’s rural economies, which is a perennial challenge that has no easy solutions. In addition to the Program, Colorado also has many other programs intended to incentivize economic activity and growth in rural, economically distressed communities, including:

- The Enterprise Zone Program, which is a geographically-targeted set of state income and sales tax incentives administered by OEDIT that is available to businesses located in areas of the state that are experiencing economic difficulties. The total amount of Enterprise Zone credits certified in Fiscal Year 2023 was \$148 million, though it is likely that some of the credits certified will not be used.
- The Strategic Cash Fund Incentive, another OEDIT-administered program that provides cash incentives to businesses for the expansion or relocation of projects for which Colorado is in competition with at least one other state, and the company has received a commitment of local government funding that matches any requested state government incentives. Cash payments are made over five years to companies that create and maintain new permanent jobs in Colorado. The total amount provided to businesses in Fiscal Year 2024 was \$6 million.
- The Job Growth Incentive Tax Credit, an OEDIT administered program that allows qualified businesses in Colorado to claim an income tax credit if they choose to locate in Colorado over another state or country and create net new full-time jobs paying above the county average wage. The total amount of Job Growth Incentive credits certified in Fiscal Year 2024 was \$39 million, though it is likely that some of the credits certified will not be used.
- Coal Transition Community Grants, administered by OEDIT and the Office of Just Transition within the Colorado Department of Labor and Employment, which are used to support long-term transition strategies in communities historically reliant on the coal industry, but facing a loss of coal industry operations. Between January 2023 and June 30, 2024, OEDIT awarded four of these grants totaling \$1.3 million to Colorado businesses.
- The Rural Economic Development Initiative, administered by the Department of Local Affairs, which provides a variety of grants intended to help rural communities diversify their economy. For the purposes of the program, a rural community is defined as a county with a population of less than 50,000 or a municipality with a population of less than 25,000. Since 2021, the program has provided about \$7.1 million in grants for projects in rural counties; \$5.9 million of which went to 20 counties that are also RJS Zones.

- Federal Opportunity Zones, which support development in economically distressed areas of the country by providing federal capital gains tax deferral and exemptions to taxpayers who invest in Qualified Opportunity Funds.
- Local government economic development programs, which vary by local jurisdiction and can include property tax abatements for specific businesses, sales tax exemptions, loan and bond programs to provide up-front funding for businesses and/or development projects, and local economic development agencies that can provide financing, grants, and education and assistance for businesses.
- The Colorado Small Business Development Center Network, which provides free consultation and free, or low-cost training programs for businesses.

Under Section 39-30.5-105(4), C.R.S., businesses that claim the Program's benefits cannot claim any other tax incentives provided under Title 39, C.R.S., that the business would be eligible for due to establishing the new business in the State. For example, a business could not claim RJS Tax Expenditures and also Colorado's Enterprise Zone New Employee Credits or Job Growth Tax Credits. Businesses that receive benefits from the RJS Program may claim tax credits for programs that do not incentivize establishing a new business and hiring new employees. For example, a business receiving benefits from the Program could also claim the Enterprise Zone Investment Tax Credit, the Historic Preservation Tax Credit, or the Advanced Industry Accelerator Grant.

Performance Measures

Starting in 2020, the General Assembly required OEDIT to produce an annual report on the Program that includes the metrics below, indicating that it intended for this information to assist the OSA when evaluating the RJS Tax Expenditures:

- The number of approved RJS Zones.
- The distribution of new businesses across RJS Zones.
- The number of RJS Zones that have graduated from the Program (i.e., the county no longer meets the definition of "distressed"), including a comparison of such numbers before and after the Program's renewal in 2020.
- The type and active/inactive status of each approved new business, including whether the business is in an advanced industry (i.e., advanced manufacturing; aerospace; bioscience; electronics; energy and natural resources; infrastructure engineering; and information technology [Section 24-48.5-117(2)(a), C.R.S.]), and a comparison of the number of approved and active new businesses over time.
- Evidence of any ancillary economic development occurring in any RJS Zone as a result of the Program.
- The number of individuals hired by a new business that do not meet the New Hire definition.

We have incorporated these OEDIT-reported metrics, when available and appropriate, into our review of the RJS Tax Expenditures using the following performance measures:

- To what extent have the RJS Tax Expenditures helped attract and retain new businesses in active RJS Zones?
- To what extent have the RJS Tax Expenditures encouraged job growth and contributed to the creation of higher-paying jobs in RJS Zones?

Evaluation Results

Attracting and Retaining New Businesses

The RJS Tax Expenditures have helped attract some new businesses to locate in RJS Zones, but the expenditures have not provided a significant financial benefit to help retain the businesses.

Between 2016, when the Program started, and June 2024, a total of 56 businesses have qualified to participate in the Program. Based on our discussions with stakeholders and surveys of business participants, it appears that the RJS Tax Expenditures likely had a positive influence on some of the participating businesses' decisions to locate in RJS Zones. Specifically, we surveyed participating businesses and 5 of the 8 respondents to our survey rated the New Business Credit and the Sales Tax Refund as "highly influential" in their decision to locate in a RJS Zone, and 4 of 8 said the same of the New Hire Credit. However, all eight respondents reported that other factors, such as affordable housing, cost of doing business, quality of life, geographic location, or infrastructure quality, were most important in determining their business location. Additionally, while the availability of the RJS Tax Expenditures may have been an important consideration for many qualifying businesses, it is likely that some of them would have located in RJS Zones regardless of the Program's tax benefits. Numerous reviews of state job creation tax incentives, including tax credits, by academics, think tanks, and state legislative fiscal offices have concluded that incentives can have some effect in shaping business location decisions, but in many cases, businesses would choose to locate in a state regardless of the incentive.

Most businesses and employees are not claiming the tax expenditures, and for those that have, the expenditures provide a relatively small amount of financial support. Based on Department individual tax return data, which is only available in even numbered years for Tax Years 2016, 2018, and 2020—we found that less than 15 percent of participating businesses claimed the New Business Credit. Due to taxpayer confidentiality requirements, we cannot disclose the exact number or dollar amount of New Business Credits that were claimed. It is likely that many participating businesses did not claim the credit because they did not have any tax liability to offset with a credit, which is common among new businesses because they are often not profitable in their initial years. However, the majority of businesses that responded to a survey question regarding the New Business Income Tax Credit indicated that they had not yet used the credit but planned on using it in future years when they have an income tax liability, so is possible that the number of businesses that claim the New Business Credit will increase if some startup businesses begin to become profitable in future years and OEDIT conducts additional education and outreach, attracting more businesses to the Program.

We also found that no businesses claimed the Sales Tax Refund despite some likely having made purchases of supplies and equipment that would have qualified, since any purchase directly used by a qualifying business in the RJS Zone is eligible. We do not know why businesses are not claiming the refund, but it might be that some businesses are not aware of it, or that some purchases, such as machinery and wholesale transactions, are already exempt from sales tax under other tax expenditure provisions. It could also be that, in particular for

smaller purchases, the administrative cost of filing the required forms and documentation with the Department to claim the Sales Tax Refund outweighs the financial benefit the businesses would receive from the refund, which is equivalent to 2.9 percent of the eligible purchases. However, if businesses make more significant purchases in the future, they might choose to claim the refund since the financial benefit would be greater.

Finally, we found that few employees of the participating businesses claimed the New Hire Credit. For Tax Years 2018 and 2020—the most recent years with available taxpayer and OEDIT data—out of 10 businesses with New Hires, only four had employees that claimed the credit, and less than half of the New Hires that were eligible for the credit claimed it. In Tax Year 2021, the Commission approved over \$300,600 in New Hire Credits, but Department data for 2021, which aggregates the amount claimed for both the New Businesses and New Hire Tax Credits, showed that taxpayers claimed only \$136,000 for both credits combined, indicating that many eligible taxpayers continued to not claim the New Hire Credit.

This lack of use could be driven by a lack of awareness. Only 3 of the 6 businesses that responded the survey questions regarding the New Hire Credit reported that employees were made aware of this benefit before they were hired. Therefore, many employees may not be aware of the credit and may not use the credits available to them. Additionally, based on feedback from OEDIT, RJS business participants, and the Department, as well as our own review of claims for the credit, a significant number of the taxpayers have experienced some kind of difficulty in claiming the New Hire Credit, typically due to missing credit certificates or forms or miscalculating the credit amount. Currently, the Department uses one form for both the New Business Credit and New Hire Credit, which may create confusion for taxpayers. Both the Department and OEDIT noted that they are working on these administrative and awareness issues. Specifically, the Department has revised the instructions for the credit form starting in Tax Year 2024 to help alleviate confusion in the future, and, since 2023 the Department and OEDIT have provided specific training to participating businesses and employees on claiming the credit.

Due in part to the challenges associated with claiming them, the RJS Tax Expenditures typically have not provided a significant financial benefit to participating businesses and their employees, and the RJS Tax Expenditures have not likely supported and helped retain businesses that participate in the Program.

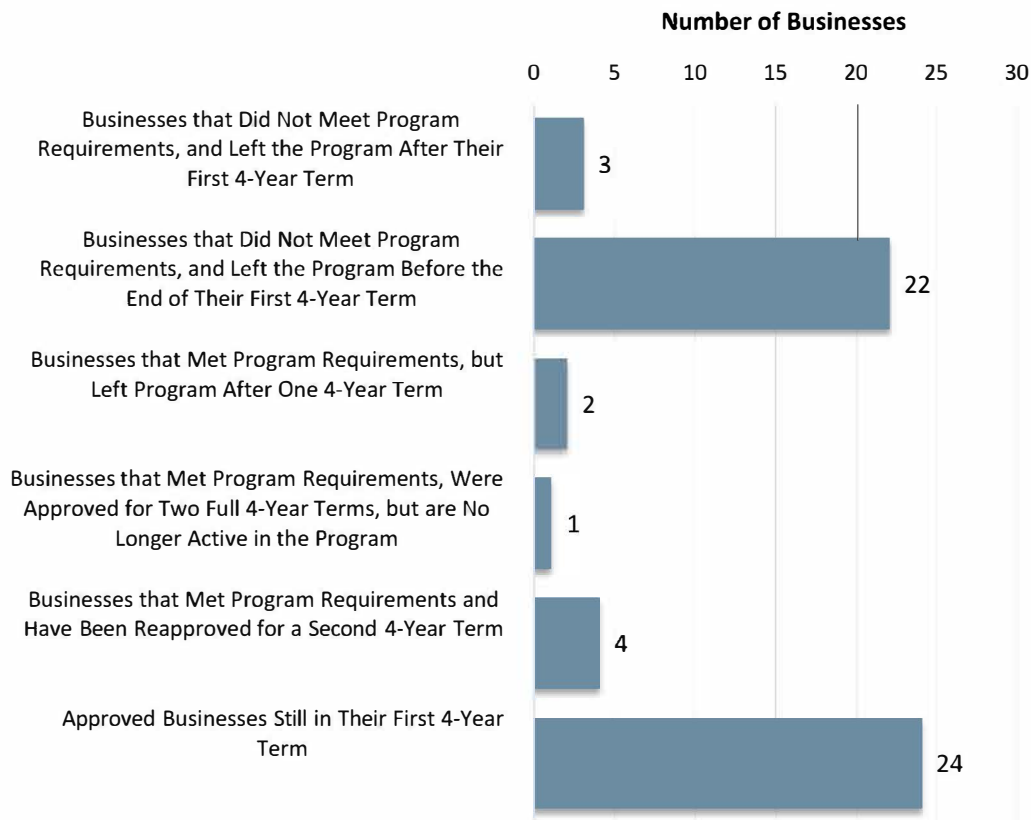
For most Program participants, especially newer businesses, the Program grants have provided more financial support than the RJS Tax Expenditures in recent years. We found that between 2016 and 2022—the most recent tax year available of aggregated data—taxpayers claimed about \$537,600 in New Business and New Hire Credits combined; while we cannot report on the specific number of businesses and amount of credits claimed due to taxpayer confidentiality requirements, less than 15 percent of the participating businesses between Tax Years 2016 and 2020 claimed the New Business credit. Additionally, no businesses claimed the Sales Tax Refund. In contrast, OEDIT has awarded \$1.6 million in Program grants to 35 participating businesses between Fiscal Years 2022 and 2024. Of the \$1.6 million in grants awarded, as of December 2024, \$646,300 has been paid out to 28 businesses. In addition to providing a larger benefit, access to capital through grants is typically more valuable to new businesses than tax credits because they are provided up front, instead of after businesses file their tax returns, and provide a more certain benefit because they are not dependent on businesses having a tax liability.

Most businesses do not graduate from the Program. Ideally, new businesses will not just locate to RJS Zones, but grow and maintain a presence there even after they are no longer eligible to participate in the

Program. However, we found that a significant number of businesses that start the Program do not stay in the Program because they either fail to meet the hiring requirements or go out of business. As of June 2024, of the 56 businesses that had been approved for the Program, 25 (45 percent) were removed from the Program either because they did not meet Program requirements (e.g., meeting New Hire requirements or submitting annual documentation) or the business closed; 22 of these businesses left the Program before the end of their first 4-year term. This is a higher rate of business attrition than retained businesses; only 7 businesses (12.5 percent) had completed a full 4-year term meeting the New Hire requirements. Of these 7 businesses, 5 were re-approved for a second 4-year term, and 4 are still active in the Program. The remaining 24 businesses (43 percent) were still in their first term, with only 1 having met or exceeded the requirement to have 5 New Hires. Exhibit 2 shows the business outcomes for the 56 approved businesses, as of June 2024.

Exhibit 2

Rural Jump-Start Program Businesses Outcomes for All Approved Businesses Between 2016 and June 2024



Source: Office of the State Auditor analysis of Office of Economic Development and International Trade's Rural Jump-Start Program business data for 2016 through June 2024.

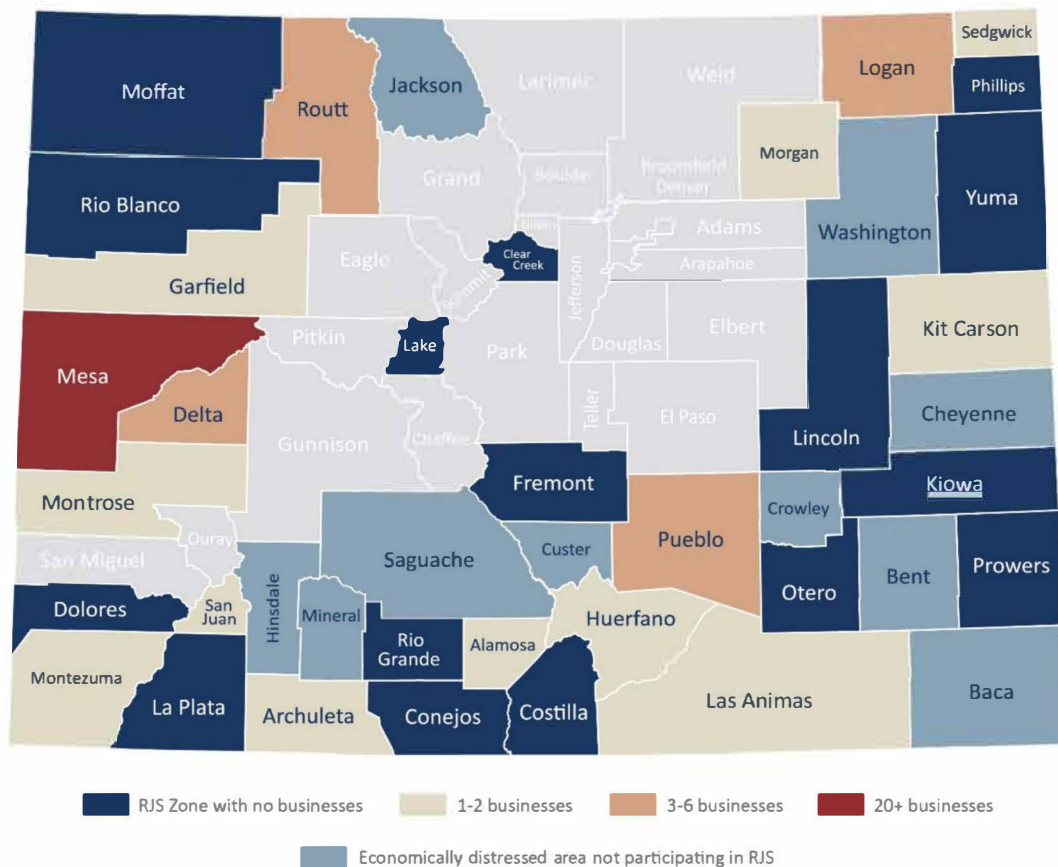
The Program's participating new businesses made up a relatively small share of new businesses in the participating counties and are concentrated in the larger counties. Exhibit 3 shows the number of new businesses approved for the Rural Jump-Start Program as a percentage of the net new businesses established in each county from 2016 through 2022, which is the most recent Bureau of Labor Statistics data available.

Exhibit 3**Rural Jump-Start Program Businesses Approved as a Percentage of Total New Businesses Reported in Counties with Rural Jump-Start Participation¹, 2016 to 2022**

RJS County	Total RJS Program Businesses Approved	Total New Businesses in RJS Zone	RJS Program Businesses as a Percent of New Businesses in RJS Zone ²
Archuleta	1	146	Less than 1%
Delta	4	127	3 %
Garfield	1	479	Less than 1%
Huerfano	1	23	4%
Logan	1	22	5%
Mesa	26	861	3%
Montrose	2	352	Less than 1%
Routt	5	402	1%
San Juan	1	15	7%
Sedgwick	1	9	11%
Source: Office of the State Auditor analysis of Office of Economic Development and International Trade data and data from the U.S. Bureau of Labor Statistics Quarterly Census of Employment and Wages for 2016 through 2022. ¹ RJS Zone approved counties with no approved or participating RJS businesses during the time period are not included in this table. ² Percentages in column have been rounded to the nearest whole number.			

In addition, although more counties have participating businesses than when we last evaluated the Program for 2016 to 2018 (at which time only Mesa County had participating businesses), the Program's businesses are concentrated in a few counties that have relatively larger populations and host a few larger participating businesses. From the Program's start in 2016 through June 2024, a total of 56 businesses were approved to participate in 16 of the 32 counties designated as RJS Zones (i.e., half of the RJS Zones never had an approved business), and half of the approved businesses were in Mesa County. Exhibit 4 shows the concentration of businesses formed in each county during this period.

Exhibit 4
Concentration of Approved Rural Jump-Start Businesses in Participating
Counties 2016 to June 2024



Source: Office of the State Auditor analysis of Office of Economic Development and International Trade's Rural Jump-Start Program business data for 2016 through June 2024.

Of all the rural, economically-distressed counties that are eligible to participate in the Program, Mesa County has the second largest population, with about 160,000 residents in 2023 and the largest number of businesses with paid employees, with about 5,500 in 2022. In contrast, during the same years, the average population in all other counties in the Program was about 22,300 residents, with an average of 776 businesses with paid employees. This concentration of workforce and suppliers is a primary reason why Mesa County continues to account for most of the Program's activity.

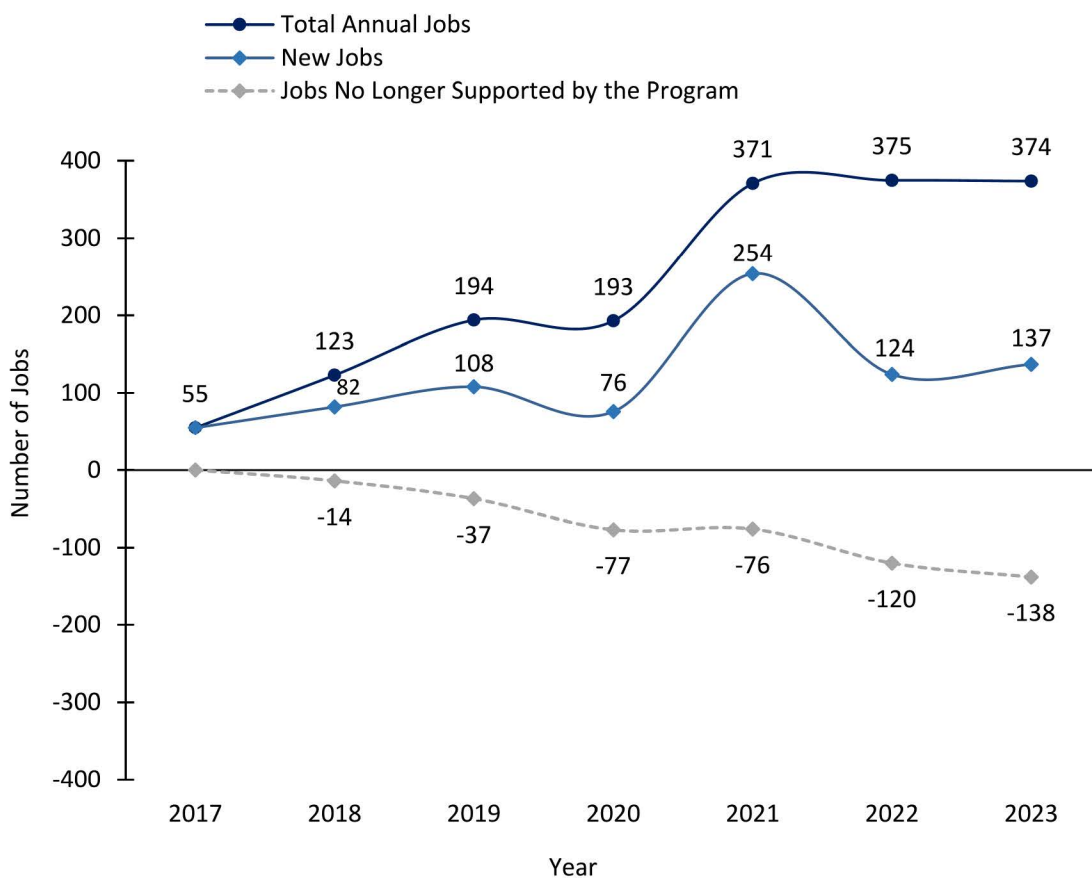
Incentive evaluations from other states with similar programs have also found that the program benefits tend to concentrate in larger, more populous parts of those states. For example, an evaluation of Kansas's PEAK Program, which allows non-metro employers who create five new jobs over a 2-year period to retain 95 percent of the state payroll withholding tax on jobs that pay at least the county median wage, found that the program likely yields positive total returns, but was not well-targeted towards rural areas and primarily benefited more populous areas of the state. Similarly, a review of Oklahoma's Quality Jobs Program, which provides quarterly cash rebates of up to 5 percent of newly created taxable payroll for certain export businesses, found that the program was a net fiscal benefit to the state (i.e., generated more revenue compared to the total cost) but noted that participants were concentrated in Oklahoma and Tulsa counties, the two most populous counties in the state. Finally, for Nebraska's Advantage Rural Development Program, which provides refundable tax incentives

for business investment projects within rural counties, a review showed that only 1 percent of projects that received incentives fell within rural areas that were also economically-distressed.

Attracting and Retaining New Jobs

The RJS Tax Expenditures have had a relatively small impact on job growth and higher-paying jobs in RJS Zones. Overall, we found that while participating businesses created new jobs each year, many of the jobs were not retained, which reduced total job growth associated with the Program. Specifically, based on OEDIT data, between 2017 and 2023, Program businesses created a total of 836 new jobs, or roughly 119 jobs per year. However, in each year some jobs were no longer supported by the Program. For example, in 2023, while businesses added 137 new jobs, 138 jobs from 2022 were no longer supported by the Program. Therefore, the change in total jobs between 2022 and 2023 stayed relatively flat with a total of 375 jobs supported in 2022 and 374 in 2023. Exhibit 5 shows the new jobs each year along with the change in jobs from the prior year to show the cumulative total job growth associated with the Program.

Exhibit 5
Rural Jump-Start Zone Employment between 2017 and 2023, Including Increases from New Jobs and Decreases from Jobs No Longer Supported by the Program



Source: Office of the State Auditor analysis of Office of Economic Development and International Trade's Rural Jump-Start Program employment data for 2017 through 2023.

While we could not determine the exact reasons for the reduction in jobs supported by the Program (i.e., whether employees left voluntarily, the companies downsized or closed, or the jobs were temporary), the number of jobs not retained was disproportionately affected by turnover at a handful of relatively larger employers. For businesses that left the Program entirely, it is possible these jobs still exist, but these businesses are not required to report this information to OEDIT. Nevertheless, it appears that for many of the jobs, the RJS Tax Expenditures did not create stable, long-term employment. Additionally, it is likely that businesses would have created at least a portion of the jobs associated with the Program regardless of the RJS Tax Expenditures. As discussed, although the stakeholders and businesses we contacted indicated that the tax expenditures were influential when deciding where to locate, they also indicated that other factors were more important and most participating businesses and employees ultimately have not used the available tax expenditures.

In addition, similar to new businesses, the Program's new jobs are largely concentrated in two larger counties with nearly 90 percent of all jobs being in Mesa or Delta County. Exhibit 6 shows the new jobs created each year for every county that created at least one job between 2017 and 2023.

Exhibit 6
Rural Jump-Start Program New Jobs Per County, 2017 to 2023

County	2017	2018	2019	2020	2021	2022	2023	Percent of Total New Jobs ²
Archuleta	0	0	0	0	1	0	0	Less than 1%
Delta ¹	0	0	0	24	36	20	19	12%
Garfield	0	0	0	0	14	20	0	4%
Kit Carson	0	0	0	0	0	0	1	Less than 1%
Las Animas	0	0	0	0	0	0	4	Less than 1%
Mesa ¹	55	82	108	42	185	68	96	76%
Montrose	0	0	0	10	18	4	1	4%
Routt	0	0	0	0	0	9	9	2%
San Juan	0	0	0	0	0	2	5	Less than 1%
Sedgwick	0	0	0	0	0	1	2	Less than 1%

Source: Office of the State Auditor analysis of Office of Economic Development and International Trade's Rural Jump-Start Program employment data for 2017 through 2023.

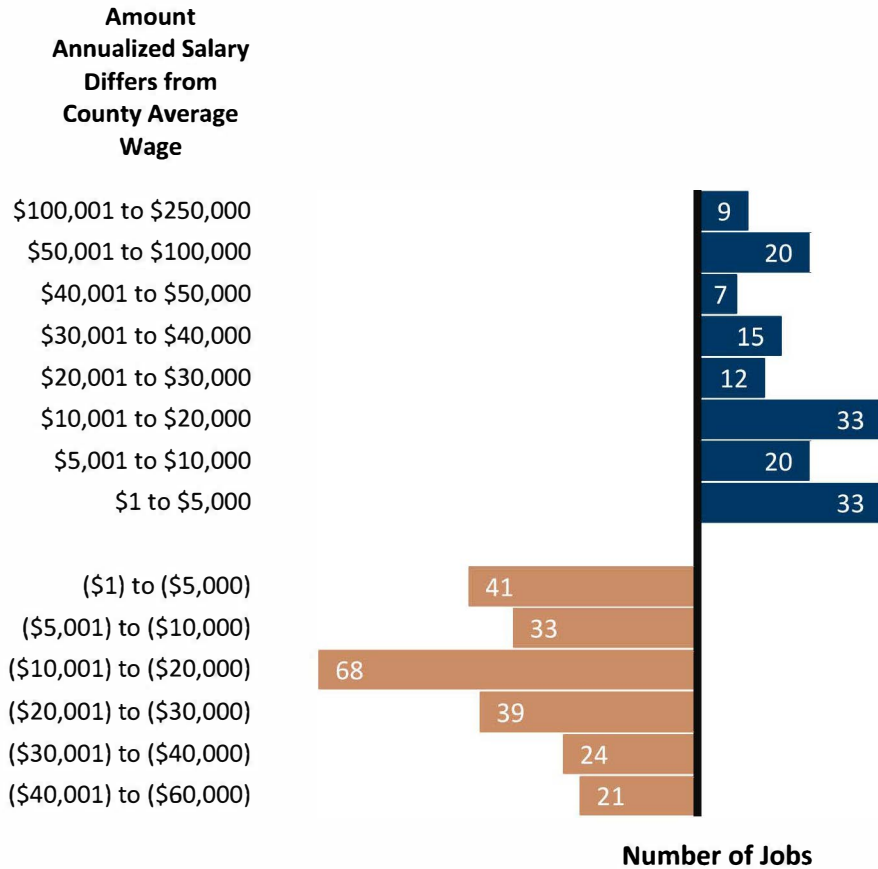
¹ A few large employers participating in the Program created most of the jobs in Delta and Mesa counties.

² Percentages in table have been rounded.

The Program does not appear to create many higher paying jobs. Although businesses must create a minimum number of jobs that pay above the county average wage in order to participate in the Program (i.e., one job in the first year, three jobs in the second year, five jobs in the third year), and employees paid at higher wages are eligible for the New Hire Credit, neither the requirement nor the tax credit appear to have a significant impact on employee wages. Specifically, we found that in Calendar Year 2023, only about 40 percent of the new jobs created by participating businesses paid above the county average wage and the average salary for all jobs was 3 percent above county average wages. We also found that over the last 4 years, the average qualifying New Hire's annual salary exceeded the county average wage by roughly \$30,000. This suggests that for many qualifying employees, their higher compensation was most likely determined by higher market rates for their positions rather than by their employer increasing their compensation in order for them to qualify for the New Hire Credit, since employers that are motivated to pay increased salaries in order to meet Program requirements would be able to do so by paying only slightly above the county average wage. Additionally, because the Program's tax benefits are underutilized, it appears that the RJS Tax Expenditures likely have only a marginal impact on businesses' decisions as to how much to pay employees. Further, because the New Hire Credit financially benefits the employee who claims the credit, not the business that creates the job, it is less likely to incentivize employers to pay employees more.

In addition, the New Hire Grants, which provide businesses \$2,500 per employee paid above the county average wage after 6 months of employment, could provide some additional incentive to pay above county average wages. However, similar to the RJS Tax Expenditures, the Program grants are relatively small compared to businesses' salary costs and so their impact on salaries is likely marginal. For example, a typical business can receive \$2,500 to \$5,000 in grants and become eligible for the New Business Credit by hiring an employee above the county average wage; therefore, they could have an incentive to increase pay to a similar degree for a job that would otherwise have wages just below the county average wage. Exhibit 7 shows the distribution of Program jobs' wages in Calendar Year 2023 based on how they compare to county average wages. As shown, only 33 of the 375 jobs (9 percent) had salaries between \$0 and \$5,000 above the county average wage. Although we could not determine the extent to which the salaries for these jobs were influenced by the Program, we considered the jobs in this range the most likely to have been influenced because if employers paid outside of this range, the cost of doing so would typically exceed Program benefits. On the other hand, 41 jobs were created with wages between \$1 and \$5,000 below county average wages, which may indicate that the Program provides very little incentive for some businesses to increase wages, since they could have potentially qualified for additional Program benefits with a relatively small increase in wages for these jobs.

Exhibit 7
Rural Jump-Start Program Jobs and Distribution of Annualized Wages in Relation to the County Average Wage for 2023



Source: Office of the State Auditor analysis of Office of Economic Development and International Trade's Rural Jump-Start Program employment data for 2023.

In some instances, we noted that even though OEDIT notifies businesses of increases in county average wages annually, some employees' wages did not keep pace with the increases and therefore they became ineligible for the New Hire Credit.

It is possible that some of the General Assembly's recent changes will help increase the number of businesses that participate in the Program, especially in rural, more-distressed areas, in future years. Specifically, in 2024, the General Assembly reduced the number of qualified New Hires a business must employ from 5 to 3 if they are operating in a county with a population under 100,000, which was true of all counties in the Program except for Mesa and Pueblo, according to the most recent Census Bureau data. Based on interviews with OEDIT staff, the five New Hire requirement was a significant challenge for new businesses operating in more rural areas, so this change could also increase the number of businesses able to participate in the Program in those counties. However, because this change happened recently, data on its impact will not be available for several more years.

In addition, in 2024, the General Assembly increased OEDIT's appropriation for Program administrative costs from \$100,000 to \$300,000. Based on conversations with OEDIT, it is likely that this will benefit outreach efforts and could lead to greater uptake of Program benefits in the future. Smart Incentives, an organization that serves economic development organizations and develops best practices, has noted: "Economic development programs can suffer from an 'if you build it, they will come' mentality. Initiatives may be crafted, funded, and set up within state or local government but lack the resources to promote the programs to intended beneficiaries." Greater outreach might help increase the number of businesses that are aware of the Program; since our last evaluation of the RJS Tax Expenditures in 2020, OEDIT staff dedicated specifically to the RJS Program have marketed the Program and worked on outreach to eligible counties and businesses, and the number of participating counties and businesses has increased.

Policy Considerations

The General Assembly may want to assess whether the New Business Income Tax Credit is sufficiently meeting the General Assembly's expectations for the Rural Jump-Start Program even though it is currently providing a limited benefit to taxpayers. As discussed, we found that the New Business Credit is providing a relatively small amount of support to businesses and has likely not provided a large enough benefit overall to have a significant impact on attracting new businesses and jobs within RJS Zones. While confidentiality requirements limit the information we can provide, based on our review of Department data for Tax Years 2016, 2018, and 2020, less than 15 percent of participating businesses claimed the New Business Credit. Further in Tax Year 2022, taxpayers only claimed about \$184,825 in RJS Tax Expenditures, but this amount includes both the New Business Credit and New Hire Credit. Therefore, the New Business Credit has had a minimal revenue impact to the State. The credit's limited use is likely due to many participating new businesses being start-ups, which often do not generate much profit in their early years and, therefore, have limited tax liability to offset with a credit. Based on our review of literature evaluating state business incentive programs, making incentive payments up front can be more impactful because new businesses tend to need additional funding the most during their earliest stages. For this reason, the Program's New Business Grants, which totaled about \$1.6 million in awards to participating businesses, may provide a more significant benefit than the New Business Credit. However, the grant program is set to expire June 30, 2025. The General Assembly may want to consider whether the New Business Credit on its own provides a sufficient benefit to attract and retain new businesses in RJS Zones.

Despite the low use of the New Business Credit, we did find some evidence that the credit was advancing the purpose of the Program. Specifically, businesses we surveyed and stakeholders indicated that the credit was a significant factor in attracting businesses to RJS Zones, even if they did not ultimately use the tax benefits. Additionally, participation in the Program has increased since our last evaluation from eight businesses approved for the Program in one county at the end of 2018, to 28 businesses participating in the Program in 13 counties as of June 2024. While most of these businesses have not used the New Business Credit, it is possible that with more participating businesses the use of the credit could increase in the future if participating and recently approved businesses become more profitable and begin claiming the credit. OEDIT staff suggested that the New Business Credit serves as more of a long-term benefit that businesses can use after several years in the Program when they are more firmly established. Also, as discussed, in 2024, the General Assembly made changes to the Program designed to increase participation and improve outreach, so it is possible that these changes will increase credit use in future years, but it is too soon to evaluate whether this has occurred as these changes had not yet taken effect at the time of our evaluation.

The General Assembly could consider eliminating the New Business Sales Tax Refund since it is not being used. While we assume that businesses have made at least some purchases that are eligible for the refund and most businesses that completed our survey were aware of it, the Department reports that no business has submitted a claim for a refund since it became available in 2016. Although we could not determine why businesses have not used the refund, it is possible that some purchases that would qualify for the refund are already exempt from sales tax under other tax expenditure provisions, such as the Manufacturing Machinery and Wholesale Exemptions. Additionally, because the exemption provides a benefit equivalent to 2.9 percent of the purchase price, it may not be significant enough for businesses to submit the required paperwork to the Department, especially for smaller purchases. However, some businesses might use the refund if they make larger purchases that justify the administrative cost and several businesses reported to us that they do plan to use it in the future. Further, OEDIT staff reported that even if businesses do not end up using the Program's tax expenditures, the ability to point to them as potential benefits can still be helpful in attracting businesses to join the Program.

The General Assembly could consider eliminating the New Hire Credit, since it does not seem to be incentivizing businesses to create many new, higher-paying jobs or helping to retain employees. The OSA's 2020 evaluation determined that the New Hire Credit was likely not encouraging participating businesses to increase compensation for their employees, as most employees hired did not qualify for the credit, and those who did, tended to be compensated well above the county average wage. The situation has not changed significantly since. As discussed, less than half of eligible employees claimed the credit in 2018 and 2020. Additionally, while the credit could potentially encourage employers to increase salaries for jobs that would otherwise pay just below the county average in order to qualify, the employees who were eligible for the credit were, on average, paid about \$30,000 more than the county average, which suggests there are other factors besides the tax credit that are driving the salaries of these employees. Finally, businesses do not receive a direct benefit from the New Hire Credit, which is claimed by their employees to offset their personal income tax liability. This could be why some of the participating businesses we surveyed indicated that they had not informed employees about the availability of the credit, which likely limits its effectiveness as an incentive to attract and retain new employees.

The Program's New Hire Grants, which, unlike the credit, directly benefit the businesses, are potentially a more significant factor in businesses' decisions to create higher-paying jobs. However, they are a one-time \$2,500 benefit, so the grants likely do not incentivize businesses to continue to pay the employee an above-average wage beyond helping the business meet the minimum program requirement of having five New Hires. The grants also are more likely to have a marginal impact on salaries for jobs that would otherwise pay just below the county average wage.

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Essential Hygiene Products Exemptions



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Tax Expenditure Evaluation • March 2025 • 2025-TE4

The Essential Hygiene Products Exemptions allow people to purchase period products and incontinence products without paying Colorado state sales or use tax on these items. More specifically, a product is exempt under the Period Products Exemption if its primary purpose is to absorb or contain menstrual flow. The Incontinence Products Exemption applies to any absorbent cloth or disposable products, such as diapers, worn by humans who are incapable of or have difficulty controlling their bladder or bowel movements.

The purpose of these exemptions is to increase the affordability of these hygiene products and to redress the inequitable burden that the imposition of sales tax places on millions of Coloradans for whom such products are essential [Section 39-26-717(2)(m)(II)(B) and (2)(n)(II)(B), C.R.S.].

The Essential Hygiene Products Exemptions appear to be effective in exempting essential hygiene products from state sales tax. However, many local governments do not provide a similar exemption. As a result, the extent to which the exemptions are accomplishing their statutory purpose varies based on the tax policies of the local jurisdictions where they are purchased.

- The major retailers we examined are applying the exemptions to eligible products.
- Most local governments have not adopted the Essential Hygiene Products Exemptions, which reduces the exemptions' effectiveness at meeting their purposes.
- A significant portion of Coloradans are still paying county and/or municipal sales taxes on purchases of essential hygiene products, and the local sales tax rate imposed on these products can vary substantially depending on where the purchaser lives.
- The exemptions increase the affordability of essential hygiene products to a modest extent.

Policy Considerations

We did not identify any policy considerations for these exemptions.

	Period Products Exemption	Incontinence Products Exemption
Tax Type:	Sales and use	Sales and use
Expenditure Type:	Exemption	Exemption
Statutory Citation:	Sections 39-26-717(m), C.R.S.	Section 39-26-717(n), C.R.S.
Year Enacted:	2022	2022
Repeal/Expiration Date:	None	None
Revenue Impact:	\$2.6 million (CY 2024)	\$11.3 million (CY 2024)
Purpose given in statute or enacting legislation? Yes		

Essential Hygiene Products Exemptions

Background

The Essential Hygiene Products Exemptions allow people to purchase period products and incontinence products without paying Colorado state sales or use tax on these items.

Colorado statute provides a variety of exemptions from the state sales tax for medical supplies, such as prescription drugs, insulin, and corrective eyeglasses. In 2022, the General Assembly enacted two additional sales tax exemptions for medical supplies—the Period Products Exemption and the Incontinence Products Exemption—which we refer to collectively in this report as the Essential Hygiene Products Exemptions. A product is exempt under the Period Products Exemption if its primary purpose is to absorb or contain menstrual flow. The Incontinence Products Exemption applies to any absorbent cloth or disposable products, such as diapers, worn by people who are incapable of or have difficulty controlling their bladder or bowel movements. Of the 45 states and the District of Columbia that have a sales tax, 23 states have an exemption for menstrual products, and 18 states have an exemption for incontinence products.

Exhibit 1
Products Eligible for the Essential Hygiene Products Exemptions¹

Period Products	Incontinence Products
• Tampons • Menstrual pads and sanitary napkins • Pantliners • Menstrual sponges, cups, and discs • 2-in-1 incontinence and period pads • Menstrual underwear designed to hold menstrual flow	• Cloth diapers • Disposable diapers • Diaper inserts and liners • Pads and liners for bladder leaks • 2-in-1 incontinence and period pads

Source: Department of Revenue Sales and Use Tax Topics on Period Products and Incontinence Products and Diapers.
¹These lists are not exhaustive.

The purpose of the Period Products Exemption is “to increase the affordability of period products and to redress the inequitable burden that the imposition of sales tax places on millions of women in Colorado for whom such products are essential” [Section 39-26-

717(2)(m)(II)(B), C.R.S.]. The Colorado State Demography Office (SDO) estimated that there were about 1.6 million women between the ages of 12 and 51 (i.e. women who are likely menstruating) in Colorado as of 2022. On average, menstruation lasts for about 5 days, and the American College of Obstetricians and Gynecologists recommends changing a typical menstrual product every 4 to 8 hours. Menstruators who change products as recommended would use between 15 and 30 products per menstrual cycle, or 196 to 391 products per year.

The purpose of the Incontinence Products Exemption is “to increase the affordability of incontinence products and diapers and to redress the inequitable burden that the imposition of sales tax places on millions of parents, individuals caring for infants and young children, and other users of incontinence products in Colorado for whom such products are essential” [Section 39-26-717(2)(n)(II)(B), C.R.S.].

There are two significant portions of the population that use incontinence products: infants and young children who do not yet have full control of their bladder and bowel movements, as well as adults who have lost some control of their bladder and/or bowel movements due to age or medical reasons. A 2015 article on diaper health published in Pediatric Nursing noted that infants need between six and eight diapers per day until they are toilet trained, which occurs by 36 months of age for about half of children, according to a publication on toilet training from the American Academy of Family Physicians. Based on data from the National Health and Nutrition Examination Survey between 2007 and 2010, about 8 percent of adults aged 65 and over who do not live in an institutional setting experience severe bladder incontinence. In 2022, there were about 188,000 children below the age of 36 months and 929,000 adults at least 65 years old living in Colorado.

Sales taxes are generally regressive—they impose a larger burden in proportion to income on those with low incomes than on individuals with high incomes. For example, according to the Department of Revenue’s (Department’s) 2020 Colorado Tax Profile Study, Colorado’s lowest income group paid an estimated 3.8 percent of their income in state sales taxes, while the highest income group paid an estimated 0.4 percent of their income in state sales taxes. This occurs because people with lower incomes must consume a higher proportion of their income on taxable goods, such as clothing, gas, and food, than people with higher incomes, who tend to spend more on nontaxable purchases, such as services, and also have the flexibility to save rather than spend. As a result, exemptions for necessities, including essential hygiene products, have the potential to provide proportionally greater savings to lower income households than to higher income households.

In addition to the Essential Hygiene Products Exemptions, the General Assembly has also enacted other bills in recent years in order to assist Coloradans in accessing essential hygiene products:

- House Bill 19-1224, passed in 2019, required correctional facilities to provide menstrual products to individuals in custody at no cost and established that the State will reimburse correctional facilities for these expenses.
- Senate Bill 21-027, passed in 2021, established a state diaper distribution program in Colorado and allocated \$2 million to fund this program in Fiscal Year 2021-22.
- House Bill 24-1164, passed in 2024, required Colorado schools to provide menstrual products at no cost to students in grades 6 through 12 by June 30, 2028.

Statute provides that our office will measure the effectiveness of both of the Essential Hygiene Products Exemptions by estimating the savings the exemptions provide to Colorado taxpayers for whom these products are essential. We also developed the following performance measures in order to evaluate how well the Essential Hygiene Products Exemptions are meeting their statutory purpose:

1. To what extent are vendors applying the Essential Hygiene Products Exemptions?
2. To what extent do the Essential Hygiene Products Exemptions increase the affordability of period and incontinence products?

Evaluation Results

The Essential Hygiene Products Exemptions appear to be effective in exempting essential hygiene products from state sales tax. However, many local governments do not provide a similar exemption. As a result, the extent to which the exemptions are accomplishing their statutory purpose—addressing the inequity of imposing tax on these products and increasing their affordability—varies based on the tax policies of the local jurisdictions where they are purchased.

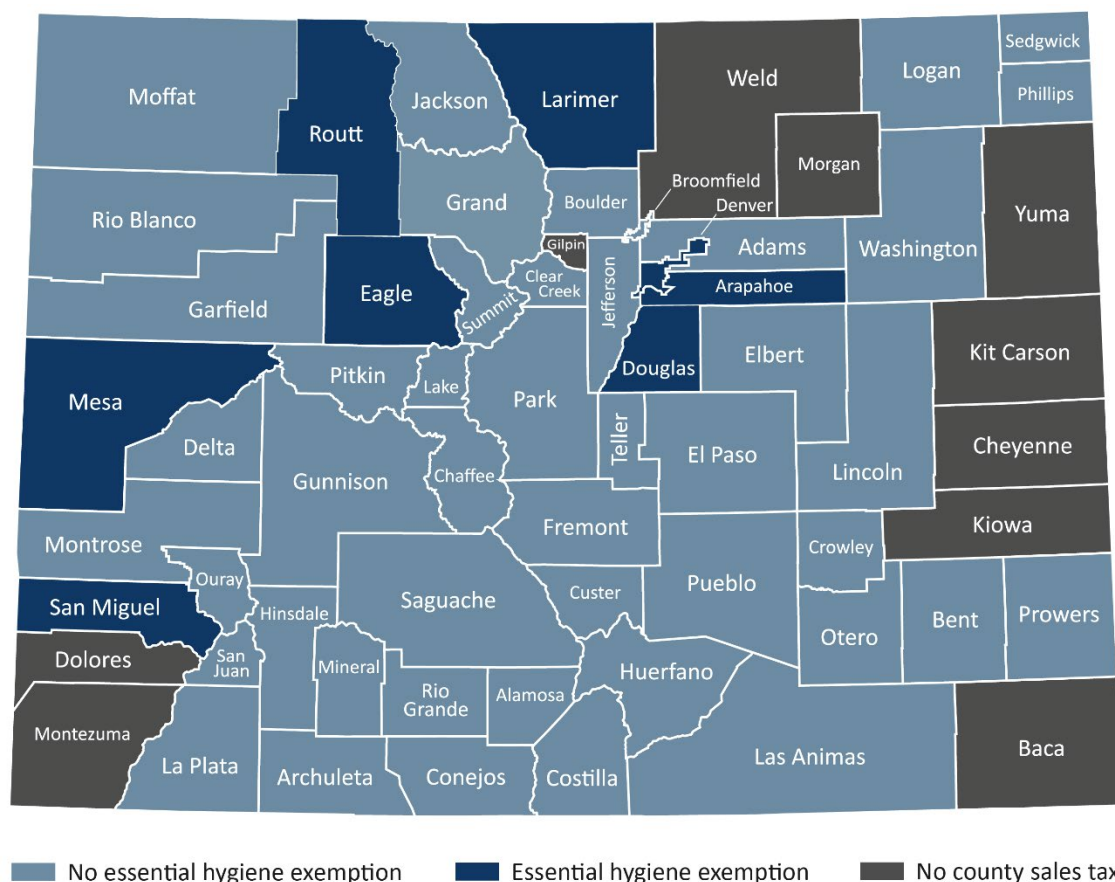
The major retailers we examined are applying the Essential Hygiene Products Exemptions to eligible products. Due to vendors reporting the exemption in aggregate to the Department and the large number of vendors in the state, we were not able to determine how frequently vendors are applying the exemption to all eligible sales. In order to get a sense for how large vendors across Colorado are applying the state and local exemptions for these products, we examined 20 sales of these products using the websites of 5 large retailers at 4 different Colorado locations. We found that these vendors are applying the exemptions correctly at all of the locations examined.

Most local governments have not adopted the Essential Hygiene Products Exemptions, which reduces the exemptions' effectiveness at meeting their purposes. In general, statute requires counties and municipalities with sales taxes that are collected by the State to adopt the same

exemptions as apply to the state sales tax. The Essential Hygiene Products Exemptions are one of several exceptions to this rule; the exemptions do not apply to state-collected local sales taxes unless the local jurisdiction expressly adopts the exemptions via local ordinance. Colorado's home rule jurisdictions can set their own sales tax policies if they collect their own sales taxes, so these jurisdictions can also choose whether to adopt an exemption for essential hygiene products. According to the Tax Foundation, Colorado has the third highest average local sales tax rate in the United States, at 4.9 percent, which is higher than the Colorado state sales tax rate of 2.9 percent. Therefore, local sales tax policies have a significant impact on the extent to which the exemptions are meeting their purposes.

Of Colorado's 64 counties, almost all of which are state-collected, 8 counties have adopted the exemptions, and an additional 10 counties do not have a sales tax, as summarized in Exhibit 2.

Exhibit 2
Summary of Essential Hygiene Products Exemptions
Applicable to County Sales Taxes as of 2024¹



Source: Department of Revenue Form DR 1002: Colorado Sales/Use Tax Rates and municipal codes for Broomfield and Denver Counties.

¹This exhibit does not account for the sales tax policies in local tax jurisdictions other than counties, such as towns, cities, and special districts. Each of these jurisdictions may or may not have a sales tax and may or may not have adopted an exemption for essential hygiene products from their sales tax.

Of Colorado's 15 most populous cities, all of which are self-collected home rule jurisdictions, 5 have an exemption for menstrual products and 4 have an exemption for incontinence products. About 8 percent of Coloradans live in state-collected municipalities, and only 6 of Colorado's 163 state-collected municipalities (less than 4 percent) have adopted the exemptions.

A significant portion of Coloradans are still paying county and/or municipal sales taxes on purchases of essential hygiene products, and the local sales tax rate imposed on these products can vary substantially depending on where the purchaser lives. We combined information from the Department on the sales tax exemptions available in each county with SDO data on county populations in 2022 to estimate that about 52 percent of Colorado's population lives in counties that impose sales tax on essential hygiene products. Based on Department information, SDO data, and municipal codes for some of Colorado's home rule cities, we estimate that between a third and one-half of Coloradans are subject to municipal sales tax on these products. The total amount of local sales tax imposed on a purchase of essential hygiene products depends on a number of factors, including the sales tax rate in the county, municipality, and any special districts in which the purchase is made, along with whether each of these tax jurisdictions has adopted exemptions for essential hygiene products. For example, Milliken has not adopted the exemptions and has a sales tax rate of 2.5 percent and is located in Weld County, which does not have a sales tax, so the local sales tax rate on essential hygiene products is 2.5 percent. However, Silverton's sales tax rate is 1 percent, and the sales tax rate in San Juan County is 6.5 percent, so essential hygiene products are subject to a total local sales tax rate of 7.5 percent because neither the county nor the city has adopted the exemptions.

The exemptions increase the affordability of essential hygiene products to a modest extent.

As shown in Exhibit 3, exempting essential hygiene products from state sales tax could allow individuals to purchase a small amount of additional products per year, about 2 days' worth of menstrual products or 11 days' worth of incontinence products. The impact of a local sales tax exemption on product affordability depends on the local sales tax rate; Exhibit 3 estimates this impact based on the average local sales tax rate in Colorado.

Exhibit 3**Summary of Essential Hygiene Products Exemptions' Effect on Affordability, Per Year¹**

	Menstrual Products	Infant Diapers	Adult Incontinence Products ²
Estimated number of products used per year	300	2,600	730
Estimated increase in affordability per year due to state exemption	9 products, covering about 2 days or \$2.27	75 diapers, covering about 11 days or \$25.71	21 products, covering about 11 days or \$23.55
Estimated increase in affordability per year due to local exemption, if adopted ³	15 products, covering about 3 days or \$3.85	128 diapers, covering about 18 days or \$43.52	36 products, covering about 18 days or \$39.87

Source: Office of the State Auditor analysis of product prices from retailer websites; Department of Revenue and Tax Foundation materials; Colorado State Demography Office data; and various articles and studies.

¹These calculations are based on the estimated price of the relevant product in Colorado as of 2024. Additionally, the savings presented here are based on the average estimated or recommended usage of products in each category. Actual savings will vary from person to person depending on the quantity and prices of products purchased.

²Adult usage of incontinence products can vary depending on individual need. These calculations assume that adults use an average of two incontinence products per day. We estimated this usage based on the total estimated sales of adult incontinence products in Colorado, the estimated price of these products in Colorado, and the estimated number of Colorado seniors experiencing moderate to severe incontinence in 2024.

³Based on the 4.9 percent average local sales tax rate in Colorado in 2024, as reported by the Tax Foundation.

Notably, individual purchasers may decide to use the savings from the exemption in different ways depending on their unique circumstances. For example, individuals who could already afford a sufficient quantity of products may choose to purchase higher quality products than they had used in the past. Alternatively, those who struggle to obtain a sufficient quantity of products due to financial strain may purchase a larger quantity of products than they were previously able to afford.

According to articles on diaper need and menstrual poverty published in *Pediatrics* and the *International Journal of Environmental Research and Public Health*, individuals who struggle to afford these products are more likely to “stretch” their supplies by using essential hygiene products for a longer period of time than is advised. Such practices can lead to health concerns such as toxic shock syndrome, polycystic ovary syndrome (PCOS), and endometriosis for menstruators or urinary tract infections and dermatitis for those using incontinence products. Therefore, to the extent that the Essential Hygiene Products Exemptions allow individuals to afford more products and reduce the need to stretch hygiene supplies, the exemptions may improve health outcomes for individuals who rely on and struggle to afford these products. Finally, some purchasers may choose to use the savings from the exemption in some other way unrelated to their purchases of essential hygiene products.

As shown in Exhibit 4, we estimated that the Period Products Exemption reduced state revenue by about \$2.6 million in Calendar Year 2024, and the Incontinence Products

Exemption reduced state revenue by about \$11.3 million in Calendar Year 2024. Data on the revenue impact of these exemptions is not available from the Department because both exemptions are reported on the same line as other miscellaneous exemptions on the Department’s sales tax return. Therefore, in order to estimate the impact of the Essential Hygiene Products Exemptions on state revenue, we used the same methods as Legislative Council Staff when they prepared the revenue impact analysis for the enacting legislation’s fiscal note (House Bill 22-1055), updating the calculations with more recent estimates on prices, population, and inflation. For menstrual products, this involved estimating the number of menstruating women in Colorado—adjusted for pregnancy, breastfeeding, and similar factors—and multiplying this by the average number of menstruation days per year, the number of menstrual products used per day, and the prices of these products. We used a similar approach for diapers, multiplying the estimated number of diapers used per child, per year by the estimated number of children using diapers in Colorado, also accounting for the portion of the population that may be using cloth diapers instead of disposable diapers, and finally by the estimated average price. For both exemptions, we examined a selection of products at multiple retailers in Colorado to estimate the average price of these products in Calendar Year 2024. Finally, for adult incontinence products, we began with a 2001 estimate of the cost of adult incontinence products from an academic article and multiplied this by the relevant inflation rate to estimate the current cost of adult incontinence products. We used this approach because we did not identify sufficient data to quantify current incontinence rates and severity—and thus, the total need for incontinence products—among Colorado adults.

Exhibit 4

Estimated Impact of the Essential Hygiene Products Exemptions on State Revenue, Calendar Year 2024

	Period Products Exemption	Incontinence Products Exemption	
Estimated amount spent on products in Colorado	menstrual products: \$91 million	child diapers: \$197 million	adult incontinence products: \$192 million
Colorado sales tax rate	2.9%	2.9%	2.9%
Estimated state revenue impact by product	\$2.6 million	\$5.7 million	\$5.6 million
Estimated state revenue impact by exemption		\$11.3 million	
Total estimated state revenue impact, Calendar Year 2024	\$13.9 million		

Source: Office of the State Auditor updates to Legislative Council Staff fiscal estimate for the Essential Hygiene Products Exemptions. Sources include the Colorado State Demography Office, the U.S. Bureau of Labor Statistics, product prices from retailer websites, and various articles and studies.

Policy Consideration

We did not identify any policy considerations for these exemptions.

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Regional Home Office Insurance Premium Tax Rate Reduction



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Tax Expenditure Evaluation • March 2025 • 2025-TE5

Colorado levies a 2 percent premium tax on insurance companies’ in-state premiums, which is the revenue insurers collect for writing insurance policies covering property or risks in the state. The Regional Home Office Insurance Premium Tax Rate Reduction (RHO Rate Reduction) allows insurers that maintain a “home office” or “regional home office” in Colorado to have a 1 percent premium tax rate. To be considered to maintain a home or regional home office, an insurer must either substantially perform certain functions related to insurance business operations in the state or maintain significant direct insurance operations in the state, and maintain at least 2.5 percent of its total domestic workforce in the state. The purpose of the RHO Rate Reduction is to create an incentive for insurance companies to maintain a substantial workforce presence in the state.

The RHO Rate Reduction may incentivize some insurers to maintain some of their workforce in the state, but the incentivizing effect is likely limited primarily to companies that have close to 2.5 percent of their workforce in Colorado and those that receive a larger benefit from the provision. We also found:

- The number of qualifying companies and the revenue impact of the RHO Rate Reduction has decreased in recent years due to the implementation of the Colorado workforce percentage requirement.
- Since the benefit of the RHO Rate Reduction is tied to premiums collected, the revenue impact of the RHO Rate Reduction is likely to increase in future years as premiums continue to increase, but may not result in additional Colorado jobs. Between 2022 and 2024, 15 of the 18 insurance groups that qualified for the RHO Rate Reduction reported a decrease in Colorado jobs, collectively cutting about 4,300 jobs while receiving a \$17.5 million increase in credits.

Policy Consideration

The General Assembly could consider whether to restructure the RHO Rate Reduction so that the benefit it provides to insurance companies more closely aligns with its purpose to incentivize insurers to maintain a substantial workforce presence in Colorado.

Tax Type:	Insurance Premium	Year Enacted:	1959
Expenditure Type:	Rate Reduction	Repeal/Expiration Date:	None
Statutory Citation:	Section 10-3-209(1)(b)(I)(B), C.R.S	Revenue Impact (2024):	\$72.3 million
Purpose given in statute or enacting legislation? Yes			



Regional Home Office Insurance Premium Tax Rate Reduction

Background

Colorado levies a 2 percent premium tax on insurance companies' in-state premiums, which is the revenue insurers collect for writing insurance policies covering property or risks in the state. **The Regional Home Office Insurance Premium Tax Rate Reduction (RHO Rate Reduction) allows insurers that maintain a “home office” or “regional home office” in Colorado to have a 1 percent premium tax rate instead of the standard 2 percent rate.** To maintain a home or regional home office in the state, an insurance company's Colorado office must meet two requirements. First, it must either (1) substantially perform certain functions related to insurance business operations in the state or (2) maintain “significant direct insurance operations” in Colorado that are supported by “functional operations which are both necessary for and pertinent to” its in-state business. More specific details about how a company demonstrates that it meets one of these two tests are provided in the technical note. Second, the company must have a workforce in Colorado that is greater than or equal to 2.5 percent of the company's total domestic workforce (referred to throughout this report as the “minimum Colorado workforce percentage”).

The requirement that an insurance company have a certain percent of its total domestic workforce in Colorado was added in 2021 by House Bill 21-1312. This requirement was gradually phased in from 2 percent for 2022, to 2.25 percent for 2023, and then 2.5 percent for 2024 and onward. This is the only direct change to the operation of the RHO Rate Reduction since our office published an evaluation of it in January 2020.

The insurance premium tax and RHO Rate Reduction are administered by the Division of Insurance (Division), which is within the Department of Regulatory Agencies. Insurers must apply for the RHO Rate Reduction every year using

Technical Note

To meet the substantial performance test, an insurance company's Colorado office must substantially perform actuarial, medical, legal, application review, issuance of policies, information and service, advertising and publications, public relations, hiring, testing, and/or training of sales/service forces for its business in three or more states in which it is licensed, or in all states in which it is licensed (if fewer than three). Division of Insurance regulations specify that insurers must perform at least two-thirds of these operations in Colorado to be eligible through this test.

To meet the significant direct insurance operations test, Division of Insurance regulations specify that a company must meet two of the following three requirements: (1) maintain a Colorado workforce of at least 150 full-time employees (excluding agents and their staff), (2) own or lease at least 30,000 square feet of office space in Colorado (excluding off-site storage of claims files), or (3) spend at least \$5 million in Colorado on salaries, administration, operating expenses, etc.

Division application forms, which require that the insurer provide information about their operations showing that they qualify, including which of the two tests they are qualifying under, their total number of domestic employees, total number of Colorado employees, and Colorado workforce percentage. There is no limit on how many insurers can be approved for the rate reduction, and insurance groups—typically composed of parent, subsidiary, and other affiliated insurers that each specialize in different markets (e.g., life insurance, accident and casualty insurance, etc.)—are allowed to submit one application per year for all of their affiliated insurers, as long as the performance of their affiliate insurers does not substantially vary and each individual affiliate insurer can independently meet the requirements. Once approved, insurers claim the rate reduction by applying a 1 percent insurance premium tax rate to their in-state insurance premiums when calculating and reporting their premium tax liability to the Division.

We inferred that the direct beneficiaries of the rate reduction are insurers that maintain home or regional home offices in Colorado and have a significant business presence in the state. In addition, to the extent that the rate reduction encourages insurance companies to expand or maintain employment in Colorado, the workers they hire or continue to employ are indirect beneficiaries. In 2024, insurers that qualified for the RHO Rate Reduction reported employing 9,775 people in Colorado. According to the U.S. Bureau of Labor Statistics (BLS) Quarterly Census of Employment and Wages data for private insurance carriers in Colorado, there were about 17,600 insurance jobs in Colorado in 2024. Between 2020 and 2024, insurance groups that qualified for the RHO Rate Reduction employed between 55 and 69 percent of the total private insurance industry employees (excluding agents) in the state each year.

The legislative declaration of House Bill 21-1312 states that **the RHO Rate Reduction “. . . was designed to create an incentive for insurance companies to maintain a substantial workforce presence in the state...”**

Statute does not provide performance measures for the RHO Rate Reduction. In order to determine whether the RHO Rate Reduction is meeting its purpose, we developed the following performance measure: **To what extent does the RHO Rate Reduction incentivize insurers to maintain a substantial workforce presence in Colorado?**

Evaluation Results

The RHO Rate Reduction may incentivize some insurers to maintain some of their workforce in the state, but the incentivizing effect is likely limited primarily to companies that have close to 2.5 percent of their workforce in Colorado and those that receive a larger benefit from the provision. The RHO Rate Reduction appears to provide the greatest incentive to insurers to maintain or increase their workforce in the state when they are close to the 2.5 percent threshold needed to qualify, but provides less incentive for companies with Colorado workforce

percentages well above or below the threshold. For example, a company with a Colorado workforce percentage of 2.4 percent (just under the threshold) and that meets one of the two tests, along with having 100 Colorado-based staff and \$100 million in annual Colorado premiums, could receive a tax benefit of \$1 million by hiring just five additional Colorado staff, which would allow it to qualify. Conversely, if the same company had a Colorado workforce percentage of 10 percent, it would receive the same \$1 million benefit from the rate reduction regardless of how much it expanded its Colorado workforce, or could cut as much as 75 of its 100 Colorado-based staff, as long as it continued to meet one of the other required tests.

We surveyed the 18 insurance groups that have qualified for the RHO Rate Reduction in all of the years that the minimum Colorado workforce percentage has been in effect (2022, 2023, and 2024) and received responses from eight groups (a 44 percent response rate). We asked these survey respondents, “To what extent has the recent requirement to maintain at least 2.5 percent of the insurance group’s total domestic workforce in Colorado incentivized your insurance group to increase or maintain employees in Colorado?” Six of the survey respondents (75 percent) said the requirement is either not at all influential, minorly influential, or somewhat influential in their insurance group’s decision to increase or maintain employees in Colorado. One other respondent said it was highly influential, and another said it was the sole deciding factor. The insurance group that said the requirement was the sole deciding factor had a Colorado workforce percentage in 2024 that was less than 1 percent higher than the requirement and received a substantial benefit (i.e., several millions of dollars) from the rate reduction; whereas, the other respondents that reported the requirement being less influential in their employment decisions had much higher Colorado workforce percentages, ranging from about 4 percent to 40 percent, and received a smaller benefit from the rate reduction (on average, the benefit was under \$500,000 for these respondents). This suggests that the requirement likely has a more incentivizing impact on maintaining or increasing jobs in Colorado when an insurance group is close to the minimum Colorado workforce percentage and receives and/or has the potential to receive a large tax benefit from the rate reduction.

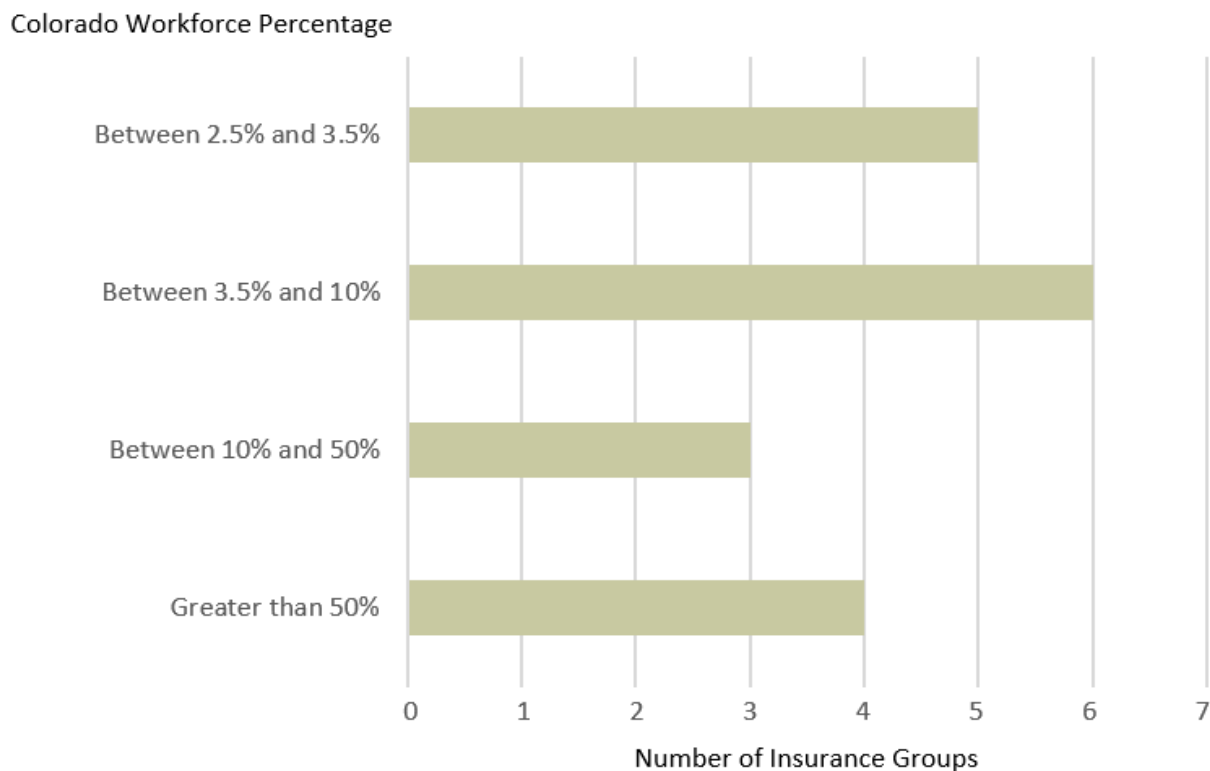
However, having a Colorado workforce percentage that is close to the requirement may not always incentivize insurance groups to increase employment in order to qualify. We surveyed 12 insurance groups that qualified for the RHO Rate Reduction in any year between 2019 and 2023, but no longer qualified as of 2024; we received three survey responses (a 25 percent response rate). All three of these insurance groups reported that they stopped qualifying for the RHO Rate Reduction because they did not meet the requirement to maintain the minimum required Colorado workforce percentage, and all three of these insurance groups said they do not intend to increase jobs in Colorado in order to requalify. All of the respondents reported having a Colorado workforce percentage around 2 percent before they stopped qualifying. One of the respondents reported that while the Colorado workforce percentage requirement was the reason they stopped qualifying, over time they had slowly been changing their company operations and they were no longer going to be able to meet one of the other two tests to qualify for the RHO Rate Reduction. They stated that if the Colorado workforce percentage requirement was the only requirement preventing them from

qualifying, they may have considered hiring enough employees in Colorado to qualify, but that since they were no longer going to be able to meet one of the other two tests without making significant changes to their operations, they were not going to hire more employees to requalify. We do not know how many additional employees all of the respondents would have needed to hire in order to qualify for the reduction again, but for at least some insurance groups, the rate reduction does not seem to provide enough of an incentive for them to increase their employment in the state or modify their operations to meet one of the two tests. All three of those insurance groups said when they qualified for the rate reduction, they kept the tax benefit as profit and have not changed their operations as a result of losing the RHO Rate Reduction benefit. On average, those three groups received a benefit of about \$1.4 million in the last year they qualified.

Exhibit 1 shows the 2024 Colorado workforce percentages for insurance groups that qualified for the RHO Rate Reduction.

Exhibit 1

Number of Insurance Groups that Qualified for the RHO Rate Reduction, by their 2024 Colorado Workforce Percentages



Source: Office of the State Auditor analysis of Division of Insurance data.

As shown, 5 of the 18 insurance groups (28 percent) that qualified for the RHO Rate Reduction had between 2.5 and 3.5 percent of their workforce in Colorado. Whereas, the other 13 insurance groups had more than 3.5 percent of their total domestic workforce in Colorado. Therefore, for a significant portion of qualifying insurance groups, the rate reduction may not provide a strong incentive to maintain employment since most have significantly above the minimum required workforce percentage (e.g., they could reduce their Colorado workforce substantially and still receive the same tax benefit as long as they were still able to meet one of the other two tests).

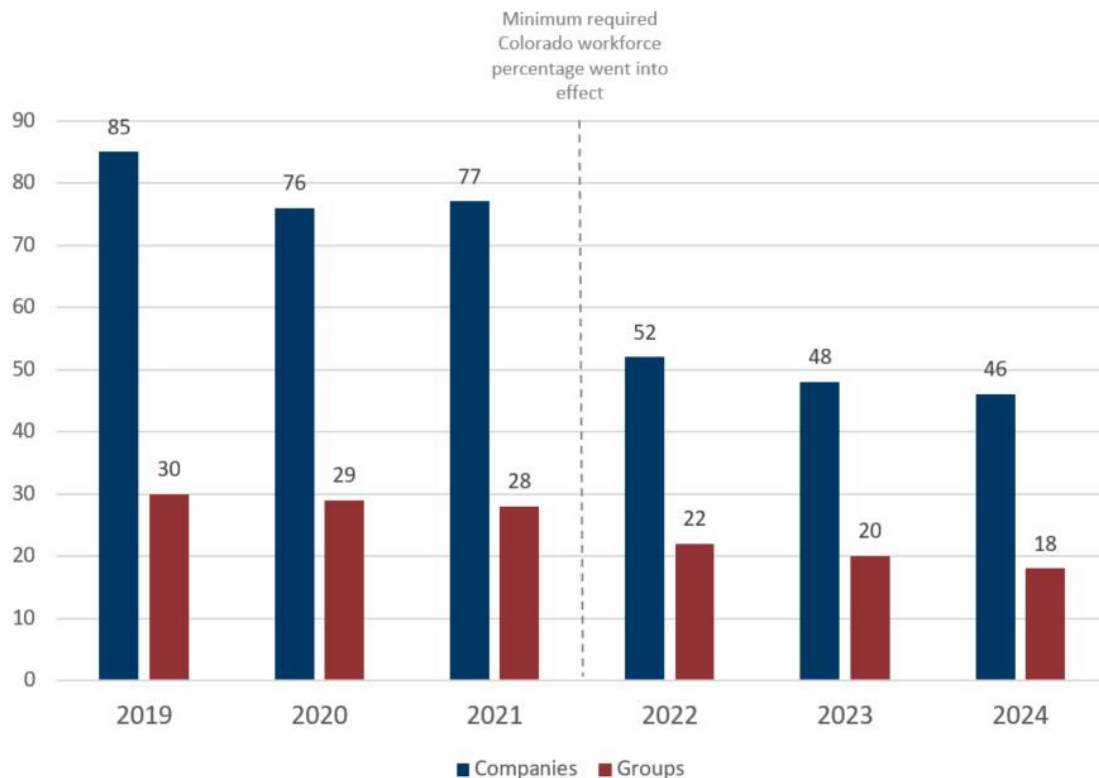
The RHO Rate Reduction provides an inconsistent incentive to maintain Colorado jobs and offset higher labor costs in Colorado because the per-employee benefit insurers receive varies considerably. In 2022, qualifying companies received a benefit ranging between \$150 and \$21,646 per Colorado employee, in 2023 between \$157 and \$29,702 per Colorado employee, and in 2024 between \$100 and \$40,139 per Colorado employee. For example, in 2024, the insurance group that received a benefit of \$40,139 per employee received a total benefit from the RHO Rate Reduction of about \$13.6 million, which we divided by the number of employees it reported employing in Colorado (339) to determine the per employee benefit. In our survey of insurance groups that qualified for the RHO Rate Reduction in 2022, 2023, and 2024, two insurance groups that responded to our survey said that cost of labor is an important factor that they consider when deciding where to locate, expand, or maintain a home or regional home office. One of the survey respondents elaborated and said that Colorado has a higher cost of labor, particularly for professional-level roles, compared to other markets that have the same or similar workforce attributes and the RHO Rate Reduction keeps Colorado competitive with those markets by providing partial relief from the higher cost of labor. According to BLS data, the average annual salary in 2022 and 2023 for private sector insurance jobs in Colorado was about \$102,700 and \$110,200, respectively. This means that the RHO Rate Reduction covered anywhere between 0.1 and 21 percent of the average insurance employee salary for companies in 2022 (calculated as \$150 and \$21,646 each divided by \$102,700) and between 0.1 and 27 percent in 2023 (calculated as \$157 and \$29,702 each divided by \$110,200). As of March 2025, BLS average annual salary data for 2024 was not available so we were not able to do the same analysis for 2024. The three insurance groups that reported an increase in Colorado jobs reported a total increase of 72 jobs and had Colorado workforce percentages between 2.75 and 3.75 percent in 2024; since they were close to the minimum required percentage, they may have been incentivized to maintain or increase jobs in order to retain the financial benefit of the RHO Rate Reduction.

The number of qualifying companies and the revenue impact of the RHO Rate Reduction has decreased in recent years due to the implementation of the Colorado workforce percentage requirement. We analyzed Division data that shows the number of insurance companies/groups that qualified for the RHO Rate Reduction from 2019 to 2024. As provided in Exhibit 2, the number of companies and groups that qualified for the rate reduction decreased substantially in 2022 when the Colorado workforce percentage requirement went into effect. The number of insurers and groups that qualified continued to drop modestly in 2023 and 2024 as the

Colorado workforce percentage requirement increased from 2 percent in 2022 to 2.25 percent in 2023 and to 2.5 percent in 2024.

Exhibit 2

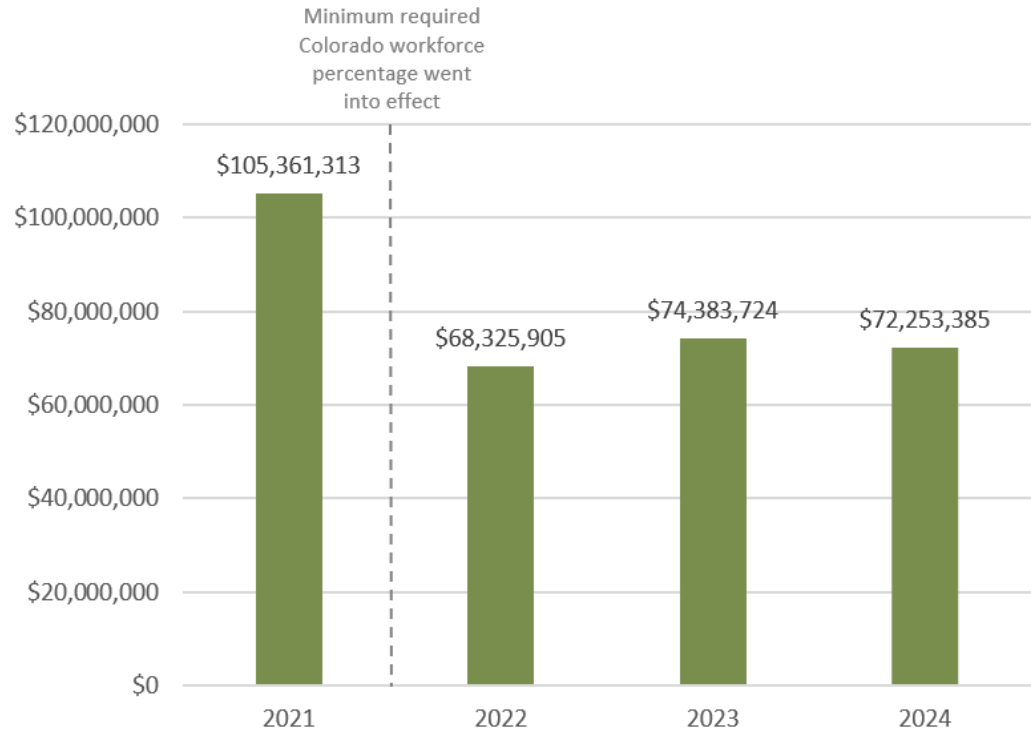
Number of Insurance Companies/Groups that Qualified for the RHO Rate Reduction 2019-2024



Source: Office of the State Auditor analysis of Division of Insurance data.

The revenue impact of the RHO Rate Reduction to the State, which corresponds to the benefit qualifying insurance groups receive, also decreased substantially when the Colorado workforce percentage requirement went into effect. In 2021, the year immediately preceding the requirement, the revenue impact to the State/benefit to taxpayers of the rate reduction was about \$105.4 million. In 2022, 2023, and 2024, the revenue impact/benefit to taxpayers of the rate reduction was about \$68.3 million, \$74.4 million, and \$72.3 million, respectively. The Division reported that it was not able to provide revenue impact data for 2019 and 2020 because it is a manual and time-consuming process to calculate these amounts, but during our last evaluation of the rate reduction, the Division provided our office with data that showed the revenue impact for 2018 was about \$89.7 million. Exhibit 3 shows the revenue impact of the RHO Rate Reduction in 2021 through 2024.

Exhibit 3
Revenue Impact to the State of the RHO Rate Reduction, 2021-2024



Source: Office of the State Auditor analysis of Division of Insurance data.

The Division did not collect data on insurance groups’ Colorado workforce percentage prior to 2022 since that was not a statutory requirement to qualify for the RHO Rate Reduction, so we were not able to verify whether insurance groups stopped qualifying because they did not meet the new requirement to maintain at least a certain percentage of their total domestic workforce in Colorado. However, as discussed above, three survey respondents reported that they stopped qualifying for the RHO Rate Reduction primarily because of the Colorado workforce percentage requirement, so it is likely that many of the others that previously qualified stopped qualifying because of this requirement, too, and the new requirement was the reason fewer groups qualified and the revenue impact to the State decreased.

Due to increasing insurance premiums, the revenue impact of the RHO Rate Reduction is likely to increase in future years, but might not result in additional Colorado jobs. Because the RHO Rate Reduction is generally equivalent to 1 percent of an insurer’s premiums, its revenue impact to the state increases when a qualifying insurer’s premium collections increase. Between Fiscal Year 2021 and Fiscal Year 2023, total insurance premium taxes collected by the State increased by 54 percent. Nationally, insurance premiums have risen in recent years and are expected to continue to rise. For example, the National Bureau of Economic Research found that insurance

premiums for property have increased by 33 percent nationwide over the last 3 years, and a representative from the Rocky Mountain Insurance Association said they are likely to continue to rise. According to the National Association of Insurance Commissioners, many factors go into determining premium prices, but they are typically tied to risk and other factors like deductibles and litigation costs. Since insurance premiums are expected to continue increasing, this means that the revenue impact of the RHO Rate Reduction is also likely to increase in the future, but not necessarily with a proportionate increase in Colorado insurance industry jobs since the increase in premiums is not tied directly to an increase in industry jobs.

Policy Consideration

In our previous evaluation of the RHO Rate Reduction, published in January 2020, we included two policy considerations: (1) the General Assembly may want to consider reviewing this provision to ensure that it is meeting its intent and consider amending statute to clarify its intent and include performance measures for the provision, and (2) consider whether the tax benefit provided under the rate reduction should continue to be tied to in-state premiums rather than other metrics more closely correlated with employment. In 2021, the General Assembly passed House Bill 21-1312, which provided that the purpose of the RHO Rate Reduction is to incentivize insurance companies to maintain a substantial workforce presence in the state and added an additional requirement that insurance companies maintain a minimum percentage of their total domestic workforce in Colorado in order to qualify for the rate reduction.

The General Assembly could consider whether to restructure the RHO Rate Reduction so that the benefit it provides to insurance companies more closely aligns with its purpose to incentivize insurers to maintain a substantial workforce presence in the Colorado. As discussed, as long as insurance groups meet either the substantial performance or significant direct insurance operations test and maintain at least 2.5 percent of their total domestic workforce in the state, they can continue to qualify for the RHO Rate Reduction despite not maintaining or increasing their overall employment in Colorado. Additionally, the benefit they receive from the RHO Rate Reduction can actually increase while they decrease jobs since the tax benefit is based on premiums collected, not jobs maintained or created. Between 2022 and 2024, we found that 15 of the 18 insurers who claimed the rate reduction collectively decreased their Colorado workforce by about 4,300 employees, but the tax benefit they received increased by about \$17.5 million during those years. These 4,300 job losses between 2022 and 2024 account for about 74 percent of the 5,800 total Colorado job losses in the private insurance industry (as reported in the BLS data) during the same period. The 5,800 job losses represent a 25 percent decline in private insurance industry jobs in the state, while, in contrast, between 2022 and 2024 nationally insurance jobs increased slightly by 0.2 percent. Therefore, the General Assembly could consider restructuring the tax expenditure so that its benefit corresponds more closely to the total jobs maintained or created each year.

Our review of other states found that 11 states structure similar tax expenditures for insurers as credits, tied to the number of employees (new or maintained) or employee payroll they have in the state. For example, in Florida and Kansas, insurers can claim a credit of 15 percent of the amount paid in salaries to eligible employees that are located in those states (in both states there is a cap on the credit). Other states allow companies to claim a credit for a specific dollar amount based on jobs created or maintained. For example, in Arizona, insurers can claim a credit for each new full-time employee hired in each of their first 3 years of employment. The credit is \$3,000 per employee hired/maintained. For context, the average per-employee benefit for Colorado insurers was about \$4,000 in 2022, \$6,100 in 2023, and \$7,400 in 2024. We identified two states—Alabama and Oklahoma—that provide a tax expenditure for insurance companies that is similar to Colorado’s RHO Rate Reduction. However, in Alabama and Oklahoma, the percent of the tax incentive is tied to the number of employees the insurer has in the state, so insurers with more employees in the state have a higher percent rate reduction in their insurance premium taxes than insurers with fewer employees. These structures (i.e., credits based on a percentage of in-state employee payroll or set dollar amount per new or maintained employee or rate reduction tiers based on number of employees in the state) all tie the benefit more closely to jobs created or maintained in the state. As a result, when employment and/or wages increase, the benefit increases, but if employment and/or wages decrease, the benefit companies get also decreases.

This approach would also be more consistent with job creation tax incentives targeted to other industries that are subject to income taxes in Colorado. For example, the Colorado Job Growth Incentive Credit [Section 39-22- 531, C.R.S.] is available for businesses that create new jobs for a project “that encourages, promotes, and stimulates economic development in key economic sectors...” The company’s annual credit amount is equal to 50 percent of the Federal Insurance Contributions Act (FICA) taxes imposed on the taxpayer during the year for net new jobs. Companies must typically create at least 20 net new jobs to qualify, but that number is reduced when the jobs are created in certain economically distressed areas of the state.

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Sustainable Aviation Fuel State Incentives Memo

Statute allows the Legislative Oversight Committee Concerning Tax Policy (Committee) to request up to three specific tax expenditure evaluations to be completed by the Office of the State Auditor (OSA) each year [Section 39-21-403(2)(c)(I)(B), C.R.S.]. During the October 31, 2024 hearing, the Committee requested that the OSA look at overlapping incentives targeted toward the sustainable aviation fuel industry in Colorado.

According to the U.S. Department of Energy (U.S. DOE), sustainable aviation fuel is a “biofuel used to power aircraft that has similar properties to conventional jet fuel but with a smaller carbon footprint.” It is produced from biomass resources, such as oils and greases, municipal solid waste, and crops. Sustainable aviation fuel must be blended with conventional fossil jet fuel before it can be certified for use in commercial aircraft.

The sustainable aviation fuel production industry is developing both nationally and globally. Although many production facilities have been announced, including a potential facility in Colorado, there were only four operational sustainable aviation fuel production facilities in the United States—none of which were located in Colorado—as of August 2024 according to U.S. DOE. The Colorado Energy Office (CEO) also reported that it is not aware of any production facilities in Colorado at this time. We did identify at least two companies that are importing sustainable aviation fuel from another state and selling the fuel in Colorado, as of March 2025, but it is not clear if they qualify for any incentives.

According to a February 2024 report prepared by the Rocky Mountain Institute (RMI), the Rocky Mountain Region, which includes Colorado, Utah, New Mexico, and Wyoming, has good potential for future development within the sustainable aviation fuel sector due to its existing infrastructure and feedstock availability. However, sustainable aviation fuel production facilities are both expensive and time-consuming to construct, with recent estimates ranging from about \$117 million for a proposed Colorado facility to over \$5 billion for the federally-sponsored “Minnesota SAF Hub.” The U.S. DOE estimates that it takes an average of over 4 years for the completion of facility construction. Therefore, the existing incentives, which are intended to encourage growth in the industry, could be used in Colorado in the future.

We found that there are several state and federal provisions that could potentially provide overlapping incentives to the sustainable aviation fuel industry in Colorado. However, because the industry is in the early stages of development in the state, most of these incentives cannot be used by Colorado businesses and several of the incentives will no longer be available going forward unless additional funding is approved.

Colorado Tax Incentives and Programs

We identified one state tax credit targeted specifically at the sustainable aviation fuel production industry—the Sustainable Aviation Fuel Production Facility Credit [Section 39-22-556, C.R.S.]. This provision, which was first available for Tax Year 2024, provides a credit to partially offset the cost of developing sustainable aviation fuel production facilities. We also identified one state grant program—the Clean Air Grant—that is not solely targeted to the sustainable aviation fuel industry, but could potentially award funding to projects that produce or utilize sustainable aviation fuel [Section 24-38.5-116, C.R.S.]. The Sustainable Aviation Fuel Production Facility Credit and the Clean Air Grant are both administered by the CEO. As of January 2025, no sustainable aviation fuel facilities had received either the credit or grant. Further, the final deadline for applications for the grant passed on January 31, 2025 and no companies within the sustainable aviation fuel industry had applied.

More detailed descriptions regarding eligibility, requirements, operation, and limitations of each of the incentives mentioned above are included below.

The Colorado Sustainable Aviation Fuel Production Facility Credit [Section 39-22-556, C.R.S.] is a refundable income tax credit, available for Tax Years 2024 to 2032, that covers a percentage of the total cost of constructing, reconstructing, or erecting a sustainable aviation fuel production facility by a qualified taxpayer. A qualified taxpayer is defined in statute as “an aviation business, a sustainable aviation fuel producer, or an airport” that is subject to income tax in Colorado. A sustainable aviation fuel production facility is defined in statute as a “facility which produces sustainable aviation fuel” or a “facility directly related to enabling the production or distribution of sustainable aviation fuel as determined under the standards established by the [Colorado Energy Office].”

Statute provides that the purpose of this credit is “to induce certain designated behavior by taxpayers, specifically the construction of sustainable aviation fuel production facilities in the state, by providing tax relief for certain businesses and individuals that construct or operate these facilities in the state.” According to statute, the credit is meeting its purpose if “the construction, reconstruction, and erection of sustainable aviation fuel production facilities in the state increase significantly in tax years for which the credit is allowed.”

In order to claim the credit, a taxpayer must submit an application for a tax credit certificate to the CEO after the facility’s construction has been completed. When the application is approved and the certificate issued, the credit can be claimed by the taxpayer in the tax year in which the facility is placed into service. The credits are issued by the CEO in the order in which eligible taxpayers apply. Statute provides the percentage used to calculate the credit award, which is based on the year that the facility construction begins, as provided in Exhibit 1.

Exhibit 1
Sustainable Aviation Fuel Production Facility Credit Percentages by Year

Calendar Year When Facility Construction Began	Percent of Qualified Costs Covered
2024-2026	30%
2027	24%
2028	18%
2029 - 2032	12%

Source: Office of the State Auditor analysis of Section 39-22-556(3), C.R.S.

Though statute does not provide a maximum award value per taxpayer, it does limit the cumulative total amount of credits that the CEO can award to \$1 million for Tax Year 2024, \$2 million per year for Tax Years 2025 and 2026, and \$3 million per year for Tax Years 2027 through 2032. For example, a taxpayer who successfully claims a credit certificate for construction of a sustainable aviation fuel production facility that began in 2025 and entered into service in 2030 would be entitled to a credit equal to 30 percent of the facility costs, up to a maximum of \$3 million.

Due to the high cost of constructing a sustainable aviation fuel production facility, it is likely that only one sustainable aviation fuel industry taxpayer could claim the credit each year. The proposed Colorado facility mentioned above is estimated to cost about \$117 million to construct. Hypothetically, if a taxpayer were awarded the maximum possible credit value of \$3 million, the percentage of costs covered for this project would be less than 3 percent of the total cost to build the production facility. All facilities awarded a credit will be required to annually report to the CEO that at least 60 percent of their total fuel production or distribution is sustainable aviation fuel for at least 3 consecutive years after they claim the credit. If this requirement is not met, the credit will be recaptured by the State. It is possible the distributors, mentioned above, that are importing sustainable aviation fuel into Colorado would be eligible for the credit; however, the businesses have not applied for the credit, so the CEO could not say whether those facilities would meet the standards.

Because the credit first became available in Tax Year 2024, we could not yet assess whether it is meeting its purpose or will in future years. As of January 2025, the CEO reported that no sustainable aviation fuel production or distribution facilities have submitted an application. Therefore, it is not clear when and if taxpayers might use this credit. We plan to evaluate the credit by December 2028.

The Colorado Clean Air Grant program [Section 24-38.5-116, C.R.S.] is a competitive grant, which had four rounds of funding between March 2023 and January 2025, to assist existing industrial and manufacturing operations in reducing emissions of air pollutants. Statute specifies that “projects producing or utilizing sustainable aviation fuel” may be considered, but gives the CEO discretion in determining what types of

projects will be considered and awarded grants. Statute provides that the purpose of this grant is “to help finance voluntary projects to reduce emissions of air pollutants from industrial and manufacturing operations.” The total funding available through this program is not to exceed \$25 million and must be expended by the end of Fiscal Year 2028.

To apply for the grant, an industrial or manufacturing operation is required to complete an application packet detailing the specific project(s) to be funded. An applicant must request at least \$100,000 in grant funding, and there is a maximum possible award of \$3 million. Projects that are awarded a grant must provide a 25 percent match of the funds awarded that cannot be met using other governmental awards. Awardees are required to comply with any on-site monitoring visits and must provide the CEO with quarterly progress reports that include both financial and program status updates and a final report due upon project completion. Awardees are required to provide additional reports as requested by the CEO for up to 5 years after project completion and must submit to on-site monitoring visits for up to a year after project completion. This program requires that all projects have an estimated payback period, defined by CEO staff as the amount of time needed to recover the cost of an investment, of greater than 3 years. The Clean Air Grant program’s final request for applications closed January 31, 2025, and CEO staff reported that they did not receive any grant applications for projects in the sustainable aviation fuel industry.

Other Possible State Tax Incentives. There are additional state incentives that a sustainable aviation fuel company could feasibly qualify for; however, these incentives do not specifically target the industry. For example, a sustainable aviation fuel business could potentially qualify for place-based incentives like the Enterprise Zone Tax Credits, depending on their business location. They could also potentially qualify for incentives related to machinery used in production of sustainable aviation fuel, such as the Manufacturing Sales Tax Exemptions. Additionally, a producer that uses clean hydrogen to make sustainable aviation fuel could potentially qualify for Colorado’s Clean Hydrogen Income Tax Credit.

Incentives in Other States. There are five other states—California, Illinois, Minnesota, Washington, and Nebraska—with tax incentives aimed at growing their respective sustainable aviation fuel production industries. However, these states have all focused on the post-construction phase with per-gallon incentives related to production, sale, or use. Colorado is the only state currently offering a tax incentive for the construction of a sustainable aviation fuel production facility.

Federal Tax Incentives and Programs

We also identified three federal tax incentives related to sustainable aviation fuel. One—the Advanced Energy Project Credit [26 USC 48C]—is available for the construction of a sustainable aviation fuel production facility and could provide a benefit similar to the State’s credit. However, federal law limits the credits that can be awarded to \$10 billion in total and, at the time of our review, all available credits had already been awarded; therefore, this credit will no longer be available unless additional credits are authorized. The other federal incentives target the production, sale, and use of sustainable aviation fuel and, although benefiting the industry generally, would not provide a benefit similar to those provided by the State that are targeted towards creating new facilities. Specifically, the Clean Fuel Production Credit [26 USC 45Z] provides a per-gallon income tax credit for each gallon of sustainable aviation fuel that is produced and sold in the U.S. on or after January 1, 2025. Finally, the Sustainable Aviation Fuel Credit [26 USC 6426(k)], which expired on January 1, 2025, provided a per-gallon excise or income/general business tax credit for sustainable aviation

fuel sold or used for end-use. We were unable to determine if any Colorado taxpayers had received this federal credit before it expired.

More detailed descriptions regarding eligibility, requirements, operation, and limitations of each of the incentives mentioned above are included below.

The federal Advanced Energy Project Credit [26 USC 48C] is a competitive income tax credit for up to 30 percent of an investment made for the construction of an advanced energy project, which includes sustainable aviation fuel production facilities. The Inflation Reduction Act of 2022 provided \$10 billion in funding for this credit. The Advanced Energy Project Credit is administered by the Internal Revenue Service in partnership with the U.S. DOE. According to the U.S. DOE, the \$10 billion has been awarded to projects in 2024 and 2025, and Congress is not considering legislation to make more funding available for it. Unless additional funding is provided, this federal credit will not be available for new sustainable aviation fuel production facilities in Colorado.

The federal Clean Fuel Production Credit [26 USC 45Z] provides an income tax credit of up to \$1.75 per gallon of sustainable aviation fuel produced and sold for end-use. Since the credit requires that the taxpayer both produce and sell the sustainable aviation fuel in order to qualify for the credit, and there are no operational sustainable aviation fuel production facilities in Colorado as of January 2025, there are currently no Colorado facilities that could qualify for this credit. Additionally, this credit is not available for fuel sold on or after January 1, 2028. Given the U.S. DOE's average minimum facility construction time of 4 years, it is unlikely any sustainable aviation fuel production facilities that might be constructed in Colorado would be completed prior to this credit's expiration.

The federal Sustainable Aviation Fuel Credit [26 USC 6426(k) and 26 USC 40B] provided an excise tax or income/general business tax credit of up to \$1.75 per gallon of sustainable aviation fuel sold or used for end-use. In the instance that the sustainable aviation fuel had already been blended with conventional jet fuel prior to its sale or use, the credit was calculated using only the amount of sustainable aviation fuel within the blend. This credit was available for fuel sold or used after December 31, 2022 and prior to January 1, 2025. The credit is no longer available and we do not know if any Colorado companies received this credit when it was available.

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Oil and Gas Severance Tax Deduction Memo

The Oil and Gas Severance Tax Deduction for Transportation, Manufacturing, and Processing Costs (Deduction) allows taxpayers to deduct these costs (i.e., transportation, manufacturing, and processing costs) when computing gross income for oil and gas severance tax purposes. Severance taxes are based on the “gross income attributed to the sale of oil and gas severed from the earth” [Section 39-29-105(1)(b), C.R.S.] and statute [Section 39-29-102(3)(a), C.R.S.] defines “gross income” for oil and gas severance tax purposes as the “net amount realized by the taxpayer for the sale of the oil or gas...at the wellhead, or after transportation, manufacturing, and processing of the product... less deductions for direct costs actually paid or accrued by the taxpayer for transportation, manufacturing, and processing...” Based on statute [Section 39-29-102, C.R.S.] and committee legislative testimony, we inferred that the purpose of the Deduction is to ensure that the severance tax on oil and gas is based on the value of oil and gas at the point of extraction (i.e., at the wellhead), rather than on the income realized at a later point of sale, since the sale price is typically higher than the value of the oil and gas at the point of extraction to cover the costs of transportation, manufacturing, and processing.

Oil and gas operators, which are companies that manage wells and also transport, process, and manufacture oil and gas, transmit the income from the sale of oil and gas to interest owners, which are companies and individuals who have an ownership interest in oil and gas wells. In some cases, operators are also interest owners for the wells they manage. Interest owners are responsible for applying the Deduction to compute “gross income”, calculating severance tax owed on their “gross income” from wells, and remitting severance taxes to the Department of Revenue (Department).

In our July 2020 evaluation of the Deduction, we found that it is generally meeting its purpose because many taxpayers and CPAs who work with oil and gas operators and interest owners are aware of and use it. We estimated that the Deduction had a revenue impact to the State of approximately \$240.8 million in reduced severance tax revenue. However, we found that it is likely that not all eligible taxpayers are claiming the Deduction, particularly interest owners that are not also operators, because operators do not always tell interest owners whether they applied the Deduction prior to transmitting their income or provide information that would allow interest owners to calculate the Deduction prior to paying their severance taxes. We included policy considerations that the General Assembly could consider:

- Clarifying the intent, scope, and definitions of the Deduction in light of the Colorado Supreme Court’s decision in *BP Am. Prod. Co. v. Colo. Dep’t of Revenue*, which effectively ruled that

statute allowed taxpayers to deduct indirect costs that Department rules had previously disallowed.

- Requiring that operators report the amount of the Deduction to interest owners who can then apply it when calculating their “gross income,” or changing the structure of the severance tax so that operators file and remit severance taxes and report the Deduction as opposed to transmitting income to interest owners who file and report their share of severance taxes (i.e., shifting the responsibility of paying the tax to operators).

The purpose of this memo is to provide an update on changes made to the Deduction since our last review and their impact.

The General Assembly clarified which costs are deductible. In 2021, the General Assembly enacted House Bill 21-1312, which scaled back allowable costs for the Deduction, restricting eligible costs to transportation, manufacturing, and processing costs that are “direct costs actually paid or accrued” by the taxpayer. This effectively disallowed the cost of capital, as defined by the Colorado Supreme Court, and other indirect costs, like the cost to dispose of saltwater used during drilling. Prior to House Bill 21-1312, the Colorado Supreme Court’s decision in *BP Am. Prod. Co. v. Colo. Dep’t of Revenue* [2016 CO 23] allowed taxpayers to claim capital costs, which, according to the ruling, is “the amount of money that an investor could have earned on a different investment of similar risk.” There is not a reliable method to determine how much this change affected the Deduction’s revenue impact.. As explained below, operators are not required to report the amount of the Deduction claimed, or the type of costs, so data is incomplete, and when operators do report the amount, it is done through paper filings, which makes gathering the information a manual process.

The Severance Tax Workgroup recommended changes to severance tax collection and how the Deduction is claimed. As of May 2025, the Department has not made any administrative changes, and there have been no legislative changes that have affected the way the Deduction is claimed since our 2020 evaluation. However, under Senate Bill 21-281 and House Bill 22-1391, a Severance Tax Workgroup (Workgroup), consisting of the director of the Office of State Planning and Budgeting and the Executive Directors of the Departments of Revenue, Natural Resources, Education, and Local Affairs, or their designees, was created to develop recommendations and an implementation plan to shift responsibility for remitting the state severance tax on oil and gas from interest owners to operators, require electronic filing of severance taxes, and require additional electronic data collection to ease administration and enforcement of oil and gas severance taxes. The Workgroup was required to submit its recommendations and implementation plan to the Joint Budget Committee by January 15, 2025. The Workgroup recommended that the General Assembly:

- Make operators responsible for remitting severance taxes beginning in Tax Year 2028. Interest owners would still be liable for severance taxes, but operators would be responsible for

computing taxes owed, withholding taxes, and remitting tax payments to the Department. The Workgroup anticipated this would significantly reduce the number of severance tax returns that are filed with the Department because there are far fewer operators than interest owners and would make it easier to collect information on the Deduction.

- Mandate electronic filing of severance taxes starting in Tax Year 2028, which is currently done through paper returns. Electronic filing would make it easier for the Department to require operators to report the amount of the Deduction claimed per well, which the Workgroup recommended the Department also start in Tax Year 2028. Currently, this information is part of an informational form (Detail Information for Producers Form DR 0021PD) that operators are required to complete, but are not required to submit to the Department. The Workgroup noted that requiring electronic filing and operators to report the amount of the Deduction they claim would allow the Department to more easily extract and use information on the Deduction for compliance and reporting purposes.

Legislation was not introduced during the 2025 Legislative Session to implement the Workgroup's proposed changes.

Current Audit

The Office of the State Auditor (OSA) is currently conducting a performance audit of oil and gas reporting, as required by Section 2-3-128, C.R.S. The legislative declaration from House Bill 22-1361, which created the audit requirement, states that the purpose of the audit is to “ensure proper reporting related to oil and gas extraction.” The audit statute requires the OSA to compare oil and gas related reporting from the Department of Revenue, Colorado Department of Public Health and Environment, and Energy and Carbon Management Commission within the Department of Natural Resources in order to find inconsistencies, and to describe missing, incomplete, or incorrect reports. Because operators are not required to report the Deduction to any of these state agencies, the audit will not be able to determine whether taxpayers are correctly claiming the Deduction or the amount deducted.

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Senior Housing Income Tax Credit

Tax Expenditure Evaluation • June 2025 • 2025-TE6

Tax Type:	Income tax
Expenditure Type:	Credit
Statutory Citation:	§ 39-22-544, C.R.S
Year Enacted:	2022
Repeal/Expiration Date:	December 31, 2024
Revenue Impact (2022):	\$73.9 million

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

The Senior Housing Credit was enacted in 2022 to provide assistance to Colorado seniors who are not eligible for another state tax expenditure, the Senior Homestead Property Tax Exemption. This exemption has been available in most tax years since 2002 to Colorado seniors who have owned and lived in their home for at least 10 years. However, it generally cannot be claimed by seniors who rent their homes or by senior homeowners who have owned and occupied their homes for fewer than 10 years.

The Senior Housing Credit allows Colorado seniors who have not claimed the Senior Homestead Exemption and who have federal adjusted gross incomes (AGIs) below certain thresholds to claim a refundable credit against their Colorado income tax liability—up to \$1,000 for Tax Year 2022 or \$800 for Tax Year 2024. The amount of a taxpayer's credit is adjusted based on their AGI, with higher credit amounts allowed for taxpayers with lower incomes. Taxpayers with AGIs less than \$25,500 may claim the maximum credit amount allowed, and taxpayers with AGIs above \$75,000 or \$125,000 (depending on the year and the taxpayer type) are not eligible for the credit.

According to statute, the purpose of the Senior Housing Credit is “to provide tax relief for income-qualified seniors” and, more specifically, “to help more seniors afford the high cost of housing in Colorado” [Section 39-22-544(1)(b), C.R.S.]. We found that the credit provided financial assistance to a significant number of Colorado seniors in Tax Year 2022 and is likely to be particularly helpful for seniors with lower incomes. Additionally, the relative proportion of seniors receiving substantial assistance from the credit is likely higher among seniors of color and in certain areas of the state. We also found that the 2024 version of the credit is likely to provide many taxpayers with less assistance than the 2022 credit.

- The credit provided financial assistance to an estimated 120,000 Colorado seniors in Tax Year 2022, including a substantial number who received the maximum credit amount.
- The extent to which the Senior Housing Credit assisted seniors with housing costs is dependent on each senior's individual situation. However, the credit is likely to be particularly helpful for seniors with low incomes. Additionally, seniors who received both the Property Tax, Rent, Heat (PTC) Rebate and

the Senior Housing Credit likely received substantial additional benefit from the credit compared with the rebate alone.

- The relative proportion of seniors potentially benefitting from the credit is higher among seniors of color and in areas of the state that have lower average housing costs and in which a higher proportion of seniors rent their homes and have lower incomes.
- Some seniors who claimed the Senior Homestead Exemption would have received greater monetary benefit from the Senior Housing Credit but were unable to claim the Senior Housing Credit because the Senior Homestead Exemption is applied automatically to seniors' property tax bills in most cases.
- Although data for the 2024 version of the Senior Housing Credit is not yet available, it appears that the 2024 credit may not provide as much assistance as the 2022 credit for many seniors. Specifically, the 2024 version of the credit provides smaller credit amounts to many taxpayers than the 2022 version, with the exception of some joint filers. Additionally, the 2024 credit is not adjusted for inflation or increases in housing costs, so the credit's relative value is lower in 2024 compared with 2022.

Policy Considerations

If the General Assembly decides to extend the Senior Housing Credit to additional tax years, legislators may want to consider whether to make adjustments to the credit to account for one or more factors identified in this report that likely reduce the value of the credit for some taxpayers. Specifically, inflation and increases in housing costs are likely to degrade the credit's value to seniors over time. Additionally, seniors who could qualify for either the Senior Housing Credit or the Senior Homestead Exemption may not receive the maximum tax benefit for which they are eligible.

Senior Housing Income Tax Credit

Background

The Senior Housing Income Tax Credit (Senior Housing Credit) was enacted in 2022 to provide assistance to Colorado seniors who are not eligible for another state tax expenditure, the Senior Property Tax Exemption (also known as the Senior Homestead Exemption). The Senior Homestead Exemption has been available in most tax years since 2002 to Colorado seniors who have owned and lived in their home for at least 10 years. However, it generally cannot be claimed by seniors who rent their homes or by senior homeowners who have owned and occupied their homes for fewer than 10 years, including seniors who owned a previous home for at least 10 years but have since moved. For Tax Years 2025 and 2026 only, statute also allows a similar benefit for seniors who qualified for the Senior Homestead Exemption in 2020 or later but lost eligibility because they later moved.

The Senior Housing Credit allows Colorado seniors who have not claimed the Senior Homestead Exemption and who have federal adjusted gross incomes (AGIs) below certain thresholds to claim a refundable credit against their Colorado income tax liability—up to \$1,000 for Tax Year 2022 or \$800 for Tax Year 2024. The credit was initially enacted for a single income tax year—2022. During the 2024 legislative session, legislators enacted a bill that extended the credit to one additional income tax year—2024—with some modifications to the original credit. Our analysis of the credit’s effectiveness generally focuses on the version of the credit available in Tax Year 2022 because Department of Revenue (Department) data on Tax Year 2024 claims of the Senior Housing Credit were not available yet at the time of our review.

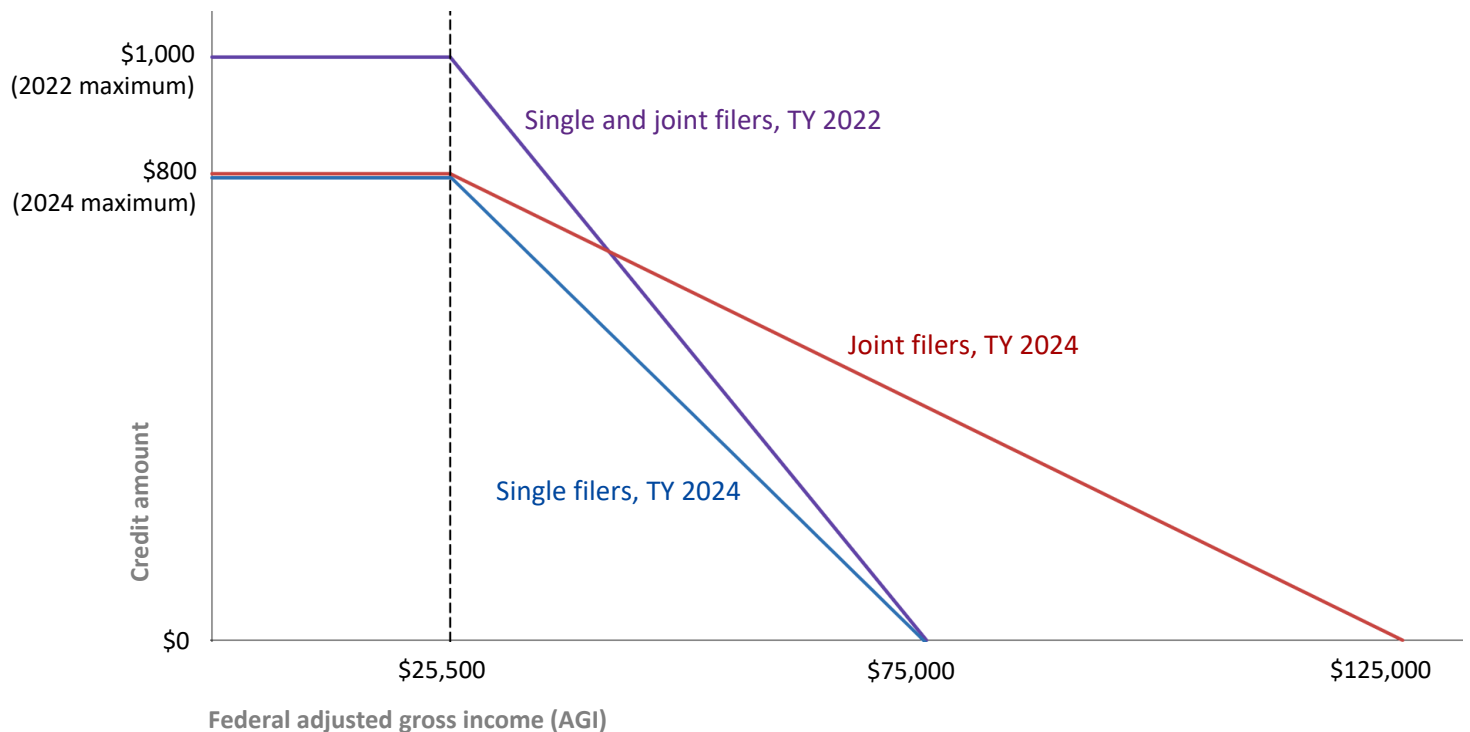
In order to qualify for the Senior Housing Credit, a taxpayer must be at least 65 years old at the end of the income tax year, and they must live in Colorado for at least part of the year. The credit is apportioned for part-year residents claiming the credit for Tax Year 2024 based on the portion of their income that is subject to Colorado income tax. Part-year residents claiming the credit during Tax Year 2022 received the full amount of the credit without apportionment. If the amount of the taxpayer’s credit exceeds their income tax liability, the remaining credit amount is refunded to the taxpayer.

As shown in Exhibit 1, the amount of a taxpayer’s credit is adjusted based on their AGI, with higher credit amounts allowed for taxpayers with lower incomes. Taxpayers with AGIs less than \$25,500 may claim the maximum credit amount allowed. Starting with AGIs of at least \$25,500, the taxpayer’s credit amount decreases incrementally for every additional \$500 in income. Taxpayers with AGIs above a certain threshold—\$75,000 or \$125,000, depending on the year and the taxpayer

type—are not eligible for the credit. Notably, seniors who qualify for the credit and have also received the Property Tax, Rent, and Heat Rebate (also known as the PTC Rebate)—granted to seniors with very low incomes who incur property tax, rent, and/or heating expenses and apply for the rebate with the Department—for the same tax year are eligible for the maximum amount of the Senior Housing Credit regardless of their AGI.

Exhibit 1

Senior Housing Credit^{1, 2, 3} Amount by Federal Adjusted Gross Income



Source: Office of the State Auditor analysis of Section 39-22-544(4) and (4.5), C.R.S.

¹Credit amounts decrease incrementally by \$10 (in Tax Year 2022), \$8 (for single taxpayers in Tax Year 2024), or \$4 (for joint taxpayers in Tax Year 2024) for every additional \$500 in AGI for taxpayers with AGIs of at least \$25,500.

²Credit amounts for individuals who are married but file separate income tax returns are not depicted. In Tax Year 2022, these filers could receive a maximum credit of \$500 each, and the credit amount for taxpayers with AGIs of at least \$25,500 decreased by \$5 for each additional \$500 in AGI. In Tax Year 2024, the maximum credit allowed for married filing separate returns was \$400, with the credit amount decreasing by \$4 for each additional \$500 in AGI.

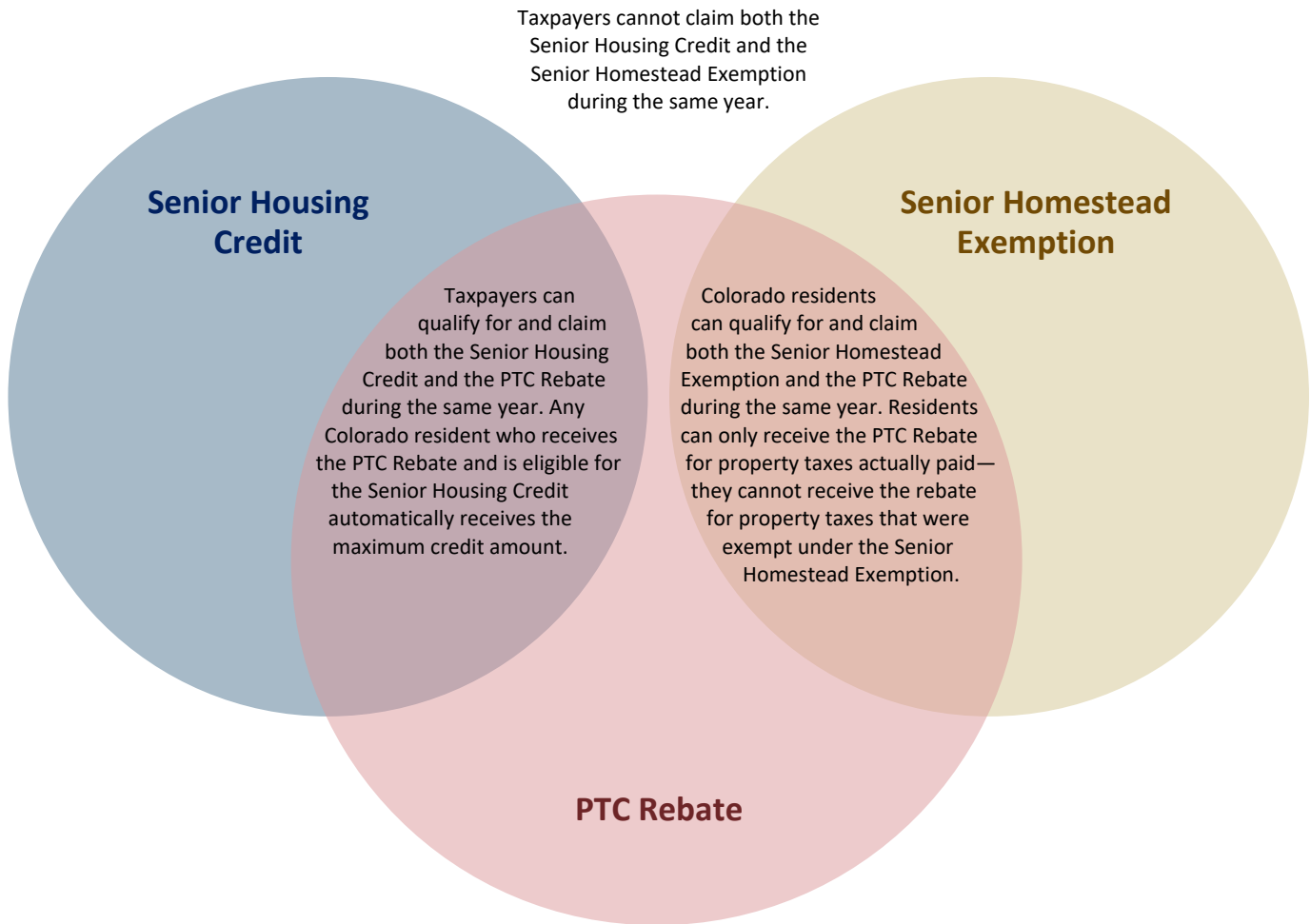
³Seniors who qualify for both the Senior Housing Credit and the PTC Rebate are eligible to receive the maximum credit amount regardless of their AGI.

As with other income tax credits, taxpayers may claim the Senior Housing Credit on their Colorado income tax return credit schedule. However, the credit may also be claimed via the application for the PTC Rebate. Many individuals who receive the PTC Rebate do not have a Colorado income tax liability and may, therefore, not be required to file a Colorado income tax return. Since seniors who receive the PTC Rebate are also likely to be eligible for the Senior Housing Credit due to their low incomes, allowing them to claim the credit via the rebate application provides them with an easier way to access the credit than filing an income tax return for the sole purpose of receiving the credit.

Exhibit 2 provides a summary of how the Senior Housing Credit, the Senior Homestead Exemption, and the PTC Rebate interact.

Exhibit 2

Summary of Overlap of the Senior Housing Credit, Senior Homestead Exemption, and PTC Rebate



Source: Office of the State Auditor analysis of Section 39-22-544(3)(a)(II)(C), (3)(b)(II)(C), (4)(c), and (4.5)(d), C.R.S.; and the Department of Revenue's DR 0104PTC Application.

Tax expenditures that are intended to alleviate housing costs for seniors are somewhat common in other states. We identified 24 other states with such tax expenditures that apply to property taxes and 3 other states with similar income tax expenditures. Characteristics of these tax expenditures vary. For example, some are limited to seniors with incomes below certain thresholds, like Colorado's Senior Housing Credit, and some are not. Additionally, although a significant number of property tax expenditures for seniors are limited to homeowners, a few states have found ways to extend their senior property tax expenditures to seniors who do not own their homes. For example,

Alaska and Illinois provide renters with direct payments or grants in lieu of a reduction in property taxes.

According to statute, the purpose of the Senior Housing Credit is “to provide tax relief for income-qualified seniors” and, more specifically, “to help more seniors afford the high cost of housing in Colorado” [Section 39-22-544(1)(b), C.R.S.].

Additionally, the section of statute that authorizes the credit acknowledges that many seniors are ineligible for the Senior Homestead Exemption, which suggests that the credit is specifically intended to assist seniors who are not eligible for the Senior Homestead Exemption—those who have owned their homes for fewer than 10 years, who rent their homes, or have housing arrangements other than home ownership. We did not identify a data source that would enable us to estimate how many Colorado seniors have owned their homes for fewer than 10 years. However, based on American Community Survey (ACS) data for 2019 through 2023, we estimate that about 19 percent of senior households in Colorado rent their home. Although older Coloradans are more likely to be homeowners than younger adults, they are also more likely to be living on fixed incomes than younger generations. Additionally, the Department’s income tax return data indicates that the average AGI for taxpayers at least 65 years old in Tax Year 2020 was over \$30,000 less than the average AGI for taxpayers between 45 and 64 years old, and 60 percent of senior taxpayers had AGIs less than \$75,000.

Technical Note

The calculation of federal adjusted gross income (AGI) can be complicated. AGI includes certain types of income, such as wages, business income, and pensions, and does not include other types of income, such as life insurance proceeds and worker’s compensation. Whether a given type of income is included in AGI can also vary depending on taxpayers’ unique circumstances. The types of income that individuals must report to the American Community Survey (ACS) largely overlap with the types of income that are included in AGI, but there are some differences—capital gains from a home sale, for example, are not included in income for purposes of the ACS but may be included in AGI. Therefore, income estimates in this report that are based on ACS data are an approximation of AGI rather than an exact representation.

Statute establishes that our office will measure the effectiveness of this credit in achieving its statutory purpose “based on the number of taxpayers who have claimed the [credit].” [Section 39-22-544(1)(c), C.R.S.]. We also developed the following performance measure in order to provide additional insight on how well the credit is meeting its purpose: **To what extent does the Senior Housing Credit provide assistance with housing costs for seniors who are not eligible for the Senior Homestead Exemption?**

Evaluation Results

The Senior Housing Credit provided financial assistance to a significant number of Colorado seniors in Tax Year 2022 and is likely to be particularly helpful for seniors with lower incomes. Additionally, the relative proportion of seniors receiving substantial assistance from the credit is likely higher among seniors of color and in areas of the state that have lower average housing costs and in which a higher proportion of seniors rent their

homes and have lower incomes. We also found that the 2024 version of the credit is likely to provide many taxpayers with less assistance than the 2022 credit.

The credit provided financial assistance to an estimated 120,000 Colorado seniors in Tax Year 2022, including a substantial number who received the maximum credit amount. We were not able to determine how many seniors were potentially eligible for the credit, so are not able to determine what percentage of the eligible population claimed the credit. A total of 85,800 taxpayers (including both joint and single filers) claimed the credit via their Colorado income tax returns, and the Department issued credits to an additional 8,500 seniors who applied for the PTC Rebate. Exhibit 3 summarizes credit claims in Tax Year 2022 by taxpayer type.

Exhibit 3

Summary of Senior Housing Credit Claims by Taxpayer Type, Tax Year 2022

Claim Method	Taxpayer Type	Number of Claimants	Average Credit Amount
Income tax return	Single filers	60,068	\$788
Income tax return	Joint filers	25,695	\$704
PTC Rebate application	Unknown ¹	8,515	\$1,000
All	All	94,278	\$784
Estimated number of individuals benefitting from the credit: ² 119,973			

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

¹PTC Rebate recipients must specify on their application whether they are applying as a single individual or a married couple. However, the Department was unable to provide this data.

²We estimated the number of individuals benefitting from the credit by multiplying the number of credit claims via income tax returns filed jointly by 2, then adding the number of claims by single filers and the number of claims granted via the PTC Rebate application.

Additionally, a total of 52,000 taxpayers received the maximum allowable credit amount of \$1,000, representing an estimated 62,600 individual seniors when factoring in joint filers (a little over half of all recipients). Of these, about 8,500 taxpayers claimed the credit via the PTC Rebate application, and all of these taxpayers received the maximum credit amount of \$1,000. Exhibit 4 provides a summary of the credit claims in Tax Year 2022 by taxpayer AGI. As shown, the average credit amount for taxpayers with AGIs up to \$25,500 was \$992, and the average amount decreases as AGI increases. Taxpayers in the highest AGI range, from \$50,000 to \$75,000, received the lowest credit amounts, averaging \$261 per taxpayer.

Exhibit 4**Summary of Senior Housing Credit Claims by Federal AGI, Tax Year 2022**

Federal AGI	Number of Claimants	Average Credit Amount
Up to \$25,500 ¹	52,933	\$992 ²
\$25,500 to \$49,999	21,892	\$746
\$50,000 to \$75,000	19,453	\$261
All	94,278	\$784

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

¹Data on federal AGI for PTC Rebate recipients is not available. However, since the PTC Rebate was only available for seniors with incomes below \$22,858 in Tax Year 2022, we have included all PTC Rebate recipients in the group with federal AGI up to \$25,500.

²Although taxpayers with AGIs in this range were generally eligible for the maximum credit amount of \$1,000 in Tax Year 2022, some taxpayers claimed amounts lower than this, which reduced the average credit amount below \$1,000. For example, taxpayers who were married but chose to file separately were each eligible for a maximum of \$500.

Additionally, some taxpayers may have claimed a smaller credit amount than they were eligible for, possibly due to misunderstanding how the credit works. Department staff noted that they do not correct taxpayer returns in cases where an eligible taxpayer claims a smaller credit amount than they are eligible for.

The extent to which the Senior Housing Credit assisted seniors with housing costs is dependent on each senior's individual situation, but the credit is likely particularly helpful for seniors with low incomes. Exhibit 5 presents four different hypothetical taxpayer scenarios with varying income and varying rent amounts and provides the percentage of annual rent and number of days' rent covered by the credit. As shown, the credit offsets the largest portion of rent for taxpayers with lower incomes and lower rents and provides a smaller benefit for moderate income taxpayers with relatively higher rents.

Technical Note

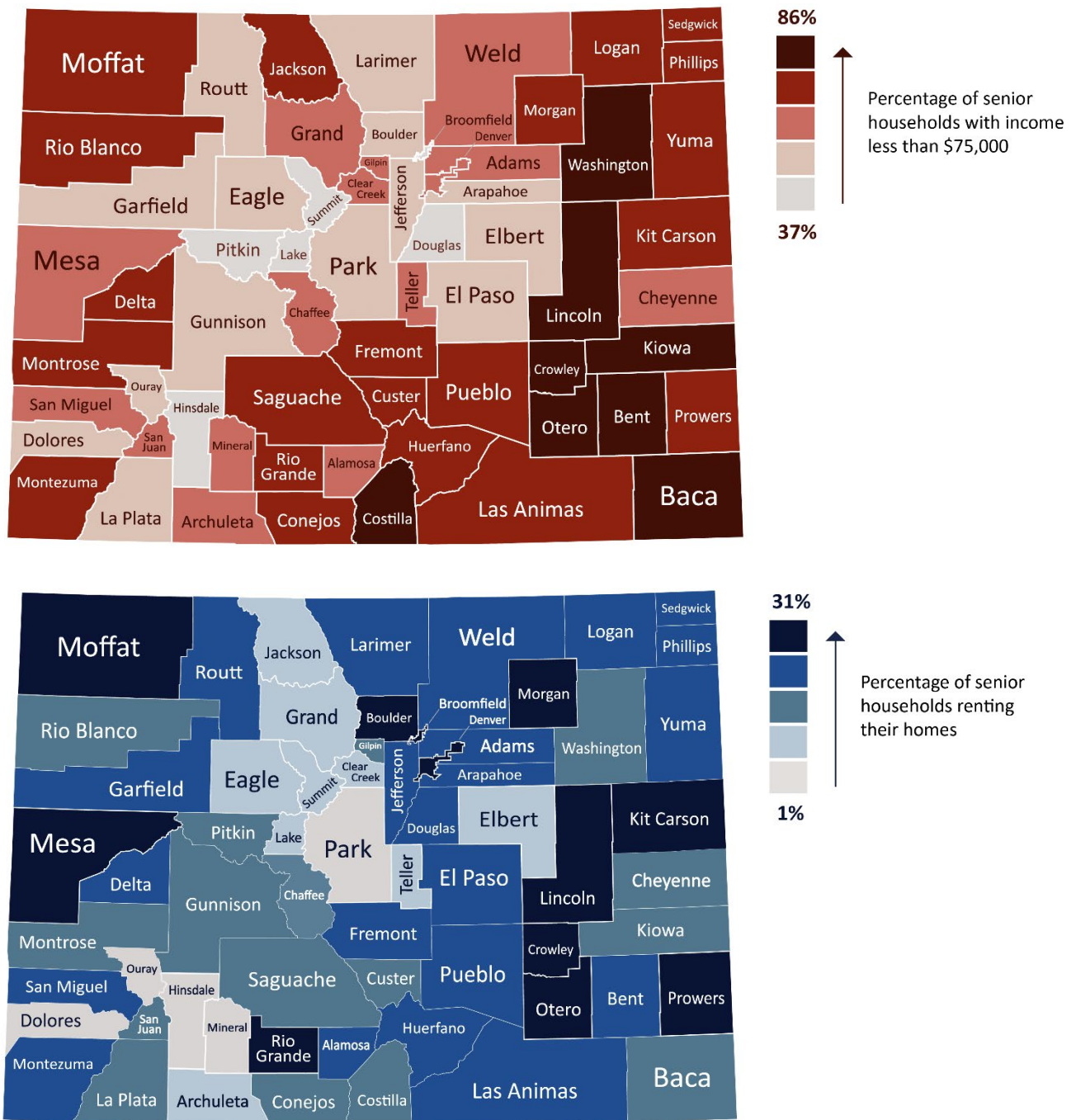
In this section of the report, we use rent as a proxy for housing costs because a significant portion of Senior Housing Credit claimants are likely renters, as opposed to homeowners, and data on rent is widely available. Although we have not presented data on mortgages, the broad conclusions reached in this section regarding the credit's benefit to renters with different rent amounts are also applicable to homeowners who received the Senior Housing Credit and have different mortgage amounts.

Exhibit 5**Comparison of Hypothetical Taxpayer Scenarios: Varying Income and Varying Rent Amounts**

	Scenario 1: Low income, low rent	Scenario 2: Low income, high rent	Scenario 3: Moderate income, low rent	Scenario 4: Moderate income, high rent
AGI	\$30,000	\$30,000	\$65,000	\$65,000
Credit amount	\$900	\$900	\$200	\$200
Monthly rent	\$700	\$1,500	\$700	\$1,500
Annual rent	\$8,400	\$18,000	\$8,400	\$18,000
Credit amount as percentage of annual rent	11%	5%	2%	1%
Number of days' rent covered by credit	39	18	9	4

Source: Office of the State Auditor analysis of Section 39-22-544, C.R.S., supported by American Community Survey data.

The relative proportion of seniors potentially benefitting from the credit is higher in certain areas of the state—those with lower average housing costs and in which a higher proportion of seniors rent their homes and have lower incomes. The Department does not publish information on where credit recipients live in the state. However, based on the percentage of seniors who meet the income requirements and rent their home, there are certain areas of the state where a greater proportion of seniors likely qualify for the credit. Exhibit 6 maps the estimated percentage of seniors renting their homes and, since the 2022 version of the credit is limited to seniors with AGIs less than \$75,000, the estimated percentage of seniors with incomes below \$75,000 in each county. For example, counties such as Moffat, Otero, and Rio Grande have comparatively high percentages of seniors renting their homes and with incomes below \$75,000.

Exhibit 6**Estimated Percentage of Colorado Seniors¹ with Incomes Below \$75,000² and Estimated Percentage of Seniors Renting, by County, 2019-2023**

Source: Office of the State Auditor analysis of the U.S. Census Bureau's American Community Survey 5-Year Estimates, 2019-2023.

¹ACS data on rentership and household income is reported per household, and senior households are those with "householders" (heads of household) who are at least 65 years old. Therefore, this data may not include seniors with certain living circumstances, such as living in the homes of younger family members who reported a householder under 65 years old.

²For Tax Year 2022, the Senior Housing Credit is only available to seniors with AGIs below \$75,000. However, for Tax Year 2024, the credit is available for taxpayers filing jointly with AGIs below \$125,000. Since this map does not include taxpayers with incomes between \$75,000 and \$125,000, the map more accurately estimates eligibility for the credit for Tax Year 2022 than for Tax Year 2024.

Exemption], but only 40 percent of older [B]lack households and just 21 percent of older Latinx households qualify.” In part, this may be due to a smaller proportion of Black and Latino households owning their homes; for example, CFT’s analysis showed that 72 percent of older Latino households do not own their home, compared with just 18 percent of older white households. Additionally, ACS data indicates that a higher percentage of households of color (with the exception of Asian households) have incomes below \$75,000 than white households in Colorado. For example, about 51 percent of Latino households and 57 percent of Black or African American households have incomes below \$75,000, compared with 38 percent of white households. Since the 2022 version of the Senior Housing Credit is available to all seniors with AGIs in this range who have not received the Senior Homestead Exemption, a substantial number of seniors of color likely qualify for the credit. The credit can help to provide seniors of color with financial assistance that they would not otherwise receive from the State if they are not eligible for the Senior Homestead Exemption because they do not own their home.

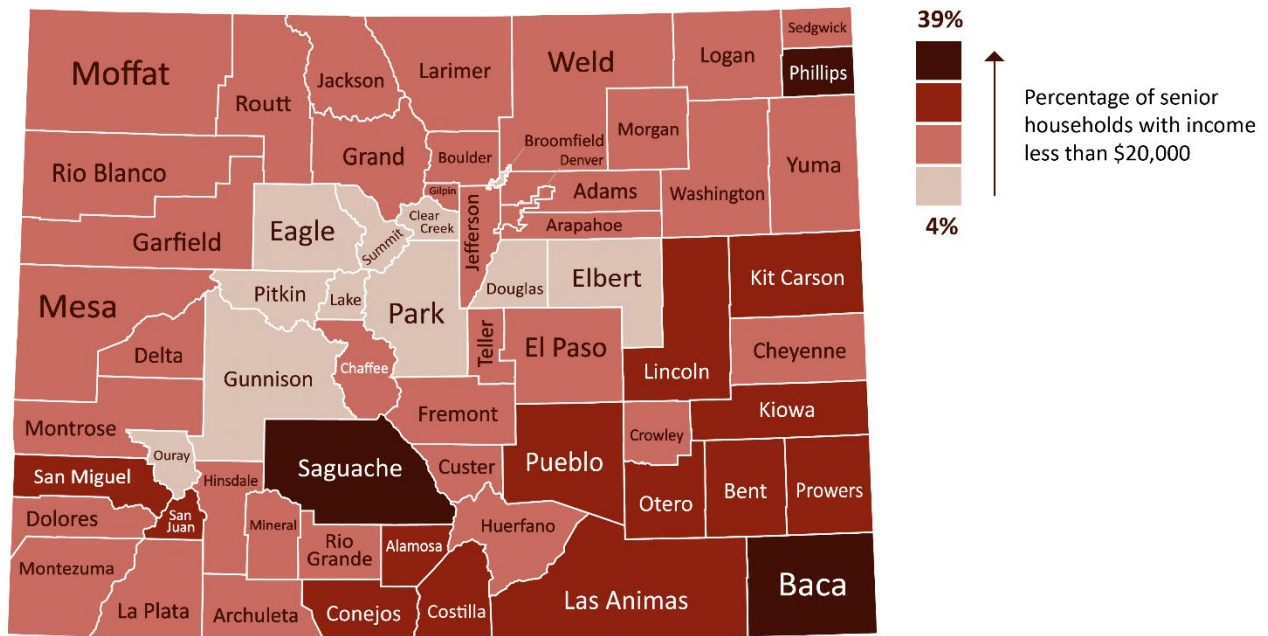
Additionally, for seniors who are at risk of losing their housing, the Senior Housing Credit may provide some assistance in staving off homelessness. For example, Generations Journal reported that poverty and the lack of affordable housing are two of the fundamental causes of homelessness. This credit does not impact the cost of housing, but, as discussed, it can make housing marginally more affordable by providing seniors with additional funds.

Seniors who received both the PTC Rebate and the Senior Housing Credit likely received substantial additional benefit from the credit compared with the rebate alone. Since statute specifies that PTC Rebate recipients who qualify for the credit can receive the maximum allowable credit amount of \$1,000, we also examined how the credit is likely to impact these taxpayers. In Tax Year 2022, the Department issued PTC Rebate amounts averaging \$502 per applicant. For an applicant receiving a PTC Rebate in this amount, a Senior Housing Credit amount of \$1,000 would have roughly tripled the amount of financial benefit provided by the State. Additionally, for seniors with AGIs that are low enough to qualify for the PTC Rebate, an extra \$1,000 could represent a substantial increase in income. For example, for a senior with an AGI of \$15,000, an additional \$1,000 would represent an estimated 7 percent increase in gross income and could, therefore, make a significant difference in the senior’s ability to pay for housing.

Exhibit 8 shows the estimated percentage of senior households that have very low incomes and may be eligible for the PTC Rebate in each Colorado county, based on ACS data collected between 2019 and 2023. Counties in the south and east of the state generally have higher percentages of seniors who may be eligible for the PTC Rebate, while counties in the center of the state have relatively low percentages of these seniors.

Exhibit 8

Estimated Percentage of Senior Households with Incomes Less than \$20,000, 2019-2023



Source: Office of the State Auditor analysis of the U.S. Census Bureau's American Community Survey 5-Year Estimates, 2019-2023.

As noted, a total of 8,515 taxpayers received both the PTC Rebate and the maximum credit amount of \$1,000 in Tax Year 2022. Since individuals with very low incomes may not be required to file a Colorado income tax return, the Department does not have comprehensive data with which to estimate how many Colorado seniors are likely eligible for the PTC Rebate. However, based on ACS 5-year estimates for 2019 through 2023, there are about 74,000 senior households in Colorado with incomes less than \$20,000.

Some seniors who claimed the Senior Homestead Exemption would have received greater monetary benefit from the Senior Housing Credit but were unable to claim the Senior Housing Credit because the Senior Homestead Exemption is applied automatically to seniors' property tax bills in most cases. As discussed, taxpayers may claim either the Senior Housing Credit or the Senior Homestead Exemption in any given tax year—not both. However, some taxpayers who qualified for the Senior Homestead Exemption would also have met the requirements for the Senior Housing Credit and, in theory, could have elected not to take the Senior Homestead Exemption if they wished to claim the Senior Housing Credit instead.

For some seniors who could have qualified for either tax benefit, the Senior Housing Credit would have provided a greater monetary benefit than the Senior Homestead Exemption. The amounts of both the credit and the exemption vary depending on each taxpayer's individual circumstances—the credit, depending on the taxpayer's AGI, and the exemption, depending on the amount of property value exempted from the value of the taxpayer's residence and the mill levy (property tax rate) on the property. In Property Tax Year 2022, the Senior Homestead Exemption reduced property taxes on about 269,000 senior residences, and the average value of the exemption was \$584. As a point of comparison, both single and joint taxpayers would have received a Senior Housing Credit of \$590 or more in Income Tax Year 2022 if their AGIs were less than \$46,000. Thus, for a taxpayer receiving the average value of the Senior

Homestead Exemption, the Senior Housing Credit would have provided a greater monetary benefit if the taxpayer's AGI were less than \$46,000. We were unable to determine how many taxpayers' credit amounts would have been greater than the value of their exemptions; however, it is likely that this may have been the case for a substantial number of taxpayers.

Most taxpayers who could have received a greater benefit from the Senior Housing Credit than the Senior Homestead Exemption likely were not able to claim the credit instead of the exemption. In order to receive the Senior Homestead Exemption, seniors must submit an application to their county assessor's office. Once they are approved for the exemption, the exemption stays in place for future property tax years unless the property's ownership or occupancy changes; in other words, after the first year in which it is claimed, the Senior Homestead Exemption is applied automatically, provided that the senior's living situation remains unchanged. According to Division of Property Taxation (Division) staff, if a senior who had previously received the Senior Homestead Exemption wished to opt out of the exemption in order to be eligible for the Senior Housing Credit, they must contact their county assessor's office in order to have the exemption removed from their property tax bill. However, according to Department staff, taxpayers reported that while certain counties allowed taxpayers to retroactively opt out of the Senior Homestead Exemption in order to qualify for the Senior Housing Credit in Tax Year 2022, other counties did not allow this. Additionally, according to Division staff, seniors who called into the Division for guidance on this topic were generally "not interested in withdrawing their exemption after they realized they would have to reapply if they wanted the exemption again and that the income tax credit is not currently a long term or permanent program." Therefore, it appears that even if seniors could have received a greater monetary value from the Senior Housing Credit than the Senior Homestead Exemption, the difficulty of opting out of the exemption and the temporary nature of the credit may have dissuaded many seniors from attempting to claim the credit in lieu of the exemption.

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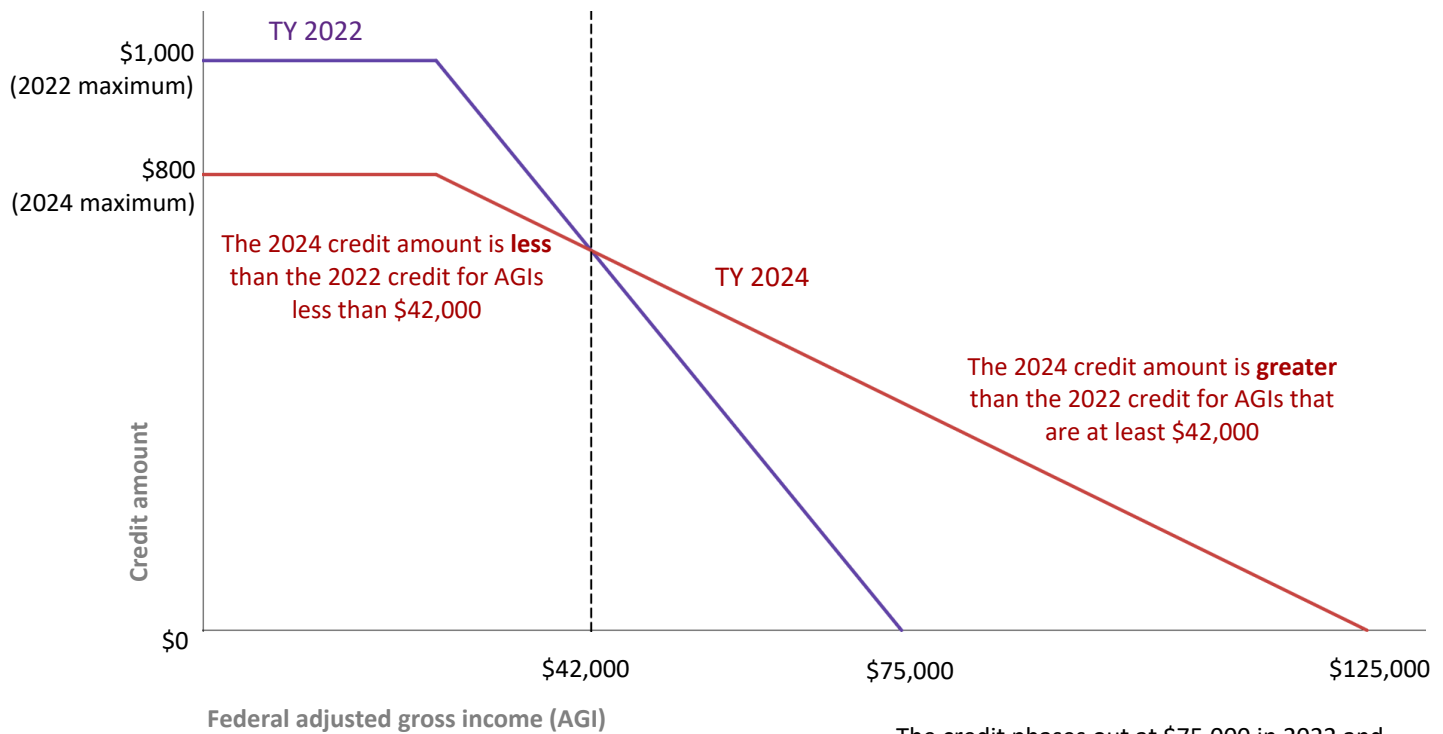
The Senior Homestead Exemption allows eligible seniors to subtract up to 50 percent of the first \$200,000 (generally, \$100,000) of actual value of their primary residence when calculating the amount of property tax owed. Therefore, eligible seniors residing in any residential property with an actual value of at least \$200,000 would receive the maximum possible value of the exemption. We estimated that the average residential property in Colorado had an actual value of about \$454,000 in Property Tax Year 2022.

Data for the 2024 version of the credit is not yet available. However, it appears that the 2024 credit may not provide as much assistance as the 2022 credit for many seniors. There are a number of factors that are likely to reduce the relative value of the version of the credit available in Tax Year 2024 for many taxpayers:

- **The 2024 version of the credit provides smaller credit amounts to many taxpayers than the 2022 version, with the exception of some joint filers.** The maximum value of the 2024 credit is \$800, compared with the \$1,000 maximum value of the 2022 credit. Additionally, for any given AGI, the amount of the credit for single filers is less in 2024 than it would have been in 2022. For example, a single filer with an AGI of \$28,000 would have received a credit of \$940 in 2022 compared with \$752 in 2024, and a single filer with an AGI of \$63,000 would have received a credit of \$240 in 2022 compared with \$192 in 2024.

However, for joint filers, the credit amount for a given AGI is less in 2024 compared with 2022 only for AGIs less than \$42,000. For joint filers with AGIs of \$42,000 or higher, the 2024 credit is higher than it would have been in 2022. This is because the 2022 credit was limited to taxpayers with AGIs below \$75,000, whereas the 2024 credit is available for joint filers with AGIs up to \$125,000. This increase in the income eligibility range for joint filers results in a lengthened phase-out of the 2024 credit for these filers, so that the 2024 credit is greater for larger AGIs in 2024 than it would have been in 2022, as shown in Exhibit 9. For example, a joint filer with an AGI of \$28,000 would have received a credit of \$940 in 2022 compared with \$776 in 2024. However, a joint filer with an AGI of \$63,000 would have received a credit of \$240 in 2022 compared with \$496 in 2024, and a joint filer with an AGI of \$85,000 would not have qualified for the credit in 2022 but would receive a credit of \$320 in 2024.

Exhibit 9

Senior Housing Credit Amount¹ by Federal Adjusted Gross Income, Joint Filers

Source: Office of the State Auditor analysis of Section 39-22-544(4) and (4.5), C.R.S.

¹Credit amounts decrease incrementally by \$10 (in Tax Year 2022) or \$4 (in Tax Year 2024) for every additional \$500 in AGI for joint filers with AGIs of at least \$25,500.

Finally, taxpayers who are part-time Colorado residents may also receive smaller credit amounts in 2024 than they would have in 2022 because the 2024 credit is apportioned based on the portion of their income that is subject to Colorado income tax, but the 2022 credit was not apportioned in this way. For Tax Year 2022, about 2,300 claimants (2 percent) were part-year Colorado residents.

- **The 2024 credit was not adjusted for inflation or increases in housing costs, so the credit's relative value is lower in 2024 compared with 2022.** Tax credits provide the same level of assistance to taxpayers from year to year only when they are adjusted to account for price increases over time. The U.S. Bureau of Labor Statistics' Consumer Price Index (CPI), which is commonly used to measure changes in average prices over time, indicates that the cost of shelter in the 10 counties comprising the Denver metro area increased by about 12 percent between 2022 and 2024; data was not available for Colorado as a whole. Since the 2024 credit amount did not increase compared with the 2022 amount for many taxpayers, the relative value of the 2024 credit is less than the 2022 credit for many seniors whose housing costs increased during that time. Additionally, since the credit's income eligibility range—which allows seniors

to claim the maximum credit if their AGI is below \$25,500 and, for single filers, phases out the credit for AGIs of at least \$75,000—was not adjusted for inflation between 2022 and 2024, seniors whose AGIs increased solely due to inflation between 2022 and 2024 may see their credit amount decrease or become ineligible for the credit.

Policy Consideration

If the General Assembly decides to extend the Senior Housing Credit to additional tax years, legislators may want to consider whether to make adjustments to the credit to account for one or more factors identified in this report that likely reduce the value of the credit for some taxpayers. As discussed, the Senior Housing Credit was initially available for just one income tax year (2022) and was later extended to an additional tax year (2024), with some modifications. Additionally, during the 2025 legislative session, Colorado legislators considered Senate Bill 25-013, which would have extended the 2024 version of the credit to Tax Years 2025 and 2026 if it had been enacted. Since legislators have shown interest in extending the credit, we included this policy consideration to provide additional information in the event that they decide to continue the credit in future years.

- **Inflation and increases in housing costs are likely to degrade the credit's value to seniors over time.** According to the Institute of Taxation and Economic Policy, “Any feature of an income tax that is based on a fixed dollar amount will be vulnerable to inflationary effects. In many states, this means that tax breaks designed to provide low-income tax relief—including exemptions, standard deductions, and most tax credits—are worth a little bit less to taxpayers every year...” Further, “...indexing income taxes for inflation helps ensure that the tax system treats people in roughly the same way from year to year.” Since the Senior Housing Credit is intended to help seniors afford the cost of housing, the General Assembly could consider adjusting the credit amount for any future tax years based on estimated changes in housing costs. For example, the U.S. Bureau of Labor Statistics estimated that the cost of shelter in the Denver metro area increased by about 12 percent between 2022 and 2024.

In addition to adjusting credit amounts for inflation or changes in housing costs, the income levels at which different tax rates apply are also commonly adjusted in order to prevent an effect known as “bracket creep,” in which taxpayers whose incomes have increased due to inflation are pushed into a higher tax bracket and must pay a higher tax rate as a result. This same concept can also be applied to income eligibility benchmarks for tax credits; if these benchmarks are not adjusted for inflation, taxpayers whose incomes have increased due to inflation can lose eligibility for a credit or receive smaller credit amounts than they would have previously. Since the income eligibility benchmarks for the Senior Housing Credit for single filers—allowing seniors to claim the maximum credit if their AGI is below \$25,500 and phasing out the credit for AGIs of at least \$75,000—were not adjusted for inflation between 2022 and 2024, seniors filing a single return whose AGIs increased solely due to inflation between 2022 and 2024 will see their credit amount decrease or become ineligible for the credit.

Legislators are often required to account for factors beyond the impact to taxpayers when enacting or extending tax provisions, such as the State's budget needs and tax revenue forecasts; some of these factors may have impacted legislators' decisions to reduce the 2024 credit amount for certain taxpayers when compared with the 2022 credit amount. However, if the General Assembly decides to extend the Senior Housing Credit to additional tax years in the future, it may want to consider whether adding provisions to account for inflation and changes in housing prices to help to maintain the credit's value to taxpayers from one tax year to the next would be beneficial.

- Seniors who could qualify for either the Senior Housing Credit or the Senior Homestead Exemption may not receive the maximum tax benefit for which they are eligible.** As discussed, seniors cannot receive both the Senior Housing Credit and the Senior Homestead Exemption in the same tax year. However, some seniors may be eligible for both tax benefits: those who own and have lived in their home for at least 10 years and who also have AGIs within the Senior Housing Credit's eligibility range. We determined that for any given senior, either the Senior Housing Credit or the Senior Homestead Exemption may provide a greater value, depending on the senior's individual circumstances—seniors with AGIs that are higher in the credit's eligibility range and who live in areas with high property tax levies are likely to receive greater value from the Senior Homestead Exemption, whereas those with lower AGIs living in areas with lower property tax levies are likely to receive greater value from the Senior Housing Credit. Although seniors are permitted to opt out of the Senior Homestead Exemption if they wish to claim the Senior Housing Credit instead, information provided by both the Department and the Division indicated that this may be logistically challenging. Specifically, seniors must contact their county assessor's office well in advance of the receipt of their property tax bill in order to have the Senior Homestead Exemption removed from their property. Feedback from seniors to Division staff suggested that seniors may not be willing to opt out of the Senior Homestead Exemption even if they would have benefitted more from the Senior Housing Credit because the credit is a temporary benefit, and they would need to reapply for the exemption if they wished to receive it again in the future.

If the General Assembly decides to extend the Senior Housing Credit to additional income tax years, legislators may want to consider whether to establish a more streamlined method for seniors to choose between the Senior Housing Credit and the Senior Homestead Exemption. Doing so would help ensure that seniors could receive the maximum tax benefit for which they are eligible. However, it would also likely increase the burden and cost of administering these tax benefits for the Department and the Division.

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Software Sales Tax Exemption Memo

In order for software to be subject to sales tax, statute [Section 39-26-102(15)(c), C.R.S.] requires the software to meet three criteria:

1. Be intended for repeated sale or license, which statute defines as “computer software that is prepackaged for repeated sale or license in the same form to multiple users without modification, and is typically sold in a shrink-wrapped box.”
2. Be governed by a tear-open nonnegotiable license agreement, which statute defines as “a license agreement contained on or in the package, which...becomes effective upon opening of the package and accepting the licensing agreement.”
3. Be delivered in a tangible medium, which statute defines as, “a tape, disk, compact disc, card, or comparable physical medium.” Statute specifies that “Computer software is not delivered to the customer in a tangible medium if it is provided through an application service provider, delivered by electronic computer software delivery, or transferred by load and leave computer software delivery.”

Any software that does not meet all three of these criteria is exempt from sales tax. This includes software that is downloaded, custom software created for a specific customer, and software with a contract or license agreement that is signed rather than being tear-open and nonnegotiable. Additionally, applications hosted by service providers that purchasers can use via the internet without needing to download the software on their own devices, such as QuickBooks Online or Microsoft Office 365, are exempt from sales tax. Also, software businesses obtain via load and leave delivery, in which the vendor manually loads the software onto the business’ device(s) at the business’ location and does not leave the software with the business in a tangible medium, are also exempt from sales tax. In contrast to software, media streaming services and media purchased for download are considered a form of “digital good,” which, for sales tax purposes, is included within the definition of tangible personal property that is always subject to sales tax [Section 39-26-102(15)(b.5)(I), C.R.S.].

In April 2022, we published an evaluation of the Software Exemption—which we referred to as the “Downloaded Software Exemption” evaluation. Based on feedback from stakeholders and our review of e-commerce platforms for a sample of vendors offering downloadable software products, we found in the 2022 evaluation that vendors were generally applying the exemption to sales of these products.

Statute allows the Legislative Oversight Committee Concerning Tax Policy (Committee) to request up to three specific tax expenditure evaluations be completed by the Office of the State Auditor each year [Section 39-21-403(2)(c)(I)(B), C.R.S.]. During its hearing on October 31, 2024, the Committee requested that our office conduct a new review of the Software Sales Tax Exemption to provide:

1. A more recent estimate of the exemption's cost to the State.
2. More information on the number of cities and counties that have adopted the exemption.

Because the eligibility criteria for the exemption have not changed since our last review, we expect that vendors are still generally applying it correctly. Therefore, we focused on the two specific areas—the revenue impact to the State and local government adoption of the exemption—that Committee members were interested in.

Cost of the Exemption to the State

Vendors are responsible for applying the exemption to eligible software purchases and reporting these sales to the Department of Revenue (Department). In our 2022 evaluation, we used U.S. Census Bureau data to estimate that the Software Sales Tax Exemption had a revenue impact to the State of at least \$83 million in Calendar Year 2020. We created this estimate because vendors did not report the exemption separately from other exemptions until October 2019, and data on the Software Sales Tax Exemption was not yet available at the time of our 2022 review.

Starting in October 2019, the Department created a new line on the sales tax return so that vendors could report exempt software sales separately from other sales of exempt items. Vendors reported not collecting about \$8.8 million in 2021 and nearly \$14 million in 2023 in state sales taxes on exempt software sales. However, these figures might underreport the amount of exempt sales for two reasons. First, vendors that only make sales that are exempt from sales tax are not required to report their sales to the Department, so these sales are not included in the amounts above. Second, some companies might still be reporting exempt sales on the “Other deductions” line of the sales tax return where it was previously reported. Reporting the exemption on an incorrect line of the Department's sales tax return would not impact the amount of revenue collected by the State but would change the amount attributed to a specific exemption in the Department's sales tax data.

Since Department data likely underestimate the exemption's revenue impact, we used more recent data from the U.S. Census Bureau to estimate that exempt software sales to businesses alone could have resulted in a reduction in state sales tax revenue of as much as \$88.5 million in 2022. We used data from the U.S. Census Bureau's 2022 Service Annual Survey and 2022 Annual Business Survey to generate this estimate. Specifically, the 2022 Service Annual Survey reported that U.S. employer firms, which includes firms whose primary business or operation is to provide services to individuals, businesses, and governments, expended about \$127.5 billion on software in 2022. To

estimate the portion of software expenditures that came from Colorado firms, we used 2022 Annual Business Survey data, which indicates that there are approximately 141,000 employer firms in Colorado, or about 2.39 percent of all employer firms in the United States. Therefore, assuming that Colorado's share of software expenditures is equivalent to its share of U.S. employer firms, we multiplied this percentage by the reported \$127.5 billion in software expenses to estimate that Colorado employer firms spent about \$3.05 billion on software in 2022. Finally, we multiplied this amount by the state sales tax rate of 2.9 percent to estimate the potential state revenue impact.

Although our estimate provides a general indication of the relative scale of exempt software sales, it likely does not represent the actual value of the revenue impact due to several data constraints. First, the estimate includes sales of web design services, which are not subject to Colorado sales tax but do not fall under the Software Sales Tax Exemption. Therefore, including these sales increases the estimated cost of the exemption. Second, our estimate does not include purchases made by individuals because we lacked a reliable data source to estimate the value of these purchases. Because individuals commonly purchase downloaded software, their purchases likely result in a significant additional revenue impact to the State. Third, the U.S. Census Bureau's 2022 Service Annual Survey only collects data from employer firms and does not reflect all industries or non-employer firms. Although an employer firm likely spends more on business software than a non-employer firm, purchases by non-employer firms likely also significantly contribute to the exemption's revenue impact. Fourth, because the available datasets did not include data disaggregated by state, our estimate assumes that Colorado employer firms purchase software at the same rate as all U.S. employer firms. Finally, the available datasets did not distinguish between different types of software, contract type, or delivery methods, so it is not possible to know how much of the software purchased would have qualified for the exemption.

Similar Local Government Exemptions

Statutory and home rule municipalities and counties that have their sales taxes collected by the State (which includes almost all of Colorado's counties) must apply most of the State's sales tax exemptions, including the Software Sales Tax Exemption. Therefore, the exemption likely reduces local sales tax revenue in these municipalities and counties to some extent. However, we lacked the necessary data to estimate the impact of the exemption on local revenue. Home rule cities and counties established under Article XX, Section 6 of the Colorado Constitution that collect their own sales taxes have the authority to set their own sales tax policies independent from the State and are not required to exempt any software from their local sales and use tax. In our 2022 evaluation, we examined the municipal codes of the five most populous home rule cities—Aurora, Denver, Colorado Springs, Fort Collins, and Lakewood—and found that all impose a sales tax on software, regardless of delivery method. For this memo, we expanded our review to the top 20 most populous home rule cities and found that none of them have an exemption that is identical to the State's Software Sales Tax Exemption. Of the 20 cities, 17 impose sales tax on software, regardless of type or delivery method. We did find that three of the cities—Arvada, Littleton, and Westminster—have an exemption for custom software.

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