Colorado Legislative Council Staff Fiscal Note

STATE and LOCAL FISCAL IMPACT

Drafting Number:	LLS 11-0415	**Date:**	February 11, 2011
Prime Sponsor(s):	Sen. Mitchell	**Bill Status:**	Senate SVMA
		Fiscal Analyst:	Fiona Sigalla (303-866-3556)

TITLE: CONCERNING THE MODIFICATION OF POLICIES THAT RESULT IN INCREASED PAYMENTS TO THE STATE.

Fiscal Impact Summary	FY 2010-2011	FY 2011-2012	FY 2012-2013
State Revenue			
General Fund	($15.2 million)	($137.3 million)	($128.7 million)
State Education Fund	($0.5 million)	($1.1 million)	($1.2 million)
State Expenditures*			
General Fund	$2,960	($238,215)	($32,980)
Cash Funds			
Conservation Easement Holder Certification Fund		($4,514)	($9,028)
FTE Position Change		(1.2 FTE)	(0.7 FTE)
Effective Date: Upon signature of the Governor, or upon becoming law without his signature.			
Appropriation Summary for FY 2011-2012: See the State Appropriations section.			
Local Government Impact: See Local Government Impact section.			

*** Expenditure changes assume passage of the 2011 supplemental appropriation to the Department of Revenue.**

Summary of Legislation

This bill reinstates state sales and use tax exemptions and income tax credits that were repealed, deferred, or suspended in 2010. Regulations and rules promulgated in response to the 2010 changes are repealed. The bill also modifies penalties for certain traffic infractions occurring within a highway maintenance, repair, or construction zone.

Sales and use tax. Effective July 1, 2011, this bill reinstates state sales and use tax exemptions for:

- standardized software, which was repealed by House Bill 10-1192;
- direct mail advertising materials, which was repealed by House Bill 10-1189;
- candy and soft drinks, which was repealed by House Bill 10-1191;

- nonessential articles of tangible personal property furnished to customers who purchase food, meals, or beverages, which was repealed by House Bill 10-1194;

- fuels used for industrial purposes, which was repealed by House Bill 10-1190; and

- the sale or storage, use, or consumption of agricultural compounds used in caring for livestock, semen for agricultural and ranching purposes, and pesticides for use in the production of agricultural and livestock products, which was repealed by House Bill 10-1195.

The bill also repeals policy changes pursuant to House Bill 10-1193 intended to increase collections of the state sales and use tax from out-of-state retailers, effective July 1, 2011.

Income Tax. The bill:

- eliminates the $26 million aggregate cap on conservation easement tax credits for income tax years 2012 through 2013, which was enacted by House Bill 10-1197;

- reinstates the use of the alternative fuel vehicle tax credit for category 7 vehicles for tax year 2011, which was removed by House Bill 10-1196;

- repeals a $500,000 annual cap on the amount a taxpayer may claim using the enterprise zone investment tax credit for tax years 2011 through 2013, which was enacted by House Bill 10-1200; and

- repeals a $250,000 cap on the amount of net operating losses that a corporation may subtract from Colorado taxable income for a portion of tax year 2011 and tax year 2012 through 2013, which was enacted by House Bill 10-1199.

Traffic Fines. The bill specifies that existing penalties for certain traffic infractions occurring within a highway maintenance, repair, or construction zone apply only if one or more construction workers are present within the zone when the violation occurs.

State Revenue

State revenue will decrease **$15.7 million in FY 2010-11, $138.4 million in FY 2011-12**, and **$129.9 million in FY 2012-13.** Of this, $15.2 million will reduce revenue to the General Fund and $0.5 million will reduce revenue to the State Education Fund in FY 2010-11, $137.3 million will reduce revenue to the General Fund and $1.1 million will reduce revenue to the state education fund in FY 2011-12, and $128.7 million will reduce the General Fund and $1.2 million will reduce the state education fund in FY 2012-13. Table 1 summarizes revenue changes under SB11-073.

For all sales tax bills, the revenue impact for FY 2011-12 and FY 2012-13 has been adjusted because, under current law, vendors will begin retaining 3.33 percent of the taxes they collect starting July 1, 2011. For sales tax provisions, the revenue impact for FY 2011-12 is an 11-month partial-year impact because tax collections for July 2011 are for sales made in June 2011.

Table 1. Revenues Under SB11-073

Fiscal Impact Summary	FY 2010-2011	FY 2011-2012	FY 2012-2013
Sales and Use Tax			
Standardized Software		($20.2 million)	($23.6 million)
Direct Mail Advertising Materials		($308,377)	($336,412)
Candy and Soft Drinks		($16.0 million)	($17.8 million)
Nonessential Food Containers		($2.0 million)	($2.0 million)
Fuels Used for Industrial Purposes		($36.9 million)	
Agricultural Compounds		($3.4 million)	($3.7 million)
Out-of-State Retailers		($11.4 million)	($17.1 million)
Income Tax			
Conservation Easement Tax Credit		($18.5 million)	($37 million)
Alternative Fuel Vehicles	($2.7 million)	($2.7 million)	
Investment Tax Credit	($5.8 million)	($11.5 million)	($11.9 million)
Net Operating Losses*	($7.2 million)	($15.5 million)	($16.5 million)
Traffic Fines			
Construction Zones		No Fiscal Impact	
Total State Revenue	($15.7 million)	($138.4 million)	($129.9 million)

* *Repealing the cap on the net operating loss deduction will reduce revenue to the State Education Fund by $0.5 million of the $7.2 million in FY 2010-11, $1.1 million of the $15.5 million in FY 2011-12, and $1.2 million of the $16.5 million in FY 2012-13.*

Standardized Software. State sales and use tax revenue to the General Fund will decrease **$20.2 million in FY 2011-12** and **$23.6 million in FY 2012-13**.

Private expenditures on computer software in Colorado are estimated to be $1.6 billion in 2011. About 60 percent of these expenditures are assumed to be affected by this bill; this assumption is based on figures from the software industry on the percentage of worldwide software sales related to the bill. Colorado expenditures were estimated using data from the Bureau of Economic Analysis on U.S. private prepackaged software sales. Colorado's share of U.S. expenditures is assumed to be the same as Colorado's share of personal income.

The inclusion of all standardized software in the definition of tangible personal property qualifies all manufacturers of standardized software for the sales tax exemption on equipment used in manufacturing. Thus, hardware and software used to develop software is exempt from the state sales tax under current law. Colorado software firms' expenditures on hardware and software are estimated to total $23.2 million in 2011 based on data from the U.S. Census Service Annual Survey of 2009. Colorado's share of expenditures is assumed to equal its share of gross domestic product in the computer and electronic product manufacturing sector. Approximately 75 percent of these expenditures are assumed to be eligible for the exemption.

This estimate is larger than the Department of Revenue's estimate based on sales tax collections for April and September 2010. Sales tax collections for this exemption are from vendors that collect sales taxes for many other products. Sales volume or prices paid for other products may have declined, making it difficult to extract changes as a result of House Bill 10-1192.

Direct Mail. State sales and use tax revenue to the General Fund will decrease by **$308,377 in FY 2011-12** and **$336,412 in FY 2012-13**.

Between April and September 2010, the Department of Revenue estimates that an additional $174,000 has been collected in sales tax revenue compared to 2009 from vendors that were likely to be affected by House Bill 10-1189. While affected by other factors, this revenue change gives an indication of the increased revenue attributable to House Bill 10-1189. The cooperative direct mail industry is not expected to grow significantly over time because of increased competition from electronic advertising.

Candy and Soft Drinks. State sales and use tax revenue to the General Fund will decrease **$16.0 million in FY 2011-12** and **$17.8 million in FY 2012-13**.

Revenue estimates are based on data on the average amount of household expenditures in the western region of the United States on candy and soft drinks. These data were obtained from the Consumer Expenditure Survey published by the U.S. Bureau of Labor Statistics. According to these data, households in the western region spend an average of about $300 annually on candy and soft drinks for off-premises consumption and through purchases from vending machines. The number of households in Colorado projected by the State Demography Office was used to estimate the total statewide amount of household purchases on candy and soft drinks.

This estimate is very similar to Department of Revenue sales tax collections for April through September 2010. The department estimates that an additional $9,739,400 has been collected in sales tax revenue compared to 2009 from vendors that were likely affected by House Bill 10-1191. While affected by other factors, this revenue change gives an indication of the increased revenue attributable to House Bill 10-1191.

Nonessential Food Containers. State sales and use tax revenue to the General Fund will decrease **$2.0 million in FY 2011-12** and **$2.0 million in FY 2012-13**.

It is estimated that food service and drinking places in Colorado will purchase $67.5 million of packaging materials and containers in 2010 and $70.1 million in 2011. These figures were derived from purchases of packaging materials and containers by this industry reported for the United States by the U.S. Census Bureau for 2007. While Census figures are the best information available to quantify purchases subject to this bill, they are not an exact match and may under- or over-state actual affected purchases. It is assumed that Colorado's share of these expenditures is equal to Colorado's share of gross domestic product in the food services and drinking places industry. The 2007 figure was grown over time based on an LCS forecast for statewide retail trade sales in the industry. Historical retail trade sales in the industry are reported by the Department of Revenue.

This estimate is very similar to Department of Revenue sales tax collections for April through September 2010. The department estimates that an additional $792,000 was collected in sales tax revenue compared to 2009 from vendors that were likely affected by House Bill 10-1194. This revenue estimate has been affected by changes in sales tax collections from other products sold by the same vendor, possibly because of changes in sales volume or product price.

Fuels Used for Industrial Purposes. State sales and use tax revenue to the General Fund will decrease **$39.6 million in FY 2011-12**.

Revenue estimates were developed using region four, fuel-specific data for the industrial sector from the federal Energy Information Administration (EIA). Data included price and consumption forecasts for coal, natural gas, distillate fuel oil, liquified petroleum gas, motor gasoline, and other petroleum products by industry. Agriculture was excluded from the industrial sector. Region four data was apportioned for Colorado. For the transportation sector, Colorado-specific 2007 consumption data from the EIA was assumed to grow through 2012 at the same rate as U.S. industrial production, as published by the Federal Reserve Board. Railroads were excluded from the transportation sector, as well as all distillate fuel oil used in the transportation industry. Electricity generation is excluded from the bill and the estimate. The estimate does not include revenue generated from sales of fuel used by the telephone, radio and TV broadcasting sectors because these data are not available.

Between April and September 2010, the Department of Revenue estimates that an additional $174,000 has been collected in sales tax revenue compared to 2009 from vendors that were likely affected by House Bill 10-1190. However, these vendors also report sales tax revenue for other items not affected by House Bill 10-1190. It is likely that sales tax collections from other items declined, making it difficult to determine the full impact of the change is sales tax collections from House Bill 10-1190. There is also likely seasonal factors affecting the sales tax collections that would lead the estimate to be understated. This estimate will be revised in a future fiscal note as new data becomes available. There will be no revenue impact for FY 2012-13 because the exemption is scheduled to be reinstated beginning on July 1, 2012 under current law.

Agricultural Compounds. State sales and use tax revenue to the General Fund will decrease **$3.4 million in FY 2011-12** and **$3.7 million in FY 2012-13**.

Between April and September 2010, the Department of Revenue estimates that an additional $2.4 million has been collected in sales tax revenue compared to 2009 from vendors that were likely to be affected by House Bill 10-1195. While affected by other factors, this revenue change gives an indication of the increased revenue attributable to House Bill 10-1195. Two-thirds of the revenue collected is assumed to be from agrichemicals, and 85 percent of chemical sales are assumed to occur between April and September. The remaining one-third of revenue collected is assumed to be from bull semen.

Out-of-State Retailers. State sales and use tax revenue to the General Fund revenue will decrease an estimated **$11.4 million in FY 2011-12** and **$17.1 million in FY 2012-13**.

This bill repeals House Bill 10-1193, which clarified the sales and use tax responsibilities of retailers that are not currently collecting sales tax and increased the Department of Revenue's enforcement power with regards to collecting these taxes. Colorado residents have always been required to remit sales or use tax on taxable purchases from out-of-state firms. Customers must declare tax obligations and remit payment voluntarily if retailers do not collect sales tax.

Colorado is expected to collect about 60 percent of previously uncollected state sales and use tax obligations from out-of-state retailers as a result of the improved enforcement provisions in House Bill 10-1193, which is repealed by this bill. This reduced collection rate is due, in part, to a de minimis requirement in the regulation that exempts retailers making less than $100,000 in total gross sales in Colorado. The estimate for total uncollected sales and use tax is based on a report by Donald Bruce, William F. Fox, and LeAnn Luna of the University of Tennessee.[1] The state's share of sales tax collections are 43.3 percent of total taxes based on state and local sales tax collections from the 2007 Census of Government Finance, U.S. Census Bureau. Taxes attributable to business-to-consumer transactions is estimated at 49 percent. Expectations for tax collections increased between FY 2011-12 and later years because awareness of the law and enforcement compliance are expected to be phased in over a few years.

Conservation Easements. Eliminating the limit on conservation easement tax credits will decrease General Fund revenue by an estimated **$18.5 million in FY 2011-12 and $37.0 million in FY 2012-13**.

Assuming that conservation easement tax credits for 2012 and 2013 would have otherwise matched the 2008 level — $63 million per year — eliminating the $26 million cap on the credits will reduce General Fund revenue by $37 million per tax year. On an accrual basis, the impact for FY 2011-12 and FY 2013-14 is estimated to be $18.5 million to account for one-half of the fiscal year. The bill could affect taxpayer behavior before and after the limit is removed. This estimate will be revised in a future fiscal note as new data becomes available.

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[1] "State and Local Government Sales Tax Revenue Losses from Electronic Commerce" by Donald Bruce, William F. Fox, and LeAnn Luna. The University of Tennessee, April 13, 2009.

Alternative Fuel Vehicles. This bill is expected to decrease General Fund revenue **$2.7 million in FY 2010-11** and **$2.7 million in FY 2011-12**.

It is projected that about 2,850 Category 7 vehicles will be purchased in 2011 by state residents that would qualify for an average state tax credit amount of $1,900. This equates to $5.4 million in tax credits claimed for the 2011 tax year, which would be accrued half ($2.7 million) to FY 2010-11 and half to FY 2011-12. Thus, revenue will increase by this amount if 2011 purchases of Category 7 vehicles became eligible for the tax credit. This estimate is based on historical data on the state's alternative fuel tax credit, sales data on types of hybrid vehicles, their incremental costs, and forecasts for hybrid vehicle sales in 2011.

Investment Tax Credit. State income tax revenue will decrease **$5.8 million in FY 2010-11, $11.5 million in FY 2011-12,** and **$11.9 million in FY 2012-13**.

As Colorado's economy recovers, companies are expected to make investments that qualify for the credit in this bill. However, to the extent that a company would have the tax liability to use the investment tax credits as the economy recovers, the amount by which revenue will be reduced as a result of this bill may increase. SB 10-73 will increase revenue in FY 2013-14 and FY 2014-15 relative to current law.

A preliminary evaluation of corporate investments indicates that predicting which companies will make large investments in the future is extremely difficult. This is due to the volatility in the number of investments large enough to be affected, limited data about future large investments, and the fact that some very large investments made in tax years 2007 and 2008 were made by industries that are not expected to continue to make large investments during the next several years. The estimate used in this analysis represents the middle of the range provided in the fiscal note for House Bill 10-1200.

Net Operating Losses. State income tax revenue decrease **$7.2 million in FY 2010-11, $15.5 million in FY 2011-12**, and **$16.5 million in FY 2012-13**. A portion of this revenue impact will occur in the State Education Fund because this provision affects Colorado taxable income. Revenue to the State Education Fund will be reduced $0.5 million in FY 2010-11, $1.1 million in FY 2011-12, and $1.2 million in FY 2012-13. Revenue to the General Fund will be reduced $6.7 million in FY 2010-11, $14.4 million in FY 2011-12, and $15.3 million in FY 2012-13. Senate Bill 11-073 will increase revenue in FY 2013-14 and FY 2014-15 relative to current law.

A corporation may reduce its Colorado taxable income by deducting its net operating loss and carrying forward any unused amount for up to 20 years. House Bill 10-1199 capped the amount that may be carried forward into tax years 2011, 2012, and 2013 to $250,000 each year. In addition, any portion of NOLs deferred to 2014 as a result of House Bill 10-1199 shall be increased by an amount equal to a rate of interest of three and one-quarter percent per annum for the duration of the deferral period.

Three years of sample data from corporate income tax returns were used to evaluate the effect of limiting the NOL carry forward deduction to $250,000. During this three-year period, corporate gross taxes owed would have increased, on average, by $16.5 million each year if the carry-forward of NOLs had been capped at $250,000.

There is a partial-year impact for tax year 2011, which results in a partial-year impact for FY 2010-11 and FY 2011-12. Senate Bill 11-073 repeals the cap on the deduction for corporations with tax years beginning on or after July 1, 2011. Thus, any corporation with a tax year beginning between January 1, 2011 and June 30, 2011 will still be subject to the cap for tax year 2011 under the bill. According to the Department of Revenue, 87.5 percent of corporate income tax liability prior to being adjusted for tax credits is attributable to businesses with tax years that begin during the first six months of the calendar year.

Construction Zones. State revenue to the General Fund will not be affected by this portion of the bill. The State Patrol reports that virtually all tickets currently issued in the construction zones covered by this bill occur when construction workers are present. Therefore, there would be **no fiscal impact**.

State Expenditures

State expenditures will increase $2,960 in FY 2010-11, and decrease $242,729 and 1.2 FTE in FY 2011-12 and $42,008 and 0.7 FTE in FY 2012-13. Table 2 summarizes expenditure changes under SB11-073.

Increased Expenditures from Tax Law Changes. The Department of Revenue will incur one-time expenses in FY 2010-11 and FY 2011-12 to notify taxpayers of the tax law changes. The department will incur 40 hours of programming costs in FY 2010-11 to modify the state's tax collection systems at a cost of $2,960, and $4,662 in FY 2011-12 for temporary staff to send out notices of the tax law changes.

Expenditure Reduction from Terminating House Bill 10-1193 Lawsuit. Assuming passage of the 2011 supplemental appropriation, the Department of Revenue will incur an expenditure reduction of $307,047 and 1.0 FTE in FY 2011-12, which in turn will reduce expenditures to the Department of Law by $241,088 in FY 2011-12. The Department of Revenue will also incur an expenditure reduction of $32,980 and 0.5 FTE in FY 2012-13.

The Department of Revenue will have an expenditure reduction of $65,959 and 1.0 FTE in FY 2011-12 as a result of reduced workload from the dismissal of the litigation in the Direct Marketing Association v. Huber case, which is challenging House Bill 10-1193. These funds had been appropriated to the department with House Bill 10-1193 to provide additional staff support to increase compliance with the use tax. The department was appropriated a permanent 0.5 FTE to maintain records regarding online retailers and 0.5 FTE for FY 2010-11 and FY 2011-12 for policy and legal research.

Expenditure Reduction from Removing Limits from Conservation Easement Tax Credit. The Department of Regulatory Agencies will have an expenditure reduction of $4,514 and 0.2 FTE in FY 2011-12 and $9,028 and 0.2 FTE in FY 2012-13 from removal of the $26 million annual income tax credit cap on conservation easements. The Division of Real Estate will have an expenditure reduction because it will no longer need to manually collect, record, and track claims for certification of conservation easement tax credits. Costs are being paid from the Conservation Easement Holder Certification Fund, and the expenditure reduction will be credited to that fund.

Table 2. Expenditures Under SB11-073*

Cost Components	FY 2010-12	FY 2011-12	FY 2012-13
Notification of Taxpayers			
Programming Costs	$2,960		
Printing and Postage		$64,170	
Temporary Staff to Send Notices		$4,662	
Dismissal of HB10-1193 lawsuit			
Personal Services		($65,959)	($32,980)
FTE		(1.0)	(0.5)
Legal Services		($241,088)	
Remove Limits from Conservation Easement Credit			
Conservation Easement Holder Certification Fund		($4,514)	($9,028)
FTE		(0.2)	(0.2)
General Fund	**$2,960**	**($238,215)**	**(32,980)**
Cash Fund		**($4,514)**	**($9,028)**
FTE Position Change		**(1.2)**	**(0.7)**
TOTAL	**$2,960**	**($247,729)**	**($42,008)**

*** Expenditure changes assume passage of the 2011 supplemental appropriation to the Department of Revenue.**

Local Government Impact

Local governments will not be affected by the reinstatement of the sales and use tax exemptions for standardized software, direct mail advertising materials, candy and soft drinks, nonessential food containers, fuels used for industrial purposes, or agricultural compounds. Local governments will also not be affected by the change in traffic fines, or income tax credits (net operating losses, alternative fuels, conservation easement tax credit, enterprise zones).

Statutory local governments will not be impacted by the repeal of the compliance measures for the sales and use tax on out-of-state purchases because they can not collect use tax under current law. Special districts will have an undetermined revenue loss because they will receive less revenue from the consumer use tax.

State Appropriations

For FY 2010-11, the Department of Revenue should receive an appropriation of $2,960 from the General Fund. For FY 2011-2012, the Department of Revenue should receive a negative General Fund appropriation of $238,215 and 1.0 FTE, which in turn reduces funds reappropriated to the Department of Law. For FY 2011-12, the Department of Regulatory Agencies should receive a negative appropriation of $4,514 and 0.2 FTE for the Conservation Easement Holder Certification Fund.

Departments Contacted

Agriculture	Law
Revenue	Colorado Counties, Inc.
Colorado Municipal League	Transportation