



PRE-PRESS PRINTING EXEMPTION

EVALUATION SUMMARY | JULY 2021 | 2021-TE14

TAX TYPE	Sales and use	REVENUE IMPACT	Could not determine
YEAR ENACTED	1992	NUMBER OF TAXPAYERS	Could not determine
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The exemption is effective at preventing the taxation of printers' purchases of pre-press materials used in printing products sold to customers.

WHAT DOES THE TAX EXPENDITURE DO?

The Pre-Press Printing Exemption exempts from sales and use tax printers' purchases of eligible pre-press materials, such as film proofs and plates, used to print products sold at retail.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation do not state the exemption's purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of legislative history and the current operation of the expenditure, our evaluation considered a potential purpose: to ensure that sales tax is only applied to purchases made by final consumers instead of at multiple steps through print jobs' production and distribution.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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



PRE-PRESS PRINTING EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Pre-Press Printing Exemption (Pre-Press Exemption) [Section 39-26-102(19)(b), C.R.S.] exempts purchases of pre-press preparation printing materials from sales and use tax. Pre-press is the term used by the printing industry to describe the process a document must go through before it can be printed, such as camera-ready work, color separating, platemaking, scanning, or other pre-press functions, and occurs between the creation of a print layout and the final printing. For example, a business requesting a print order of brochures, letterheads, or greeting cards would submit a print order to a printing company in Colorado. The printing company would then purchase the general manufacturing pre-press materials such as aluminum plates, sheets, and other proofing materials from a wholesale distributor to create customized plates and engravings. Eligible pre-press preparation printing materials include tangible products such as “light sensitive film, plates, and proofing materials,” used for a specific print job and a specific customer, which are reusable, and for which ownership passes to the customer as part of the total sale [1 CCR 201-5, Special Rule 35 and Section 39-26-102(6.7), C.R.S.].

The Pre-Press Exemption was created in 1992 by House Bill 92-1248. Although purchases of materials incorporated into final tangible goods were generally exempt under the broader Wholesales Exemption [Section 39-26-102(19)(a), C.R.S.], the bill clarified that sales and use of pre-press printing materials, which are a necessary input to the printing process, but not typically incorporated into a final printed product and not necessarily delivered to the customer, are also exempt as wholesale transactions. There have been no amendments to the Pre-Press Exemption since it was created.

Under the exemption, pre-press printing materials are also exempt from local sales and use taxes in statutory and home rule cities and counties that have their sales taxes collected by the State. Statute [Section 29-2-105(1)(d)(I), C.R.S.] requires local governments that have their sales taxes collected by the State to apply most of the State’s tax exemptions, including the Pre-Press Exemption. Conversely, home rule cities and counties established under Article XX, Section 6 of the Colorado Constitution that collect their own sales and use tax have the authority to set their own tax policies independent from the State, and are not required to exempt pre-press printing materials from their local sales and use tax.

Vendors apply the exemption at the time of sale and use the Department of Revenue’s (Department) Retail Sales Tax Return (Form DR 0100), Line 1 of Schedule A, to report all wholesale transactions that have been exempted from retail sales tax, including those for pre-press printing materials. If a vendor does not apply the exemption to an eligible sale, printing companies may submit a Claim for Refund of Tax Paid to Vendors (Form DR 0137B) to the Department to request a refund.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the intended beneficiaries of the Pre-Press Exemption. Based on the operation of the tax expenditure and discussions with stakeholders, we considered the intended beneficiaries of this exemption to be printing companies and retailers because it reduces the cost of the materials they use in the pre-press printing process for specific jobs in which they cannot reuse the materials. Furthermore, we also considered consumers of print jobs to be indirect beneficiaries of this exemption because it may reduce printing prices to the extent printing companies pass their tax savings on to consumers in the form of lower prices.

Stakeholders reported that there are approximately 900 printing companies in Colorado, most of which perform pre-press in-house. Of the three types of printing companies, including commercial offset,

screen, and digital printers, commercial offset and screen printers typically conduct more rigorous print jobs and therefore require pre-press materials.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the Pre-Press Exemption do not explicitly state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the exemption, conversations with stakeholders, and Department regulations, we considered a potential purpose: to ensure that sales tax is only applied to purchases made by final consumers instead of at multiple steps through print jobs' production and distribution. Similar structural provisions are common in states with a sales tax to prevent "tax pyramiding," which refers to a process that increases the effective sales tax rate on a good by taxing its inputs and the transactions that occur prior to its final sale to a consumer. In addition to increasing the effective sales tax on a good, tax pyramiding can create economic distortions, for example favoring manufacturers with smaller supply chains. It can also hide the full cost of sales taxes from consumers if businesses increase prices to account for sales taxes at earlier steps in the production chain.

As discussed, the Wholesales Exemption generally exempts purchases of materials that are incorporated into goods that will later be sold at retail; however, the materials exempt under the Pre-Press Exemption may have not been included in the Wholesales Exemption because materials used in pre-press are not incorporated into the final product sold to customers. Therefore, the Pre-Press Exemption may have been intended to clarify that certain materials, such as proofing materials for pre-press printing, that are utilized for the production of a specific product sold to the customer but retained by the printing company, are also exempt.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We could not definitively determine whether the Pre-Press Exemption is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that it is likely meeting the purpose we considered in order to conduct this evaluation because wholesale distributors and printing companies are likely applying the exemption to tax exempt sales of pre-press printing materials.

Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its potential purpose:

PERFORMANCE MEASURE: To what extent is the Pre-Press Exemption applied to eligible purchases of pre-press printing materials?

RESULT: Overall, we found evidence that vendors commonly apply the Pre-Press Exemption to eligible sales. The Department was not able to provide data on the amount of pre-press materials reported exempt from sales tax or how frequently the exemption is taken because vendors report exempt sales using the same reporting line as the broader Wholesales Exemption, which cannot be disaggregated for analysis. However, we spoke to a printing association and a wholesale distributor of printing materials located in the state who reported that they were aware of the exemption, that they or their vendors regularly apply it to their purchases of eligible pre-press materials, and that it is important to printing companies. They also reported that it is widely used in the printing industry in Colorado, so it is likely that other printers are using the exemption as well.

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

We lacked the necessary information to estimate the revenue impact to the State for the Pre-Press Exemption. However, based on information we received from stakeholders, it appears that the revenue impact to the State and benefit it provides to taxpayers is relatively small. For example, one printing materials distributor we identified in the state indicated that it sold about \$280,000 in exempt materials in Calendar Year 2019. Based on the State's 2.9 percent sales tax rate, this equates to about \$8,120 in sales tax exempted. Furthermore, because the exempt materials the distributor reported to us also include items such as paper and ink, which are covered by other exemptions, the amount exempted under the Pre-Press Exemption is likely lower than this amount.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Pre-Press Exemption would impact printing companies in Colorado by adding additional costs to the printing process. Specifically, printing companies would see a 2.9 percent increase on eligible pre-press printing materials purchased from wholesale distributors. For example, a typical cost for a pre-press aluminum print plate is about \$215, which would be subject to about \$6 in additional sales taxes if the exemption was not in place. In comparison, a print job that uses a print plate could cost about \$2,000 to \$4,000, though these costs are highly variable based on the specific job. Printers would either have to absorb this additional cost or pass the cost on to customers in the form of higher prices. According to stakeholders, eliminating the exemption would negatively impact the printing industry in the state and some printers, particularly those with smaller operations, would not be able to absorb the additional cost and would likely pass the costs on to customers.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Based on our review of the seven states surrounding Colorado, we determined that none of the states' statutes explicitly exempt pre-press printing materials in the same manner as Colorado; however, all of them may exempt pre-press materials under other statutory exemptions. We reviewed statutes, legislation, and case law within Arizona, Utah, Wyoming, Nebraska, Oklahoma, New Mexico, and Kansas, and found that each state has statutory exemptions such as machinery equipment or component part exemptions that appear to exempt purchases of pre-press printing materials. Additionally, we found that Kansas likely exempts pre-press materials based on case law, indicating that Kansas provides an exemption for pre-press materials consumed in the manufacturing process. Furthermore, stakeholders indicated that many other states' codes exempt purchases of pre-press materials from sales and use tax.

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

Colorado provides other sales and use tax exemptions with a similar potential purpose as the Pre-Press Exemption intended to prevent tax pyramiding. For example, ingredients and component parts used to manufacture goods are exempt from sales tax under the Wholesales Exemption [Section 39-26-102(20)(a), C.R.S.]. Similarly, purchases of machinery used in manufacturing are exempt from sales tax under the Manufacturing Exemption [Section 39-26-709(1)(a)(II) and (IV), C.R.S.].

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

The Department could not provide data on the use of the Pre-Press Exemption. Specifically, vendors report sales that qualify for the exemption on the Department's Retail Sales Tax Return (Form DR 0100) using the same line that they use to report all types of sales that

qualify for the Wholesale Sales Exemption, which covers a wide-variety of purchases, not just pre-press printing materials.

If the General Assembly determined that a more accurate estimate is necessary, it could direct the Department to collect information specifically on exempt pre-press materials transactions as part of the Retail Sales Tax Return and make changes in GenTax to allow it to pull this data. However, according to the Department, this would require additional resources to complete the necessary programming in GenTax (see the Tax Expenditures Overview section of *the Office of the State Auditor's Tax Expenditures Compilation Report* for additional details on the limitations of Department data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE PRE-PRESS EXEMPTION. Statute and the enacting legislation for the exemption do not state the exemption's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for the exemption: to ensure that sales tax is only applied to purchases made by final consumers instead of at multiple steps through print jobs' production and distribution. We identified this purpose based on the operation of the exemption, conversations with stakeholders, and its legislative history. We also developed a performance measure to assess the extent to which the exemption is meeting this potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).