



# EXEMPTION FOR DONATIONS BY MANUFACTURERS TO GOVERNMENT AND CHARITABLE ORGANIZATIONS

EVALUATION SUMMARY | SEPTEMBER 2021 | 2021-TE24

TAX TYPE	Sales and use	REVENUE IMPACT	Could not determine
YEAR ENACTED	1998	NUMBER OF TAXPAYERS	Could not determine
REPEAL/EXPIRATION DATE	None		

**KEY CONCLUSION:** The exemption is generally effective at exempting sales and use tax on donations of manufactured goods from manufacturers to government(s) or charitable organizations. However, we were unable to determine how frequently these donations occur, how often this exemption is claimed, or the amount claimed.

## WHAT DOES THE TAX EXPENDITURE DO?

The Exemption for Donations by Manufacturers to Government and Charitable Organizations [Sections 39-26-705(2) and 713(1)(d), C.R.S.] (Manufacturer Donations Exemption) exempts from sales and use tax donations of manufactured goods exceeding \$1,000 in aggregate value from manufacturers to the U.S. federal government, the State of Colorado (including its political subdivisions, departments, and institutions), local governments, and Internal Revenue Code 501(c)(3) tax-exempt organizations.

## WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and enacting legislation do not explicitly state a purpose for the Manufacturer Donations Exemption; therefore, we could not definitively determine the General Assembly's original intent. However, based on the operation of the exemption, its enacting legislation, and legislative audio for House Bill 98-1269, we considered a potential purpose: to ensure that manufacturers who make donations exceeding \$1,000 in value receive the same sales and use tax treatment whether they sell their manufactured goods or donate them to government(s) or charitable organizations.

## WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

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



# EXEMPTION FOR DONATIONS BY MANUFACTURERS TO GOVERNMENT AND CHARITABLE ORGANIZATIONS

## EVALUATION RESULTS

### WHAT IS THE TAX EXPENDITURE?

The Exemption for Donations by Manufacturers to Government and Charitable Organizations [Sections 39-26-705(2) and 713(1)(d), C.R.S.] (Manufacturer Donations Exemption) exempts manufacturers' donations of manufactured goods to government(s) or charitable organizations from sales and use tax. To qualify, the donor must have manufactured the goods and the aggregate value of the donation must exceed \$1,000. Eligible recipients include the U.S government, the State of Colorado (including its political subdivisions, departments, and institutions), local governments, and charitable organizations that qualify as tax-exempt under Internal Revenue Code Section 501(c)(3). The Manufacturer Donations Exemption was created in 1998 by House Bill 98-1269 and it has remained substantively unchanged since then.

Typically, manufacturers' purchases of components or materials used to manufacture goods that will be sold at retail are exempt from sales and use tax under the Wholesales Exemption [Section 39-26-102(20)(a), C.R.S.] However, the Wholesales Exemption generally does not apply if the manufacturer intends to use the goods itself or donate the goods. For example, a furniture manufacturer that purchases materials that it intends to use to manufacture furniture that it will use in its own offices would not qualify for the Wholesales Exemption, and

this purchase would be subject to sales tax. If, instead, a manufacturer makes goods that it originally intends to sell at retail, but later removes the goods from inventory for its own use, it would not have owed sales tax at the time of its purchase of the materials used to manufacture the goods, but would be required to remit use tax when it removes the goods from its inventory. The Manufacturer Donations Exemption exempts manufacturers' donations from sales or use tax under either circumstance. However, according to Department of Revenue (Department) staff, in practice, the exemption more typically applies to use tax when a manufacturer donates goods that are already in its inventory.

Taxpayers who make donations that are eligible for the exemption typically do not report their use of the exemption to the Department because the Department generally does not require taxpayers to report use tax exemptions. If a manufacturer is exempt from sales tax under the exemption when it purchases materials that it plans to manufacture into goods that it will donate, the vendor of the materials can report the exempt sale on its Retail Sales Tax Return (Form DR 0100), using Schedule A, line 12 for "other exempt sales." Alternatively, manufacturers can use the Claim for Refund of Tax Paid to Vendors form (Form DR 0137B) to apply for a refund of sales taxes paid in the event that sales tax was mistakenly charged on its purchase.

#### WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not directly state the intended beneficiaries of the exemption. Based on our review of the statutory language, legislative audio for House Bill 98-1269, and discussions with Department staff, we considered the intended beneficiaries to be manufacturers in Colorado that donate their manufactured goods to the U.S. government, the State of Colorado (including its political subdivisions, departments, and institutions), and/or 501(c)(3) organizations, and the recipients of the donations. Although testimony in the House Finance Committee for House Bill 98-1269 by the bill sponsor and witnesses focused largely on

the benefits that this exemption would provide to computer manufacturers, specifically when it came to donations of computer systems to Colorado public schools, colleges, and universities, the bill sponsors indicated that the exemption was intended to benefit all types of manufacturers in the state.

#### WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for this exemption do not explicitly state its purpose; therefore, we could not definitively determine the General Assembly's original intent. However, based on the operation of the exemption, its enacting legislation, and legislative audio for House Bill 98-1269, we considered a potential purpose: to ensure that manufacturers who make donations exceeding \$1,000 in value receive the same sales and use tax treatment whether they sell their manufactured goods or donate them to government(s) or charitable organizations. Testimony for House Bill 98-1269 indicated that the Manufacturer Donations Exemption was created due to the bill sponsor's concern about a computer manufacturer that intended to make a donation of a large computer system to a Colorado university and became aware that it would have to pay use tax on the donation if it was removed from its inventory in Colorado. Furthermore, testimony from witnesses indicated a general concern that a requirement for manufacturers to pay sales or use tax on their donated goods may be a disincentive for such donations, and that the exemption may remove the disincentive by eliminating financial barriers for eligible donations made by manufacturers.

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

We could not definitively determine if the Manufacturer Donations Exemption is meeting its purpose because no purpose is provided for it in statute or its enacting legislation. However, we found that the

exemption is likely meeting the potential purpose that we identified in order to conduct this evaluation.

Neither statute nor the enacting legislation provide quantifiable performance measures to evaluate the exemption. 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 are manufacturers in Colorado making eligible donations and using the exemption?*

**RESULT:** Based on information we received from both manufacturers who donated manufactured goods and the recipients of said goods, it appears that the exemption is used, though we could not quantify the extent of its use due to a lack of data because taxpayers do not report to the Department when they claim this exemption. Of the manufacturers we contacted, we heard back primarily from machinery manufacturers. Generally, the taxation and/or accounting departments of these manufacturers were aware that they would not need to pay sales or use tax on their donations, even though most said they had not used this exemption in recent years. Based on records kept in the State's accounting system and outreach to stakeholders, some common recipients of donations of manufactured goods are schools, such as public K-12 schools, and state institutions of higher education. Representatives from these schools stated that donations of goods that they receive from manufacturers provide an important support to their educational programs. However, based on conversations with staff from these schools, it appears that many of the donations they received in recent years would not have been eligible for the Manufacturer Donations Exemption because the donations were for items, such as new or used equipment, that was not manufactured by the donor business. However, these donations would not likely have been subject to sales or use tax anyway because (1) the donor should have paid any applicable sales or use tax on the purchase or use of the equipment, and (2) a donation is not a taxable transaction.

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

Due to a lack of data, we were unable to determine the revenue impact that this exemption has on the State or quantify the economic benefits it provides. Based on our discussions with stakeholders it appears that donations of manufactured goods that are eligible for this exemption are not recurring or consistent, leading to a revenue impact that likely varies by year.

Additionally, statute [Section 29-2-105(1)(d)(I), C.R.S.] mandates that local governments that have their sales taxes collected by the State apply most of the State's sales tax exemptions, including the Manufacturer Donations Exemption. Therefore, this exemption likely reduces local sales and use tax revenue to some extent, although we also lacked the data necessary to estimate this impact. Furthermore, home rule cities and counties established under Article XX, Section 6 of the Colorado Constitution that collect their own sales and use taxes have the authority to set their own tax policies independent from the State and are not required to exempt donations made by manufacturers from their local sales and use taxes. Of the 15 most populous home rule cities in Colorado, only three (Denver, Broomfield, and Centennial) have similar exemptions.

## WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If the Manufacturers Donations Exemption were eliminated, manufacturers would have to pay sales or use tax on the acquisition cost of the components purchased to produce the goods that they donate to governments or charitable organizations. This may increase the financial and administrative burdens of making these kinds of donations. One stakeholder reported that if this exemption were repealed, it could lead to the overall value of donations decreasing because they would have to factor in the cost of sales or use tax into their budget. A similar sentiment was expressed in testimony before the

House Finance Committee in favor of House Bill 98-1269. The bill's sponsor and a witness stated that manufacturers in the state were facing disincentives to donate because they had to pay use tax before the exemption was enacted. This could mean that recipients might receive donations that are less frequent or lower in value if this exemption were eliminated.

#### ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We found that, of the 44 states (excluding Colorado) and the District of Columbia that levy sales and use taxes, only one state (New York) has a similar exemption specifically for manufacturers, though it does not impose a minimum donation requirement. Additionally, at least 18 states and the District of Columbia have similar exemptions that are generally broader than Colorado's exemption in terms of the types of donations that are eligible and the types of eligible donors. For example, most of those states allow manufacturers, as well as retailers and other sellers, to claim an exemption for donations of inventory. Some states impose additional restrictions on the types of donations or eligible recipients. For example, Alabama only allows the exemption for donations with an aggregate value of \$10,000 or less, and Louisiana only grants an exemption for donations to schools or food banks. Additionally, in March 2020, the Governor of Indiana signed an executive order to exempt manufacturers who produce and donate medicine, medical supplies, and other supplies used to fight the COVID-19 pandemic from paying sales and use tax on those donated goods.

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

Federal law [26 USC 170] allows manufacturers to claim a charitable contribution deduction for donations of inventory. When filing federal income tax returns, manufacturers organized as C-corporations can deduct the cost of property taken from inventory and donated to qualified organizations from their income for the tax year that the donation took place. The manufacturer can deduct the fair market value

of the property taken from inventory and donated after subtracting the amount of ordinary income that would have been earned had the property been sold. Manufacturers can deduct charitable contributions up to 10 percent of their federal taxable income per year.

Since Colorado uses federal taxable income as the starting point for calculating Colorado taxable income, the federal deduction flows through to the Colorado income tax return and manufacturers who claim the federal deduction can also benefit from the Manufacturer Donations Exemption.

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

The Department could not provide data showing the revenue impact for the Manufacturer Donations Exemption. Manufacturers who make eligible donations generally do not report their use of the exemption on any Department forms; therefore, no data was available from the Department on the use of the exemption. As a result, we were unable to determine the revenue impact or determine how often manufacturers claim the exemption.

If the General Assembly determines that additional information on the exemption's revenue impact is necessary, it could direct the Department to add additional reporting lines on its Consumer's Use Tax Return and make changes in GenTax, its tax processing and information system, to capture and extract this additional information. Additionally, manufacturers would need to be required to begin reporting the exemption when they make eligible donations. However, this requirement could also increase the administrative burden on manufacturers using the exemption. Additionally, according to the Department, this type of change would require additional resources to develop new or revised forms and complete the necessary programming in GenTax (see the Tax Expenditures Overview Section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for



additional details on the limitations of Department 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 MANUFACTURER DONATIONS EXEMPTION. As discussed, statute and the enacting legislation do not state the exemption's purpose. Therefore, for the purposes of our evaluation, we considered a potential purpose for the exemption: to ensure that manufacturers who make donations exceeding \$1,000 in value receive the same sales and use tax treatment whether they sell their manufactured goods or donate them to government(s) or charitable organizations. We identified this purpose based on the operation of the exemption, the enacting legislation, and legislative audio for House Bill 98-1269. We also developed a performance measure to assess the extent to which the exemption is meeting its potential purpose. However, the General Assembly may want to clarify its intent for the exemption by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemption's purpose and allow our office to more definitively assess the extent to which the exemption is accomplishing its intended goal(s).