



EXONERATED PERSONS DEDUCTION

EVALUATION SUMMARY | JULY 2022 | 2022-TE31

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2021)	Too few taxpayers to report
YEAR ENACTED	2013	NUMBER OF TAXPAYERS (TAX YEAR 2021)	Too few taxpayers to report
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: Changes to federal law exempting compensation awarded to wrongfully incarcerated persons from taxable income have made the Exonerated Persons Deduction largely redundant. However, the deduction still provides a benefit to any immediate family members who receive compensation for an exonerated, deceased relative.

WHAT DOES THE TAX EXPENDITURE DO?

The Exonerated Persons Deduction [Section 39-22-104(4)(q), C.R.S.] allows taxpayers to deduct any compensation received from the State resulting from their, or an immediate family member's, wrongful incarceration pursuant to the Compensation for Certain Exonerated Persons Act (the Act) [Section 13-65-101, et seq., C.R.S.], from their Colorado income.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Exonerated Persons Deduction; therefore, we could not definitively determine the General Assembly's original intent. Instead, we considered a potential purpose for the deduction: to exclude the State's compensation for exonerated persons from the Colorado income tax base.

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 Exonerated Persons Deduction.



EXONERATED PERSONS DEDUCTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Exonerated Persons Deduction [Section 39-22-104(4)(q), C.R.S.] allows taxpayers to deduct from their Colorado taxable income any compensation received pursuant to the Compensation for Certain Exonerated Persons Act (Act) [Section 13-65-101, et seq., C.R.S.] as a result of their, or an immediate family member's, wrongful incarceration. The Act was passed in 2013, and created a program by which persons exonerated of a Colorado felony (or what would have been a felony for an adult if the delinquent was convicted as a minor) in Colorado can file a civil claim in state district court to receive compensation for their wrongful incarceration. In the event that an eligible exonerated person is deceased, the Act also allows their immediate family members to petition the court for compensation.

In order to receive compensation pursuant to the Act, a petitioner must demonstrate the exonerated person's "actual innocence" of the crime for which they were wrongfully incarcerated. Actual innocence represents a higher legal standard than what must be met for a person to be exonerated; for instance, a person could be exonerated if a court found insufficient evidence, legal error, or other reasons to overturn their conviction, but not found actually innocent if they could not provide reliable evidence of being factually innocent of the crime. If the district court decides in favor of a petitioner's claim, then they are awarded compensation as follows:

- \$70,000 per year the petitioner was incarcerated for the felony for which they have been exonerated

- \$50,000 additionally per year the petitioner was sentenced to execution
- \$25,000 additionally per year the claimant served on parole, probation, or as a registered sex offender after a period of incarceration as a result of the felony for which they have been exonerated
- Additionally, a petitioner may be compensated for: any fine, penalty, court costs, or restitution imposed and paid by the exonerated person as a result of their wrongful conviction; child support payments owed by the exonerated person that became due during their incarceration; and reasonable attorney fees for bringing a claim for compensation. However, statute [Section 39-22-104(4)(q), C.R.S.] does not allow attorney fees awarded to be deducted as part of the Exonerated Persons Deduction. Also, if the exonerated individual was incarcerated for at least 3 years, they and their children who were adopted or conceived prior to that individual's incarceration are eligible to receive full tuition waivers at Colorado public institutions of higher education.

The State Court Administrator's Office (SCAO) is responsible for disbursing the compensation, and pays the exonerated person's award in annual installments of \$100,000, adjusted annually for inflation, until the balance of their compensation is depleted. After the first annual payment, the exonerated person may elect to receive the remaining balance of their compensation in one lump sum. In order to receive funds after the first annual installment, the exonerated person must provide evidence of completing a recognized personal financial management course. Additionally, recipients must provide evidence of acquiring and committing to maintain a qualified health insurance plan or incur a financial penalty.

The deduction was established as part of the Act in 2013 by House Bill 13-1230. No changes have been made to the deduction since. If a taxpayer had included their exonerated persons compensation in their

federal taxable income, they could deduct the compensation on Line 18, “Other subtractions, explain below,” of Form DR 0104AD in order to exclude it from their Colorado taxable income. When the deduction was established in 2013, compensation granted to wrongfully incarcerated individuals was not excludable from federal income tax. However, in 2015, 26 USC 139F was added to the U.S. Code, which created an exclusion from federal taxable income for compensation received by an individual for their own wrongful incarceration, which has remained in effect since. Because Colorado uses federal taxable income as the starting point for calculating state taxable income, this federal change results in compensation received by an individual for their wrongful incarceration being automatically excluded from Colorado taxable income as well as if they exclude it from their federal taxable income.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Individuals who are found to be actually innocent, or their immediate family members, are the intended beneficiaries of the deduction. Since 2013, the year the Act was established, three individuals have been awarded compensation under the Act and were eligible for the deduction, to the extent they included the compensation in their federal taxable income.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Exonerated Persons Deduction; therefore, we could not definitively determine the General Assembly’s original intent. Instead, we considered a potential purpose for the deduction: to exclude the State’s compensation for exonerated persons from the Colorado income tax base.

We based this potential purpose on a review of existing Colorado statute and after conducting a review of legislative testimony presented during the Act’s passage. We found that the compensation provided by the Act created a novel form of income, for which existing Colorado

statute did not address the taxability. Legislative testimony indicated that, while the sponsors of House Bill 13-1230 calculated the average wages of a Coloradan between 45 and 50 years of age when they determined the amount of compensation provided in the Act, they did not intend for the compensation to recoup lost wages, but rather to be inclusive of other additional damages, such as the pain and suffering inflicted by wrongful incarceration, and to provide general welfare and support to formerly incarcerated people who have few resources upon their release. We therefore concluded that the General Assembly considered the compensation under the Act to be distinct from other—taxable—types of income.

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

We could not definitively determine whether the Exonerated Persons Deduction is meeting its purpose because no purpose is provided for it in statute or enacting legislation. However, we found that the deduction is likely meeting the potential purpose that we considered for the purposes of this evaluation.

Statute and the deduction’s enacting legislation do not provide performance measures; therefore, we created the following performance measure to evaluate its effectiveness in meeting its potential purpose.

PERFORMANCE MEASURE: *To what extent are eligible taxpayers aware of and using the deduction?*

Since the Act was passed in 2013, the State has paid a total of \$3,216,690 in compensation to three exonerated individuals. The SCAO does not provide recipients with any information or guidance on the tax treatment of their awards; recipients are responsible for determining the correct tax treatment for their compensation. We searched GenTax, the Department of Revenue’s tax return processing and information system, for the income tax returns of the three individuals who had received exonerated persons compensation

pursuant to the Act in order to determine whether eligible taxpayers are aware of and using the deduction. However, too few eligible taxpayers claimed the deduction for us to report the number who did not pay tax on their exonerated compensation awards without revealing confidential taxpayer information.

The extent to which Colorado's deduction is utilized may be influenced by the changes to federal law passed in 2015. Specifically, 26 USC 139F, which was created in 2015 by Public Law 114-113, establishes an exclusion from federal gross income for any "civil damages, restitution, or other monetary award" relating to the wrongful incarceration of a wrongfully incarcerated individual. Because federal taxable income is the basis for which Colorado taxable income is determined, all compensation for wrongful incarceration to wrongfully incarcerated individuals is also exempt from Colorado income tax (26 USC 139F applied retroactively to all tax years, including years since the Exonerated Persons Deduction was passed). It is therefore possible that exonerated persons receiving compensation from Colorado have excluded their compensation from their Colorado taxable income as a result of excluding it on their federal taxable income, instead of by using Colorado's deduction. However, due to taxpayer confidentiality requirements, we are unable to report on the extent to which this occurred.

Although the deduction is largely duplicated by the federal exclusion under 26 USC 139F, it may serve to clarify the intended treatment of compensation awarded under the Act and would prevent this income from being taxed if federal law changed to no longer allow the exclusion. Further, the federal exclusion does not apply to compensation received by immediate family members who file a claim in the event the exonerated person is deceased, while Colorado's deduction does include compensation to immediate family members. While no compensation has yet been paid to immediate family members of exonerated persons, the deduction would prevent this income from being taxed if such an award is made in the future.

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

Due to taxpayer confidentiality requirements, we are unable to report whether exonerated persons in Colorado utilized Colorado's deduction for the compensation they received, or whether they utilized the federal exclusion under 26 USC 139F, to exclude that compensation from their federal and Colorado taxable income. Regardless of whether Colorado's deduction or the federal exclusion was used, the ultimate impact on Colorado's revenue is the same: Colorado income tax is not levied on compensation granted to exonerated persons. Given that the State has paid exonerated persons a total of \$3.2 million since the Act was established, the forgone income tax revenue equates to roughly \$150,000 in total, or about \$19,000 each year since the Act was established. However, this cost is only attributable to Colorado's deduction to the extent that taxpayers utilized Colorado's deduction, instead of the federal exclusion under 26 USC 139F. Therefore, these figures represent the maximum possible revenue impact of the deduction, while the actual amount specifically attributable to the deduction may be less.

Additionally, the Exonerated Persons Deduction allows for the deduction of compensation for the immediate family members of an exonerated person, in the event that the exonerated person is deceased. That compensation is not excluded by 26 USC 139F, and therefore, allowing a state-level deduction for it could have a revenue impact to the State. However, according to SCAO records, no immediate family members of exonerated persons have been awarded compensation since the Act was passed.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating this deduction would likely have no impact on exonerated persons who currently receive compensation from the State themselves, as their compensation can be excluded from their federal taxable income by 26 USC 139F, which automatically excludes the income from

their Colorado taxable income. However, if this deduction were eliminated and immediate family members of an exonerated person receive compensation from the State in the future, they would have to pay Colorado income tax on the compensation they receive, since federal law does not permit an exclusion for family members of the exonerated person.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

According to the Innocence Project, a national nonprofit that works to exonerate wrongfully convicted persons, 37 other states, the District of Columbia, and the federal government all have laws granting compensation to exonerated persons. The amount of compensation, eligibility requirements, and procedure to claim compensation vary among these jurisdictions.

Although we did not identify a source of comprehensive information on these states' tax treatment of compensation awarded to exonerated persons, we reviewed the laws of a sample of six states of similar population to Colorado that grant compensation to exonerated persons—Alabama, Minnesota, Wisconsin, Maryland, Missouri, and Indiana. We were not able to find a state-level tax expenditure excluding such compensation from state income taxes in any of these six states. However, of the 37 states that award compensation to exonerated persons, 32 states link their taxable income to either federal adjusted gross income or federal taxable income, only tax dividend and interest income, or do not have an income tax. Therefore, compensation paid for wrongful incarceration in those states likely would not be subject to tax. However, we were unable to verify whether any states excluded 26 USC 139F from their conformity of the U.S. Code.

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

As previously noted, 26 USC 139F allows Colorado taxpayers to exclude compensation they received for their wrongful incarceration from their federal and state taxable income. This provision applies to

recipients of compensation from Colorado pursuant to the Act, and also applies to any Colorado taxpayer who receives compensation for their wrongful incarceration from the federal government or another state.

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

We did not encounter any significant data constraints while evaluating this tax expenditure.

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 EXONERATED PERSONS DEDUCTION. As discussed, statute and the enacting legislation for the deduction do not state the deduction's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for the deduction: to exclude the State's compensation for exonerated persons from the Colorado income tax base. We identified this purpose based on our review of other relevant Colorado statutes and legislative testimony from the passage of House Bill 13-1230. We also considered a performance measure: to what extent are eligible taxpayers aware of and using the deduction? The General Assembly may want to clarify its intent for the deduction by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the deduction's purpose and allow our office to more definitively assess the extent to which the deduction is accomplishing its intended goal(s).