

COMPLIMENTARY MARKETING PROPERTY TO OUT-OF-STATE VENDEES EXEMPTIONS



EVALUATION SUMMARY

JULY 2020
2020-TE21

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

	SALES TAX EXEMPTION	USE TAX EXEMPTION
YEAR ENACTED	1977	1977
REPEAL/ EXPIRATION DATE	None	None
REVENUE IMPACT	None	Minimal, if any
NUMBER OF TAXPAYERS	None	Could not determine
AVERAGE TAXPAYER BENEFIT	None	Could not determine
IS IT MEETING ITS PURPOSE?	Yes, by clarifying statute, but it is not used by taxpayers.	Yes, by clarifying statute, but it is likely used by few taxpayers, if at all

WHAT DO THESE TAX EXPENDITURES DO?

The Complimentary Marketing Property to Out-of-State Vendees Exemptions (Marketing Property Exemptions) [Section 39-26-713 (1)(b) and (2)(i), C.R.S.] provide a sales and a use tax exemption available to businesses that transfer items to an out-of-state vendee to use in selling the businesses' products and do not receive any payment from the vendee for these items.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not explicitly state a purpose for the Marketing Property Exemptions. We inferred that the purpose was to clarify the application of the State's sales and use tax for out-of-state transfers of marketing property. In particular, it may not have been clear to businesses whether they should pay use tax when transferring marketing property to vendees free of charge and the exemptions serve to clarify that the transfers are not subject to the tax.

WHAT DID THE EVALUATION FIND?

We determined that the sales tax exemption covers transactions that would already be considered exempt and so taxpayers do not have a need to use it. In addition, the use tax exemption is likely used by few taxpayers, if at all, with Department of Revenue staff and CPAs we contacted being unaware of any taxpayers who use it.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly could consider repealing the Marketing Property Exemptions since they appear to be rarely, if ever used. However, because they may add clarity to the application of the State's sales and use taxes, the General Assembly may want to keep them in place.

COMPLIMENTARY MARKETING PROPERTY TO OUT-OF-STATE VENDEES EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THE TAX EXPENDITURES?

The Complimentary Marketing Property to Out-of-State Vendees Exemptions (Marketing Property Exemptions) [Section 39-26-713 (1)(b) and (2)(i), C.R.S.] provide two parallel exemptions, one for sales and one for use tax. These exemptions are available to businesses that transfer items to an out-of-state vendee to use in selling the businesses' products when the businesses do not receive any payment or "consideration, other than the purchase, sale, or promotion" of their products [Section 39-26-713(1)(b), C.R.S.]. One example would be a Colorado manufacturer of air freshener canisters that delivers air freshener dispensers (which only work with the canisters) to customers outside the state free of charge. When the manufacturer removes from inventory, stores, and then ships the dispensers for the purpose of selling the manufacturer's air freshener canisters, the transfer of the dispensers qualifies for the use tax exemption. Another example would be a Colorado tire manufacturer that also manufactures marketing items, such as tire display racks. The manufacturer sends the racks to out-of-state retailers in order to display its tires for sale. When the manufacturer removes the racks from its inventory for this purpose, it qualifies for this exemption and does not have to pay Colorado sales or use tax on those racks. House Bill 77-1535 created these exemptions, which have remained substantially unchanged since 1977.

According to the Department of Revenue, it does not have an established process for taxpayers to claim the Marketing Property Exemptions. Businesses are still able to use the exemptions, but they do not report their use or take any administrative action other than excluding the value of the transferred property from the amounts they report as sales or taxable use.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly identify the intended beneficiaries of the Marketing Property Exemptions. Based on our review of statute, regulations, applicable case law, Department of Revenue taxpayer guidance documents, and discussions with CPAs and Department of Revenue staff, we inferred that the intended beneficiaries are Colorado businesses that remove items, such as displays, dispensers, and signs, from their inventory to send, free of charge, to out-of-state vendees, which can include individual customers, in order to market the products they sell. Therefore, although we lacked data on the types of businesses that use them, the exemptions could potentially benefit a wide range of Colorado manufacturers and wholesalers that sell products outside the state.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state a purpose for the Marketing Property Exemptions. We inferred that the purpose was to clarify the application of the State's sales and use tax for out-of-state transfers of marketing property. In particular, it may not have been clear to businesses whether they should pay use tax when transferring marketing property to vendees free of charge and the exemptions serve to clarify that the transfers are not subject to the tax. Generally, if a business purchases tangible personal property with the intent to resell it or incorporate it into a product for sale, the sale is exempt from sales tax under the Wholesale Sales Tax Exemption [Sections 39-26-102(18)-(20), and 39-26-713(2), C.R.S.]. However, if after receiving the property, the wholesaler or manufacturer does not sell it, but instead removes it from its inventory and uses it for its own purposes, it is required to pay use tax on the value of the property. Therefore, in the case of marketing property transferred out-of-state, it may have been unclear to businesses whether they needed to pay use tax on the transfers if they remove the marketing property from inventory and transfer it to a vendee, to facilitate a sale of other products, but without selling the marketing property itself. We inferred this purpose based on our review of legislative history and statutory language, discussions with CPAs, and Department of Revenue guidance.

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We found that the Marketing Property Exemptions are meeting their purpose, but only to a limited extent, because they appear to be used by few taxpayers, if at all. However, they may continue to serve their purpose of clarifying that the transfers of marketing property that they cover are exempt from sales and use tax. Statute does not provide a quantifiable performance measure for this exemption. Therefore, we created and applied the following performance measure to determine the extent to which the exemptions are meeting their purpose:

PERFORMANCE MEASURE: *To what extent are Colorado companies using the exemptions to avoid paying sales and use tax on complimentary items they provide to out-of-state retailers or consumers in order to sell the companies' products?*

RESULTS: We found that the Marketing Property Exemptions appear to be used by few taxpayers or not at all.

Sales tax exemption. Although we lacked data to confirm that no taxpayers have used the sales tax exemption, based on our review of statute and regulations, and discussions with Department of Revenue staff, we could not identify a situation where a taxpayer would need to use it. Specifically, the delivery of personal property outside the state is not subject to Colorado sales tax, since Colorado only imposes a sales tax on retail sales made in Colorado [Sections 39-26-102(9) and 104, C.R.S.]. Because the marketing property must be delivered outside the state in order to qualify for the Marketing Property Exemptions, it would already be exempt from Colorado sales tax under these broader provisions. Furthermore, according to Section 39-26-102(10), C.R.S., there must be a corresponding exchange of consideration (i.e., monetary payment, property or services) for a transfer of personal property to be considered a sale subject to sales tax. According to Department of Revenue staff, it is unlikely that the transfers covered under the exemption would be considered sales because businesses transfer the property free of charge and thus, the transfers lack the necessary exchange of consideration.

Use tax exemption. Although we lacked data to confirm that no taxpayers have used the use tax exemption, Department of Revenue staff told us that they consider this to be an obscure exemption that is rarely, if ever used. Additionally, Department of Revenue staff indicated that they have not collected information on the exemption's use and have not interacted with any taxpayers regarding the exemption, such as discussing how to take the exemption or what circumstances qualify, which indicates few taxpayers are aware of it. Further, we consulted with several CPAs practicing in Colorado and they were not familiar with the exemption. None of the CPAs had heard of a taxpayer using it. One CPA told us that the taxpayers that could potentially use the exemption are companies with sophisticated tax law knowledge that operate on a large-scale over numerous states or countries.

Although it appears that few taxpayers use these exemptions, because some businesses likely engage in the types of transactions they cover, the Marketing Property Exemptions may continue to serve their purpose of clarifying statute even though the intended beneficiaries likely apply other exemptions to avoid paying sales and use tax.

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

Although we lacked data to determine the actual cost of the Marketing Property Exemptions to the State, we determined that any revenue forgone by the State from these tax expenditures is likely minimal. Specifically, we determined the sales tax exemption has no cost to the State because eligible transfers of property would have already been exempted from sales tax without the expenditure. Because the use tax exemption is likely used by few taxpayers if at all, we determined that it likely has little or no revenue impact to the State.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

Because it appears that the tax expenditures are either not used, or used only by a small number of taxpayers, we determined that the overall impact of eliminating the Marketing Property Exemptions would likely be minimal. As discussed, it appears that the sales tax exemption is not being used and so there

would be no impact to beneficiaries if it were eliminated. To the extent it is used, eliminating the use tax exemption could result in current beneficiaries potentially having to pay use tax on all items they removed from inventory to send out-of-state to help sell their product. However, as discussed, it was not necessarily clear at the time that the exemptions were created that the transactions they cover were taxable, so some current beneficiaries might determine that they can continue to exempt these transfers from use tax even if the exemption were eliminated. Alternatively, companies might choose to charge money for these items instead of giving them away on a complimentary basis.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We did not identify any similar tax expenditures in other states.

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

We did not identify any tax expenditures or programs with a similar purpose available in the state.

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

The Department of Revenue was not able to provide us with data for the Marketing Property Exemptions because taxpayers are not required to report their use on any form. To obtain data on the extent to which the exemptions are being used, the Department of Revenue would have to create new reporting lines on its sales and use tax reporting forms (Forms DR 0100, DR 0173, and DR 0137B) and then capture and house the data collected on those lines in GenTax, its tax processing and information system, which would require programming changes and additional resources. These changes may not be cost-effective since the exemptions appears to be rarely used (See the Tax Expenditures Overview Section of the Office of the State Auditor's *Tax Expenditures Compilation Report* for details on the limitations of Department of Revenue data and the potential costs of addressing these limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY COULD CONSIDER REPEALING THE MARKETING PROPERTY EXEMPTIONS SINCE THEY APPEAR TO BE USED BY FEW TAXPAYERS, IF AT ALL. Specifically, we could not identify a circumstance under which a taxpayer would need to use the sales tax exemption. Because property must be transferred outside the state to qualify, this type of transaction would already be exempt because only in-state sales are subject to sales tax. Further, such transactions likely do not qualify as taxable sales because they are made free of charge. In addition, although some taxpayers could potentially claim the use tax exemption, we could not find evidence that taxpayers are claiming it, with neither the Department of Revenue nor CPAs we contacted being aware of any such taxpayers. However, the General Assembly may want to keep the exemptions in place in order to clarify that the qualifying transactions are not taxable.