



PREFABRICATED HOMES EXEMPTIONS

EVALUATION SUMMARY | APRIL 2021 | 2021-TE8

EXPENDITURE	PREFABRICATED HOMES PARTIAL EXEMPTION	MANUFACTURED HOMES EXEMPTION	SUBSEQUENT HOME SALES EXEMPTION
TAX TYPE	Sales and use	Sales and use	Sales and use
YEAR ENACTED	1979	2018	1973
REPEAL/EXPIRATION DATE	None	None	None
REVENUE IMPACT	\$1.4 million (annual average from 2016 to 2020)	\$5.6 million (Fiscal Year 2020)	\$252,000 (Fiscal Year 2020)
NUMBER OF TAXPAYERS	Could not determine	Could not determine	Could not determine

KEY CONCLUSION: Stakeholders are aware of the Prefabricated Homes Partial Exemption and Subsequent Home Sales Exemption and indicated that the exemptions are being applied to eligible sales. Additionally, the Manufactured Homes Exemption makes manufactured homes more affordable by reducing the overall cost of purchasing a home.

WHAT DO THESE TAX EXPENDITURES DO?

- PREFABRICATED HOMES PARTIAL EXEMPTION—Exempts 48 percent of the purchase price of a manufactured or modular home from sales and use tax.
- MANUFACTURED HOMES EXEMPTION—Exempts the sale, storage, usage, or consumption of a manufactured home constructed on or after June 15, 1976, in compliance with the National Manufactured Housing Construction and Safety Standards, from sales and use tax.
- SUBSEQUENT HOME SALES EXEMPTION—Exempts subsequent sales of previously sold manufactured and modular homes from sales and use tax.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation do not state these tax expenditures’ purposes; therefore, we could not definitively determine the General Assembly’s original intent. Based on our review of their legislative history and operation, our evaluation considered these exemptions to have the following potential purposes:

- PREFABRICATED HOMES PARTIAL EXEMPTION—Taxing only a fixed percentage of the purchase price of a modular or manufactured home that is estimated as attributable to materials, thereby treating modular and manufactured homes similarly to traditional site-built homes for sales tax purposes.
- MANUFACTURED HOMES EXEMPTION—Making manufactured homes more affordable by eliminating all of the state sales and use tax, which represents an additional cost to homebuyers when purchasing manufactured homes.
- SUBSEQUENT HOME SALES EXEMPTION—Treating all subsequent sales of homes the same for sales and use tax purposes since many manufactured homes remain tangible personal property after they are installed at the building site.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider:

- Establishing statutory purposes and performance measures for the exemptions.
- Amending statute to provide a corresponding use tax exemption for the Prefabricated Homes Partial Exemption.

PREFABRICATED HOMES EXEMPTIONS

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

Prefabricated homes are residential structures without motive power that are manufactured in a factory setting and then later transported and installed at the building site. There are two main types of prefabricated homes:

- **MODULAR HOMES** are constructed to the same state, local, or regional building codes as traditional site-built homes and are transported on trucks, sometimes in multiple sections, to the building site. Modular homes are generally more expensive to purchase than manufactured homes.
- **MANUFACTURED HOMES** are constructed to a federal building code set by the Department of Housing and Urban Development (HUD), which requires that the homes be built on a permanent chassis, bear a certification label (known as a HUD tag), and generally be at least 320 square feet when erected on site. HUD began regulating the construction of manufactured homes on June 15, 1976; manufactured homes that were constructed prior to June 15, 1976, are typically referred to as mobile homes.

At the time of their construction and/or transport to the building site, modular and manufactured homes are generally considered tangible personal property and are thus, subject to sales or use tax in Colorado. However, statute [Section 39-26-721, C.R.S.] provides several sales and use tax exemptions related to manufactured and/or modular homes:

- **PREFABRICATED HOMES PARTIAL EXEMPTION** [SECTION 39-26-721(1), C.R.S.]—This provision exempts 48 percent of the purchase price of a modular or manufactured home from state sales tax. Statute does

not explicitly provide a parallel exemption from use tax; however, because they are exempt from sales tax, it is the Department of Revenue's (Department) practice to also exempt transactions concerning modular and manufactured homes from use tax in Colorado. Additionally, statutory and home rule local governments that have their sales taxes collected by the State are required to apply the Prefabricated Homes Partial Exemption. This exemption was created in 1979 with House Bill 79-1451, and it has remained substantively unchanged since its enactment.

- **MANUFACTURED HOMES EXEMPTION [SECTION 39-26-721(3), C.R.S.]**—Beginning July 1, 2019, this provision exempts the sale, storage, usage, or consumption of a manufactured home from state sales and use tax. To qualify for the exemption, the home must be eligible for a certificate of title pursuant to Part 1 of Article 29 of Title 38, C.R.S., and be constructed in compliance with the National Manufactured Housing Construction and Safety Standards, which are administered by HUD, and apply to homes built on or after June 15, 1976; homes built prior to this date are not eligible for the exemption. Statutory and home rule local governments that have their sales taxes collected by the State may choose to apply the exemption, but must opt in through adoption of a local ordinance. This exemption was created in 2018 with House Bill 18-1315, and it has remained substantively unchanged since its enactment.
- **SUBSEQUENT HOME SALES EXEMPTION [SECTIONS 39-26-721(1) AND (2), C.R.S.]**—This provision exempts subsequent sales of manufactured and modular homes from state sales and use tax. This exemption appears to have limited applicability since the Manufactured Homes Exemption went into effect on July 1, 2019. Specifically, sales of manufactured homes constructed on or after June 15, 1976, are exempt from state sales and use tax under the Manufactured Homes Exemption, regardless of whether it is the first or a subsequent sale, and modular homes generally become real property once they are placed at the building site, making their subsequent sale exempt from sales tax. However, it continues to

apply more broadly to local sales taxes since statutory and home rule local governments that have their sales taxes collected by the State are required to apply the exemption. Therefore, the Subsequent Home Sales Exemption potentially provides an unduplicated exemption for (1) manufactured homes constructed prior to June 15, 1976, (i.e., mobile homes) and (2) state-collected municipal and county sales taxes for subsequent sales of manufactured homes in state-collected municipalities and counties that have not adopted the Manufactured Homes Exemption (state-collected municipal and county sales taxes are discussed later in this report; see discussion in performance measure #2 in the *Are the Tax Expenditures Meeting Their Purposes?* section). This exemption was created in 1973 with Senate Bill 73-365, and it has remained substantively unchanged since its enactment.

Retailers report the Prefabricated Homes Partial Exemption and Manufactured Homes Exemption on the Other Exempt Sales line (Line 11) of the Schedule B of the Retail Sales Tax Return (Form DR 0100). The Subsequent Home Sales Exemption is not required to be reported and is not consistently reported on any Department form, though the Department reported that some taxpayers may report the subsequent sale of a manufactured home on the Standard Sales Tax Receipt for Vehicle Sales form (Form DR 0024).

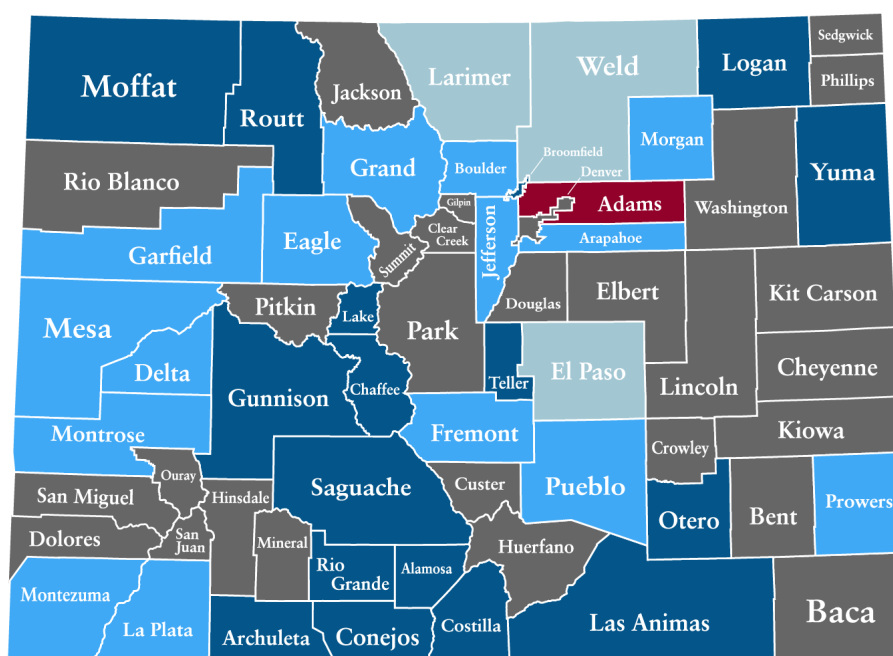
WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not directly state the intended beneficiaries of any of the sales and use tax exemptions for prefabricated homes. Because purchasers of the modular and manufactured homes would pay the sales or use tax, we considered them to be the intended beneficiaries of all of the exemptions.

According to the Division of Property Taxation's (within the Department of Local Affairs) 2019 Annual Report, in Calendar Year 2019, there were more than 87,000 manufactured homes located in all

counties in the state. EXHIBIT 1 shows the number of manufactured homes in each county throughout the state.

EXHIBIT 1. MAP OF MANUFACTURED HOMES
THROUGHOUT COLORADO BY COUNTY
CALENDAR YEAR 2019



KEY



SOURCE: Office of the State Auditor analysis of manufactured homes data from the Division of Property Taxation's 2019 Annual Report.

Additionally, according to data from the Division of Housing within the Department of Local Affairs, in 2020 (through September), there were 964 manufactured homes certified by HUD and delivered to Colorado. The Division of Housing did not have data on the total number or location of modular homes in Colorado.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute and the enacting legislation for these exemptions do not state their purposes; therefore, we could not definitively determine the General Assembly's original intent. Our evaluation of the tax expenditures considered the following potential purposes:

- **PREFABRICATED HOMES PARTIAL EXEMPTION**—Based on discussions with Department staff, Department regulations, and the State's process for applying the sales tax to building and construction materials, we considered a potential purpose: to tax only the portion of the purchase price of a modular or manufactured home that is attributable to materials, which are tangible personal property and generally subject to sales tax, and to avoid taxing the portion of the purchase price of a modular or manufactured home that is attributable to the labor used to build the home, thereby treating modular and manufactured home sales similarly to traditional site-built homes for sales tax purposes.

Building and construction materials are generally subject to sales tax in Colorado because they are tangible personal property. However, these materials typically lose their identity as tangible personal property when they are incorporated or transformed into real property, which is not subject to sales tax. In many instances, these materials are purchased by contractors that build or incorporate the materials into real property, such as a traditional site-built home, which is then sold to another party. To capture the sales tax on those materials before they become real property, the contractor is generally considered the end consumer of the materials and pays sales or use tax on them. When the end product (e.g., a home) is sold, no sales tax is collected because real property is not subject to sales tax. Therefore, no sales tax is applied to the portion of the purchase price that covers the cost of labor used to build the home. In the case of a manufactured or modular home, manufacturers/builders of the homes do not pay sales tax on the materials because of the wholesales exemption [Section 39-26-102(19)(a) and (20)(a), C.R.S.] since the

homes generally remain tangible personal property when they are sold to a homebuyer. When the modular or manufactured home is sold to the homebuyer, the purchase price of the home includes some amount that is attributable to labor used to build the home and some amount for the materials. Therefore, to provide similar tax treatment as is provided to purchases of site-built homes, the exemption serves to reduce the amount of the purchase subject to sales tax to account for the portion of the purchase price that is attributable to labor costs.

- **MANUFACTURED HOMES EXEMPTION**—Based on committee hearing testimony from the enacting legislation [House Bill 18-1315], we considered a potential purpose: to make manufactured homes more affordable by eliminating all of the state sales and use tax, which represents an additional cost to homebuyers when purchasing manufactured homes.

- **SUBSEQUENT HOME SALES EXEMPTION**—Based on the operation of the exemption and discussions with Department staff, we considered a potential purpose: to treat all subsequent sales of homes the same for sales and use tax purposes. Subsequent sales of traditional site-built and modular homes are not subject to sales or use tax because they are real property rather than tangible personal property; in general, modular homes become real property once they are placed at the building site on a permanent foundation. However, many manufactured homes remain tangible personal property even after they are placed at the building site, particularly those homes that are placed in manufactured home parks or communities. Therefore, in cases in which a manufactured home remains tangible personal property, without the Subsequent Home Sales Exemption, the subsequent sale of the home could be subject to sales tax, which would create unequal tax treatment for subsequent sales of different types of homes.

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

We could not definitively determine whether these exemptions are meeting their purposes because no purpose is provided for them in statute or their enacting legislation. However, we found that they are likely meeting the potential purposes we considered in order to conduct this evaluation. Specifically, the Prefabricated Homes Partial Exemption and Subsequent Home Sales Exemptions are likely meeting their inferred purposes because stakeholders are aware of them and indicated that, to their knowledge, the exemptions are being applied to eligible sales. Additionally, we found that the Manufactured Homes Exemption is meeting its inferred purpose, to some extent, because it makes manufactured homes more affordable by reducing the overall cost of purchasing a home.

Statute does not provide quantifiable performance measures for any of the exemptions. Therefore, we created and applied the following performance measures to determine the extent to which the exemptions are meeting their inferred purposes:

PERFORMANCE MEASURE #1: To what extent is the Prefabricated Homes Partial Exemption being used to prevent the taxation of labor that was used to build prefabricated homes?

RESULT: The Department was unable to provide us with data on the number of homes sold to which this exemption would apply, and therefore, we were unable to quantify the extent to which this exemption is being used. However, we spoke with stakeholders, including a trade organization for modular and manufactured homes, three modular and manufactured home dealers, and one modular and manufactured home manufacturer, and they were all aware of the exemption and said they apply it when making eligible sales.

Additionally, we asked stakeholders about the costs of building modular and manufactured homes to try to determine whether the 48 percent amount provided by the exemption accurately exempts the portion of a home attributable to labor. A manufacturer that we spoke with estimated the labor cost for both manufactured and modular homes to be about 45 to 50 percent of the total cost of building a home. One modular and manufactured home dealer we spoke with estimated the labor costs for manufactured homes to be about 50 percent of the total cost and 40 percent for modular homes. However, neither of these stakeholders conducted a thorough cost analysis and provided this information to us only as an estimate. These estimates are all close to the exemption amount provided by the Prefabricated Homes Partial Exemption (48 percent), and it is reasonable to expect that the ratio of material costs versus labor costs will vary among manufacturers, home floor plans/size, and over time, as material and labor costs fluctuate with the market.

PERFORMANCE MEASURE #2: To what extent does the Manufactured Homes Exemption make manufactured homes more affordable?

RESULT: The Manufactured Homes Exemption reduces the after-tax purchase price of a qualifying home by 2.9 percent and can also reduce the cost of financing the purchase. To calculate the potential savings from the Manufactured Homes Exemption, we considered a hypothetical scenario in which a homebuyer purchases a manufactured home for \$98,400, which was the average price of a manufactured home in Colorado in 2019, according to U.S. Census Bureau data. Purchasing a home at this price would result in a direct savings of about \$2,900 in state sales tax due to the exemption ($\$98,400 \times 2.9$ percent) when not considering the Prefabricated Homes Partial Exemption, which exempts 48 percent of the purchase price from sales tax. When taking this exemption into account, the direct savings would be about \$1,500 in state sales tax ($\$98,400 \times 52$ percent $\times 2.9$ percent).

According to stakeholders, many manufactured homes are placed into manufactured home parks or communities where the homebuyer owns

the home, but rents the land on which the home is placed. Because the home is not financed with the purchase of land, the home is generally financed as a chattel loan, which is a type of personal property loan that is similar to a loan used to purchase an automobile. Chattel loans generally have higher interest rates and shorter repayment terms than conventional home mortgages that are available for other types of home purchases. Assuming the homebuyer in the previous example financed the home using a chattel loan with an annual interest rate of 6 percent, had a 20-year repayment term, and provided a 20 percent down payment, we estimated that over the life of the loan, the homebuyer would save about \$1,700 in total interest because of the exemption from state sales taxes, since any sales tax included in the loan as principal would incur interest, when not taking into consideration the Prefabricated Homes Partial Exemption. The interest savings when considering the Prefabricated Homes Partial Exemption would be about \$900. These loan terms were based on information provided to us by a lender that offers chattel loans on manufactured homes in Colorado. However, the actual terms of a loan are dependent on the credit score of the homebuyer and the amount of down payment they are able to provide. In this example, the homebuyer would save about \$16 a month, or about \$198 per year, in principal and interest on the amount financed with the exemption in place as compared to the exemption not being in place when not taking into consideration the Prefabricated Homes Partial Exemption. Considering this exemption, the homebuyer would save about \$9 a month or \$103 per year. This scenario does not consider any local sales taxes.

Additionally, statute [Section 29-2-105(1)(d)(I), C.R.S.] requires that statutory and home rule municipalities and counties that have their sales taxes collected by the State apply most of the State's sales tax exemptions, but also provides that some of the State's sales tax exemptions are optional, including the Manufactured Homes Exemption under Section 39-26-721(3), C.R.S. Therefore, if the municipality or county wants to allow the Manufactured Homes Exemption for local sales tax purposes, it must explicitly adopt it. As of February 2021, of all of the municipalities or counties with state-

collected local sales taxes, only Cañon City had adopted the Manufactured Homes Exemption. Therefore, the exemption does not apply to most local sales taxes and homebuyers are liable for these taxes.

PERFORMANCE MEASURE #3: *To what extent does the Subsequent Home Sales Exemption prevent the taxation of prefabricated homes that are resold?*

RESULT: We found evidence that the exemption is being applied to eligible sales, though we were unable to quantify the extent to which this exemption is being used because the Department was unable to provide us with data on the number of qualifying homes sold. However, we spoke with several modular and manufactured home dealers, and those that sell used homes stated that they were aware of this exemption and apply it when making eligible sales. Additionally, we spoke with several realtors that sell modular and manufactured homes, and they were all aware of it and believe it is being applied to applicable sales.

This exemption appears to have limited applicability due to the Manufactured Homes Exemption, which provides an overlapping exemption for many eligible sales and went into effect on July 1, 2019. Specifically, the Subsequent Home Sales Exemption potentially provides an unduplicated exemption from (1) municipal and county sales taxes for subsequent sales of all manufactured homes in jurisdictions that have their sales taxes collected by the State, which are not required to apply the Manufactured Homes Exemption, but must apply the Subsequent Sales Exemption, and (2) state and state-collected municipal and county sales taxes for subsequent sales of manufactured homes that were constructed prior to June 15, 1976 (i.e., mobile homes), which are not exempt under the Manufactured Homes Exemption [Section 39-26-721(3), C.R.S.]. Manufactured homes are generally required to be titled with the Department's Division of Motor Vehicles. The Department was able to provide us with data on the number of manufactured homes titled and the model year of the homes titled. The data indicate that a significant number of homes titled in Fiscal Year 2020 were pre-1976

manufactured homes. Specifically, 1,460 of the approximately 5,000 manufactured homes (29 percent) titled during Fiscal Year 2020 were pre-1976 manufactured homes, though the data did not include information on whether the exemption was applied.

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

The Department was not able to provide us with data on the amount claimed for any of the Prefabricated Homes Exemptions. Therefore, we estimated the revenue impact of these exemptions using other sources of data, including Department of Local Affairs, Division of Housing data on the number of modular home installation inspections conducted in the state; Institute of Building and Safety data provided to us by the Division of Housing on new manufactured homes shipped into the state; U.S. Census Bureau data on manufactured home prices; Division of Motor Vehicles data on manufactured homes titled in the state; and information provided to us by stakeholders.

PREFABRICATED HOMES PARTIAL EXEMPTION—We estimate that the Prefabricated Homes Partial Exemption resulted in about \$1.4 million in annual foregone revenue to the State between 2016 and 2020. This exemption primarily applies to modular homes since manufactured homes are fully exempt from state sales and use tax under the Manufactured Homes Exemption. For this reason, our estimate for the Prefabricated Homes Partial Exemption only includes the revenue impact attributable to sales of modular homes.

To calculate this estimate, we used information from the Division of Housing that showed the State inspected 297 modular homes for installation in Colorado since late 2016. Division of Housing staff with experience in the industry estimated that its state inspectors inspect about 15 percent of all modular homes installed in the state, with other partners (e.g., local building departments, registered independent inspectors) inspecting the remaining 85 percent, though the Division does not maintain data on this. Based on that information, we estimated

that there were likely around 1,980 modular homes installed in the state between late 2016 and late 2020. Prices of modular homes can vary substantially depending on the size of the home and the quality of the materials used in the home. For purposes of our estimate, we used an average price of \$200,000 per modular home, which we determined is a typical cost for a modular home based on discussions with stakeholders, as well as publicly available price information from modular home dealers' websites. We multiplied the estimated number of modular homes installed in Colorado since late 2016 (1,980) by the average price (\$200,000) to estimate that the total sales price of all modular homes installed in the state since late 2016 was \$396 million. We then multiplied that amount by the exemption allowed (48 percent of the purchase price) to estimate that the total purchase price exempted on all modular homes was \$190.1 million. We multiplied that total by the 2.9 percent state sales tax rate and then divided that amount by 4 years to estimate an annual revenue impact.

MANUFACTURED HOMES EXEMPTION—We estimate that the Manufactured Homes Exemption resulted in about \$5.6 million in foregone revenue to the State in Fiscal Year 2020, with \$3.4 million attributable to sales of new manufactured homes and \$2.2 million attributable to subsequent sales of preowned manufactured homes. This estimate includes sales of new manufactured homes, as well as subsequent sales of preowned manufactured homes, since the exemption covers the sale of a manufactured home regardless of whether it is the first or a subsequent sale of the home.

To estimate the revenue impact, we estimated the total potential sales of new manufactured homes in the state using Institute of Building and Safety data provided to us by the Division of Housing on manufactured homes shipped into Colorado and the average sales price of manufactured homes in Colorado as reported by the U.S. Census Bureau. Specifically, we multiplied the 1,197 new manufactured homes shipped into Colorado from July 2019 to June 2020 by the \$98,400 average sales price of a new manufactured home in 2019 (2020 data on the average sales price was not available) to estimate the total potential

sales. We then multiplied the \$117.8 million in total potential sales by the 2.9 percent state sales tax rate to arrive at our estimate of \$3.4 million. Since our estimate relies on data for homes shipped into the state rather than homes sold in the state—to the extent that the homes shipped into the state were not immediately sold—our estimate could vary from the actual revenue impact. However, a stakeholder reported that it is reasonable to assume that homes shipped into the state have already been sold or will soon be sold after they are shipped into the state, since sellers do not typically maintain large inventories of unsold manufactured homes in the state.

We then estimated the revenue impact of preowned manufactured homes that were sold in the state in Fiscal Year 2020 based on Division of Motor Vehicles data on manufactured homes titled in Fiscal Year 2020, with model years between 1976 and 2017; we assumed homes in the data with model years 2017 and older were preowned homes and not sales of new homes. We calculated our estimate of \$2.2 million by multiplying the \$74.1 million total reported purchase price from Department title data for all titled homes in Fiscal Year 2020 by the 2.9 percent state sales tax rate. However, our estimate could underestimate the actual revenue impact because about 1,500 of the approximately 3,500 homes titled (43 percent) did not have purchase price data. Because homes may be included in the titling data because of events other than a sale (e.g., transfer of ownership due to inheritance) it is likely that the exemption would not have applied to some of these homes, though we were unable to quantify the extent to which this was the case.

Additionally, in estimating the revenue impact of the Manufactured Homes Exemption, we did not consider the effects of the Prefabricated Homes Partial Exemption, or the Subsequent Home Sales Exemption, which both overlap with sales eligible for the Manufactured Homes Exemption and would be available to taxpayers in the absence of the Manufactured Homes Exemption.

SUBSEQUENT HOME SALES EXEMPTION—Based on Division of Motor Vehicles data on manufactured homes titled in Fiscal Year 2020, we estimate that the Subsequent Home Sales Exemption may have reduced state revenue by approximately \$252,000 in Fiscal Year 2020. This estimate is limited to manufactured homes with model years before 1976 because homes constructed after that date are covered under the Manufactured Homes Exemption and included in our estimate for its revenue impact. To estimate the revenue impact for the Subsequent Home Sales Exemption, we multiplied the \$8.7 million in total sales of titled homes with model year dates before 1976 by the 2.9 percent state sales tax rate. However, similar to the Manufactured Homes Exemption, this could underestimate the actual revenue impact because 780 of the 1460 pre-1976 homes (53 percent) titled did not have purchase price data, though some of this title data may not represent sales of homes.

STATE-COLLECTED LOCAL SALES TAXES—Additionally, statute [Section 29-2-105(1)(d)(I), C.R.S.] requires that statutory and home rule municipalities and counties that have their sales taxes collected by the state apply most of the State’s sales tax exemptions, including the Prefabricated Homes Partial Exemption and Subsequent Home Sales Exemption. Therefore, both of these exemptions likely reduce local sales tax revenue to some extent. However, we lacked the data necessary to estimate this impact. In addition, the Manufactured Home Exemption, which only applies to state-collected local governments that opt in to the exemption, has likely had little to no revenue impact to local governments statewide, because as of February 2021, only Cañon City had adopted the exemption.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If the Prefabricated Homes Exemptions were repealed, it would result in homebuyers paying sales tax on purchases of new modular and manufactured homes and purchases of preowned manufactured homes. Specifically:

- **PREFABRICATED HOMES PARTIAL EXEMPTION**—Repealing this exemption could result in homebuyers who purchase modular homes paying an additional 48 percent of sales tax on those homes. On average, between late 2016 and 2020, we estimated that this could have increased state sales taxes on new modular homes by about \$1.4 million in each year, with homebuyers paying additional local sales taxes within local jurisdictions for which the State collects sales tax. Additionally, stakeholders reported that this exemption is very important because it creates parity between the prefabricated housing and the traditional site-built home industries, since sales taxes are generally only applied to the cost of materials used in the construction of site-built homes, with the additional cost of labor not being subject to tax.
- **MANUFACTURED HOMES EXEMPTION**—Repealing this exemption would result in homebuyers who purchase manufactured homes paying sales tax on the purchase of the homes. In Fiscal Year 2020, we estimated that this could have increased sales taxes on new manufactured homes by about \$3.4 million and by about \$2.2 million on subsequent sales of preowned manufactured homes, though if the Subsequent Home Sales Exemption was maintained, subsequent sales of the homes would continue to be exempt under that exemption instead. Likewise, if the Manufactured Homes Exemption were repealed and the Prefabricated Homes Partial Exemption was maintained, homebuyers would pay sales tax on 52 percent of the purchase price of a new home, which would have been an increase of \$1.8 million in Fiscal Year 2020. Additionally, if the homes were financed, taxpayers would owe interest on the sales tax that is included in their loan. Most stakeholders that we consulted reported that this exemption is very important and helps potential homebuyers, particularly low income Coloradans, purchase manufactured homes.
- **SUBSEQUENT HOME SALES EXEMPTION**—Repealing this exemption could result in some preowned manufactured homes being subject to

state sales tax and local sales taxes in municipalities and counties with state-collected sales taxes, particularly those homes that are placed into manufactured home parks and generally remain tangible personal property. In Fiscal Year 2020, we estimated that this could have increased sales taxes on pre-1976 preowned manufactured homes by about \$252,000. Repealing this exemption would be unlikely to affect sales of preowned modular homes because modular homes generally become real property once they are installed at the building site. Repealing the Subsequent Home Sales Exemption would result in preowned manufactured homes being treated differently from modular and traditional site-built homes for sales tax purposes.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We examined the state tax laws of the seven states surrounding Colorado (Arizona, Kansas, Nebraska, New Mexico, Oklahoma, Utah, and Wyoming) to determine whether they have similar exemptions for prefabricated homes. Five of these states (Arizona, Kansas, Oklahoma, Utah, and Wyoming) partially exempt new homes or first-time sales of prefabricated homes from sales tax. The exemptions provided in these states are summarized in EXHIBIT 2.

EXHIBIT 2. SURROUNDING STATES WITH A SIMILAR EXEMPTION	
STATE	EXEMPTION DETAILS
Arizona	35 percent of the gross proceeds derived from selling manufactured, mobile, and modular homes is exempt from the transaction privilege tax, which is similar to a sales tax.
Kansas	40 percent of the gross proceeds derived from selling manufactured, mobile, or modular homes is exempt from sales tax.
Oklahoma	45 percent of the sales price of a modular home is exempt from sales tax; new manufactured homes are exempt from sales tax and are instead subject to vehicle excise tax on 50 percent of the retail selling price.
Utah	45 percent of the sales price of a manufactured home is exempt from sales tax; modular homes are fully taxable.
Wyoming	30 percent of the sales price of a manufactured, mobile, or modular home is exempt from sales tax.

SOURCE: Office of the State Auditor analysis of other states' statutes and regulations.

Most of the surrounding states provide exemptions for subsequent sales and/or sales of used manufactured and modular homes. However, in Oklahoma, used manufactured homes are exempt from sales tax, but are subject to vehicle excise tax on 32.5 percent of the retail selling price. Additionally, in Nebraska, sales of new and used manufactured and modular homes delivered into the state are subject to sales tax.

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

Home rule cities established under Article XX of the Colorado Constitution have the authority to set their own tax policies independent from the State and are not required to exempt sales of modular or manufactured homes from their local sales tax. We examined the municipal codes of the five most populated home rule cities in 2010, according to Colorado State Demography Office data—Aurora, Denver, Colorado Springs, Fort Collins, and Lakewood—and found that Aurora, Colorado Springs, Fort Collins, and Lakewood exempt subsequent sales of modular and manufactured homes from their local sales tax; Aurora and Lakewood exempt 48 percent of the purchase price of new modular and manufactured homes; and Fort Collins exempts 50 percent of the purchase price of new modular and manufactured homes. Denver fully taxes sales of new prefabricated homes, as well as subsequent sales of manufactured homes.

We did not identify any similar tax expenditures or programs at the state level other than the overlapping of the exemptions included in this evaluation.

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

The Department was not able to provide data on the amount of exemptions claimed related to prefabricated homes. Therefore, we estimated the revenue impact of the exemptions using other sources of data, including Division of Housing information on modular home installation inspections; U.S. Census Bureau data on manufactured

home prices; Institute of Building and Safety data provided to us by the Division of Housing on shipments of manufactured homes into the state; Division of Motor Vehicles data on manufactured homes titled in the state; and information from stakeholders. As a result, our estimates may vary from the actual revenue impact of the exemptions, and we could not determine how many taxpayers claimed them.

The Department's Retail Sales Tax Return (Form DR 0100) does not have separate lines where retailers can report partially exempt sales of modular homes and fully exempt sales of manufactured homes. Retailers report the Prefabricated Homes Partial Exemption and Manufactured Homes Exemption on the Other Exempt Sales line (Line 11) of the Schedule B of the Retail Sales Tax Return, which aggregates several unrelated exemptions and cannot be disaggregated for analysis. Additionally, according to Department staff, the Subsequent Home Sales Exemption is not consistently reported on any Department forms, though the Department reported that some taxpayers may report the subsequent sale of a home on the Standard Sales Tax Receipt for Vehicle Sales form (Form DR 0024); however, this form is designed for sales of motor vehicles rather than manufactured homes.

If the General Assembly determines that more accurate figures are necessary, it could direct the Department to add additional reporting lines on its Retail Sales Tax Return and make changes in GenTax, its tax processing and information system, to capture and extract this additional information. However, this would increase retailers' reporting requirements and, according to the Department, this type of change would require additional resources to develop the form 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 STATUTORY PURPOSES AND PERFORMANCE MEASURES FOR THE PREFABRICATED HOMES EXEMPTIONS. As discussed, statute and the enacting legislation for the Prefabricated Homes Exemptions do not state the exemptions' purposes or provide performance measures for evaluating their effectiveness. Therefore, for the purposes of our evaluation, we considered the following potential purposes for the exemptions:

- PREFABRICATED HOMES PARTIAL EXEMPTION—We considered its potential purpose to be only taxing the portion of the purchase price of a modular or manufactured home that is attributable to materials, thereby treating modular and manufactured home sales similarly to traditional site-built homes for sales tax purposes. We identified this purpose based on the operation of the exemption, our review of the process used to tax the construction of site-built homes, and discussions with Department staff and stakeholders.
- MANUFACTURED HOMES EXEMPTION—We considered its potential purpose to be making manufactured homes more affordable by eliminating all of the state sales and use tax, which represents an additional cost to homebuyers when purchasing manufactured homes. We identified this purpose based on our review of its legislative history, including the legislative committee discussions on the enacting legislation for the Manufactured Homes Exemption [House Bill 18-1315].
- SUBSEQUENT HOME SALES EXEMPTION—We considered its potential purpose to be treating all subsequent sales of all types of homes the same for sales and use tax purposes since many manufactured homes remain tangible personal property after they are placed at the building site, whereas preowned modular and traditional site-built homes become real property not subject to sales tax. We identified

this purpose based on discussions with Department staff who indicated that the purposes of the Subsequent Home Sales Exemption is to treat modular and manufactured homes similar to traditional site-built homes.

We also developed three performance measures to assess the extent to which the exemptions are meeting their potential purposes. However, the General Assembly may want to clarify its intent for the exemptions by providing purpose statements and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the exemptions' purposes and allow our office to more definitively assess the extent to which the exemptions are accomplishing their intended goal(s).

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO INCLUDE A CORRESPONDING USE TAX EXEMPTION FOR THE PREFABRICATED HOMES PARTIAL EXEMPTION. Statute [Section 39-26-721(1), C.R.S.] currently provides only a sales tax exemption for the Prefabricated Homes Partial Exemption. Therefore, it is not clear that purchasers of qualifying prefabricated homes are exempt from use tax. It appears that the General Assembly may not have intended that use tax apply to this circumstance because this would effectively nullify the tax benefit provided by the sales tax exemption. In practice, Department of Revenue staff indicated that the Department has not enforced use tax under this circumstance due to general principles of taxation and Colorado Supreme Court cases that provide that use tax is a complement to sales tax and should not be viewed in isolation. However, the General Assembly may want to amend statute to clarify whether purchases of prefabricated homes should be exempt from both sales and use tax.