RESIDENTIAL POWER SALES AND USE TAX EXEMPTION

EVALUATION SUMMARY

SEPTEMBER 2020
2020-TE29

THIS EVALUATION WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2020

YEAR ENACTED	1979
REPEAL/EXPIRATION DATE	None
REVENUE IMPACT	$107 million (CALENDAR YEAR 2019)
NUMBER OF TAXPAYERS	2,250,000 million households
AVERAGE TAXPAYER BENEFIT	$48 per household
IS IT MEETING ITS PURPOSE?	Yes

WHAT DOES THIS TAX EXPENDITURE DO?

The Residential Power Exemption allows purchases of fuel or electricity for residential use to be exempt from Colorado state sales and use tax.

WHAT IS THE PURPOSE OF THIS TAX EXPENDITURE?

Statute does not directly state a purpose for this tax expenditure. We inferred that the purpose of the exemption is to eliminate a sales and use tax on basic necessities. Sales tax exemptions for basic necessities are common in Colorado and in other states, and are intended to reduce the tax burden on lower-income residents for whom necessities make up a larger percentage of overall income.

WHAT DID THE EVALUATION FIND?

We determined that the Residential Power Exemption is meeting its purpose as it is likely applied to most purchases of fuel and electricity for domestic consumption. It likely has the most significant impact to lower income residents.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations regarding the Residential Power Exemption.

RESIDENTIAL POWER SALES AND USE TAX EXEMPTION

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Fuel for Residential Heat, Light, and Power Exemption (Residential Power Exemption) [Section 39-26-715(1)(a)(II) and (2)c, C.R.S.] exempts all residential sales and use of fuel and electricity from sales and use tax. This tax expenditure was established in 1979 and has remained substantially unchanged since that time.

According to statute, electricity or fuel must be used in a residence for residential uses to qualify for the exemption. Residence is defined in statute as "a separate dwelling in a multi-unit apartment, condominium, townhouse, or mobile trailer home park, or a separate single unit dwelling." [Section 39-26-715(1)(a)(II)(B), C.R.S.] Minor buildings such as garages, which are billed under the residential utility meter are similarly defined as residences. Residential use is defined as "the use of electricity, coal, wood, gas, fuel oil, or coke for domestic purposes, including powering lights, refrigerators, stoves, water heaters, space heaters, air conditioners, or other domestic items that require power or fuel in a residence." [Section 39-26-715(1)(a)(II)(C) and (2)(c)(III), C.R.S.].

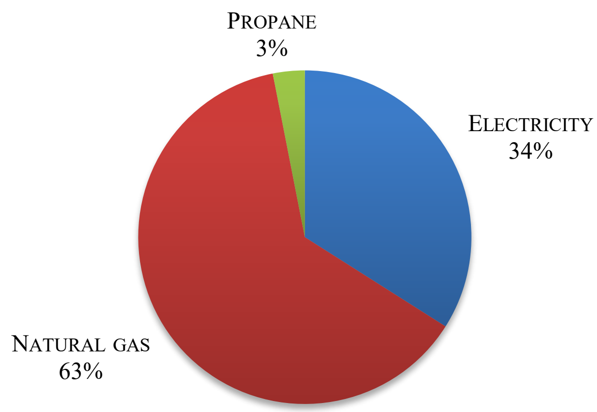
In addition, the Department of Revenue has issued a general information letter that provides more specific guidance for retailers regarding when sales of fuel can be considered exempt under the Residential Power Exemption [GIL-2009-017]. For instance, propane sold by retailers, such as grocery stores, is presumed to be for residential use, and, therefore, exempt, when the volume does not exceed that which is necessary to fill a 20-pound propane tank. Additionally, recreational vehicles that use propane can qualify as a residence and sales of propane into vehicle tanks can generally qualify. Retailers can also consider sales of firewood to be exempt when sold in bulk (e.g., a full, half, or quarter cord).

The Residential Power Exemption is typically applied by a utility company or vendor at the point of sale, at which point they do not collect sales tax from customers. Industry stakeholders specified that utility companies typically determine whether customers qualify based on the property location and intended use of the energy source. Retailers selling fuel, such as propane and fire wood, over-the-counter are responsible for determining whether the purchases of these items are exempt, based on statutory and regulatory requirements. Retailers report the amount of their exempt sales on Schedule B, Line 3 of the Department of Revenue's Colorado Retail Sales Tax Return (Form DR 0100). The Department of Revenue instructs retailers to report exempt use tax on Line 3B and itemize these exemptions in Section 2B of the Retailer's Use Tax Return (Form DR 0173).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

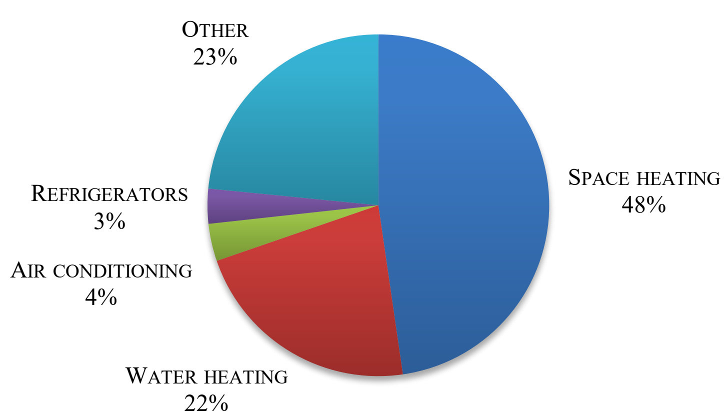
Statute does not specifically identify the intended beneficiaries of the Residential Power Exemption. Based on its operation and eligibility requirements, we inferred that the intended beneficiaries are Coloradans who purchase fuel or electricity for residential use. In Calendar Year 2019, we estimate that residents purchased a total of $3.7 billion in fuel and electricity for residential use in the state, based on Department of Revenue data. EXHIBITS 1.1 and 1.2 further detail residential consumption of utilities by type of energy source and end use in the mountain region, which includes Colorado.

EXHIBIT 1.1.
ENERGY CONSUMPTION BY FUEL TYPE IN MOUNTAIN NORTH[1] CENSUS DIVISION,
CALENDAR YEAR 2015



SOURCE: Office of the State Auditor analysis of U.S. Energy Information Administration data: Table CE2.5 Annual household site fuel consumption in the West—totals and averages, 2015.
[1]Includes Colorado, Idaho, Montana, Utah, and Wyoming.

EXHIBIT 1.2.
ENERGY CONSUMPTION BY END USE IN MOUNTAIN NORTH[1] CENSUS DIVISION,
CALENDAR YEAR 2015



SOURCE: Office of the State Auditor analysis of U.S. Energy Information Administration data: Table CE3.5 Annual household site end-use consumption in the West—totals and averages, 2015.
[1]Includes Colorado, Idaho, Montana, Utah, and Wyoming.

In addition, because the exemption lowers the after-tax cost of energy, we identified utility companies and fuel vendors as indirect beneficiaries, since lower prices could increase sales of energy. The Colorado Energy Office reported 57 electric utilities in the state, consisting of two investor-owned, 29 municipal, and 26 cooperative utilities. The two investor-owned utilities provide about half of the electricity for Colorado households while the rural cooperatives and municipal utilities provide the rest. Five investor-owned utilities, along with eight municipal utilities provide natural gas to Colorado households.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not directly state a purpose for the Residential Power Exemption. Based on our review of statute, the legislative history of the statutory provisions, and other similar tax expenditures, we inferred that the exemption is intended to ensure sales and use tax are not applied to the purchase and use of residential energy, which is considered a basic necessity. This is consistent with sales tax exemptions in other states, as well as Colorado, which commonly exempt items considered to be basic living necessities from sales tax. For example, in addition to residential fuel and electricity, Colorado and many other states exempt medical supplies and food for home consumption from sales tax.

Tax policy guidance from the U.S. Department of Treasury further clarifies that sales tax exemptions for basic necessities are a means to aid individuals adversely affected by a regressive sales tax. A tax is classified as regressive when lower-income earners pay a larger share of their income in tax and can occur with sales taxes because purchases of basic necessities, like residential energy, compose a larger share of income for low-income earners. In Colorado, several sales and use tax exemptions for basic necessities were introduced in the late 1970s and early 1980s when the State was experiencing budget surpluses, indicating a broad shift in state policy towards reducing the financial burden of sales taxes collected on necessities.

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

We determined that the Residential Power Exemption is meeting its purpose because it is likely applied to most sales of fuel and electricity for residential use. Statute does not provide performance measures for this tax expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the expenditure is meeting its inferred purpose:

PERFORMANCE MEASURE: *To what extent are fuel and electricity for residential use being exempted from Colorado sales and use tax?*

RESULT:

We found that the exemption is likely applied to most sales of fuel and electricity for residential use. We examined data from the Colorado Department of Revenue, which indicate that $3.7 billion in residential use sales were reported exempt from state sales and use tax during Calendar Year 2019. Additionally, we compared the Department of Revenue's data on exempt sales to total Colorado residential energy sales, as indicated by price, consumption, and revenue data for natural gas and electricity provided by the U.S. Energy Information Administration, to assess the proportion of energy sales that were exempt. We found that approximately the same amount of energy was sold in the state, according to U.S. Energy Information Administration data, as the Department of Revenue reported as exempt, which indicates that the exemption is commonly applied to eligible sales. Furthermore, interviews conducted with two large and three small electric and gas utilities, as well as the largest propane and gas association in Colorado, indicated that they are generally applying the Residential Power Exemption properly.

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

Data provided by the Department of Revenue show a total state revenue impact of about $107 million due to the Residential Power Exemption in Calendar Year 2019.

In addition, statute [Section 29-2-105(1)(d)(I)(B), C.R.S.] allows statutory cities, counties, and districts for which the State collects sales taxes to choose whether to apply the Residential Power Exemption. We estimate a combined local government revenue impact of about $10.5 million for local jurisdictions that also applied the exemption in Calendar Year 2019. We estimated this amount by analyzing data from the State Demographer's Office and local tax rate information from the Department of Revenue. Specifically, we calculated a population-weighted average combined local tax rate (including county, municipal, and districts) in jurisdictions that apply the exemption of 1.34 percent (which does not include the vendor allowance). We then multiplied that rate by the total residential energy sales reported as exempt statewide ($3.7 billion) and again by the percentage of the State's population that resides in a state-collected jurisdiction that applies the Residential Power Exemption (21 percent) to arrive at our estimate.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

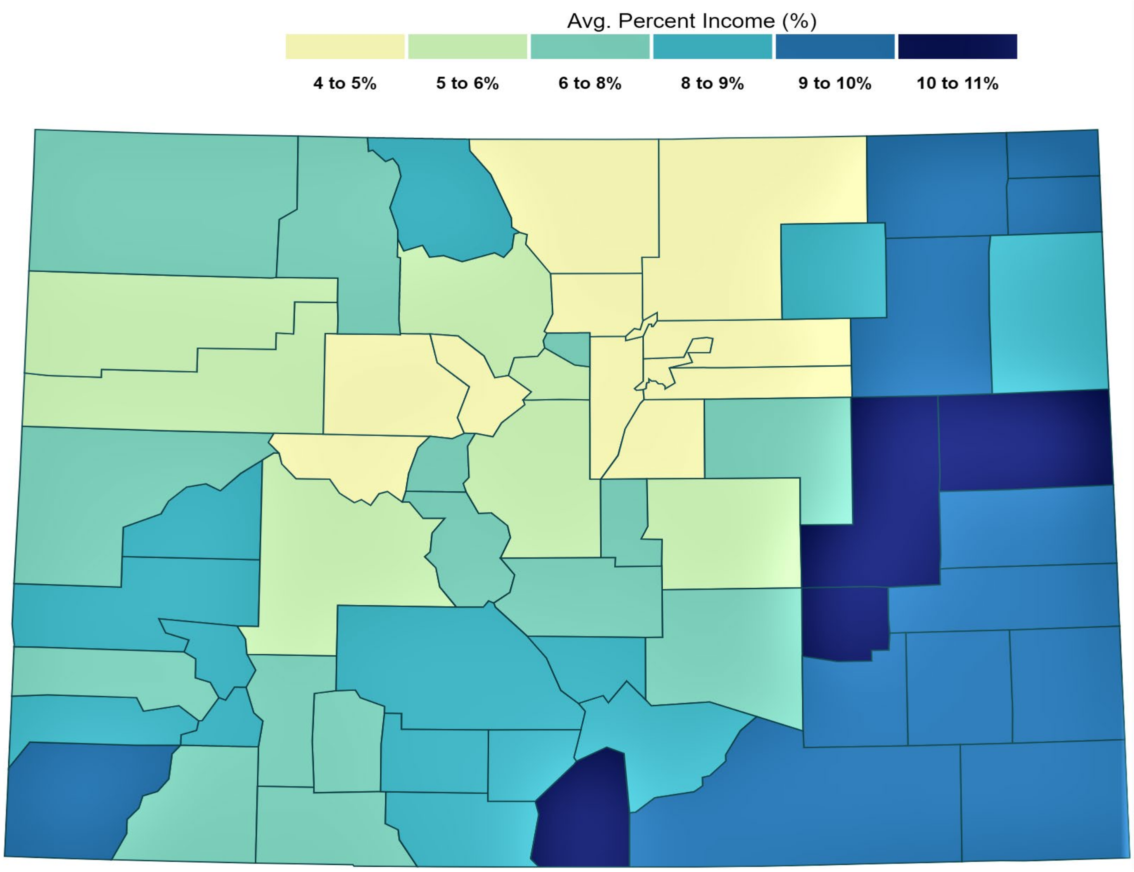
If the Residential Power Exemption was eliminated, Colorado households would see at least a 2.9 percent increase in their utility and fuel costs due to the state sales and use tax. This would have resulted in households paying, on average, about $48 more on residential energy per year in Calendar Year 2019, which we calculated by dividing the state revenue impact by the 2,250,000 households in the state. In addition, residents located within local jurisdictions for which the State collects sales tax and that have elected to apply the Residential Power Exemption would see an additional local sales tax increase. Based on our review of 2019 sales tax rates, the average local tax rate for taxpayers in those jurisdictions was about 1.37 percent after applying the vendor allowance, which would increase the average resident's utility cost by an additional $22 per year (in addition to the increase from the state sales tax).

Additionally, eliminating the exemption would have a larger impact on low-income residents and in certain parts of the state with more energy-burdened households. The Colorado Energy Office has specified three categories to interpret the varying degrees of energy burden:

- Energy stressed: Energy burden between 4 percent and 7 percent of annual income.
- Energy burdened: Energy burden between 7 percent and 10 percent of annual income.
- Energy impoverished: Energy burden greater than 10 percent of annual income.

We analyzed data from the U.S. Department of Energy to determine which counties experience the greatest energy burden. Certain areas, such as the east and southeast regions of the state, may experience a larger energy burden compared to other parts of the state. According to our review of demographic information and discussions with stakeholders, this may be the case in these areas due to less access to natural gas, increased use of propane, higher utility costs, lower overall income, and types of household units (e.g., single unit houses tend to have higher energy costs per household than apartment units). EXHIBIT 1.3 provides the average energy burden experienced by low-income households (i.e., those making 80 percent of area median income or less) within each county.

EXHIBIT 1.3.
AVERAGE ENERGY BURDEN AS A PERCENTAGE OF INCOME FOR LOW-INCOME[1] HOUSEHOLDS



SOURCE: U.S. Department of Energy Low-income Energy Affordability Database (LEAD). Golden, CO: National Renewable Energy Laboratory.
[1]Households earning 80 percent or less of average median income by Colorado county.

Furthermore, eliminating the exemption would potentially have the most significant impact on households with the lowest income. According to U.S. Department of Energy data, extremely low-income households, those making 30 percent or less of Colorado's median income, spend, on average, about 13 percent of their annual income on residential power. Eliminating the exemption would increase these households' share of income expended on residential power to about 13.4 percent statewide. For a household with an annual income of $8,377 (the estimated average extremely low-income household income), this would equate to roughly $32 more per year in utilities, on average, without the exemption and about $47 more, on average, in state-collected local jurisdictions that currently apply the Residential Power Exemption to local sales taxes. However, it is possible that many of these residents would qualify for programs that assist with home energy costs, which could offset the impact of eliminating the exemption.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 44 states (excluding Colorado) and District of Columbia that levy a sales tax, we found that 33 states have exemptions for residential energy use. However, there is variation among different states regarding which energy sources are exempt and the degree to which they are exempt. EXHIBIT 1.4 provides the number of states exempting each energy source.

EXHIBIT 1.4.
NUMBER OF STATES EXEMPTING RESEDENTIAL ENERGY SOURCES FROM SALES TAX

Energy source	Number of states with an exemption (out of 45)*
Natural Gas	31
Electricity	31
Propane	19
Firewood	9

SOURCE: Office of the State Auditor analysis of Bloomberg Law resources and other states' statutory provisions, accessed in May 2020.
*Includes the District of Columbia

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

We identified the following state programs and policies that aim to reduce the cost of power for low-income households and assist with energy costs:

- PROPERTY TAX/RENT/HEAT CREDIT REBATE (PTC REBATE)—Assists elderly, low-income, and disabled Colorado residents through property tax, rent, or heat assistance grants. The elderly qualify if they are 65 years or older or surviving spouses aged 58 and older. The amount of the rebate is based on individuals' income and expenses. The program is administered by the Department of Human Services and Department of Revenue.

- LOW-INCOME ENERGY ASSISTANCE ACT [SECTION 40-8.7-101-112, C.R.S.]—Electric and gas utility companies advertise and collect voluntary energy assistance contributions, which are transmitted via Energy Outreach Colorado, a non-profit organization, to be distributed to low-income residents to offset energy costs.

- LOW-INCOME ENERGY ASSISTANCE PROGRAM (LEAP)—Assists low-income residents with heating costs during the winter. LEAP is funded by the federal government and administered by the Colorado Department of Human Services.

- COLORADO WEATHERIZATION ASSISTANCE PROGRAM—Aims to maximize energy cost savings for low-income residents by providing them with cost-effective energy efficiency services such as air sealing, LED light bulbs, furnace testing, and insulation services, to name a few. The program is administered by the Colorado Energy Office.

- COLORADO'S AFFORDABLE RESIDENTIAL ENERGY PROGRAM—Provides free energy efficiency upgrades to low income households living in certain counties and served by specific utility companies in the form of energy audits, energy conservation education, and equipment replacement, to name a few. The program is administered by Energy Outreach Colorado.

Generally, qualifying residents can participate in more than one of these programs and stakeholders specified that participation in multiple programs is often encouraged because the programs assist residents in different ways, and some only occur during specified months. To the extent that program participants have energy costs, they also benefit from the Residential Power Exemption.

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

The revenue impact reported by the Department of Revenue was primarily based on the amount reported as exempt by utilities and vendors on the Department of Revenue's Colorado Sales and Use Tax Return (Form DR 0100). However, these energy retailers may also report the exemption using the Retailer's Use Tax Return (Form DR 0173), which does not have a separate line designated for each type of exempt energy source. While exempt electricity use can be reported on Line 3 of Schedule 3B, which was included in the Department's revenue impact figure, all other fuel sources are reported under "Other" on Line 10, which is also used for several unrelated exemptions and was not included in its estimate. Therefore, the Department's revenue impact figure could slightly underestimate the revenue impact.

In order to provide complete information, the Department of Revenue would need to add additional reporting lines to the Retailer's Use Tax Return for residential energy uses and reconfigure the GenTax processing system to collect and extract this data. However, according to the Department of Revenue, 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 of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

We did not identify any policy considerations related to the Residential Power Exemption.