



Eliminating the Domestic Production Activities Deduction in Colorado

It is time for Colorado to follow the lead of 22 other states and keep the federal Domestic Production Activities Deduction (DPAD) from reducing revenue here. This federal loophole costs Colorado taxpayers approximately \$20.7 million per year by providing tax cuts to companies regardless of whether the company has employees or production in Colorado.

In 2004, the federal government enacted a tax deduction to allow select businesses to capitalize on an additional business deduction for certain production activities. Although the deduction was intended only as a limited manufacturing incentive, it has been very broadly interpreted and includes food processing, software developing, filmmaking, mining and oil extraction, publishing, electricity and natural gas production, construction, engineering and architecture. The definition of manufacturing has been interpreted so broadly that in 2005, businesses claimed that 26 percent of all of their business income qualified for the exemption.

In 2010, the amount of the deduction is set to increase. At the previous rate*, the deduction cost the federal government an estimated \$7.9 billion annually. The new rate** is estimated to result in roughly \$20.7 million dollars in lost revenue to Colorado by fiscal year 2011.

The fiscal impact is not restricted to the federal government. Twenty-seven states, including Colorado, currently allow the DPAD deduction to affect their state taxable income. This federal deduction is estimated to cost state governments \$1.9 billion dollars each year. **Colorado alone stands to lose roughly \$20.7 million dollars in state revenue in 2011 and this number will only continue to increase.**

The Case for Closing this Loophole:

1. This change increases state revenue. Colorado is not required to allow this deduction. In fact, 22 states have already disallowed the provision. **If Colorado opts to disallow the deduction, the state could gain an estimated \$20.7 million dollars in revenue annually.**

2. The deduction creates tax favorites and isn't related to jobs in Colorado

The deduction is based on production activity anywhere in the country. It reduces the taxes a company pays in Colorado even if it has no employees or operations in the state. **This credit favors "production" companies over all other companies, even those that provide no jobs to Coloradans.**

3. Congressional tax decisions should not be allowed to hurt services in Colorado.

Colorado has chosen to use federal taxable income as the starting point for calculating Colorado taxes. Therefore, when a federal tax credit increases, state revenue in Colorado decreases. **This corporate tax credit has no job creation effect here, thus it is simply a tax giveaway that costs Colorado families important services they depend on.**

4. This change is easy to enact and inexpensive to administer. The 22 states that have disallowed this deduction have proven it is as simple as adding a single sentence to state law that requires entities to add back the federal deduction on their Colorado returns. Many of these entities are already adding back the deduction on their returns for other states.

The 22 States that have decoupled from DPAD:

Arkansas, California, Connecticut, Georgia, Hawaii, Indiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Oregon, South Carolina, Tennessee, Texas, West Virginia, Wisconsin, and the District of Columbia.

Example:

X Co., a multi-state publishing corporation, has \$500,000 in federal taxable income and apportions 2.5 percent of sales in Colorado.

X Co. Example		
Federal taxable income	\$500,000	
DPAD (at 9 percent - 2010 rate)	\$45,000*	
Colorado income tax return:	With DPAD change	Without DPAD change
Federal taxable income	\$500,000	\$500,000
Add back: DPAD	\$45,000	N/A
Colorado taxable income	\$545,000	\$500,000
Apportionment (2.5 percent)	\$13,625	\$12,500
Colorado taxes owed (4.63 percent)	\$631	\$579
Additional revenue from X Co.	\$52	
Percent increase in tax owed	9 percent	

** assumes 9 percent of federal taxable income is lower than 9 percent of qualified production activities income and 50 percent of wages according to federal tax law.*

For more information please contact:

Ali Mickelson
amickelson@cclponline.org
 303-573-5669 ext. 304

Carolyn Siegel
carolyn@siegelpa.com
 303-710-2856

*2007-09 rate of exemption — 6 percent of qualifying expenses
 **2010 and after rate of exemption — 9 percent of qualifying expenses