



COLORADO FISCAL POLICY INSTITUTE

Eliminating the Domestic Production Activities Deduction (DPAD) in Colorado

It is time to follow the lead of twenty other states and keep the federal Domestic Production Activities Deduction (DPAD) from reducing revenue in Colorado. 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 special 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 is so broadly interpreted that in 2005, businesses claimed that 26% of *all* of their business income qualified for the exemption.

In 2010, the amount of the deduction is set to increase. At the previous rate¹, the deduction cost the federal government an estimated \$7.9 billion annually. The new rate² is estimated to result in roughly \$20.7 billion dollars in lost revenue 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.³

The Case for Closing this Loophole:

1. *This change increases state revenue.* Colorado is not required to allow this deduction. In fact, twenty states have already chosen to disallow this provision in their state tax laws. **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. This deduction reduces the taxes a company pays in Colorado even if they have no employees or operations in the state.

¹ 2007-2009 rate of exemption—6% of qualifying expenses

² 2010 and after rate of exemption—9% of qualifying expenses

³ Estimate comes from Center on Budget and Policy Priorities

This credit favors “production” companies over all other companies even if they don’t provide any jobs to Coloradoans.

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 in our state, 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 20 states that have disallowed this deduction have proven that 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. There is a chance that many of these entities are already adding back the deduction on their returns for other states.

States that have decoupled from DPAD:

Arkansas, California, District of Columbia, Georgia, Hawaii, Indiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, New Hampshire, New Jersey (partially), New York, North Carolina, North Dakota, Oregon, South Carolina, Tennessee, Texas, West Virginia

Example:

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

X Co. Example		
Federal Taxable Income	\$500,000	
DPAD (at 9% - 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%)	\$13,625	\$12,500
Colorado Taxes Owed (4.63%)	\$631	\$579
Additional Revenue from X Co.	\$52	
Percent Increase in Tax Owed	9%	

** assumes that 9% of FTI is lower than 9% of QPAI and 50% of wages according to federal tax law. FTI is federal taxable income. QPDI is Qualified Production Activities Income*

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JOIN THE EFFORT TO TAKE A BALANCED APPROACH TO THE BUDGET
BALANCE SERVICE CUTS WITH CLOSING CORPORATE LOOPHOLES
DISALLOW THE DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

My organization supports closing the loophole that allows certain corporations to use the Federal Domestic Production Activities Deduction to avoid contributing to Colorado taxes. We know that this corporate deduction is not based on the number of jobs a corporation has in Colorado and that eliminating it will not cause job losses. At a time when Colorado's economy is suffering and families are struggling, allowing corporations to apply the Domestic Production Activities Deduction in Colorado is undermining critical priorities like health care, K-12 education, higher education, and others that provide a direct benefit to Coloradans and our state's economy. We believe that Colorado should join the 20 other states that disallow this deduction so that Colorado can invest in key priorities instead of corporate deductions in order to strengthen Colorado's economic and fiscal future.

Please list my organization as supporting the effort to disallow the Domestic Production Activities Deduction

Name of Organization _____

Contact Person _____

Address _____

Phone #s _____

E-mail _____

_____ We are willing to communicate with our members and supports about this issue in our newsletter, web site, blog, letters, and other communications materials.

___ We are willing to attend coalition and other meetings and hearings to advance this policy.

___ We are willing to provide people to testify at the Capitol and speak at other events.

___ We are willing to gather signatures of support for this policy.

___ Other: _____

___ We know the following organizations to contact about involvement in this campaign. (please list names and contact on reverse side)

Please return completed form to:

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