HB 22-1163

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

Final Fiscal Note

Drafting Number:	LLS 22-0527	**Date:**	August 22, 2022
Prime Sponsors:	Rep. Soper Sen. Smallwood	**Bill Status:**	Postponed Indefinitely
		Fiscal Analyst:	Jeff Stupak | 303-866-5834 Jeff.Stupak@state.co.us

Bill Topic: **STATE INCOME TAX DEDUCTION FOR MEDICAL EXPENSES**

Summary of Fiscal Impact:

☒ State Revenue
☒ State Expenditure
☒ State Transfer
☒ TABOR Refund
☐ Local Government
☐ Statutory Public Entity

The bill would have created an income tax deduction for qualifying out-of-pocket medical expenses. It would have decreased state revenue beginning in FY 2022-23, and increased state expenditures beginning in FY 2023-24.

Appropriation Summary: No appropriation would have been required.

Fiscal Note Status: The fiscal note reflects the introduced bill. This bill was not enacted into law; therefore, the impacts identified in this analysis do not take effect.

Table 1
State Fiscal Impacts Under HB 22-1163

		Budget Year FY 2022-23	Out Year FY 2023-24
Revenue	General Fund	(at least $180.7 million)	(at least $369.4 million)
	Total Revenue	**(at least $180.7 million)**	**(at least $369.4 million)**
Expenditures	General Fund	-	$4,543,493
	Total Expenditures	**-**	**$4,543,493**
	Total FTE	**-**	**54.7 FTE**
Transfers	General Fund	$13.2 million	$27.1 million
	State Education Fund	($13.2 million)	($27.1 million)
Other Budget Impacts	TABOR Refund	($167.5 million)	($342.4 million)
	General Fund Reserve	-	$534,327

Summary of Legislation

The bill creates an income tax deduction for unreimbursed medical expenses for tax years beginning on or after January 1, 2023, but before January 1, 2030. To qualify, expenses may not be:

- claimed as a deduction on the taxpayer's federal income tax return;
- paid or reimbursed from a medical savings account; or
- paid or reimbursed by the taxpayer's insurance company.

State Revenue and Assumptions

The bill is expected to reduce General Fund revenue by at least $180.7 million in FY 2022-23 (a half-year impact), by at least $369.4 million in FY 2023-24, and by increasing amounts in future years, consistent with growth in health care expenditures, until the deduction expires in FY 2030-31. The bill reduces individual income tax revenue, which is subject to TABOR.

This estimate is based on the value of a similar income tax deduction for unreimbursed medical expenses available in New Jersey. Many other states offer a similar income tax deduction, but New Jersey's deduction aligns most closely with this bill. Similar to this bill, taxpayers in New Jersey can deduct health insurance premiums, which is not allowed in many other states. New Jersey restricts the deduction to taxpayers whose medical expenses exceed 2 percent of their adjusted gross income, while this bill does not include any threshold. As such, this estimate likely provides a lower bound estimate for the bill's deduction.

Based on data for 2016, the most recent year available, New Jersey taxpayers deducted about $10.2 billion in unreimbursed medical expenses. To account for differences between New Jersey and Colorado, this figure was adjusted based on relative spending on health care between the two states. On average, Colorado's total personal consumption expenditures on health care are about 55 percent of New Jersey's, according to the Bureau of Economic Analysis. As such the 2016 value of the deduction for Colorado is assumed to be $5.6 billion (55 percent of $10.2 billion).

Using data from the Bureau of Labor Statistics, this figure was adjusted further to reflect inflation in health care costs. Based on this analysis, Colorado taxpayers are estimated to deduct $7.9 billion in unreimbursed medical expenses in tax year 2023 and $8.3 billion in tax year 2024. As such, state revenue is expected to decrease by $361.5 million in 2023 and $377.4 million in 2024.

State Transfers

The bill decreases transfers from the General Fund to the State Education Fund by $13.2 million in FY 2022-23, by $27.1 million in FY 2023-24, and by increasing amounts in subsequent years. Under current law, an amount equal to one-third of one percent of taxable income is transferred from the General Fund to the State Education Fund each year. The bill's deduction decreases taxable income and therefore reduces the transfer to the State Education Fund.

State Expenditures

The bill will increase General Fund expenditures in the Department of Revenue (DOR) by $4.5 million in FY 2023-24, by $4.2 million in FY 2024-25, and by similar amounts in future years. Expenditures are summarized in Table 2 and detailed below.

Table 2
Expenditures Under HB 22-1163

	FY 2022-23	FY 2023-24	FY 2024-25
Department of Revenue			
Personal Services	-	$2,828,599	$2,868,725
Operating Expenses	-	$78,975	$74,385
Capital Outlay Costs	-	$365,800	-
GenTax Programming and Testing	-	$54,705	-
Legal Services	-	$177,426	$177,426
Data Reporting	-	$8,256	$8,256
Document Management and Tax Form Changes	-	$48,421	$48,421
Employee Insurance / Supplemental PERA / Leased Space	-	$981,311	$1,003,872
FTE – Personal Services	-	53.7 FTE	55.1 FTE
FTE – Legal Services	-	1.0 FTE	1.0 FTE
Total Cost	-	**$4,543,493**	**$4,181,085**
Total FTE	-	**54.7 FTE**	**55.1 FTE**

Personal Services. The DOR will require additional resources to process income tax claiming the bill's deduction. This deduction will be broadly utilized by taxpayers, as only about 3 percent of Colorado taxpayers in 2018 utilized the federal deduction for unreimbursed medical expenses. Additionally, because the bill does not include a third-party verification process, tax examiners will have to manually review the deduction and supporting documentation submitted with tax returns. The fiscal note assumes that DOR will only review about 10 percent of returns claiming this credit at a rate of 3.2 returns per hour, but the necessary manual review and broad usage of the deduction drive a significant workload increase for the department.

Computer programming and testing. For FY 2023-24 only, the bill will require changes to DOR's GenTax software system and additional testing. Changes are programmed by a contractor at a cost of $225 per hour. Approximately 80 hours of computer programming will be required to implement this bill, totaling $18,000. Additional computer and user acceptance testing are required to ensure programming changes are tested and functioning properly, resulting in an additional $36,705 in expenditures by the department.

Legal Services. In response to anticipated legal disputes surrounding this new deduction, the Department of Revenue will require 1,800 hours of legal services. The federal deduction has been litigated quite frequently, and the fiscal note assumes similar disputes will arise at the state level. Legal service costs take place in the Department of Law and are paid using reappropriated DOR funds.

Data reporting. Beginning in FY 2023-24, the Office of Research and Analysis within DOR will expend $9,600 each year to collect and report data on the new tax deduction.

Document management and tax form changes. Beginning in FY 2023-24, the bill requires $48,421 in expenditures for document management, data entry, and tax form changes. These expenditures will take place in the Department of Personnel and Administration using reappropriated funds from the DOR.

Employee Insurance/Supplemental PERA. Pursuant to fiscal note and Joint Budget Committee policy, centrally appropriated costs for bills involving more than 20 FTE are appropriated in the bill, rather than through the annual budget process. These costs, which include employee insurance, supplemental employee retirement payments, and leased space for a portion of staff, are shown in Table 2.

Other Budget Impacts

TABOR refunds. The bill is expected to decrease the amount of state revenue required to be refunded to taxpayers by $167.5 million in FY 2022-23 and by $342.4 million in FY 2023-24. This estimate assumes the March 2022 LCS revenue forecast, and is based on the decrease in revenue shown in the State Revenue section, after subtracting the amount of revenue transferred to the State Education fund, which is not subject to TABOR. A forecast of state revenue subject to TABOR is not available beyond FY 2023-24. Because TABOR refunds are paid from the General Fund, decreased General Fund revenue will lower the TABOR refund obligation, but result in no net change to the amount of General Fund otherwise available to spend or save.

General Fund reserve. Under current law, an amount equal to 15 percent of General Fund appropriations must be set aside in the General Fund statutory reserve beginning in FY 2022-23. Based on this fiscal note, the bill is expected to increase the amount of General Fund held in reserve by $681,524 in FY 2023-24 and by $627,163 in FY 2023-24, which will decrease the amount of General Fund available for other purposes.

Effective Date

This bill was postponed indefinitely by the House Finance Committee on April 7, 2022.

Departmental Difference

DOR estimates the bill requires General Fund expenditures of $9,376,876 and 114.3 FTE in FY 2023-24 and $7,574,503 and 105.5 FTE in FY 2023-24 on the assumptions that tax examiners will be only able to review one tax return per hour. This fiscal note assumes that tax examiners will be able to review

3.2 returns per hour. As such, the workload impact and associated expenditures in this fiscal note are lower than the estimate provided by DOR.

State and Local Government Contacts

Information Technology	Law
Personnel	Revenue