Colorado Legislative Council Staff

Initiative # 166

INITIAL FISCAL IMPACT STATEMENT

Date: March 20, 2018 **Fiscal Analyst:** Greg Sobetski (303-866-4105)

LCS TITLE: POLICY CHANGES PERTAINING TO STATE INCOME TAXES

Fiscal Impact Summary	FY 2018-2019	FY 2019-2020	FY 2020-2021
State Revenue	$7.0 million	$19.9 million	$33.0 million
State Expenditures	-	$7.2 million	$14.1 million
FTE Position Change	-	38.7 FTE	92.3 FTE
TABOR Refund	($30.3 million)	($156.4 million)	not estimated

Note: This *initial* fiscal impact estimate has been prepared for the Title Board. If the initiative is placed on the ballot, Legislative Council Staff may revise this estimate for the Blue Book Voter Guide if new information becomes available.

Summary of Measure

This measure repeals the constitutional provision requiring that all taxable net income be taxed at one rate. Beginning in tax year 2019, the measure increases the tax rate to 9.75 percent on individual taxable income in excess of $500,000. The measure also replaces the current state earned income tax credit (EITC) with a more expansive EITC. These provisions are described below.

Constitutional provision. The Colorado Constitution requires that all taxable net income be taxed at one rate, excluding refund tax credits or voter-approved tax credits, with no added tax or surcharge. The measure repeals this provision, allowing for the graduated income tax rate it enacts in statute.

Graduated tax rate. Beginning in tax year 2019, the measure increases the individual income tax rate from 4.63 percent to 9.75 percent for taxable income in excess of $500,000. Beginning in 2020, the threshold at which the higher rate applies is adjusted consistent with Internal Revenue Service (IRS) cost-of-living adjustments. The individual income tax rate applies to individuals, estates, and trusts, as well as nonresident partners in Colorado partnerships. It does not apply to corporations.

Table 1 presents the amount of 2019 Colorado income tax owed, before credits, under current law and the measure. As shown, the higher tax rate applies only to the portion of taxable income that exceeds $500,000.

Table 1. 2019 Colorado Tax Obligation before Credits Under Current Law and Initiative #166			
Taxable Individual Income	**$500,000**	**$600,000**	**$1,000,000**
Current Law Tax Obligation (4.63 percent)	$23,150	$27,780	$46,300
Initiative #166 Tax Obligation			
first $500,000 (4.63 percent)	*$23,150*	*$23,150*	*$23,150*
over $500,000 (9.75 percent)	*0*	*9,750*	*48,750*
Total Tax Obligation	$23,150	$32,900	$71,900
Tax Increase Attributable to Initiative #166	**$0**	**$5,120**	**$25,600**

Under the measure, revenue collected from the graduated tax rate is exempt from TABOR as a voter-approved revenue change. In years for which the income tax rate reduction TABOR refund mechanism is triggered, the 4.63 percent rate for income of $500,000 or less is reduced to 4.50 percent, while the 9.75 percent rate for income greater than $500,000 is unaffected. Revenue from the tax increase must be used for the new EITC, described below, except that up to 2 percent of revenue may be used to pay administrative expenses.

Earned income tax credit. On its effective date, the measure replaces the current law EITC with a more expansive EITC. The new EITC is available to a taxpayer who is a Colorado resident with less than $70,000 in earned income in 2019, modified annually by IRS cost-of-living adjustments, and who satisfies one or more of the following conditions:

- has a qualifying child;
- is between ages 19 and 64 at the end of the tax year and is not claimed as a dependent on another taxpayer's return;
- is a caregiver who claimed a child under age 6, or a disabled relative age 70 or older, as a dependent; or
- is a student who is enrolled in a tax-exempt institution of higher education, is pursuing a degree or certificate and is enrolled for at least one-half of the normal full-time workload for that program, has been awarded a federal Pell Grant, and is not claimed as a dependent on another taxpayer's return.

The amount of the credit varies according to a taxpayer's earned income, adjusted gross income, number of qualifying children, and status as a caregiver or student, as described in Table 2. Taxpayers who qualify may claim the credit even if they do not owe income tax for a given year. The amount by which the credit exceeds the taxpayer's income tax liability is refunded to the taxpayer. If the amount refunded exceeds $240, the refund is disbursed on a monthly basis unless the taxpayer notifies the Department of Revenue (DOR) that he or she chooses to receive a lump sum payment. The measure directs the DOR to promulgate rules as necessary to allow the issuance of refunds by electronic funds transfer or debit card distributions.

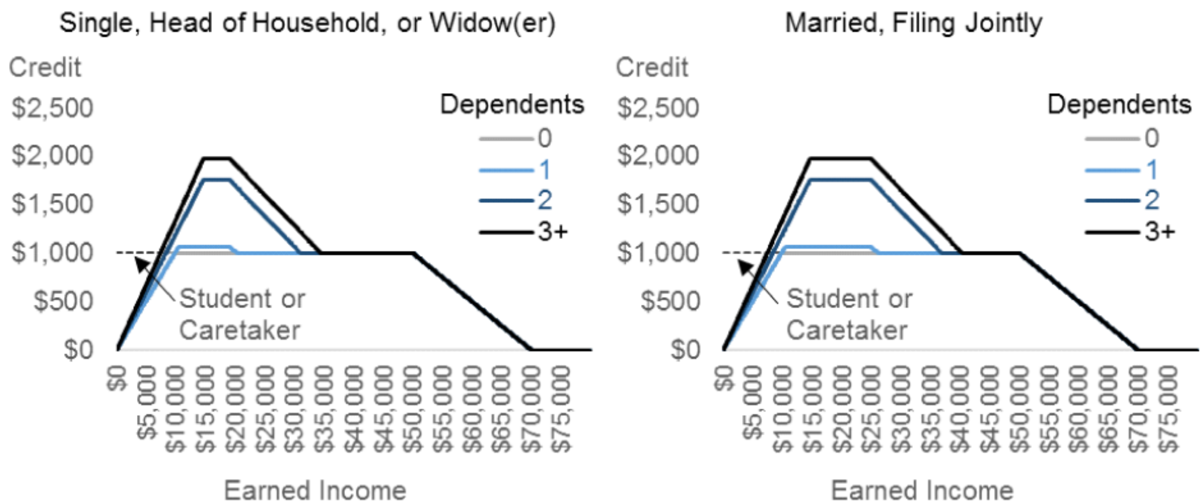
Credit amounts. The amount of credit allowed to each taxpayer is presented in Table 2. Figure 1 shows the amount of the credit available to taxpayers of different earned incomes.

Table 2. Amount of Credit Allowed in Tax Year 2019* Under Initiative #166

Qualifying Children	**Earned Income**	**Student or Caregiver**	**Credit Amount**	**Example with specific earned income**
None	less than $9,803*	No	10.2% of earned income	$5,000 earned income: $510 credit
		Yes	$1,000*	$5,000 earned income: $1,000 credit
	$9,803* to $50,000*	No or Yes	$1,000*	$35,000 earned income: $1,000 credit
	$50,001* to $70,000*	No or Yes	$1,000* less 5% of earned income or adjusted gross income over $50,000*	$55,000 earned income: $750 credit
At least one	less than $19,093* (single filers) or less than $24,912* (joint filers)	No	30% of federal EITC	See Figure 1. Federal EITC depends on income and the number of children. For 2017, the amount of the federal credit was capped at $6,318 for taxpayers with three or more children, which would cap the Colorado credit at $1,895. These amounts are expected to grow in future years.
		Yes	Greater of 30% of federal EITC or $1,000*	
	$19,093* to $50,000* (single filers) or $24,912* to $50,000* (joint filers)	No or Yes	Greater of 30% of federal EITC or $1,000*	
	$50,001* to $70,000*	No or Yes	Greater of 30% of federal EITC or $1,000*, less 5% of earned income or adjusted gross income over $50,000*	

* *The values marked with an asterisk apply for tax year 2019. For tax year 2020 and future years, these values are adjusted according to the IRS cost-of-living adjustment methodology.*

Figure 1
2019 Earned Income Tax Credit Available to Taxpayers by Earned Income



Background

Earned income tax credit. Under current law, the state allows a refundable EITC equal to 10 percent of the federal EITC. The federal EITC is available to taxpayers with earned income, i.e. income from wages or salaries or operating a business or farm. The EITC is available to taxpayers with low and middle incomes. For 2017, the federal and state EITC are not available to taxpayers with greater than $48,340 in federal adjusted gross income.

Federal EITC amounts depend on a taxpayer's adjusted gross income and number of qualifying children. The federal EITC amount available to specific households can be found in the EITC tables published on the IRS website for each tax year.

State Revenue

The measure is expected to increase General Fund revenue by $7.0 million for FY 2018-19, $19.9 million for FY 2019-20, and $33.0 million for FY 2020-21. These amounts represent the net impact of the revenue increase attributable to the graduated rate and the revenue decrease attributable to the new EITC. Additionally, the amount for FY 2018-19 represents a half-year impact for tax year 2019 on an accrual accounting basis. Revenue impacts are presented in Table 3 and described in detail below.

Table 3. General Fund Revenue Impacts of Initiative #166

Revenue Components	FY 2018-19*	FY 2019-20	FY 2020-21
Graduated Income Tax Rate	$651,200,000	$1,322,500,000	$1,363,100,000
New Earned Income Tax Credit	(688,400,000)	(1,391,900,000)	(1,422,400,000)
Repeal Current Earned Income Tax Credit	44,150,000	89,300,000	92,300,000
TOTAL	**$6,950,000**	**$19,900,000**	**$33,000,000**

**The estimate for FY 2018-19 reflects a half-year impact for tax year 2019.*

Graduated tax rate. The graduated income tax rate is expected to increase state income tax revenue by $651.2 million in FY 2018-19, $1,322.5 million in FY 2019-20, and $1,363.1million in FY 2020-21. The amount for FY 2018-19 represents a half-year impact for tax year 2019 on an accrual accounting basis.

Estimates were derived using actual taxpayer data for tax year 2015. In that year, 22,408 taxpayers remitted individual, fiduciary, or partnership tax returns showing $22.4 billion in taxable income exceeding $500,000 per taxpayer. This amount is assumed to increase through 2021 consistent with past growth in the amount of this income. In 2019, the first year for which the graduated tax rate is in place, taxable income in excess of $500,000 is expected to total $25.4 billion. Gross Colorado income tax on this amount, before credits, would total $1,177.8 million at the current law 4.63 percent rate and is expected to total $2,480.2 million at the 9.75 percent rate in the measure. To the extent that Colorado taxable income in excess of $500,000 decreases as a result of the higher tax rate imposed in the measure, revenue from the graduated tax will be less than estimated.

Repeal of the current EITC. All taxpayers who would receive the current law Colorado EITC are expected to receive a larger tax credit under the measure. Because the estimated revenue reduction attributed to the new EITC incorporates the full value of credit estimated for taxpayers who would otherwise claim the current law EITC, Table 3 nets out the current law portion of the new credit in order to isolate the revenue impact of the measure relative to current law. The amount of the current law credit is estimated at $88.3 million in 2019 and $90.3 million in 2020.

New EITC. This fiscal impact statement assumes that most taxpayers are able to claim the new EITC, provided that they are between the ages of 19 and 64 and that their earned income or adjusted gross income is less than $70,000. Table 4 presents the amount of credit assumed to be allowed to various taxpayer classes for tax year 2019. For tax year 2020, these amounts are grown by inflation and population.

The taxpayer populations in Table 4 were derived from actual taxpayer data for 2015. Population estimates were increased by Colorado population growth between 2015 and 2017 and the March 2018 LCS forecast of population growth between 2017 and 2019. Some credit amount estimates in Table 4 are dictated by the measure, while others reflect 30 percent of the federal EITC.

For taxpayers who are eligible to claim the Colorado EITC under current law, the amounts in Table 4 represent the total (gross) amount of credit that will be available under the measure. The amount of the tax credit that is uniquely attributable to the measure is less than that presented in Table 4 because the current law credit is repealed.

Table 4. Estimated 2019 EITC Amounts Under Initiative #166					
Taxpayer Class					
Qualifying Children	**Earned Income**	**Student/ Caregiver**	**Population**	**Total Credit Allowed**	**Average Credit Allowed**
None	less than $9,803*	No	269,900	$146.4 million	$542
		Yes	64,600	$64.6 million	$1,000
	$9,803* to $50,000*	No or Yes	684,300	$684.3 million	$1,000
	$50,001* to $70,000*	No or Yes	163,000	$68.7 million	$421
At least one	less than $19,093* (single filers) or less than $24,912* (joint filers)	No	91,100	$113.4 million	$1,245
		Yes	21,800	$21.8 million	$1,000
	$19,093* to $50,000* (single filers) or $24,912* to $50,000* (joint filers)	No or Yes	202,500	$243.7 million	$1,203
	$50,001* to $70,000*	No or Yes	77,100	$33.9 million	$440
TOTAL			**1,574,400**	**$1,376.9 million**	**$875**

**Grown by IRS cost-of-living adjustments in years beyond 2019.*

Actual taxpayer population data are unavailable for the number of qualifying students. 86,400 taxpayers with incomes below the federal phaseout amount are assumed to be able to claim the minimum $1,000 credit as students or caretakers based in part on the number of federal Pell grants issued in 2017.

TABOR Impact

The measure reduces state income tax revenue subject to TABOR by expanding the EITC. The measure specifies that revenue collected via the graduated income tax is exempt from TABOR as a voter-approved revenue change. Net of the repeal of the current law EITC, the measure reduces state revenue subject to TABOR by $644.3 million in FY 2018-19, $1,302.6 million in FY 2019-20, and $1,331.1 million in FY 2020-21.

These impacts are more than sufficient to eliminate TABOR surpluses anticipated in the March 2018 Legislative Council Staff forecast for FY 2018-19 and FY 2019-20. As a result, the measure eliminates TABOR refunds of $30.3 million for FY 2018-19 and $156.4 million for FY 2019-20. State revenue subject to TABOR has not been estimated for FY 2020-21; however, reducing state revenue subject to TABOR may reduce or eliminate refunds that would otherwise be collected in these years.

Current law TABOR refunds are expected to be paid via the property tax expenditure reimbursement TABOR refund mechanism. The amount to be refunded for FY 2018-19 will offset General Fund obligations for property tax expenditure reimbursements for FY 2019-20 and the amount to be refunded for FY 2019-20 will offset General Fund obligations for property tax expenditure reimbursements in FY 2020-21. Under the measure, these offsets will not occur.

Because anticipated TABOR surpluses will be eliminated, taxpayers will not be able to claim partially refundable conservation easement income tax credits for tax years 2019 and 2020.

State Expenditures

The measure is expected to increase General Fund expenditures by $7,185,086 and 38.7 FTE in FY 2019-20, $14,086,630 and 92.3 FTE in FY 2020-21, and similar amounts in subsequent years. Expenditures are for administration of the graduated income tax rate and new EITC in the DOR, as summarized in Table 5.

Table 5. Expenditures Under Initiative #166

Cost Components	FY 2018-19	FY 2019-20	FY 2020-21
Personal Services	-	$2,337,762	$5,567,554
FTE	-	38.7 FTE	92.3 FTE
Operating, Capital, and Leased Space Costs	-	683,124	586,105
Debit Card Servicing	-	240,000	1,440,000
Document Management and Postage	-	3,776,340	6,492,971
Computer Programming and Testing	-	147,860	-
TOTAL	**-**	**$7,185,086**	**$14,086,630**

Assumptions. The amounts in Table 5 assume that the graduated income tax rate and new EITC will both become effective in tax year 2019; see the Technical Notes section of this fiscal impact statement. Workload for administration of the new policies is assumed to begin in January 2020, with certain updates to software and tax forms occurring in the fall of 2019. Personal services expenditures for FY 2019-20 represent roughly half-year impacts, with small modifications for training and for the General Fund pay date shift.

Department of Revenue. Expenditures are for various administrative responsibilities to be accomplished in the DOR as described below.

Personal services. The tax policy changes in the measure will increase workload in DOR's Taxpayer Service Division, Tax Audit and Compliance Division, and Office of Research and Analysis. The Taxpayer Service Division is estimated to require 23.3 FTE in FY 2019-20 and 55.8 FTE in FY 2020-21 to process tax returns and accommodate increased call center volume, based on the assumption that 10 percent of claimed credits will require review and that 10 percent of taxpayers claiming the credit will call the department. It is assumed that a staff person can accomplish 6 calls or 3.2 reviews per hour. Additionally, 2.8 percent of returns are assumed to require some type of action by higher level staff. These figures are based on the department's previous experience with tax credit administration.

The Tax Audit and Compliance Division is estimated to require 15.2 FTE in FY 2019-20 and 36.5 FTE in FY 2020-21 to take action against improperly filed returns and provide call center support in discussions with taxpayers whose credit claims are under review. These workload figures assume that 10 percent of claimed credits will be sent to the division for review and that a staff person can resolve 5 referred returns, or assist 10.5 taxpayers via phone, per hour.

Additionally, 41 percent of reviewed returns are assumed to require some type of action by higher level staff. These figures are based on the department's previous experience with tax credit auditing and enforcement.

The Office of Research and Analysis is estimated to require 0.2 FTE in FY 2019-20 only to map the credit to its data reporting database. This estimate reflects 360 hours of workload for mapping 45 lines from tax forms at an estimated 8 hours per line. Ongoing reporting in FY 2020-21 and subsequent years can be accomplished within existing appropriations.

Operating, capital, and leased space costs. The estimates in Table 5 reflect standard operating (telephone and office supplies), capital (furniture and computer), and leased space costs for tax personnel in DOR.

Debit card servicing. An estimated 25 percent of taxpayers receiving refunds are assumed to choose to receive refunds via debit cards. The costs for issuing and administering debit cards are estimated at $120,000 per month. The estimate for FY 2019-20 reflects only two months of debit card servicing, based on the assumption that refunds will be issued beginning in May 2020.

Document management and postage. A portion of document management workload is accomplished in the Department of Personnel and Administration (DPA) using reappropriated DOR funds. DPA costs for document management include $551,028 in FY 2019-20 and $557,798 in FY 2020-21 to process EITC credits claimed using paper tax returns or documentation. These estimates assume that 15.5 percent of taxpayers will file paper returns, and that 50 percent of electronic filers will file supplementary paper documentation. An additional $7,200 is required in FY 2019-20 only to update 6 income tax forms at a cost of $1,200 each.

The remaining document management and postage expenses are expected to occur in DOR and include printing and postage costs for correspondence with taxpayers. These costs, $3,218,112 in FY 2019-20 and $5,935,173 in FY 2020-21.

The remaining 25 percent of EITC claimants are assumed to receive refunds via electronic funds transfer. Mailing costs assume a constant postage rate of $0.49 per mailing.

Computer programming and testing. This measure requires changes to DOR's GenTax software system. Changes are programmed by a contractor at a rate of $250 per hour. The programming costs in this measure are expected to total $132,500 in FY 2019-20 only, representing 530 hours of programming. All GenTax programming changes are tested by department staff. Testing for this measure will require the expenditures for contract personnel totaling $15,360, representing 640 hours of testing at a rate of $24 per hour.

Economic and Taxpayer Impacts

The measure increases taxes on 23,400 individuals with incomes greater than $500,000 by an average of $55,700, and reduces taxes on 1,574,400 individuals with incomes less than $70,000 by an average of $818, after accounting for the repeal of the current law Colorado EITC. The total amount of the tax increase on high income earners is greater than the amount of the credit allowed to taxpayers with low and middle incomes. By increasing after-tax income for low and middle income earners, the measure is expected to increase household consumption and retail trade. Reducing after-tax income for high income earners is expected to partially offset the increase in consumption and to reduce investment. The measure may reduce or eliminate TABOR refunds in future fiscal years for which the state issues refunds to taxpayers.

Technical Notes

The graduated income tax rate applies to the portion of federal taxable income that exceeds $500,000. Because the provision applies to federal taxable income, and not Colorado taxable income, it is unclear how taxpayers with federal taxable income in excess of $500,000 will be able to apply Colorado income additions, subtractions, and deductions for tax purposes.

The measure requires that all funds collected as a result of the graduated income tax rate be expended for the EITC or its administration. It is unclear whether revenue collected in excess of this amount may be used to expand the EITC further, whether it may be saved to issue future income tax credits, or whether it must be refunded to taxpayers. The administration of this requirement will ultimately affect the measure's net revenue impact and TABOR impact.

The new EITC takes effect when the measure becomes law. This fiscal impact statement assumes that the EITC will first be available for tax year 2019. However, because the results of the election are expected to be proclaimed by the Governor during November or December of 2018, the EITC may legally become available for tax year 2018, even though it will not appear on 2018 tax forms prepared by DOR. This contingency may raise litigation by taxpayers eligible to claim the credit in 2018, requiring expenditures in the Department of Law beginning in FY 2018-19. If the EITC is found to apply for tax year 2018, the measure will reduce state revenue for FY 2018-19 by about twice the amount estimated in this fiscal impact statement, and will also reduce state revenue in the current FY 2017-18 on an accrual accounting basis.

Effective Date

The measure takes effect on the date of the official declaration of the vote by proclamation of the Governor, not later than 30 days after the votes have been canvassed.

State and Local Government Contacts

Revenue

Abstract of Initiative 166: POLICY CHANGES PERTAINING TO STATE INCOME TAXES

This initial fiscal estimate, prepared by the nonpartisan Director of Research of the Legislative Council as of March, 2018, identifies the following impacts:

The abstract includes estimates of the fiscal impact of the initiative. If this initiative is to be placed on the ballot, Legislative Council Staff will prepare new estimates as part of a fiscal impact statement, which includes an abstract of that information. All fiscal impact statements are available at www.ColoradoBlueBook.com and the abstract will be included in the ballot information booklet that is prepared for the initiative.

This measure raises the income tax rate to 9.75 percent for the portion of individual taxable income that exceeds $500,000. It also expands the state earned income tax credit (EITC) to allow a tax credit, generally equal either to 30 percent of the federal EITC or $1,000, to most taxpayers aged 19 to 64 with less than $70,000 in earned income.

State revenue. The measure increases state revenue by a net of $7.0 million in FY 2018-19, $19.9 million in FY 2019-20, and $33.0 million in FY 2020-21 and subsequent years. These amounts reflect the increase in income tax on high incomes minus the amount of the new EITC for low and middle income earners.

State expenditures. The measure increases state expenditures by $7.2 million and 38.7 FTE in FY 2019-20 and $14.1 million and 92.3 FTE in FY 2020-21 and subsequent years. Expenditures reflect costs anticipated in the Department of Revenue to administer the tax rate increase and new EITC.

Economic and taxpayer impacts. The measure increases taxes on 23,400 individuals with incomes greater than $500,000 by an average of $55,700, and reduces taxes on 1,574,400 individuals with incomes less than $70,000 by an average of $818. The total amount of the tax increase on high income earners is greater than the amount of the credit allowed to taxpayers with low and middle incomes. By increasing after-tax income for low and middle income earners, the measure is expected to increase household consumption and retail trade. Reducing after-tax income for high income earners is expected to partially offset the increase in consumption and to reduce investment. The measure may reduce or eliminate TABOR refunds in future fiscal years for which the state issues refunds to taxpayers.