COLORADO ALTERNATIVE MINIMUM TAX CREDIT

EVALUATION SUMMARY | JULY 2021 | 2021-TE19

TAX TYPE	Individual income
YEAR ENACTED	1992
REPEAL/EXPIRATION DATE	None
REVENUE (TAX YEAR 2018)	$7.3 million
NUMBER OF TAXPAYERS	20,732 individuals and 29 estates and trusts

KEY CONCLUSION: The credit is effective at allowing taxpayers with prior-year alternative minimum tax (AMT) liability to recoup the additional state taxes they paid due to deferral items, which delay the recognition of taxable income to later years, but generally do not cause a permanent change in taxable income.

WHAT DOES THE TAX EXPENDITURE DO?

The Colorado Alternative Minimum Tax (AMT) Credit allows individuals, estates, and trusts that claim the federal AMT credit to claim a similar state income tax credit, equivalent to 12 percent of the federal credit. The credits are generally available to taxpayers who paid the federal AMT in the previous year because they used certain federal tax provisions, referred to as deferral items, that allow for a temporary delay in taxable income.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation do not state the credit's purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of federal guidance documents, other states' reports on their AMT credits, and the current operation of the expenditure, our evaluation considered a potential purpose: to allow qualifying taxpayers to recoup the additional state taxes they paid under the Colorado AMT in the prior year due to deferral items since such deferrals do not typically cause a permanent reduction in taxable income.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider establishing a statutory purpose and performance measures for the credit.

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EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

The Colorado Alternative Minimum Tax (AMT) Credit [Section 39-22-105(3)(b), C.R.S.] allows individuals, estates, and trusts that claim the federal AMT credit to claim an additional state income tax credit.

The current federal AMT was enacted in 1986 to ensure that high-income earners who significantly benefit from certain federal tax provisions pay a minimum amount of tax relative to their income. Specifically, the federal AMT is calculated separately from, and paid in addition to, taxpayers' regular income tax to the extent that it exceeds their regular federal tax liability.

Generally, two types of tax provisions cause taxpayers to pay AMT tax—exclusions and deferrals. Exclusion items taxpayers claim in a given tax year permanently reduce their taxable income and include adjustments like deductions for business operating expenses and interest. These adjustments are considered permanent because they reduce taxable income in the year they are claimed, and generally do not cause a corresponding increase in taxable income in later years. In contrast, deferral items allow taxpayers to adjust their taxable income in the current tax year, but generally do not cause a permanent difference in taxable income because there is a corresponding increase in taxable income in later years. For example, provisions allowing for accelerated depreciation expenses are considered deferral items. Taxpayers typically use depreciation to subtract the cost of long-term business assets from their taxable income over the useful life of the assets instead of recognizing the entire cost in the year the assets are purchased; however, accelerated depreciation provisions allow taxpayers to subtract the cost of certain assets over a shorter period than the assets' useful life. This shorter period for recognizing depreciation expenses allows taxpayers to initially subtract larger amounts from their taxable income and reduce their tax liability in the short-term, but causes a corresponding increase in taxable income in later tax years, since the total amount they can deduct in either case is limited to the cost of the assets. Generally, taxpayers are more likely to be liable for the federal AMT if they have a high income and use exclusions and deferrals to substantially reduce their federal taxable income.

To determine whether they owe federal AMT, taxpayers must generally calculate their federal AMT income by adding exclusion and deferral items to their regular federal taxable income and then subtracting a federal AMT exemption amount of $56,700, $72,900, or $113,400, based on their filing status (i.e., married filing separately, single, and married filing jointly). They then multiply their federal AMT income by a rate, set between 26 and 28 percent based on their income level and filing status, to determine their federal AMT. As discussed, federal AMT is only paid to the extent that it exceeds their regular federal tax liability. For example, if a taxpayer's federal AMT is $20,000 and their regular federal income tax liability is $18,000, they would owe $2,000 in federal AMT as well as $18,000 in regular federal income tax. EXHIBIT 1 shows each step in this process.

EXHIBIT 1. CALCULATION OF FEDERAL AMT OWED	
	Federal Taxable Income
+	Exclusion and Deferral Items
–	Federal AMT Exemption
=	Federal AMT Income
X	Federal AMT Rate
=	Federal AMT
–	Regular Tax Liability
=	Federal AMT Owed

Additionally, Colorado levies a Colorado AMT [Section 39-22-105(1.5), C.R.S.]. According to the Department of Revenue (Department), when taxpayers are subject to the federal AMT, they are typically subject to the Colorado AMT as well. To determine whether they owe the Colorado AMT, taxpayers first calculate their Colorado AMT income, which is equivalent to the federal AMT income, adjusted for any state-level additions or subtractions such as local bond interest not included in federal alternative taxable income, the federal AMT exemption, or any additions to or subtractions from regular income tax. They then multiply this amount by the Colorado AMT rate of 3.47 percent to determine their Colorado AMT, which calculates taxpayers' Colorado AMT in proportion to their federal AMT relative to regular state and federal taxable income. Similar to the federal AMT, taxpayers only pay Colorado AMT to the extent that it exceeds their regular Colorado tax liability. EXHIBIT 2 shows how the Colorado AMT is calculated.

EXHIBIT 2. CALCULATION OF COLORADO AMT OWED	
	Federal AMT Income
+ / –	State-level Additions/Subtractions to Taxable Income
=	Colorado AMT Income
x	Colorado AMT Rate (3.47%)
=	Colorado AMT
–	Regular Colorado Tax Liability
=	Colorado AMT Owed

The federal and Colorado AMT credits are available to certain taxpayers who were liable for federal AMT in the prior tax year, but are no longer liable for it in the current tax year. The credits allow taxpayers to recoup the additional taxes they paid due to deferral items they claimed in the prior year that caused them to owe AMT. For example, if a taxpayer was subject to the federal AMT in the prior year solely because they claimed a deferral item, such as the accelerated depreciation deduction, but they no longer owe federal AMT in the current year, they could claim the federal AMT credit. The taxpayer would also then qualify for the Colorado AMT Credit, which is calculated as 12 percent of the federal AMT credit amount. EXHIBIT 3 shows how the Federal and Colorado AMT Credits would be calculated for this taxpayer.

EXHIBIT 3. CALCULATION OF FEDERAL AND COLORADO AMT CREDIT FOR A TAXPAYER WITH ONLY ELIGIBLE DEFERRAL ITEMS FROM THE PRIOR YEAR

	Prior Year AMT
–	Prior Year Regular Tax Liability
=	Federal AMT Credit
x	12%
=	Colorado AMT Credit

As discussed, the federal AMT credit is only available to the extent the taxpayer owed AMT in the prior year due to deferral items. If instead the taxpayer also paid federal AMT in the prior year due to an exclusion item, such as an interest deduction, they would not be able to claim the credit for the portion of additional federal AMT due to the exclusion.

House Bill 87-1331 created the Colorado AMT Credit in 1987, the same year in which the State established a Colorado AMT. The Colorado AMT Credit is only available to individuals, estates, and trusts and cannot be claimed by corporations. Originally, the State's credit was calculated at 18 percent of the federal AMT credit with the intention of making it proportionate to the federal AMT credit for state tax purposes. The General Assembly reduced the credit amount to 12 percent in 2001, at the same time federal legislation lowered the highest federal income tax rate to 35 percent, which required a reduction in the Colorado AMT Credit to remain proportionate to the federal AMT credit. The Colorado AMT Credit can only be claimed to offset taxpayers' tax liability in the year it is claimed; if the credit amount exceeds taxpayers' tax liability, it cannot be refunded or carried forward.

Taxpayers claim the Colorado AMT Credit on Line 19, Column A of the Individual Credit Schedule (Form DR 0104CR), which they submit with their Colorado Individual Income Tax Return (Form DR 0104).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not explicitly state the intended beneficiaries of the Colorado AMT Credit. Based on its operation, we inferred that the intended beneficiaries of the credit are individuals, estates, and trusts that previously paid Colorado AMT due to deferral items, which typically only delay the recognition of taxable income. According to literature on the federal AMT credit and our review of IRS data, the federal and Colorado AMT Credits are typically used by high-income individuals whose income is tied to investments, incentive stock options, or capital gains; and also individuals with substantial depreciable assets.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute and the enacting legislation for the Colorado AMT Credit do not explicitly state its purpose; therefore, we could not definitively determine the General Assembly's original intent. Based on the operation of the credit, federal guidance documents, and other states' reports on their AMT credits, we considered a potential purpose: to allow qualifying taxpayers to recoup the additional state taxes they paid under the AMT in the prior year due to deferral items, since such deferrals do not typically cause a permanent reduction in taxable income. According to guidance from the Joint Committee on Taxation and IRS Form 8801, the federal AMT credit is allowed because adjustments that defer taxable income to another tax year generally do not make a permanent difference to an individual's taxable income over time and the purpose of the federal AMT is to prevent taxpayers from permanently avoiding tax liability on income received in a given year. Therefore, the federal AMT credit is intended to prevent taxpayers whose tax circumstances do not fall within the intent of the federal AMT from paying additional tax. Because the Colorado AMT is designed to parallel the federal AMT at the state level, the Colorado AMT Credit appears to have a similar purpose as the federal AMT credit.

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

We could not definitively determine whether the Colorado AMT Credit is meeting its purpose because no purpose is provided in statute or its enacting legislation. However, we found that it is likely meeting the purpose we considered in order to conduct this evaluation.

Statute does not provide quantifiable performance measures for this tax expenditure. Therefore, we created and applied the following performance measure to determine the extent to which the exemption is meeting its potential purpose.

PERFORMANCE MEASURE: *To what extent do taxpayers claim the Colorado AMT Credit when deferral items in prior tax years resulted in AMT tax liability?*

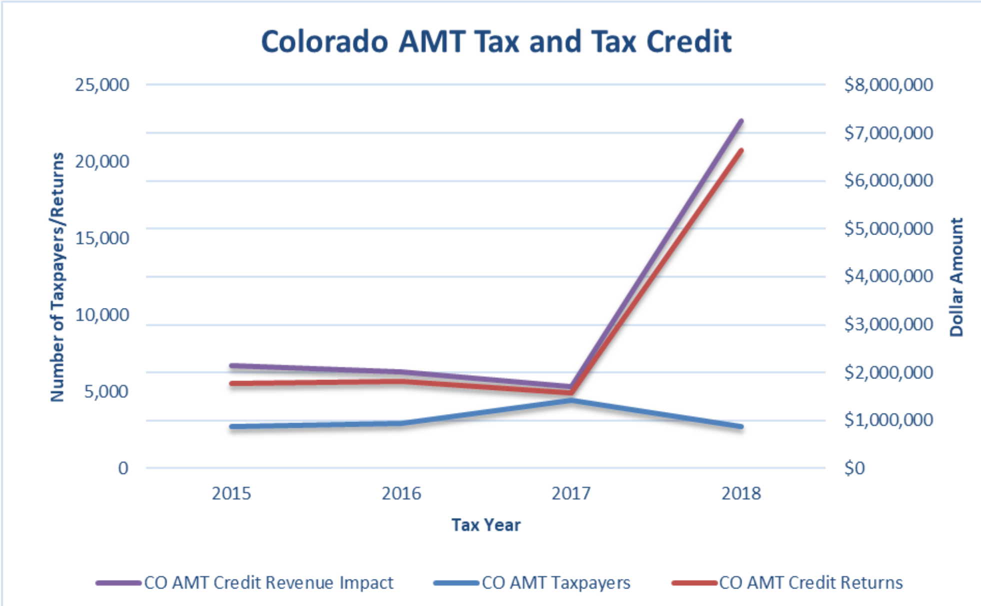
RESULT: Overall, we found that the credit is likely being claimed by taxpayers who had prior-tax-year AMT liability due to deferral items recognized in later years. In Tax Year 2018, the Colorado AMT Credit was claimed by 20,732 individuals and 29 estates and trusts according to Department data. The number of individual taxpayers who claimed the credit increased by 320 percent, or 15,784 claimants, from Tax Year 2017 to 2018, largely due to changes to federal law under the Tax Cuts and Jobs Act of 2017. Specifically, the legislation made changes that significantly reduced the number of taxpayers subject to federal AMT, beginning in Tax Year 2018 through 2025. Because the federal and Colorado AMT credits are available to taxpayers who paid AMT in the previous tax year, but are no longer subject to AMT, the change caused many more taxpayers to qualify for the credits in 2018. Based on the large increase in the number of individuals claiming the Colorado AMT Credit, it appears that taxpayers and tax preparers are aware of and using the Colorado AMT Credit when it applies. However, according to projections prepared by the Tax Policy Center, nationally, only about 5 percent of taxpayers who have owed AMT in recent years are likely to owe it through 2025; therefore, it is likely that it will also be less common for taxpayers to use the federal and Colorado AMT Credits during that time period. The previous AMT requirements will resume in 2026, expanding the number of taxpayers who owe AMT, unless the provisions in the Tax Cuts and Jobs Act limiting the AMT are extended.

Moreover, data from the Department and the IRS indicate that most eligible taxpayers are claiming the Colorado AMT Credit. Specifically, the ratio of individual federal AMT taxpayers to individual federal AMT credit takers was roughly equivalent to the ratio of individual federal AMT taxpayers from Colorado to individual Colorado AMT credit takers in Tax Year 2018. For every individual federal AMT taxpayer, there are roughly four credit takers at the federal and state level. Because the ratios are roughly equivalent, it indicates that individuals who receive a federal AMT credit are also generally claiming the state credit, assuming that taxpayers in Colorado who pay federal AMT take the federal AMT credit at a similar rate as taxpayers nationally.

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

Based on Department data, the Colorado AMT Credit resulted in $7.3 million in forgone state revenue in Tax Year 2018, the most recent year for which data was available. This was a significant increase from the $1.7 million revenue impact for Tax Year 2017. As discussed, we found that federal legislative changes passed in 2017 with the Tax Cut and Jobs Act resulted in a substantial increase in the number of taxpayers eligible for the Colorado AMT Credit in Tax Year 2018. However, this is likely to be a temporary increase because taxpayers can only claim the Colorado AMT Credit when they paid federal AMT in the prior tax year, and far fewer taxpayers were likely eligible for the Colorado AMT Credit beginning in 2019, though we lacked data to confirm this. EXHIBIT 4 provides revenue impacts for the Colorado AMT Tax and Tax Credit for Tax Years 2015 through 2018.

EXHIBIT 4.



SOURCE: Office of the State Auditor's analysis of Colorado Department of Revenue Statistics of Income and Annual Report data.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

The average Colorado AMT Credit claimed per return for Tax Years 2015 through 2018 was $359. If the credit was eliminated, individuals, estates, and trusts who use the Colorado AMT Credit would see their state income tax liability increase by similar amounts. However, based on the Department's Statistics of Income reports for Tax Years 2015 to 2017, taxpayers with a larger Adjusted Gross Income (AGI) tend to receive a greater benefit from the Colorado AMT Credit. For example, those with an AGI exceeding $1 million received an average benefit of about $2,000 per return in Tax Year 2015 to 2017. Therefore, eliminating the credit would likely have a more substantial impact on high income earners that claim a greater amount of deferral items.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 42 states that levy an individual income tax, including the District of Columbia, we identified four other states that levy a state

AMT on taxpayers who file as individuals, including California, Connecticut, Iowa, and Minnesota. All four states also provide a corresponding AMT credit; however, Iowa's individual AMT and corresponding credit are set to expire in 2023 and 2024. In contrast to Colorado, three states also levy a corporate AMT including California, Connecticut, and Minnesota, but only Minnesota provides a corresponding corporate AMT credit. Finally, six other states previously levied an individual AMT that has since been repealed along with any corresponding AMT credits.

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

As discussed, taxpayers benefitting from the Colorado AMT Credit also benefit from the federal AMT credit, which provides a similar benefit for federal tax purposes.

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

We did not encounter any data constraints during the evaluation.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE COLORADO AMT CREDIT. Statute and the enacting legislation for the credit do not state the credit's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for the credit: to allow qualifying taxpayers to recoup the additional state taxes they paid under the AMT in the prior year due to deferral items, since such deferrals do not typically cause a permanent reduction in taxable income. We identified this purpose based on the operation of the credit, federal guidance documents, and other states' reports on their AMT credits. We also developed a performance measure to assess the extent to which the credit is meeting this potential purpose. However, the

General Assembly may want to clarify its intent for the credit by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the credit's purpose and allow our office to more definitively assess the extent to which the credit is accomplishing its intended goal(s).