HB 21-1327

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

Final Fiscal Note

Drafting Number:	LLS 21-0892	**Date:**	July 23, 2021
Prime Sponsors:	Rep. Ortiz; Van Winkle Sen. Kolker; Woodward	**Bill Status:**	Signed into Law
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Bill Topic: **STATE & LOCAL TAX PARITY ACT FOR BUSINESSES**

Summary of Fiscal Impact:

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

The bill allows pass-through businesses to elect to pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2022. The bill will increase state expenditures beginning in FY 2021-22.

Appropriation Summary: For FY 2021-22, the bill requires and includes an appropriation of $432,578 to the Department of Revenue.

Fiscal Note Status: The fiscal note reflects the enacted bill.

Table 1
State Fiscal Impacts Under HB 21-1327

		Budget Year FY 2021-22	Out Year FY 2022-23
Revenue		-	-
Expenditures	General Fund	$432,578	$492,444
	Centrally Appropriated	$40,723	$117.517
	Total Expenditures	**$473,301**	**$609,961**
	Total FTE	**2.8 FTE**	**8.0 FTE**
Transfers		-	-
TABOR Refund		-	-

Summary of Legislation

Pass-through businesses, such as sole proprietorships, partnerships, and S-corporations, do not pay the corporate income tax. Rather, any profits generated by the business are "passed through" to the owners of the business and subsequently taxed at the individual level. This bill allows partnerships and S-corporations to elect to pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2022.

Background

The federal Tax Cuts and Jobs Act of 2017 placed a temporary $10,000 annual cap on the federal income tax deduction for state and local taxes ("SALT" deduction) for individual income taxpayers. No cap exists for this deduction for C-corporations. The cap is set to expire on December 31, 2025. This bill allows Colorado owners of partnerships and S-corporations to avoid the cap on the federal deduction by filing taxes at the entity level instead of the individual level.

Assumptions

Based on federal tax data, Colorado filers with an approximate adjusted gross income of $150,000 and up tend to reach the federal SALT deduction cap. Based on Colorado state tax data, approximately 18 percent of Colorado taxpayers with business income have an adjusted gross income in this range. As such, this fiscal note assumes that approximately 18 percent of pass-through businesses will elect to file at the entity level to bypass the SALT deduction limit. This results in an estimated 56,064 businesses in tax year 2022 and 58,085 businesses in tax year 2023 electing to pay their state income taxes at the entity level. The fiscal note assumes that on average pass-through businesses have five individual partners, based on data from the Colorado Department of Revenue.

State Revenue

The bill is not expected to affect state revenue. Under Colorado law, taxpayers are required to add back any state and local taxes deducted at the federal level to their Colorado taxable income. As such, total Colorado taxable income is not expected to change under this bill.

State Expenditures

The bill is expected to increase General Fund expenditures in the by $473,301 and 2.8 FTE in FY 2021-22, and by $609,961 and 8.0 FTE in FY 2022-23 and subsequent years through FY 2025-26 when the cap expires under federal law. Expenditures are summarized in Table 2 and described below.

Table 2
Expenditures Under HB 21-1327

		FY 2021-22	FY 2022-23
Department of Revenue			
Personal Services		$140,616	$414,640
Operating Expenses		$4,050	$10,800
Capital Outlay Costs		$18,600	-
GenTax Programming		$66,375	-
Computer and User Acceptance Testing		$98,991	-
Data Reporting		$1,600	-
Form Changes, Scanning, and Data Entry		$102,346	$67,004
Centrally Appropriated Costs[1]		$40,723	$117,517
	Total Cost	**$473,301**	**$609,961**
	Total FTE	**2.8 FTE**	**8.0 FTE**

[1] *Centrally appropriated costs are not included in the bill's appropriation.*

Department of Revenue. The bill is expected to increase expenditures for the department by $473,301 and 2.8 FTE in FY 2021-22, and by $609,961 and 8.0 FTE in FY 2022-23 and subsequent years. The bill requires the department to provide additional review of pass-through tax returns that opt to file at the entity level. Additionally, the department will have to cross verify the individual tax returns of the pass-through owners to ensure that the proper subtractions and additions are made on these returns.

Other costs for the department are related to programming the department's GenTax software, software and related user acceptance testing, tax form changes performed in the Department of Personnel and Administration using reappropriated DOR funds, and data reporting in the DOR's Office of Research and Analysis.

Centrally appropriated costs. Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. These costs, which include employee insurance and supplemental employee retirement payments, are estimated to be $40,723 in FY 2021-22 and $117,517 in FY 2022-23.

Effective Date

The bill was signed into law by the Governor and took effect on June 23, 2021.

State Appropriations

For FY 2021-22, the bill requires a General Fund appropriation of $432,578 to the Department of Revenue, and 2.8 FTE. Of this amount, $102,346 should be reappropriated to the Department of Personnel and Administration.

State and Local Government Contacts

Information Technology	Local Affairs
Personnel	Revenue