SB 22-124

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

Fiscal Note

Drafting Number:	LLS 22-0769	**Date:**	February 17, 2022
Prime Sponsors:	Sen. Woodward; Kolker Rep. Ortiz; Van Winkle	**Bill Status:**	Senate Finance
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Bill Topic: **SALT PARITY ACT**

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 retroactively pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2018. The bill will increase state expenditures beginning in FY 2022-23.

Appropriation Summary: For FY 2022-23, the bill requires an appropriation of $1,772,961 to the Department of Revenue.

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

Table 1
State Fiscal Impacts Under SB 22-124

		Budget Year FY 2022-23	Out Year FY 2023-24
Revenue		-	-
Expenditures	General Fund	$1,772,961	$144,133
	Centrally Appropriated	$331,153	$38,073
	Total Expenditures	**$2,104,114**	**$182,206**
	Total FTE	**22.2 FTE**	**2.6 FTE**
Transfers		-	-
Other Budget Impacts	General Fund Reserve	$265,944	$21,620

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. Under current law (HB 21-1327), taxpayers may elect to pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2022. This bill allows partnerships and S-corporations to retroactively elect to pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2018.

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 file taxes at the entity level instead of the individual level, which may allow taxpayers a larger SALT deduction.

Assumptions

The number of individuals and entity level tax returns that will be amended and refiled with the Department of Revenue (DOR) as a result of this bill is uncertain. In the 2018 tax year, the most recent data available and the first year of the SALT deduction cap, a total of 39,120 taxpayers that were part of a partnership or S-corporations exceeded the SALT deduction cap on their tax return. Those taxpayers were associated with 56,550 different partnerships and S-corps. However, the number of distinct individual taxpayers who were associated with those 56,550 businesses was significantly higher, about 220,530 individuals. As such, in 2018 there were 39,120 taxpayers who would directly benefit from amending their returns and filing at the entity level; however, the total universe of taxpayers that may file amended returns as a result of this bill could be as high as 220,530. This is because if the business chooses to amend their returns to file at the entity level, all members of the business will also have to amend their individual returns.

This fiscal note assumes that approximately 18 percent of this total universe of taxpayers and businesses will choose to amend their returns to file at the entity level, or about 10,030 businesses and 39,120 individuals for tax year 2018. Further, this fiscal note assumes a similar number of returns will be amended for tax years 2019, 2020, and 2021. This results in approximately 41,500 business returns and 161,850 individual returns being amended and filed with the DOR for tax years 2018 through 2021. Additionally, this fiscal note assumes that 90 percent of amended returns will be processed by the DOR in FY 2022-23, and 10 percent will be processed in FY 2023-24.

Because the number of taxpayers impacted by the bill may differ significantly from the assumptions in this fiscal note, workload impacts may differ significantly from those estimated. If more (or fewer) businesses and individuals file amended returns than assumed in this fiscal note, expenditures in DOR could be significantly higher (or lower) than presented in this fiscal note. If this occurs, the fiscal assumes that DOR would address this difference through the annual budget process.

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 increases state expenditures in the Department of Revenue by $2,104,114 in FY 2022-23 and $182,206 in FY 2023-24 from the General Fund. Expenditures are shown in Table 2 and detailed below.

Table 2
Expenditures Under SB 22-124

	FY 2022-23	FY 2023-24
Department of Revenue		
Personal Services	$1,155,261	$134,223
Operating Expenses	$32,805	$3,510
Capital Outlay Costs	$148,800	-
GenTax Programming	$90,000	-
Computer and User Acceptance Testing	$186,795	
Document Management and Form Changes	$152,899	
Data Reporting	$6,400	$6,400
Centrally Appropriated Costs[1]	$331,153	$38,073
Total Cost	**$2,104,114**	**$182,206**
Total FTE	**22.2 FTE**	**2.6 FTE**

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

Department of Revenue. The DOR will require an additional 22.2 FTE tax examiners in FY 2022-23 and 2.6 FTE tax examiners in FY 2023-24 to implement this bill. The bill generates additional workload for the department to process amended returns for both businesses and individuals across four different tax years. The department anticipates that amended returns will include more errors than usual and require longer review times due to the retroactive nature of these changes.

- **Computer programming and testing.** For FY 2022-23 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 400 hours of computer programming are required to implement this bill, totaling $90,000. Additional computer and user acceptance testing are required to ensure programming changes are tested and functioning properly, resulting in an additional $186,795 in expenditures by the department.

- **Document management and form changes.** The bill requires $152,899 in FY 2022-23 for expenditures related to document management, data entry, and tax form changes. These expenditures take place in the Department of Personnel and Administration using reappropriated funds from the DOR.

- **Data reporting.** Beginning in FY 2022-23, the Office of Research and Analysis within DOR will expend $6,400 annually to collect and report data related to the changes in this bill.

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 shown in Table 2.

Other Budget Impacts

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 $265,944 in FY 2022-23 and by $21,620 in FY 2023-24, which will decrease the amount of General Fund available for other purposes.

Effective Date

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

State Appropriations

For FY 2021-22, the bill requires a General Fund appropriation of $1,772,961 to the Department of Revenue, and 22.2 FTE. Of this amount, $152,899 is reappropriated to the Department of Personnel and Administration.

Departmental Difference

DOR estimates the bill requires General Fund expenditures of $12,020,748, and 143.9 FTE in FY 2022-23 and $525,509, and 7.7 FTE in FY 2023-24 on the assumption that a total of 205,420 business and 1,027,100 individual tax returns will be amended and filed with DOR as a result of this bill. This fiscal note uses different assumptions and estimates that a total of 41,500 business returns and 161,850 individual returns will be amended and filed with DOR as a result of this bill. The number of amended returns is expected to be lower than the estimate presented by DOR due to the relatively small number of individuals who would directly benefit from amending their returns, and the additional inconvenience to file amended returns. As such, the workload impact and associated expenditures in this fiscal note are significantly lower than the estimate provided by DOR.

State and Local Government Contacts

Information Technology	Law
Personnel	Revenue