2nd Draft

#126 - TABOR Spending and Property Tax Limits

The proposed amendment to the Colorado Constitution:

- Changes the limit on state government spending, reducing taxpayer refunds and allowing the state to spend more of the money it collects; and

- Repeals the local government spending limit and changes the local government property tax limit.

Background

The TABOR amendment to the Colorado Constitution requires voters to approve any new or increased taxes and limits the amount of money from taxes and fees that the state and local governments may spend. For local governments, it also limits property taxes. This proposal changes some limits and repeals others, but does not affect the requirement for voter approval of tax increases.

How does the state spending limit work? TABOR limits annual state spending increases to the rate of inflation plus the percentage change in state population, unless voters approve a higher amount. Any money collected over the limit must be refunded to taxpayers. For example, if state spending is limited to $100, but the state collects $105, the additional $5 must be refunded to taxpayers.

How does the proposal change the limit? The proposal sets a new state limit using the ratio of state spending to personal income that existed in 2000. The proposal thereby allows the state to spend up to roughly 6 percent of statewide personal income, which is more than the current limit allows. State spending was about 7 percent of statewide personal income in 1992 when TABOR passed and is currently about 5 percent. The higher limit would allow the state to spend money that would otherwise be refunded to taxpayers after July 1, 2005. Like current law, any money collected over the limit is refunded to taxpayers. However, state officials estimate that the proposal will likely eliminate any refunds for at least the next five years.

The proposal also changes how the state limit is calculated in the future. Today, state spending is capped at the legal limit or actual collections, whichever is lower. For example, if the state limit is $100, but the state only collects $95, future spending growth is calculated from $95. The proposed limit is a fixed percentage of statewide personal income and is not affected by how much money the state actually collects.

Local government spending and property tax limits are also affected by the proposal. Similar to the state's limit, the constitution limits local government spending and requires voter approval for any tax increases. This proposal repeals the local government spending limit, but does not change the requirement for voter approval of tax increases. This proposal generally allows local governments to spend more from existing taxes than the constitution currently allows, except where voters have already waived the current limits.

The state constitution also limits how much local governments may collect from property taxes. The property tax limit uses a formula that includes the rate of inflation. This proposal replaces the inflation rate with the change in per capita personal income, which generally lets local governments collect more in property taxes than under current law, without increasing tax rates.

Other limits. In addition to the specific limits described above, the state constitution requires voter approval to weaken other limits on revenue or spending adopted prior to TABOR's approval. The proposal repeals this requirement. The state legislature and local elected officials may modify any such limits without first seeking voter approval.

Arguments For

1) The proposal provides the state with the money to restore services that were cut or eliminated during the most recent economic recession without increasing taxes. During the recession, state General Fund revenue declined by $1.1 billion. Without the proposal, the state will be forced to cut services over the next two years while it is also issuing taxpayer refunds.

2) The state spending limit should be linked to growth in the overall economy, so that the state can better meet the needs of its citizens. The current revenue limit is too restrictive because it does not take into account the actual costs of providing such services as public safety, education, and health care. These costs sometimes grow faster than the rate of inflation (which is based on household spending) and population (which often doesn't meet the growing demand for state services by some groups, such as Medicaid recipients, students, and prison inmates).

3) Colorado's business climate and future economic growth requires a balance between limiting taxes and investing in roads, public safety, and schools. Over the past 12 years, state spending has fallen from 7 percent of personal income to 5 percent. Now, it is time for the state to focus again on investing in these and other areas.

Arguments Against

1) The proposal is equivalent to a tax increase. The new, higher limit will let the state spend roughly $2.25 billion over the next five years that should be refunded to taxpayers. The current limit already permits government spending to grow each year to match increases in population and inflation. The government should live within these limits, just

as citizens have to live within their means, and let Colorado residents and businesses keep more of their own money.

2) The TABOR limit doesn't need to be permanently changed in order for the government to spend more money. Governments can already ask voters to spend more of what they currently collect or increase taxes. Spending limits force the government to be more efficient. This measure completely repeals the state constitutional limit on local goverments, giving local governments virtually unlimited power to raise fees.

3) The proposal may increase property taxes paid by homeowners and businesses because the new property tax revenue limit is higher than the old limit. Higher property taxes make it harder for low-income citizens to stay in their homes and for the state to maintain a competitive business climate.

Estimate of Fiscal Impact

The proposal changes the state's constitutional spending limit. This change increases the amount of money that the state may spend, and at the same time, eliminates $2.25 billion in TABOR refunds through budget year 2009-2010. Within certain restrictions provided by law, the state legislature will annually direct how the additional money that is kept will be spent.

The state has 20 different methods of refunding surplus revenue. Most of the decline in the refund will occur in seven categories. These include the sales tax refund to individual taxpayers ($806 million); the refund of business personal property tax ($546 million); the refund for capital gains on Colorado assets purchased prior to 1994 for individuals and businesses ($211 million); the earned income tax credit for certain low-income taxpayers ($181 million); the interest, dividend, and capital gains exclusion for individual taxpayers ($158 million); the reduction in motor vehicle registration fees ($128 million); and the child care credit for individual taxpayers ($114 million). The remaining refund categories total $109 million.

The new property tax limit will allow for more property taxes to be collected for the local share of public school finance. In turn, this will reduce the state's obligation for public school funding. For the 2005-06 school year, $XXX more in property taxes will be collected for school general operating expenses, decreasing the need for state spending on schools. In addition, some local governments that are not already exempt from the TABOR revenue limit will likely be allowed to collect and spend more revenue than they would otherwise.