HB08-1362

Colorado Legislative Council Staff Fiscal Note

FINAL STATE and LOCAL CONDITIONAL FISCAL IMPACT

Drafting Number:	LLS 08-0328	**Date:**	April 4, 2008
Prime Sponsor(s):	Rep. Kefalas Sen. Boyd	**Bill Status:**	Postponed Indefinitely
		Fiscal Analyst:	Natalie Mullis (303-866-4778)

TITLE: CONCERNING THE EARNED INCOME TAX CREDIT, AND MAKING AN APPROPRIATION IN CONNECTION THEREWITH.

Fiscal Impact Summary	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
State Revenue				
General Fund	($27.1 Million)*	($55.8 Million)	($28.7 Million)*	$0
Cash Funds				
Unemployment Insurance Fund	$0	($0.3 Million)	($1.6 Million)	($1.3 Million)
Earned Income Tax Credit Fund	$0	$0.3 Million	$1.2 Million	$0
State Transfers or Diversions				
Diversion from the UI Fund to the Earned Income Tax Credit Fund	$0	($24.2 Million)	($25.1 Million)	$0
Transfer to the General Fund from the Earned Income Tax Credit Fund	$0	$5.4 Million	$5.7 Million	$0
Transfer to the UI Fund from the Earned Income Tax Credit Fund	$0	$0	$0	$39.6 Million
State Expenditures				
General Fund	$0	$99,080**	$98,170	$50,734
Appropriation of Federal TANF Funds:				
General Fund	$0	$48.8 Million	$51.7 Million	$0
County Block Grant Program	$0	($48.8 Million)	($51.7 Million)	$2.7 Million
FTE Position Change	0.0 FTE	1.0 FTE	1.9 FTE	1.0 FTE
Effective Date: The bill was postponed indefinitely by the House Finance Committee on April 2, 2008.				
Appropriation Summary for FY 2008-2009: See the State Appropriations section.				
Local Government Impact: See the Local Government Impact section.				

* *Represents a half-year impact on an accrual accounting basis.*

** *$47,991 of this amount is contained in the FY 2008-09 Long Bill for programming costs in the Department of Revenue for 2008 legislation.*

Summary of Legislation

HB08-1362 allows an earned income tax credit (EITC) equal to 10 percent of the federal EITC in tax years 2008 and 2009. Ninety percent of the credit is paid for with appropriations in FY 2008-09 and FY 2009-10 from the federal Temporary Assistance for Needy Families (TANF) block grant. The remaining 10 percent is paid for with unemployment insurance (UI) surcharge revenue, diverted from the UI Fund into the newly created Earned Income Tax Credit (EITC) Fund in FY 2008-09 and FY 2009-10. The balance of the EITC Fund is transferred back to the UI Fund on July 1, 2010.

To protect the UI Trust Fund in the case of an economic downturn, a trigger is placed on the credit and on the diversion of money from the UI Fund. The diversion of money will not occur and an EITC will not be available for the current tax year if, as of June 30th of 2008 or 2009, either of the following has occurred:

- The four-quarter moving average of UI benefits paid to claimants has increased by at least 10 percent during any of the previous four quarters for which data is available, or
- The four-quarter moving average of average weekly wages paid by employers statewide to workers covered by the program has decreased by at least 3 percent during any of the previous four quarters for which data is available.

In addition, for purposes of calculating whether the UI solvency tax should be levied, the bill requires that the balance of the UI Fund be calculated as if the diversion did not occur.

Background

The Colorado Earned Income Tax Credit (EITC). The Colorado EITC "piggybacks" on the federal credit. The federal EITC is refundable and may be claimed by taxpayers with earned wages and modified federal adjusted gross income and investment income less than a certain amount. The credit varies depending on whether a taxpayer is single or married and on the number of children in the home.

Colorado has a *TABOR refund mechanism* that provides a state EITC equal to 10 percent of the federal credit. FY 2010-11 is the first year for which a surplus can exist under Referendum C. The surplus in FY 2010-11 would need to be at least $288 million in order for the EITC to be in effect for tax year 2011. Based on the March 2008 Legislative Council Staff revenue forecast, no surplus is expected in FY 2010-11 or FY 2011-12. The EITC was used to partially refund the FY 1998-99, FY 1999-00, and FY 2000-01 TABOR surpluses. In FY 2001-02, 210,942 taxpayers received an average exemption of $159, for a total tax reduction of $32.9 million.

Temporary Assistance for Needy Families (TANF). TANF is a federal program that provides a block grant to states to help poor families with children. Federal TANF statutes require states to use the money on programs that discourage out-of-wedlock pregnancies and encourage families to pursue educational and work opportunities and remain in two-parent families. Low-income families with at least one child in the home can receive assistance for up to five years. Legal aliens are not eligible for assistance until they have resided in the country for at least five years. Colorado is required to meet certain work participation requirements in its TANF population and must spend $82.8 million of state money each year to meet maintenance of effort requirements.

Within the boundaries described above, the General Assembly has broad authority to appropriate Colorado's TANF block grant as it sees fit. Colorado received $149.6 million in federal block grant funds in FY 2007-08. Of this amount, Colorado made a total of $131.1 million in block grants to counties. The state expects to receive $139.5 million in FY 2008-09. In FY 2009-10 and each year thereafter, the state expects to receive $136.1 million from the federal government.

Unemployment Insurance (UI) Surcharge. Employers pay a UI surcharge equal to 0.22 percent of the first $10,000 of wages that they paid to each of their employees during a calendar year. The UI surcharge raises about $50 million a year, of which half is deposited into the UI Fund and the other half is deposited into the Employment Support Fund. Money in the UI Fund is required by federal law to be used only to pay UI benefits.

Summary of Fiscal Impact

The impacts identified by this note are conditional predicated on the occurrence of a diversion of money away from the UI Fund to the EITC Fund. The diversion and the EITC are subject to the trigger described in the summary of legislation section of the note.

This bill provides an EITC of $54.3 million in tax year 2008 and $57.4 million in tax year 2009. The General Fund is backfilled for the reduction in revenue with an appropriation from the federal TANF block grant and with UI surcharge revenue diverted from the UI Fund to the EITC Fund. Whatever amount of the diverted UI surcharge revenue that remains in the balance of the EITC Fund on July 1, 2010, will be transferred back to the UI Fund. The UI Fund balance is expected to be permanently reduced by approximately $13 million. The appropriations from the federal TANF block grants will reduce TANF block grants from the state to counties. County TANF reserves are sufficient to absorb the reductions in FY 2008-09 and FY 2009-10, but will require an annual increase in block grants of approximately $3 million each year thereafter to maintain current levels of spending.

HB08-1362 backfills the General Fund for the entire loss of revenue due to the EITC. While the reduction in income taxes will be accrued over three fiscal years beginning in FY 2007-08, the backfill to the General Fund will not be accrued. Therefore, revenue to the General Fund will be reduced by $27.1 million in FY 2007-08 without any backfill. In addition, the General Fund will receive $27.1 million windfall in FY 2009-10. Based on the March 2008 Legislative Council Staff forecast, this will *reduce* the amount of money available to be transferred to the Highway Users Tax Fund (HUTF) and Capital Construction Fund (CCF) through the mechanism passed in HB 02-1310 by $18.1 million and $9.0 million, respectively, in FY 2007-08. In addition, this bill will *increase* the SB97-1 diversion to the HUTF by $27.1 million in FY 2009-10.

State Revenue

General Fund - Individual Income Tax. This bill provides an EITC of $54.3 million in tax year 2008 and $57.4 million in tax year 2009. On an accrual accounting basis, the EITC will reduce individual income tax to the General Fund by $27.1 million in FY 2007-08, $55.8 million in FY 2008-09, and $28.7 million in FY 2009-10.

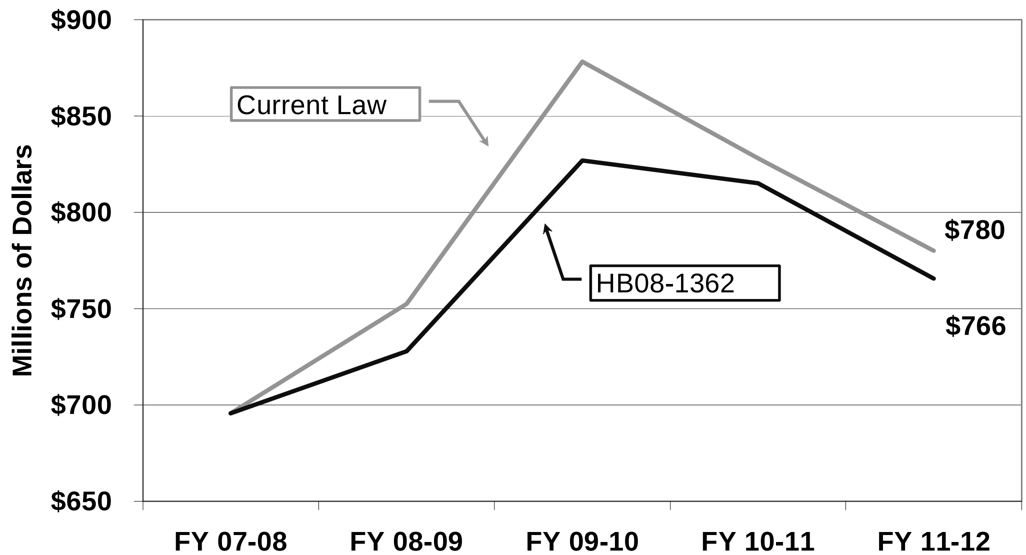
Cash Fund Interest Earnings. Because of the movement of money between the UI Fund and the EITC Fund, the balance of the UI Fund will be reduced and interest earnings to the two funds will be affected. Interest earnings to the UI Fund will decrease $293,000 in FY 2008-09, $1.6 million in FY 2009-10, and $1.3 million in FY 2010-11. Interest earnings to the EITC Fund, which will eventually accrue to the UI Fund when its balance is transferred to that fund on July 1, 2010, will equal $280,000 in FY 2008-09 and $1.2 million in FY 2009-10.

UI taxes are not expected to increase because the bill requires that, for purposes of the UI solvency tax, the balance of the UI Trust Fund be calculated as if the diversion did not occur.

State Transfers or Diversions

Subject to the trigger related to the solvency of the UI Fund described above, HB08-1362 diverts that portion of the UI surcharge that would normally be deposited into the UI Fund to the EITC Fund during FY 2008-09 and FY 2009-10. An estimated $24.2 million will be diverted in FY 2008-09 and $25.1 million in FY 2009-10. The bill transfers an estimated 10 percent of the cost of the EITC from the EITC Fund to the General Fund on June 30, 2009 and June 30, 2010. The bill also requires that the balance of the EITC Fund be transferred back to the UI Fund on July 1, 2010. An estimated $39.6 million will be returned to the UI Fund at that time. The balance of the UI Fund will ultimately be permanently reduced by approximately $13 million plus normal growth each year. Figure 1 shows the impact of HB08-1362 on the balance of the UI Fund.

Figure 1. Unemployment Insurance Fund Year-End Balance



State Expenditures

General Fund - Department of Revenue - $99,080 and 1.0 FTE in FY 2008-09. Table 1 summarizes the costs to the Department of Revenue. Because HB08-1362 requires the Department to track the credit, the Cash and Document Processing Division will experience an increased workload to data capture the information on the income tax return about the EITC. Based on an estimated 262,482 tax returns that will qualify for the state EITC, data entry and problem resolution costs are expected to be $44,652, and require 0.6 FTE for tax year 2008 and 2009.

The Department will also incur costs in the Taxpayer Services Division to verify the eligibility of claimants to receive funding from the federal TANF block grant. The Department will match the driver license or state ID number of taxpayers claiming the credit to the Driver License System File. The Department estimates that 9 percent of these tax returns will require a tax examiner's inspection. Therefore, the Department requires $51,713 and 1.3 FTE for tax year 2008 and 2009. Programming costs to put a new line on the 2008 tax return will require a one-time cost of $47,991. This amount is contained in the FY 2008-09 Long Bill for programming costs in the Department of Revenue for 2008 legislation.

Table 1. Department of Revenue Expenditures

General Fund Costs	FY 2008-09	FY 2009-10	FY 2010-11
Cash and Document Processing	$20,827	$44,652	$20,827
FTE	0.3	0.6	0.3
Taxpayer Services	$25,857	$51,713	$28,957
FTE	0.7	1.3	0.7
Capital Outlay and Operating for FTE	$4,405	$1,805	$950
Income Tax System Programming*	$47,991	$0	$0
TOTAL General Fund	**$99,080**	**$98,170**	**$50,734**
TOTAL FTE	**1.0**	**1.9**	**1.0**

* *This amount is contained in the FY 2008-09 Long Bill for programming costs in the Department of Revenue for 2008 legislation.*

Federal Funds - TANF Block Grant - Net $0 in FY 2008-09. HB08-1362 requires that 90 percent of the cost of the EITC be paid for with money from the federal TANF block grant. In order to appropriate $48.8 million to the General Fund to for the EITC, the state will reduce the amount of block grants to counties by $48.8 million in FY 2008-09. In addition, county block grants will be reduced by $51.7 million in order to spend that amount on the EITC in FY 2009-10. While no federal TANF dollars will be appropriated to the EITC in FY 2010-11, county reserves will have been reduced sufficiently by then that the state will need to increase its county block grants by a total of approximately $3 million that year and each year thereafter to prevent some county reserves from going negative.

The Colorado Long-Term Works Reserve, which is the state reserve for programs funded by the federal TANF block grant, is expected to be approximately $10 million a year under current law. It is expected to be largely unaffected by HB08-1362.

Local Government Impact

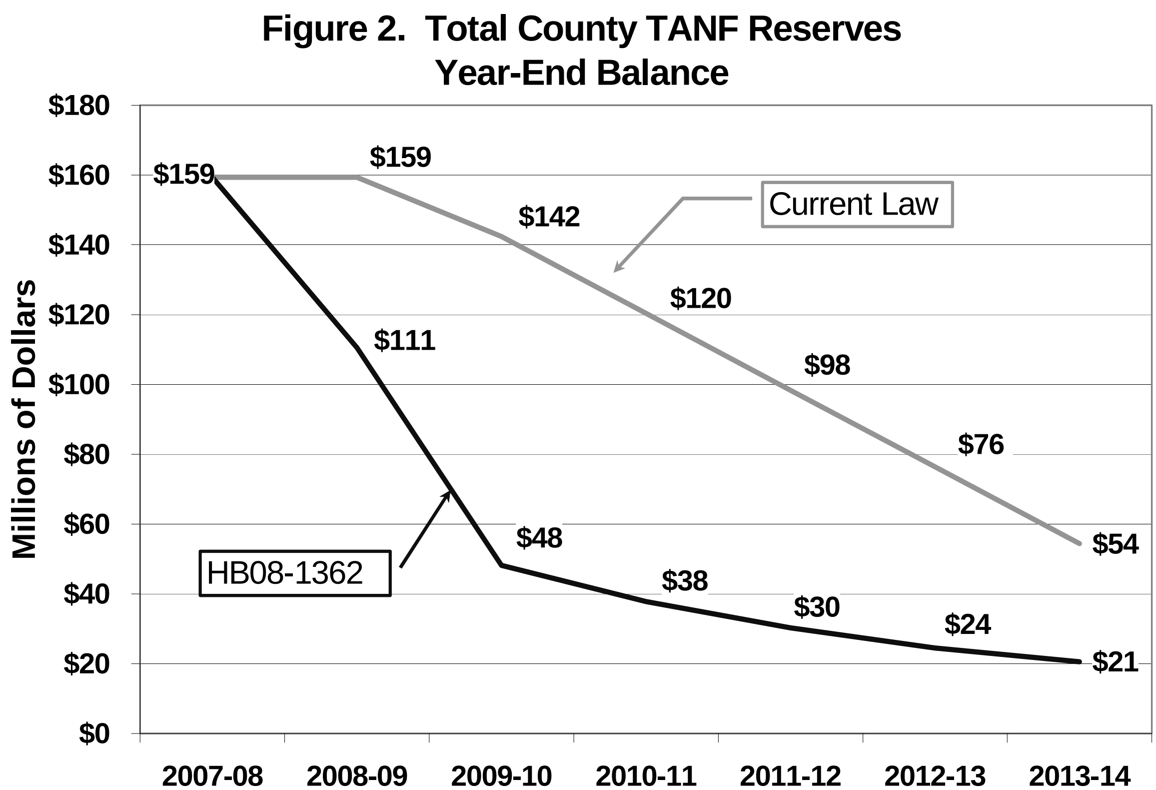
County TANF Block Grants and Reserves. HB08-1362 requires 90 percent of the EITC be paid for with money from the federal TANF block grant. The total TANF block grant is expected to be $139.5 million in FY 2008-09 and $136.1 million in FY 2009-10. Block grants from the state to counties constitute by far the largest expenditure the state makes from its federal block grant; this is the line item that will be reduced in order to provide funding for the EITC in FY 2008-09 and FY 2009-10.

Table 2 shows the impact that HB08-1362 is expected to have on county block grants. HB08-1362 is expected to reduce the state's block grants to counties from federal funds by $48.8 million in FY 2008-09 and $51.7 million in FY 2009-10. County reserves are expected to be sufficient to absorb these reductions during FY 2008-09 and FY 2009-10. However, by FY 2011-12, they will require an annual increase in block grants over current law levels of between $2.7 million to $3 million to prevent some county reserves from going into deficit.

Figure 2 shows the impact on total county TANF reserves. County TANF reserves are decreasing under current law because it is assumed that they will continue to spend at the same levels they are spending in 2008, even with a scheduled reduction in the federal TANF block grant. Likewise, this analysis assumes that counties will continue to spend at 2008 levels regardless of the reduction in the grants they receive from the state as a result of HB08-1362.

Table 2.
Impact on Block Grants to Counties from Federal TANF Monies

	Current Law	HB08-1362	Difference
FY 2008-09	$131.3 Million	$80.5 Million	($48.8 Million)
FY 2009-10	$114.3 Million	$62.6 Million	($51.7 Million)
FY 2010-11	$109.1 Million	$111.9 Million	$2.7 Million
FY 2011-12	$109.1 Million	$111.9 Million	$2.8 Million



State Appropriations

Department of Revenue. This fiscal note indicates that a $51,089 appropriation and 1.0 FTE should be made from the General Fund to Department of Revenue. In addition, $48,837,000 should be appropriated from the federal TANF block grant to the reserve in the General Fund created in section 39-22-622 (1), C.R.S.

Department of Human Services. HB08-1362 reduces the appropriation from the federal TANF block grant to the county block grant program by a total of $48,837,000 in FY 2008-09.

Departments Contacted

Human Services	Revenue	Treasury
Labor and Employment	Legislative Council Staff	