SB15-001

Colorado Legislative Council Staff Fiscal Note

STATE
REVISED FISCAL IMPACT

(replaces fiscal note dated April 1, 2015)

Drafting Number:	LLS 15-0692	**Date:**	May 4, 2015
Prime Sponsor(s):	Sen. Cadman	**Bill Status:**	Senate Appropriations
		Fiscal Analyst:	Natalie Mullis (303-866-4778)

BILL TOPIC: EXCESS STATE REVENUES REFUND MECHANISM

Fiscal Impact Summary*	FY 2015-2016	FY 2016-2017
State Revenue	**($116.8 million)**	**($434.9 million)**
Revenue Change		
General Fund	($116.8 million)	($434.9 million)
State Transfers		
General Fund	($125.3 million)	($262.5 million)
Capital Construction Fund	$25.1 million	$52.5 million
Highway Users Tax Fund	$100.2 million	$210.0 million
State Expenditures		
General Fund	$16,960	
FTE Position Change		
TABOR Set-Aside	**($116.8 million)**	**($434.9 million)**
Appropriation Required: $16,960 - Department of Revenue (FY 2015-16).		

* *This summary shows changes from current law under the bill for each fiscal year. Transfers result in no net change to state revenue. Parentheses indicate a decrease in funds.* ***The fiscal impact is sensitive to the accuracy of each September Legislative Council Staff forecast for revenue in excess of the TABOR limit.*** *This impact assumes the March 2015 forecast and is accurate if each September forecast predicts a TABOR surplus equal to or larger than the actual surplus. If the September forecast predicts a lower TABOR surplus than actually occurs, the impact on state transfers and the earned income tax credit may differ from what is shown here.*

Summary of Legislation

As amended by the ***Senate Finance Committee***, this bill creates a sales tax rebate and changes how money in excess of the state's constitutional revenue limit (TABOR limit) is refunded. Each of these is described below.

Sales tax rebate. SB15-001 creates a sales tax rebate equal to anticipated revenue in excess of the TABOR limit each year beginning in FY 2015-16. The rebate would be administered identically to the three-tier sales tax refund created by this bill. It would be provided to taxpayers simultaneous with any sales tax refund of excess revenue collected during the prior year and is based on the Legislative Council Staff (LCS) economic and revenue forecast published during September of the fiscal year in which the excess revenue is expected to be collected. Although the rebate is provided to taxpayers using the income tax return, the bill specifies that the rebate is a partial repayment of state sales taxes paid on transactions occurring during the first half and a partial payment in advance of state sales taxes anticipated during the second half of the fiscal year during which the rebate is made.

For example, the amount by which state revenue collected in FY 2015-16 is expected to exceed the TABOR limit in the September 2015 LCS forecast will be rebated on income tax returns filed for tax year 2015 along with any sales tax refund for excess revenue collected in FY 2014-15. The rebate thus reduces revenue subject to the TABOR limit during FY 2015-16.

TABOR refund mechanisms. SB15-001 changes how money in excess of the state's constitutional revenue limit (TABOR limit) is refunded. It repeals the temporary income tax rate reduction and replaces the six-tier sales tax refund mechanism with a three-tier sales tax refund mechanism. The earned income tax credit refund mechanism is not affected. The bill does not change the administration of the sales tax refund; however, it changes the distribution of the refund. Under current law, the sales tax refund is required to be distributed among six tiers of taxpayers as it was distributed during tax year 1999. Each individual taxpayer within each of the six tiers receives the same refund amount. The bill specifies the following distribution based on adjusted gross income (AGI) for refunds that occur in tax year 2015 and requires each threshold in the distribution to be indexed to the Denver-Boulder-Greeley consumer price index in future years:

Tier 1: AGI up to $36,600;
Tier 2: AGI more than $36,600 and up to $117,100; and
Tier 3: AGI more than $117,100.

Under the bill, the sales tax refund is equal to a certain percentage of income. The Department of Revenue is required to calculate this percentage each year such that the estimated refund is equal to the amount required by TABOR to be refunded. Taxpayers with an AGI of up to $36,600 each receive an identical refund equal to that percentage times $36,600. Taxpayers with an AGI of more than $117,100 each receive an identical refund equal to that percentage times $117,100. Taxpayers in the middle income tier receive refunds equal to their individual AGI times that percentage. Taxpayers filing joint returns receive twice the amount refunded to taxpayers filing single returns. The Executive Committee of the Legislative Council is required to approve this percentage of income each year.

Background

TABOR requires revenue collected above the Referendum C Cap to be refunded to taxpayers during the fiscal year immediately after it is collected. Current law contains three mechanisms to refund this money: the six-tier sales tax refund, the earned income tax credit, and a temporary cut in the income tax rate from 4.63 percent to 4.50 percent. The size of the TABOR refund determines which refund mechanisms are available each year.

This *six-tier sales tax refund* allows taxpayers to receive a state sales tax refund based on where their adjusted gross income falls among six adjusted gross income tiers. State law requires the Department of Revenue to distribute the money among the six tiers as it was distributed for the tax year 1999 sales tax refund. The refund is distributed to the six tiers when the amount to be refunded using this mechanism is large enough to support at least a $15 refund for each Colorado income taxpayer. If the average refund is less than $15 per taxpayer, an equal refund is provided to each taxpayer, regardless of income. The six-tier sales tax refund mechanism can be viewed as both the first and the last refund mechanism. It may be the first and only refund triggered in a year when the TABOR refund obligation is not sufficient to trigger other mechanisms. In years when the refund obligation is large enough to trigger other refund mechanisms, the sales tax refund distributes any revenue beyond what is refunded by the other mechanisms.

The Colorado *earned income tax credit* (EITC) is based on the federal EITC, which provides a tax credit to individuals who work but do not earn high incomes. Qualifying Colorado taxpayers who claim the federal credit may receive up to 10 percent of that amount from the state. The EITC refund mechanism is triggered when the TABOR refund obligation exceeds a threshold amount that increases each year by growth in Colorado personal income. In FY 2014-15, if the amount required to be refunded exceeds $97.7 million, the EITC will be triggered. State law converts the EITC to a permanent tax credit the year following the first year the EITC refund mechanism is triggered.

The *income tax rate cut* refund mechanism temporarily reduces the state income tax rate from 4.63 percent to 4.50 percent. The tax rate reduction is triggered when the state experiences a refund obligation equal to at least the EITC refund mechanism trigger plus the projected amount of the income tax rate reduction. Once the EITC becomes permanent, the temporary income tax rate reduction is triggered when the TABOR refund obligation reaches the projected amount of the income tax rate reduction.

State Revenue

SB15-001 will reduce General Fund revenue by **$116.8 million in FY 2015-16 and $434.9 million in FY 2016-17**, as shown in Table 1. These amounts are equal to expectations for revenue in excess of the TABOR limit in the March 2015 LCS economic and revenue forecast.

The fiscal impact is sensitive to the accuracy of each September Legislative Council Staff forecast for revenue in excess of the TABOR limit. The implications of these are as follows:

- If the September forecast for any particular year is equal to or larger than the actual surplus, SB09-228 transfers to the Capital Construction Fund and the Highway Users Tax Fund will occur in full, the conservation easement tax credit will not be refundable, and the earned income tax credit will not be used as a refund mechanism. Figures presented in this note assume this scenario.

- If the September forecast predicts a lower TABOR surplus than actually occurs, a TABOR surplus will be collected and refunded in the following year along with that year's sales tax rebate. If the TABOR surplus exceeds 1 percent (3 percent) of General Fund revenue, SB09-228 transfers will be halved (eliminated). If the surplus exceeds the amount required by law to use the earned income tax credit as a refund mechanism, the earned income tax will become permanent in the following year.

Table 1. General Fund Revenue Impact of SB15-001 by Tax Policy

Tax Policy	FY 2015-16	FY 2016-17
Sales Tax Rebate	($122.1 million)	($491.2 million)
Earned Income Tax Credit		$45.3 million
Conservation Easement Tax Credit	$5.3 million	$8.8 million
Total	($116.8 million)	($434.9 million)

Totals may not sum due to rounding.

Sales Tax Rebate. The bill directs the Department of Revenue to rebate expectations for revenue in excess of the TABOR limit published in the September LCS revenue forecast along with the sales tax refund for revenue collected above the limit in the prior fiscal year. Based on the March 2015 LCS forecast, the rebate would reduce sales tax revenue by $122.1 million in FY 2015-16 and $491.2 million in FY 2016-17. These figures exceed current expectations for a TABOR surplus because they include anticipated positive revenue impacts resulting from the conservation easement tax credit and the earned income tax credit.

Earned income tax credit. The EITC first becomes available in the tax year following the fiscal year when the amount of the state TABOR surplus is large enough to absorb its cost. After it is used as a TABOR refund mechanism, the EITC becomes a permanent tax credit available to qualifying taxpayers in all subsequent tax years. Under current law, the EITC is expected to be used as a TABOR refund mechanism in tax year 2016, and to be available as a permanent tax credit beginning in tax year 2017. If excess revenues collected in FY 2015-16 fall below the threshold to trigger the EITC as a refund mechanism, this schedule would be interrupted and the EITC would no longer be available as a permanent tax credit in tax year 2017. This results in a $45.3 million increase in state revenue in FY 2016-17 relative to current law, reflecting half of the impact of the EITC in tax year 2017.

Conservation Easement Tax Credit. Under current law, part of the gross conservation easement income tax credit becomes refundable during tax years following fiscal years for which the state incurs a TABOR surplus. Taxpayers claiming a conservation easement credit, or carrying forward credit from prior tax years, receive up to $50,000 as a refundable credit in tax years following fiscal years for which the state incurs a TABOR surplus. Under current law, the state is expected to incur a TABOR surplus beginning FY 2014-15, and the tax credit is expected to become refundable in tax years 2015 through at least 2017. Under the bill, state revenue subject to TABOR is expected to be eliminated beginning in FY 2015-16. The revenue estimate assumes a half-year impact for tax year 2016 and a full year impact for tax year 2017 on an accrual accounting basis.

State transfers. General Fund transfers to the Highway Users Tax Fund (HUTF) and the Capital Construction Fund (CCF) will increase by $100.2 million and $25.1 million, respectively, in FY 2014-15 and $210.0 million and $52.5 million, respectively, in FY 2016-17. Senate Bill 09-228 requires transfers equal to 2.0 percent and 0.5 percent of General Fund revenue to the HUTF and the CCF, respectively; however, transfers may be reduced or eliminated depending on the size of the state TABOR surplus expressed as a share of General Fund revenue. Under current law, transfers are expected to be halved in FY 2015-16 and eliminated during FY 2016-17. Under the bill full transfers are expected to occur because the rebate is assumed to eliminate the TABOR surplus during FYs 2015-16 and 2016-17.

TABOR and Taxpayer Impact

Table 2 shows the projected impact of the bill on the mechanisms used to refund money collected in excess of the TABOR limit, while Tables 3 and 4 on pages 6 and 7 show the average taxpayer impact for full-time resident single and joint income tax filers, respectively, based on the March 2015 Legislative Council Staff forecast. The rebate will reduce revenue during the year the anticipated surplus would have otherwise been collected. If the rebate does not reduce revenue by enough to eliminate a TABOR surplus, the surplus will be refunded the year after it is collected.

It is important to note that a very small error in the forecast for revenue subject to TABOR can result in large changes in the forecast for the TABOR refund obligation. Since money collected in excess of the TABOR limit represents the last dollar collected by the state, the TABOR refund obligation will increase (or decrease) by a dollar for every dollar collected above (or below) the amount expected in the forecast. Therefore, the actual impact on TABOR refunds and the average taxpayer could differ significantly from that described here. Please see the state revenue section for a more complete explanation.

Refunds made during FYs 2015-16 and FY 2016-17 (tax years 2016 and 2017) are assumed to be replaced with a prospective sales tax rebate in tax years 2015 and 2016. In tax year 2015, a total of $191.8 million will be provided to taxpayers, of which $69.7 million will be refunded via the three-tier sales tax refund and $122.1 million provided as a three-tier sales tax rebate. In tax year 2016, the bill provides a $491.2 million three-tier sales tax rebate.

Repealing the temporary income tax rate cut and replacing the current law sales tax refund with the three-tier refund in this bill shifts the distribution of the refund such that lower income tiers will receive a larger share and higher income tiers will receive a lower share of the overall TABOR refund than under current law.

The repeal of the temporary income tax rate cut will affect all individual and corporate income taxpayers. Corporate income taxpayers will no longer receive an estimated $23.0 million in TABOR refunds during tax year 2017. Nonresident individual income taxpayers will no longer receive an estimated $24.4 million; only full-time resident individual income taxpayers are eligible for the sales tax refund. Because state income taxes are deductible at the federal level, all taxpayers will receive a partial offset on their federal tax bill.

Table 2. Impact of SB15-001 on Current Refund Mechanisms
Millions of Dollars

	FY 2014-15 Surplus FY 2015-16 Refund Tax Year 2015	**FY 2015-16 Surplus FY 2016-17 Refund Tax Year 2016**	**FY 2016-17 Surplus FY 2017-18 Refund Tax Year 2107**
Current Law			
Revenue above the TABOR limit	$66.1 million	$116.8 million	$434.9 million
Earned Income Tax Credit		$91.1 million	permanent*
Income Tax Rate Reduction			$226.6 million
Six-Tier Sales Tax Refund	$69.7 million**	$25.7 million	$208.3 million
Senate Bill 15-001			
Revenue above the TABOR limit	$66.1 million	$0	$0
Earned Income Tax Credit		$0	$0
Income Tax Rate Reduction	repealed	repealed	repealed
Three-Tier Sales Tax Refund	$69.7 million**	$0	$0
Change from Current Law			
Revenue above the TABOR limit	$0.0	($116.8 million)	($434.9 million)
Earned Income Tax Credit	$0.0	($91.1 million)	$0.0
Income Tax Rate Reduction	$0.0	$0.0	($226.6 million)
Sales Tax Refund	$0.0	($25.7 million)	($208.3 million
Total Change from Current Law	$0.0	($116.8 million)	($434.9 million)

Source: Legislative Council Staff Forecast, March 2015.
* *The EITC becomes permanent beginning in the first tax year following the tax year when it is used as a TABOR refund mechanism. Under current law, the EITC is expected to become permanent beginning in tax year 2017.*
** *$3.6 million is added to the sales tax refund in FY 2014-15 to correct for previous under-refunds.*

Table 3. Sales Tax Rebates and TABOR Refunds to Full-Time Resident Individual Income Taxpayers: Single Filers Only
March 2015 Legislative Council Staff Forecast

Current Law — Single Filers				SB15-001 — Single Filers	
Estimated Adjusted Gross Income Tiers	**Six-Tier Sales Tax**	**Income Tax Rate Cut**	**Total**	**Estimated Adjusted Gross Income Tiers**	**Three-Tier Sales Tax**
Single Filers: FY 2014-15 Surplus and Rebate for FY 2015-16, Tax Year 2015 — Single Filers					
Sales Tax Refund: $69.7 million				Sales Tax Refund: $69.7 million Sales Tax Rebate: $122.1 million Total: $191.8 million	
Tier 1: up to $36,500	15	Not Available	**15**	Tier 1: up to $36,600	**33**
Tier 2: $36,500 to $78,500	20		**20**	Tier 2: $36,600 to $117,100	**59**
Tier 3: $78,500 to $114,100	23		**23**		
Tier 4: $114,100 to $148,200	27		**27**	Tier 3: $117,100 and up	**103**
Tier 5: $148,200 to $181,100	29		**29**		
Tier 6: $181,100 and up	47		**47**		
FY 2015-16 Surplus and Rebate for FY 2016-17, Tax Year 2016 — Single Filers					
Sales Tax Refund: $25.7 million EITC: $91.1 million /a				Sales Tax Rebate: $491.2 million Sales Tax Refund: $0; EITC: $0 c/	
Tier 1: up to $37,500	8	Not Available	**8**	Tier 1: up to $37,600	**81**
Tier 2: $37,500 to $80,700	8		**8**	Tier 2: $37,600 to $120,400	**150**
Tier 3: $80,700 to $117,300	8		**8**		
Tier 4: $117,300 to $152,300	8		**8**	Tier 3: $120,400 and up	**258**
Tier 5: $152,300 to $186,100	8		**8**		
Tier 6: $186,100 and up	8		**8**		
FY 2016-17 Surplus and Rebate for FY 2017-18, Tax Year 2017 — Single Filers					
Sales Tax Refund: $208.3 million Income Tax Rate Cut: $226.6 million /b				Sales Tax Rebate: unknown Sales Tax Refund: $0; EITC: $0 c/	
Tier 1: up to $38,400	43	9	**52**	Tier 1: up to $38,500	**unknown**
Tier 2: $38,400 to $82,600	57	51	**108**	Tier 2: $38,500 to $123,200	**unknown**
Tier 3: $82,600 to $120,100	66	99	**165**		
Tier 4: $120,100 to $155,900	78	152	**230**	Tier 3: $123,200 and up	**unknown**
Tier 5: $155,900 to $190,600	84	198	**282**		
Tier 6: $190,600 and up	134	548	**682**		

/a Under current law, an estimated 377,200 households in tiers 1 and 2 will receive an average EITC of $240 in tax year 2016. Pursuant to state law, the credit is expected to become permanent in tax year 2017. This means the credit will be available but will not be used to refund money above the TABOR limit.

/b Under current law, the temporary income tax rate cut refund mechanism is expected to refund a total of $179.2 million to full-time resident households, $24.4 million to nonresident households, and $23.0 million to corporations in tax year 2017.

/c A sales tax refund or EITC will occur to the extent that the estimate used to determine the sales tax rebate is below actual revenue. If the estimate is below actual revenue by at least an amount equal to the threshold trigger on the EITC, an EITC refund mechanism will occur.

Table 4. Sales Tax Rebates and TABOR Refunds to Full-Time Resident Individual Income Taxpayers: Joint Filers Only
March 2015 Legislative Council Staff Forecast

Current Law — Joint Filers				SB15-001 — Joint Filers	
Estimated Adjusted Gross Income Tiers	**Six-Tier Sales Tax**	**Income Tax Rate Cut**	**Total**	**Estimated Adjusted Gross Income Tiers**	**Three-Tier Sales Tax**
Single Filers: FY 2014-15 Surplus and Rebate for FY 2015-16, Tax Year 2015 — Joint Filers					
Sales Tax Refund: $69.7 million				Sales Tax Refund: $69.7 million Sales Tax Rebate: $122.1 million Total: $191.8 million	
Tier 1: up to $29,700	30	Not Available	**30**	Tier 1: up to $36,600	**66**
Tier 2: $29,700 to $73,100	40		**40**	Tier 2: $36,600 to $117,100	**118**
Tier 3: $73,100 to $116,000	46		**46**		
Tier 4: $116,000 to $156,400	54		**54**	Tier 3: $117,100 and up	**206**
Tier 5: $156,400 to $194,300	58		**58**		
Tier 6: $194,300 and up	94		**94**		
FY 2015-16 Surplus and Rebate for FY 2016-17, Tax Year 2016 — Joint Filers					
Sales Tax Refund: $25.7 million EITC: $91.1 million /a				Sales Tax Rebate: $491.2 million Sales Tax Refund: $0; EITC: $0 c/	
Tier 1: up to $30,600	16	Not Available	**16**	Tier 1: up to $37,600	**162**
Tier 2: $30,600 to $75,100	16		**16**	Tier 2: $37,600 to $120,400	**300**
Tier 3: $75,100 to $119,200	16		**16**		
Tier 4: $119,200 to $160,800	16		**16**	Tier 3: $120,400 and up	**516**
Tier 5: $160,800 to $199,700	16		**16**		
Tier 6: $199,700 and up	16		**16**		
FY 2016-17 Surplus and Rebate for FY 2017-18, Tax Year 2017 — Joint Filers					
Sales Tax Refund: $208.3 million Income Tax Rate Cut: $226.6 million /b				Sales Tax Rebate: *unknown* Sales Tax Refund: $0; EITC: $0 c/	
Tier 1: up to $31,600	86	1	**87**	Tier 1: up to $38,500	**unknown**
Tier 2: $31,600 to $76,900	114	27	**141**	Tier 2: $38,500 to $123,200	**unknown**
Tier 3: $76,900 to $122,100	132	84	**216**		
Tier 4: $122,100 to $164,600	156	142	**296**	Tier 3: $123,200 and up	**unknown**
Tier 5: $164,600 to $204,400	168	197	**365**		
Tier 6: $204,400 and up	268	568	**836**		

/a Under current law, an estimated 377,200 households in tiers 1 and 2 will receive an average EITC of $240 in tax year 2016. Pursuant to state law, the credit is expected to become permanent in tax year 2017. This means the credit will be available but will not be used to refund money above the TABOR limit.

/b Under current law, the temporary income tax rate cut refund mechanism is expected to refund a total of $179.2 million to full-time resident households, $24.4 million to nonresident households, and $23.0 million to corporations in tax year 2017.

/c A sales tax refund or EITC will occur to the extent that the estimate used to determine the sales tax rebate is below actual revenue. If the estimate is below actual revenue by at least an amount equal to the threshold trigger on the EITC, an EITC refund mechanism will occur.

State Expenditures

One-time General Fund expenditures for the Department of Revenue (DOR) will increase by $16,960 in FY 2015-16 to add a line to the income tax form for the rebate. The line on the income tax form is the least expensive way for the state to track the rebate separately from the refund. Beyond this one-time cost, the Department of Revenue can implement the bill within existing resources.

Effective Date

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

State Appropriations

For FY 2015-16, this bill will require a $16,960 General Fund appropriation to the Department of Revenue for one-time programming costs.

State and Local Government Contacts

Revenue	Human Services
Corrections	Personnel and Administration
Law	Office of State Planning and Budgeting
Counties	