HB06S-1015

Colorado Legislative Council Staff

STATE FISCAL IMPACT

Drafting Number:	LS 06B-2081	**Date:**	July 6, 2006
Prime Sponsor(s):	Rep. A. Kerr Sen. Keller	**Bill Status:**	House Business Affairs & Labor
		Fiscal Analyst:	Ron Kirk (303-866-4785)

TITLE: CONCERNING A REQUIREMENT THAT A PERSON WITHHOLD COLORADO INCOME TAX FROM A PAYMENT TO A PERSON OTHER THAN AN EMPLOYEE FOR SERVICES PERFORMED.

Fiscal Impact Summary	FY 2006/07	FY 2007/08
State Revenues General Fund	Potential Increase	Potential Increase
State Expenditures General Fund		
FT Position Change	0.0 FTE	0.0 FTE
Effective Date: January 1, 2007		
Appropriation Summary for FY 2006/07: None Required		
Local Government Impact: None		

Summary of Legislation

For federal income tax purposes, federal law requires a trade or business that pays at least $600 in miscellaneous income to non-employees in the course of their business (such as for services) to report the income on Form 1099-MISC. For income tax years beginning January 1, 2007, this bill requires a trade or business that pays a non-employee for services and reports that payment on the Form 1099-MISC to deduct and withhold state income tax at the rate of 4.63 percent if the person performing the services fails to provide a correct taxpayer identification number (TIN) *or* provides an Internal Revenue Service (IRS) -issued TIN for nonresident aliens.

Background. Individuals who file federal income tax returns and other tax-related documents are required to provide the Internal Revenue Service with a TIN. There are different types of TIN's but the most commonly used is the Social Security Number (SSN). Individuals who are not U.S. citizens (aliens) and ineligible to obtain a SSN, must use the Federal Form W-7 to apply for an individual taxpayer identification number (ITIN).

For tax purposes, this IRS assignable ITIN is available to resident and non-resident aliens, an alien's spouse claimed as an exemption, or an alien individual eligible to be claimed as a dependent. Generally, a resident alien of the United States for tax purposes must either meet the green card test or the substantial presence test. The green card test is satisfied whenever the individual is a lawful permanent resident of the United States at any time during the calendar year. Generally, the substantial presence test is met if the individual is physically present in the United States for at least 31 days during the current year and 183 days during the 3-year period that includes the current year and 2 years immediately before. A nonresident alien (not a U.S. citizen) for tax purposes is an individual that meets neither test for a resident alien.

Whenever the IRS issues an ITIN, it is only used for income tax purposes and does not entitle the person to collect Social Security benefits or be allowed the earned income tax credit refund.

Taxpayers can file federal tax returns without TIN's but the IRS will assess a $50 penalty for each document filed that does not include an identification number. The penalty also applies to individuals who fail to provide a TIN to another person for reporting purposes. In addition to penalties, the IRS may withhold any refunds due to taxpayers until a TIN is received.

For certain income, such as the income reported on the federal Form 1099-MISC, brokers and contractors are required to withhold 28 percent of any reportable income paid to payees who fail to furnish his or her TIN. Backup withholdings are also required whenever the IRS notifies a payer (broker or contractor) that an individual has submitted an incorrect TIN.

The Colorado Department of Revenue processes state income tax returns with and without TIN's. If a tax return does not have a TIN, the department performs an employer-verification check to determine if the individual provided a TIN to the employer. If a TIN is not provided, the department assigns a nine-digit TIN, but similar to the IRS, will not issue a tax refund.

State Revenues

Under the bill, a trade or business that reports income paid to an non-employee for services on the federal Form 1099-MISC is required to withhold state income taxes if the person performing the services fails to provide a correct TIN *or* provides an Internal Revenue Service (IRS) -issued TIN for nonresident aliens. This bill would likely increase state General Fund revenue. But, the increase cannot be estimated.

State revenue would increase by an undeterminable amount from a trade or business that is required to withhold state income taxes under this bill. The money withheld would be remitted to the state as income tax revenue and increase General Fund money correspondingly. Under current policies, it is likely that the state would incur a net revenue gain because state withholdings would not be subject to state tax refunds.

Several factors make it difficult to quantify the increase in state revenue. First, it is impossible to determine the number of trades or businesses that would make payments to non-employees for services that will be *able to determine* whether the non-employee providing the service is using a correct TIN unless a person paying for the services is notified by the IRS that the payee submitted an incorrect TIN. It is unknown whether a trade or business has the means to verify a TIN with the IRS and would likely need access to a database of TIN's to verify the existence and correctness of the numbers.

Second, it is impossible to estimate the "dollar value" of the services provided by persons using fictitious TIN's. If both of these variables were known, it would be possible to calculate the gross income that would be subject to state tax withholdings and thus, determine the state revenue increase.

State Expenditures

Thus far, no state expenditures have been identified by the Department of Revenue. However, the department has identified that there are no enforcement requirements in the bill and assumes there will be no audit program associated with the bill. The requirements in the bill could also result in additional wage withholding account and return activity. The department would absorb this cost for setting up accounts and processing returns. It is unclear if any additional expenditures would be necessary to implement the measure. Additional information will be provided in revised fiscal notes as it becomes available.

State Appropriations

The fiscal note implies that no appropriation for FY 2006-07 is necessary to implement the bill. However, it should be noted that some executive departments could need increased appropriations in FY 2007-08 in order to enforce the bill. Staff is attempting to acquire this information and will provide a revised fiscal note when it becomes available.

Departments Contacted

Labor and Employment Personnel and Administration Revenue