2nd Draft

Proposition 101
Income, Vehicle, and Telecommunications Taxes and Fees

Proposition 101 proposes amending the <u>Colorado statutes</u> to:

- ♦ reduce the state income tax rate from 4.63 percent to 4.5 percent in 2011, and to 3.5 percent gradually over time;
- ♦ reduce or eliminate taxes and fees on vehicle purchases, registrations, leases, and rentals over the next four years;
- ♦ eliminate all state and local taxes and fees on telecommunication services, except 911 fees; and
- ♦ require voter approval to create or increase fees on vehicles and telecommunication services.

Summary and Analysis

Proposition 101 reduces or eliminates various taxes and fees on income, vehicles, and telecommunication services. Table 1 shows the annual impact of Proposition 101 on three different households, Table 2 shows the impact on three different businesses, and Table 3 shows the impact on government budgets.

The figures in Tables 1 through 3 show the impact as if Proposition 101 were fully implemented in 2011. Because some of the reductions are phased in over time, the full impact shown will not occur immediately. The impact will be smaller in the first year and will grow in size over the next 15 to 20 years. Although the dollar amounts will differ in the future as inflation and growth increase the size of the economy, the comparable budget impacts on taxpayers and governments are expected to remain the same.

Impact on households and businesses. Tables 1 and 2 show the estimated amount of additional money three different households and businesses will save as a result of the tax and fee reductions in Proposition 101. Households and businesses will be impacted differently depending on annual income, vehicles owned, vehicles purchased, and amount paid for phone and cable service.

Table 1. Annual Change in Representative Households' Tax and Fee Bills As a Result of Proposition 101, When Fully Implemented /a

(In Today's Dollars)

	Income Taxes	Vehicle Fees & Taxes	Telecommunication Fees & Taxes	Total	% of Household Income
Household A	*Household Description:* Annual Income: $35,000; owns a 10-year-old car worth $3,500; $60 monthly phone bill.				
	-$185	-$61	-$43	-$289	-0.8%
Household B	*Household Description:* Annual Income: $55,000; owns a 5-year-old car worth $7,000 and a 5-year-old car worth $10,000; $130 monthly combined phone bills.				
	-$320	-$191	-$93	-$604	-1.1%
Household C	*Household Description:* Annual Income: $110,000; bought a new car worth $20,000 and owns a 3-year-old car worth $15,000; $180 monthly combined phone bills.				
	-$780	-$1,335	-$128	-$2,243	-2.0%

/a This analysis assumes an 7.0 percent combined state and local sales tax rate.

Table 2. Annual Change in Representative Businesses' Tax and Fee Bills As a Result of Proposition 101, When Fully Implemented /a

(In Today's Dollars)

	Income Taxes	Vehicle Fees & Taxes	Telecommunication Fees & Taxes	Total	% of Business Income
Business A	*Business Description:* Annual Revenue: $X owns X company vehicles worth $X; $XX monthly phone bill.				
	$X	$X	$X	$X	X%
Business B	*Business Description:* Annual Revenue: $X owns X company vehicles worth $X; $XX monthly phone bill.				
	$X	$X	$X	$X	X%
Business C	*Business Description:* Annual Revenue: $X bought X new cars worth $X and owns X company vehicles worth $X; $XX monthly phone bill.				
	$X	$X	$X	$X	-X%

/a This analysis assumes an 7.0 percent combined state and local sales tax rate.

Impact on government budgets. Table 3 shows the estimated impact of Proposition 101 on tax and fee collections used for local government budgets, the state's general operating budget, and transportation budgets once it is fully implemented. More information on the impact on each type of budget follows. Except for school districts, which will be reimbursed by the state for their loss of specific ownership taxes, the decrease in tax and fee collections will cause the state and local governments to decrease spending, increase fees to pay for services, or do some combination of both.

Table 3. Annual Change in Government Tax and Fee Collections As a Result of Proposition 101, When Fully Implemented

Government Budget	Current Law	Prop 101	Change*	Percent Change
Local Governments Vehicle Specific Ownership Taxes and Sales Taxes	$3.9 billion	$2.9 billion	-$936 million	-24.2%
State Government General Operating Budget Sales Taxes, Income Taxes, and Telecommunication Fees	$7.2 billion	$5.5 billion	-$1.6 billion	-22.6%
City, County, and State Government Transportation Budgets Vehicle Registration Fees and State Rental Fee	$392 million	$50 million	-$342 million	-87.2%

** Totals may not sum due to rounding.*

Impact on local government budgets. Local governments will collect less money from vehicle specific ownership taxes and sales taxes. Local governments affected by the measure include school districts, cities, counties, and special districts such as recreation, fire, water, sewer, and public transportation districts. The money collected in taxes and fees pays for different services depending on the local government. Most of the money is used for education, public safety, roads, trash service, and parks and recreation. State law requires that school districts be reimbursed by the state for their loss in tax collections.

Impact on the state government operating budget. The state government will collect less money from sales taxes, income taxes, and telecommunication fees. The state spends 96 percent of its general operating budget on: preschool through higher education; health care; prisons; the courts; and programs that help low-income, elderly, and disabled people. Once Proposition 101 is fully phased in, the amount of money available to pay for the state's general operating budget will be reduced by an estimated 23 percent.

The state will also be required to reimburse school districts for their loss of vehicle specific ownership taxes. This increases the total impact on the state general operating budget from the $1.6 billion figure shown in Table 3 to $1.8 billion.

Impact on state and local government transportation budgets. Proposition 101 reduces funding dedicated to transportation budgets. The state constitution requires that vehicle-related fees collected by the state be spent on road safety, construction, and maintenance. This money is shared between the state, cities, and counties. These fees will be reduced by 87 percent, which will decrease the state's transportation budget by an estimated 27 percent. The impact on city and county government transportation budgets will vary by government. Because cuts affecting the transportation budget are immediate, the full impact shown in Table 3 will occur in 2011.

State Income Tax

Households and businesses pay taxes on their income to both the state and federal governments. The state income tax is the largest source of money the state receives to pay for its main programs.

The state's income tax rate is a flat 4.63 percent and is the same for all income levels and for both households and businesses. On average, Colorado households pay about $2,000 in state income taxes and $9,000 in federal income taxes. Due to tax credits, deductions, and exemptions, some lower-income households pay little or no state income tax, while other higher-income households pay much more state income tax.

Proposition 101 gradually lowers the state income tax rate from 4.63 percent to 3.5 percent over time. The rate is first cut to 4.5 percent starting in 2011. This will reduce income tax collections to the state by an estimated $145 million, a decrease of 3 percent. A household with an annual income of $55,000 will save $40 in 2011. In the future, the rate is reduced by 0.1 percentage point each year in which state income tax collections grow by more than 6 percent. For example, if tax collections increase fast enough, the income tax rate will decrease from 4.5 percent to 4.4 percent in 2012. This will occur until the income tax rate decreases to 3.5 percent. When the tax rate is fully reduced, income tax collections to the state will be an estimated 26 percent less, or a decline of $1.3 billion in today's dollars. A household with an annual income of $55,000 will save $320 when the cut is fully phased in. Because income tax collections do not grow by more than 6 percent every year, it will likely take 15 to 20 years for the tax rate to reach 3.5 percent.

Vehicle Fees and Taxes

Proposition 101 reduces several types of vehicle fees and taxes as shown in Table 4. The amounts in the table show the impact when the cuts are fully implemented — sales tax reductions on vehicle purchases and specific ownership tax reductions are phased in over a four-year period, while all other fee and tax changes occur immediately.

Table 4. Vehicle Fees and Taxes Under Current Law and Proposition 101, When Fully Implemented

	Average Payment		State & Local Govt. *Change in Yearly Collections*
	Current	*Prop. 101*	
Vehicle Owners			
Sales Tax /a	$2,100 one-time payment	$1,400 one-time payment	-$285 million total for state and local
Registration and Licensing Fees	$74 paid once per year	$10 paid once per year	-$258 million total for state and local
Specific Ownership Tax	$95 paid once per year	$2 (new cars) or $1 (used cars) paid once per year	-$379 million total for all school districts */b* and local governments
Vehicle Lessees			
Sales Tax /a	$1,080 total ($30 paid monthly during lease term)	$0	-$60 million total for state and local
Registration and Licensing Fees	$74 paid once per year	$10 paid once per year	-$64 million total for state and local
Specific Ownership Tax	$95 paid once per year	$0 paid once per year	-$95 million total for all school districts */b* and local governments
Vehicle Renters			
Sales Tax /a	$2.45 per rental day	$0	-$80 million total for state and local
State Car Rental Fee	$2 per rental day	$0	-$19 million total for state

/a This analysis assumes a 7.0 percent sales tax rate. For vehicle owners and lessees, it assumes a $30,000 car is purchased or leased for 36 months. For vehicle renters, the analysis assumes a vehicle is rented for $35 a day.
/b State law requires the state to reimburse school districts for their loss of specific ownership taxes.

Vehicle owners. Upon purchase, vehicle buyers are required to pay sales tax. In addition, each year vehicle owners must register their vehicle(s) with the state and pay a number of registration fees and a specific ownership tax. Proposition 101 reduces all three taxes and fees.

<u>Vehicle sales tax.</u> Sales taxes are paid on the purchase of a new or used vehicle. The tax is applied to the price of the vehicle, including any manufacturer's rebate. The total tax rate is a 2.9 percent state rate plus any applicable local government sales tax rates. Because different local governments have different tax rates, the sales tax a person pays differs depending on where the buyer lives. The average combined sales tax rate is close to 7 percent.

Proposition 101 reduces the sales taxes due on vehicle purchases by exempting the first $10,000 of the vehicle's price and any manufacturer's rebate from the sales tax. The $10,000 exemption is phased in over a four-year period beginning in 2011. When fully implemented, vehicles worth $10,000 or less will not have a sales tax bill. Vehicles with greater values will receive a $10,000 "write-off." For example, a vehicle purchased for $18,000 will only be taxed on $8,000 of the value. This sales tax cut will reduce local government collections by an estimated $165 million, or 5 percent, and state government collections by an estimated $120 million, or 6 percent.

Vehicle registration and licensing fees. Vehicle owners pay registration fees each year. Most fees vary according to vehicle weight, age, and value. While most of the money pays for roads and bridges, some pays for services like emergency medical services, vehicle emissions reduction programs, the Colorado State Patrol, and snow plowing.

Beginning in 2011, Proposition 101 combines all registration, licensing, and titling fees into a single $10 annual fee, with the exception of vehicle inspection and new license plate fees. As shown in Table 4, the average registration and licensing fee for vehicle owners would fall from $74 to $10 and the amount collected by state and local governments would decrease by about $258 million, or 86 percent.

Vehicle specific ownership tax. Vehicle owners also pay a specific ownership tax each year when registering a vehicle. The specific ownership tax is a property tax on a vehicle. The tax ranges from 0.45 percent to 2.10 percent of the vehicle's value. As a vehicle ages, the tax is reduced. The minimum specific ownership tax is either $3 or $5 per vehicle, depending on the type of vehicle. Counties collect specific ownership taxes and distribute them to schools, cities, counties, and special districts within their boundaries.

Proposition 101 phases in a cut to specific ownership taxes over four years, beginning in 2011. It also requires permission from voters to create or increase future registration and licensing fees. Table 4 shows the change in vehicle owners' bills and state and local government collections.

Vehicle lessees. Like vehicle owners, persons who lease vehicles must pay sales taxes, registration fees, and specific ownership taxes each year. Proposition 101 reduces all three taxes and fees for vehicle leases.

Vehicle sales tax and specific ownership tax. Proposition 101 eliminates sales taxes and annual specific ownership taxes on leased vehicles. Under Proposition 101, persons who lease a vehicle would no longer pay vehicle sales taxes beginning in 2011. The specific ownership tax on these vehicles is phased out over four years. This will reduce state and local sales tax collections by an estimated $60 million per year, or 1 percent. It will also eliminate all specific ownership taxes collected by local governments.

Vehicle registration and licensing fees. Leased vehicles are also required to be registered with the state and lessees must pay annual registration fees. Beginning in 2011, Proposition 101 eliminates all registration fees and imposes a single $10 fee per vehicle, resulting in savings of $64 for vehicle lessees. The measure reduces state collections by approximately $64 million per year, a decrease of 86 percent.

Vehicle renters. The state charges $2 per day for car rentals. The is money is shared by the state, cities, and counties to build, repair, and maintain roads and bridges. Sales tax is also applied, with revenue going to the state and local governments. Proposition 101 eliminates this fee and all sales taxes, beginning in 2011. As a result, state and local transportation budgets will have an estimated $19 million less per year.

Other vehicle fees. The state also charges use and permitting fees for large and overweight vehicles for using Colorado roads. A passenger mile tax is also charged for passenger bus or shuttle businesses. Proposition 101 eliminates these fees beginning in 2011, resulting in $X less in state funds, saving trucking and carrier companies a like amount.

Telecommunication Fees and Taxes

Proposition 101 eliminates state and local sales tax and other fees on customer bills for any kind of telecommunications service, except for existing 911 fees. The measure lists the following as telecommunication services, even though some of them are not currently taxed: phone, pager, cable, television, radio, Internet, and computer services. Currently, the state and some local governments charge sales tax on a portion of the cost of phone and pager services, and some local governments charge sales tax on cable services. State fees that are eliminated include fees that help telephone companies provide access to phone service in rural areas of the state, to the blind or deaf, and to low-income people. Local governments may have other fees, such as television franchise fees, that may be eliminated.

Proposition 101 freezes 911 fees at their 2009 level. These fees differ from county to county and ranged from 43 cents to $1.25 per month in 2009. The 911 fees are charged by local governments to help pay for 911 emergency services.

As shown in Tables 1 and 2, the amount of money each household and business would save as a result of cuts in telecommunication taxes and fees depends on how much it spends on taxable phone and cable. Tax collections by local governments would be reduced by at least $193 million each year. Tax and fee collections to the state government would be reduced by an estimated $183 million each year.

New voter approval requirements. Proposition 101 redefines all telecommunication fees and most vehicle fees as taxes. Because the state constitution requires a vote to increase taxes but not to increase fees, this means governments will need to ask voters for permission to create new or increase existing vehicle or telecommunication fees in the future. Proposition 101 excludes vehicle-related fines, parking fees, tolls, vehicle impound fees, vehicle identification and emission inspection fees, and new license plate fees from this requirement.

How do Amendments 60 and 61 and Proposition 101 interact? These ballot measures contain provisions that affect state and local government finances by decreasing taxes for households and businesses and restricting government borrowing. How these measures work together may require clarification from the state legislature or the courts. Since these measures are all phased in over time, the actual impacts to taxpayers and governments will be less in the initial years of implementation and grow over time.

Amendment 60 reduces local property taxes, while requiring state expenditures for K-12 education to increase by an amount that offsets the property tax loss for school districts. Amendment 61 reduces state and local government revenue by requiring a decrease in tax rates when debt is repaid. The analysis of Amendment 61 assumes that this provision applies to the existing debt of state and local governments. Proposition 101 reduces state and local government revenue by cutting income taxes, sales taxes, specific ownership taxes, vehicle registration fees, and telecommunications fees.

The estimated savings to taxpayers and the financial impacts to governments assume that all three measures are approved by voters and fully implemented today. An average household making $55,000 per year that owns a $295,000 house would save an estimated $1,800 per year in taxes. State government would lose an estimated $2.1 billion annually, while state spending for K-12 education would increase by $1.6 billion per year to offset local funding losses for school districts. This would leave the state's general operating budget almost entirely committed to paying for the constitutional requirements of K-12 education, with no money left to pay for other government functions. Local government would lose an estimated $3.8 billion per year if these measures were fully implemented today.

Arguments For

1) Allowing citizens and businesses to keep more of their own money helps support the economy. A family with a yearly income of $55,000 could save $486 per year. Most businesses will also have more money, allowing them to invest in their companies and create new jobs. In addition, people who buy or lease cars will save even more from lower sales taxes. Reducing taxes and fees helps businesses and lower- and middle-income families who are struggling in this difficult economy. Consumer spending and business investment tend to increase when the tax burden is lower.

2) The tax and fee savings in Proposition 101 will require state and local governments to eliminate unnecessary spending. State and local governments already spend $X billion a year, which amounts to an average of $X per household in the state. Also, government spending continues to grow in most years. The amount of spending by governments in the state has increased by about 14 percent since 1990, even after

accounting for inflation and population growth. The government can fund basic services with less money by making better choices about how it spends its money.

3) Proposition 101 gives people a voice in decisions about fees on phones and vehicles. The state recently increased vehicle registration fees by an average of $45 per car even though registration fees exceed what it costs the government to process vehicle registrations. Some telecommunication fees raise the cost of basic services for everyone but help only a small part of the state's population. Proposition 101 eliminates these complicated vehicle and phone fees and requires voters to agree before such fees are created or increased again.

Arguments Against

1) Proposition 101 will force cuts to government services that people rely on for a high quality of life and that businesses need to succeed. Services that have already been reduced because of the economic downturn, such as schools, colleges, prisons, firefighters and police, and water and sewer systems, will be cut further. These cuts could further weaken the already slow economy and, over time, hurt the quality of the state's work force. Rural economies may also be affected because money currently dedicated to phone and Internet service for rural areas will be eliminated. The state's operating budget is estimated to be cut by $1.6 billion when the measure is fully implemented, an amount greater than what the state currently spends on prisons, courts, and the Colorado State Patrol combined. Further, local governments will have $936 million less.

2) Proposition 101 will hurt the ability of the state and local communities to maintain already inadequate roads and bridges. Studies show that Colorado needs more than twice as much money each year than it currently spends just to maintain existing roads and bridges. Proposition 101 would cut state transportation funding by an estimated 27 percent each year. In 2009 alone, the state and local governments maintained more than 193,000 lane miles of roadway and 8,000 bridges. The state also snow-plowed and sanded 5.6 million miles of highway, repaired 77,000 street signs, and monitored 278 avalanche paths. Public health and safety may also be affected due to fewer resources for emergency medical services, vehicle emission programs, and road maintenance.

3) Colorado already has a lean government. State government spending as a percentage of the economy is third lowest among all states. Combined state and local government spending is eighth lowest. The state constitution already limits the amount of taxes and fees that governments can spend and gives voters the power to make decisions on taxes that reflect their local communities' values. In addition, higher-income people will benefit the most from the income tax cut, while low-income people, most of whom will not be helped by the income tax cut, will lose a source of money that helps them get basic telephone service. People who are deaf or blind will also lose a source of money that helps them communicate within society.

Estimate of Fiscal Impact

State revenue. Proposition 101 contains several provisions that decrease revenue to the state government. If fully implemented today, state tax and fee collections would decrease by an estimated $1.9 billion, which includes $234 million in vehicle fees used for transportation projects. Because some of the reductions are phased in over time, the reduction in revenue will be lower at first. Most notably, the income tax reduction will likely take between 15 and 20 years to be fully implemented. The income tax reduction will be around $150 million to $200 million each year in the first few years, and then grow over time.

State spending. The state will have about $234 million, or 27 percent, less to spend on transportation projects in 2011. This amount will grow slightly over time. Further, if fully implemented today, the state would have $1.6 billion, or 23 percent, less to spend on operating programs such as education, prisons, and social services. Though the reductions to the transportation budget will be immediate, the reductions to operating programs will occur over time as the cuts to the income and sales tax are phased in. The impact on the state's operating programs depend on the future budgeting decisions of the state legislature.

Proposition 101 will also create some additional costs for the state. The state will be required to replace the loss of vehicle specific ownership taxes for school districts. This will cause the state to spend an additional $150 million for schools annually when the measure is fully implemented. Also, Proposition 101 increases state administrative costs by about $150,000 in 2011 and $100,000 in subsequent years to implement the reductions in taxes, fees, and charges, and to audit compliance with the measure's provisions.

Local revenue and spending. If fully implemented today, local government revenue would decrease by an estimated $1.0 billion, with $90 million of this amount for transportation projects. Because reductions in the sales tax on vehicles are phased in over four years, revenue decreases in the first few years will be lower than this amount.

The extent to which each local government program will be affected will vary depending on what services the government provides and its budget decisions.

Impact on taxpayers. The savings to taxpayers from Proposition 101 depends on their income, the number and type of vehicles they have, the costs of their phone and cable bills, and whether they purchase or lease vehicles in a given year. If the measure were fully implemented today, an average household with an annual income of $55,000 would save about $600 annually, though households that purchase a vehicle would have additional sales tax savings. A business with taxable income of X with X vehicles, would save about X annually.