HB10-1087

Colorado Legislative Council Staff Fiscal Note

STATE and LOCAL FISCAL IMPACT

Drafting Number:	LLS 10-0122	**Date:**	February 10, 2010
Prime Sponsor(s):	Rep. Swalm Sen. Cadman	**Bill Status:**	House Finance
		Fiscal Analyst:	Jason Schrock (303-866-4720)

TITLE: CONCERNING THE ELIMINATION OF THE REQUIREMENT THAT AN EMPLOYER WITHHOLD COLORADO INCOME TAX.

Fiscal Impact Summary	FY 2010-2011	FY 2011-2012	FY 2012-2013
State Revenue General Fund	($38 million)	($70 million)	($60 million)
State Expenditures General Fund	$6.7 million	$4.6 million	$8.4 million
FTE Position Change	44.8 FTE	5.7 FTE	62.3 FTE
Effective Date: August 11, 2010, assuming the General Assembly adjourns May 12, 2010, as scheduled and no referendum petition is filed. Withholding of income taxes from employee wages would no longer be required starting January 1, 2011.			
Appropriation Summary for FY 2010-2011: See State Appropriations Section.			
Local Government Impact: See Local Government Impact Section.			

Summary of Legislation

This bill eliminates the requirement that employers deduct and withhold Colorado income tax from an employee's wages starting January 1, 2011. Under the bill, withholding of state income tax from a worker's wages would only occur if the employee and employer voluntarily agree to it.

Individuals who stop having state income tax withheld would still generally be required to file annual tax returns and those with state income tax liabilities above $1,000 would be required to make quarterly estimated payments to the state due to provisions in current law.

State Revenue

This bill is likely to decrease General Fund revenue starting in FY 2010-11. The extent to which income tax revenue will be reduced will depend upon how many individuals stop having state income tax withheld from their paychecks and the number of these taxpayers that fail to pay their entire tax liability through estimated payments and annual tax returns.

For purposes of this fiscal note, it is assumed that 50 percent of taxpayers, or about 1 million individuals, would no longer have state income tax withheld from their paychecks. Of these taxpayers, it is assumed 15 percent would fail to file estimated payments **and** their annual tax return.

It is assumed that most of these "noncompliant" taxpayers would be lower income taxpayers who would likely lack the ability to pay income taxes due in one lump sum each year with their annual return. However, it assumed that compliance would increase over time as taxpayers learn their responsibilities and/or are penalized by the department for failing to pay their tax due.

Using these assumptions, the amount of income tax revenue not collected by the state would be an estimated $38 million in FY 2010-11 (half-year impact), $70 million in FY 2011-12, and $60 million in FY 2012-13. The Department of Revenue would be able to capture at least some of the income tax due to the state from these taxpayers through compliance efforts. However, there would likely be some delay in which the state were to receive the tax due as it takes time to identify and collect liabilities from noncompliant taxpayers.

Offsetting some of the decrease in income tax revenue would be increased penalty revenue from taxpayers who fail to comply with the state's income tax laws. The amount of additional penalty revenue generated would depend on the amount of noncompliance, the income tax liability of taxpayers failing to comply, and the state's ability to collect penalties from taxpayers.

Reduction in tax intercept revenue. Certain programs are authorized under current law to intercept state income tax refunds to provide payments owed for certain purposes, such as for child care and support, victim restitution, and court fines and fees. This bill is likely to reduce the amount of income tax refunds as more individuals stop having income tax withheld from their paychecks. Many taxpayers who have tax withheld end up with refunds when they file their annual returns. Thus, there is likely to be less ability to intercept state tax refunds and therefore revenue from intercepts will be reduced.

State Expenditures

This bill will increase state expenditures by $6.7 million and 44.8 FTE in FY 2010-11, $4.6 million and 5.7 FTE in FY 2011-12, and $8.4 million and 62.3 FTE in FY 2012-13.

Department of Revenue. The Department of Revenue will incur additional costs to administer and enforce the state's income tax laws. The amount of additional costs will depend on the extent that employers and employees stop withholding state income tax revenue and the extent these individuals comply with existing income tax laws, including the requirements to pay quarterly estimated income taxes and file annual tax returns. The estimates for the department's costs are based on what is assumed to be needed for the department to help ensure compliance with the state's income tax laws and collect income tax due to the state.

For purposes of this fiscal note, it is assumed that 50 percent of taxpayers, or about 1 million individuals, would no longer have state income tax withheld from their paychecks. Of these taxpayers, it is assumed that 20 percent, or 200,000 taxpayers, would make quarterly estimated payments. Further, it is assumed that 15 percent, or 150,000 taxpayers, would initially fail to file estimated payments and annual tax returns. However, it is likely that both of these compliance rates would increase over time as taxpayers learn their responsibilities and/or are penalized by the department for failing to comply with state tax laws.

The department's additional administrative needs and costs are identified in Table 1 below. The department will incur additional costs from working with taxpayers and employers regarding the tax change, mailing additional forms, notices, and letters to taxpayers, and processing more quarterly estimated payments submitted by taxpayers.

The department's costs are expected to increase starting in FY 2012-13 as it begins to discover individuals that did not file an annual tax return. At this time the department will need additional staff to identify and recover tax liabilities from the additional number of taxpayers who fail to make estimated payments or file annual tax returns. However, the amount of staff and costs for these functions is expected to decrease in future years as more taxpayers learn their responsibilities and become compliant with the state's tax laws.

Table 1. Expenditures for the Department of Revenue Under HB 10-1087			
Cost Components	**FY 2010-11**	**FY 2011-12**	**FY 2012-13**
Mailing of notification letters to 2.6 million taxpayers and employers	$802,838		
FTE	0.3		
Phone communications with an assumed 1.3 million taxpayers and employers about law change	$1,601,600		
FTE (250 temp staff during a 2-month period)	41.7		
Printing and Mailing of Additional Estimated Payment Returns	$116,339	$174,508	$226,681
Processing of Additional Quarterly Estimated Payment Returns (Sorting, Data Entry, Resolution of Errors, Handling Bounced Checks, Shredding of Confidential Documents)	$218,889	$437,778	$656,665
FTE	2.8	5.7	8.5
Notices and billing statements to noncompliant taxpayers	$5,375	$16,125	$900,031
FTE			3.4
Identifying noncompliance, working with taxpayers, handling disputes, and recovering tax liabilities			$2,328,706
FTE			50.4
Operating Expenses and Capital Outlay for Additional Staff	$4,822	$6,571	$311,996
Summary of Expenditures			
Personal Services	$1,829,505	$436,967	$3,099,568
FTE	44.8	5.7	62.3
Operating Expenses and Capital Outlay	$920,357	$198,016	$1,324,690
TOTAL	**$2,749,862**	**$634,983**	**$4,424,259**

In addition to these costs, the department is likely to incur legal services expenses provided through the Department of Law for its additional compliance efforts, such as with taxpayer protests, its tax conferee's duties, and to represent taxpayer services. These costs have not been quantified at this time.

Department of Treasury – increased borrowing costs of $4 million annually. Currently, the Department of Treasury borrows money through General Tax Revenue Anticipation Notes (GTRANs) to aid in the state's cash needs due to the uneven flow of tax revenue and expenditures during the fiscal year. Income tax withholding revenue generally comprises a little under half of annual General Fund revenue. Thus, a reduction in withholding tax revenue would create the need for additional borrowing by the Treasurer to ensure the state's cash flow needs are met. Assuming that 50 percent of the state's withholding tax revenue stops being withheld, and that 20 percent of this amount will instead come in quarterly estimated payments (with the remaining amount being paid with annual tax returns or not at all), the state will incur an estimated $4 million in interest costs per year starting with FY 2010-11. However, its important to note that this amount would be higher or lower depending on the future direction of interest rates.

State agencies that administer income tax wage withholding for state employees – minimal fiscal impact. This bill will likely create both additional costs and savings to the state's agencies that withhold state income tax for the state's employees. This includes the Department of Personnel and Administration and the state's institutions of higher education. To the extent these agencies change their current income tax withholding processes, they will incur costs in changing their payroll systems and records for employees. It is assumed agencies can incur any costs within existing resources. It is assumed that agencies would experience minimal savings by ending the withholding of state income taxes from employees because they would still be required to withhold federal income taxes.

Agency Differences

It is the position of the University of Colorado system that it will incur expenditures of $64,020 in FY 2010-11 and $60,000 thereafter for costs involved in changing its payroll system and forms due to some employees not having state income taxes withheld while continuing to withhold federal income taxes. Since all other state agencies affected by the bill indicated any costs could be absorbed within existing resources, this fiscal note assumes that the University of Colorado system could also absorb any additional costs within existing resources.

Expenditures Not Included

Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. The centrally appropriated costs subject to this policy are summarized in Table 2.

Table 2. Expenditures Not Included Under HB 10-1087*

Cost Components	FY 2010-11	FY 2011-12
Employee Insurance (Health, Life, Dental, and Short-term Disability)	$6,092	$8,302
Supplemental Employee Retirement Payments	$1,244	$2,174
TOTAL	**$7,336**	**$10,476**

**More information is available at: http://www.colorado.gov/cs/Satellite/CGA-LegislativeCouncil/CLC/1200536133924*

Local Government Impact

Similar to the state's agencies that withhold income tax for the state's employees, this bill will create additional costs and savings to local governments. To the extent local government agencies change their current income tax withholding processes, they will incur costs in changing their systems and records for employees. It is assumed local governments can incur any costs within existing resources.

Reduced child support intercept money. Currently, 50 percent of child support for participants in the Temporary Assistance for Needy Families (TANF) is retained by county child support agencies. Depending on the extent to which there is less child support payments intercepted from state income tax refunds, these agencies will lose revenue.

State Appropriations

In FY 2010-11, the Department of Revenue requires $2,749,862 and 44.8 FTE from the General Fund.

Departments/Entities Contacted

Judicial	Governor	Higher Education
Human Services	Local Governments	Personnel
Revenue	Treasury	