

Colorado Legislative Council Staff Fiscal Note



STATE FISCAL IMPACT

Drafting Number: LLS 15-0692
 Prime Sponsor(s): Sen. Cadman

Date: April 1, 2015
 Bill Status: Senate Finance
 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		
State Expenditures		
FTE Position Change		
Impact on TABOR Refund	See TABOR Impact Section	
Appropriation Required:	None.	

Summary of Legislation

This bill 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.

TABOR Impact

Table 1 shows the projected impact of the bill on the mechanisms used to refund money collected in excess of the TABOR limit, while Tables 2 and 3 on pages 4 and 5 show the impact on average refunds for full-time resident single and joint income tax filers, respectively, based on the March 2015 Legislative Council Staff forecast. Revenue is refunded in the year following the year in which 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 could differ significantly from that described here.

Refunds made in FY 2016-17 (tax year 2016) are not expected to be affected. The bill does not affect the earned income tax credit. In addition, because current law and SB15-001 both require each taxpayer to receive an equal amount if the average sales tax refund per taxpayer is \$15 or less, full-time individual income taxpayers will each receive \$8 from the sales tax refund under both current law and the bill.

Refunds made during FYs 2015-16 and FY 2017-18 (tax years 2015 and 2017) are expected to be affected by the bill. In tax year 2015, \$69.7 million will be refunded via the three-tier sales tax refund rather than the six-tier sales tax refund. In tax year 2017, the bill refunds a total of \$226.6 million via the three-tier sales tax refund instead of the temporary income tax rate cut. An additional \$208.3 million will be refunded via the three-tier sales tax mechanism rather than the six-tier sales tax mechanism.

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 1. 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 <i>Earned Income Tax Credit</i> <i>Income Tax Rate Reduction</i> <i>Six-Tier Sales Tax Refund</i>	\$66.1 million \$69.7 million**	\$116.8 million \$91.1 million \$25.7 million	\$434.9 million permanent* \$226.6 million \$208.3 million
Senate Bill 15-001 Revenue above the TABOR limit <i>Earned Income Tax Credit</i> <i>Income Tax Rate Reduction</i> <i>Three-Tier Sales Tax Refund</i>	\$66.1 million repealed \$69.7 million**	\$116.8 million \$91.1 million repealed \$25.7 million	\$434.9 million permanent* repealed \$434.9 million
Change from Current Law Revenue above the TABOR limit <i>Earned Income Tax Credit</i> <i>Income Tax Rate Reduction</i> <i>Sales Tax Refund</i> Total Change from Current Law	\$0.0 \$0.0 \$0.0 \$0.0 \$0.0	\$0.0 \$0.0 \$0.0 \$0.0 \$0.0	\$0.0 \$0.0 (\$226.6 million) \$226.6 million \$0.0

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 2. 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, Tax Year 2015 — Single Filers						
Sales Tax Refund: \$69.7 million				Sales Tax Refund: \$69.7 million		
Tier 1: up to \$36,500	15	Not Available	15	Tier 1: up to \$36,600	12	
Tier 2: \$36,500 to \$78,500	20		20	Tier 2: \$36,600 to \$117,100	22	
Tier 3: \$78,500 to \$114,100	23		23	Tier 3: \$117,100 and up		
Tier 4: \$114,100 to \$148,200	27		27			
Tier 5: \$148,200 to \$181,100	29		29			
Tier 6: \$181,100 and up	47		47			
FY 2015-16 Surplus, Tax Year 2016 — Single Filers						
Sales Tax Refund: \$25.7 million EITC: \$91.1 million /a				Sales Tax Refund: \$25.7 million EITC: \$91.1 million /a		
Tier 1: up to \$37,500	8	Not Available	8	Tier 1: up to \$37,600	8	
Tier 2: \$37,500 to \$80,700	8		8	Tier 2: \$37,600 to \$120,400	8	
Tier 3: \$80,700 to \$117,300	8		8	Tier 3: \$120,400 and up		
Tier 4: \$117,300 to \$152,300	8		8			
Tier 5: \$152,300 to \$186,100	8		8			
Tier 6: \$186,100 and up	8		8			
FY 2016-17 Surplus, Tax Year 2017 — Single Filers						
Sales Tax Refund: \$208.3 million Income Tax Rate Cut: \$226.6 million /b				Sales Tax Refund: \$434.9 million		
Tier 1: up to \$38,400	43	9	52	Tier 1: up to \$38,500	70	
Tier 2: \$38,400 to \$82,600	57	51	108	Tier 2: \$38,500 to \$123,200	132	
Tier 3: \$82,600 to \$120,100	66	99	165	Tier 3: \$123,200 and up		
Tier 4: \$120,100 to \$155,900	78	152	230			
Tier 5: \$155,900 to \$190,600	84	198	282			
Tier 6: \$190,600 and up	134	548	682			

/a The earned income tax credit (EITC) refund mechanism is unaffected by SB15-001 and not shown in this table. 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 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. This refund mechanism results in an increase to federal taxable income, the impact of which is not incorporated here.

**Table 3. 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, Tax Year 2015 — Joint Filers							
Sales Tax Refund: \$69.7 million				Sales Tax Refund: \$69.7 million			
Tier 1: up to \$29,700	30	Not Available	30	Tier 1: up to \$36,600	24		
Tier 2: \$29,700 to \$73,100	40		40	Tier 2: \$36,600 to \$117,100	44		
Tier 3: \$73,100 to \$116,000	46		46				
Tier 4: \$116,000 to \$156,400	54		54	Tier 3: \$117,100 and up	76		
Tier 5: \$156,400 to \$194,300	58		58				
Tier 6: \$194,300 and up	94		94				
FY 2015-16 Surplus, Tax Year 2016 — Joint Filers							
Sales Tax Refund: \$25.7 million EITC: \$91.1 million /a				Sales Tax Refund: \$25.7 million EITC: \$91.1 million /a			
Tier 1: up to \$30,600	16	Not Available	16	Tier 1: up to \$37,600	16		
Tier 2: \$30,600 to \$75,100	16		16	Tier 2: \$37,600 to \$120,400	16		
Tier 3: \$75,100 to \$119,200	16		16				
Tier 4: \$119,200 to \$160,800	16		16	Tier 3: \$120,400 and up	16		
Tier 5: \$160,800 to \$199,700	16		16				
Tier 6: \$199,700 and up	16		16				
FY 2016-17 Surplus, Tax Year 2017 — Joint Filers							
Sales Tax Refund: \$208.3 million Income Tax Rate Cut: \$226.6 million /b				Sales Tax Refund: \$434.9 million			
Tier 1: up to \$31,600	86	1	87	Tier 1: up to \$38,500	140		
Tier 2: \$31,600 to \$76,900	114	27	141	Tier 2: \$38,500 to \$123,200	264		
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	446		
Tier 5: \$164,600 to \$204,400	168	197	365				
Tier 6: \$204,400 and up	268	568	836				

/a The earned income tax credit (EITC) refund mechanism is unaffected by SB15-001 and not shown in this table. 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 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. This refund mechanism results in an increase to federal taxable income, the impact of which is not incorporated here.

State Expenditures

State expenditures are not affected. The costs of administering a three-tier sales tax refund are identical to those for a six-tier sales tax refund. Programming costs to alter the income tax rate are minimal, and therefore the repeal of the temporary income tax rate cut has no expenditure impact.

Effective Date

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

State and Local Government Contacts

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