SB15-068

Colorado Legislative Council Staff Fiscal Note

STATE FISCAL IMPACT

Drafting Number:	LLS 15-0478	**Date:**	January 29, 2015
Prime Sponsor(s):	Sen. Jones Rep. Moreno	**Bill Status:**	Senate SVMA
		Fiscal Analyst:	Greg Sobetski (303-866-4105)

BILL TOPIC: HIGHER ED LOWER DEBT ACT

Fiscal Impact Summary*	FY 2015-2016	FY 2016-2017	FY 2017-2018
State Revenue	**($29.7 million)**	**($14.8 million)**	**($20.8 million)**
Revenue Change			
General Fund	($29.7 million)	($14.8 million)	($20.8 million)
Student Loan Income Tax Deduction		*($62.3 million)*	*($68.2 million)*
*Earned Income Tax Credit***		*$47.5 million*	*$47.5 million*
State Transfers			
General Fund	($127.4 million)		
Cash Funds	$127.4 million		
State Expenditures		**$137,092**	**$283,571**
General Fund		$119,773	$228,521
Centrally Appropriated Costs***		$17,319	$55,050
TABOR Set Aside	($29.7 million)	($14.8 million)	****
FTE Position Change		1.5 FTE	4.7 FTE
Appropriation Required: None.			

* *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 effective date of the earned income tax credit, a TABOR refund mechanism, is expected to change as a result the revenue reduction in FY 2015-16. See the State Revenue and TABOR Impact sections for more information.*

*** *These costs are not included in the bill's appropriation. See the State Expenditures section for more information.*

**** *Neither state revenue subject to TABOR, nor the Referendum C cap, has been forecast for FY 2017-18.*

Summary of Legislation

This bill creates a state income tax deduction for repayment of student loans, beginning in tax year 2016. The deduction is equal to the amount of principal and interest paid by a taxpayer, less any amount that is otherwise deducted from federal taxable income for state income tax purposes. The deduction is available to taxpayers who received student loans for their education, their spouses, and to taxpayers who claimed a student as a dependent at the time a student loan was disbursed.

Additionally, the bill caps the annual interest rate that a private or nongovernmental lender may charge for a student loan at two percentage points higher than the rate charged by the federal government for an unsubsidized loan made for the same purpose. The cap is imposed on loans made to students, their spouses, and to taxpayers claiming a student as a dependent.

Background

Both the federal government and private institutions offer loans to students, their spouses, and their parents for the purpose of financing postsecondary education. Interest rates on federal student loans are set by Congress each year. Federal unsubsidized loans disbursed between July 1, 2014, and June 30, 2015, are offered to undergraduate students at 4.66 percent annual interest, and to graduate or professional students at 6.21 percent annual interest.

The federal government offers an income tax deduction for payment of student loan interest only. The deduction reduces federal taxable income by up to $2,500, and may be claimed by taxpayers with modified adjusted gross incomes of less than $80,000, or $160,000 if married filing jointly. Claiming the deduction does not require a taxpayer to use the federal itemized deduction, meaning that this deduction can be taken by taxpayers who use the federal standard deduction. Because Colorado taxable income is computed using federal taxable income, a Colorado taxpayer who has claimed the federal student loan interest deduction receives a deduction for his or her interest payments, up to $2,500, in current law, provided that the taxpayer's income is less than the federal cap.

State Revenue

General Fund revenue will decrease by $29.7 million in FY 2015-16, $14.8 million in FY 2016-17, and $20.8 million in FY 2017-18. An income tax deduction for student loan repayment is expected to reduce state revenue by $29.7 million, $62.3 million, and $68.2 million in FYs 2015-16, 2016-17, and 2017-18, respectively. The revenue estimate for FY 2015-16 represents a half-year impact for the income tax deduction beginning in tax year 2016. The revenue estimates for FY 2016-17 and FY 2017-18 represent a full-year impact for the income tax deduction, combined with the impact of a change to the mechanisms used to refund the state's TABOR surplus incurred in FY 2015-16 and FY 2016-17.

Under current law, the state earned income tax credit (EITC) becomes a permanent income tax credit beginning the tax year after it is used as a mechanism to refund part of the state TABOR surplus. The EITC is expected to be used as a TABOR refund mechanism in tax year 2016, and is expected to become a permanent tax credit beginning tax year 2017. Under the bill, the EITC will be used as a TABOR refund mechanism in tax year 2017 and become permanent beginning tax year 2018. This change will result in an increase in state income tax revenue equal to approximately $47.5 million in each of FY 2016-17 and FY 2017-18 on an accrual accounting basis, partially offsetting the revenue decrease resulting from the income tax deduction in the bill. For more information about TABOR refund mechanisms, see the TABOR Impact section of this fiscal note.

Assumptions. The Federal Student Aid Office in the U.S. Department of Education reports that Coloradans paid approximately $1,240 million toward repayment of federal student loans in calendar year 2014, of which $892 million was paid on principal and $348 million was paid on interest. Federal government loans are assumed to account for approximately 92 percent of all student loans, the average share reported by College Board between 2009 and 2013. Total student loan repayment is assumed to grow at a rate of about 9.5 percent annually, a weighted average of growth in Colorado's total federal student loan interest deduction between 2009 and 2012. Approximately 80 percent of interest payments are assumed to be used to claim the federal income tax deduction in current law, applying the same growth rate as used for student loan repayment to data from the Internal Revenue Service for tax year 2012. The fiscal impact of the bill is therefore restricted to principal payments and the remaining 20 percent of interest payments.

Finally, this analysis assumes that all student loan repayment costs not used to reduce federal taxable income can be taken as a deduction against state taxable income. To the extent that a taxpayer's student loan repayment costs exceed his or her state taxable income, the decrease in state revenue will be less than estimated.

State transfers. General Fund transfers to the Highway Users Tax Fund (HUTF) and the Capital Construction Fund (CCF) will increase $101.9 million and $25.5 million, respectively, for FY 2015-16. Under current law, General Fund transfers to the HUTF and the CCF are expected to equal to 1 percent and 0.25 percent of General Fund revenue, respectively, for FY 2015-16, because the state TABOR surplus is expected to be between 1 and 3 percent of General Fund revenue for that year. The bill reduces the size of the TABOR surplus to less than 1 percent of General Fund revenue, allowing transfers to the HUTF and the CCF to grow to 2 percent and 0.5 percent of General Fund revenue, respectively. State transfers for subsequent fiscal years will not change.

TABOR Impact

The state TABOR set aside will be reduced by $29.7 million in FY 2015-16 and $14.8 million in FY 2016-17. Neither the state TABOR limit nor state revenue subject to TABOR is forecast for FY 2017-18.

Under current law, the state will refund an estimated $120.3 million in tax year 2016 because revenue is expected to exceed the state TABOR limit in FY 2015-16. Because the amount to be refunded is expected to exceed the amount needed to fund a state EITC, $89.3 million is expected to be refunded in tax year 2016 via the EITC refund mechanism. The bill reduces the amount of the TABOR surplus in FY 2015-16 to a level insufficient to trigger the EITC refund mechanism. Instead, the full TABOR surplus in FY 2015-16 would be refunded via the six tier sales tax refund, with the EITC refund mechanism triggering with the TABOR surplus incurred in FY 2016-17. Changes to TABOR refund mechanisms are shown in Table 1.

Table 1. TABOR Refund Mechanisms under Current Law and SB 15-068

	FY 2015-16 and TY 2016	FY 2016-17 and TY 2017
Current Law		
Revenue above the TABOR limit	$116.7 million	$620.4 million
Earned Income Tax Credit	*$89.3 million*	*permanent**
Income Tax Rate Reduction		*$229.7 million*
Sales Tax Refund	*$31.0 million***	*$390.7 million*
Senate Bill 15-068		
Revenue above the TABOR limit	$87.0 million	$605.6 million
Earned Income Tax Credit		*$94.9 million*
Income Tax Rate Reduction		*$229.7 million*
Sales Tax Refund	*$90.6 million***	*$281.0 million*
Difference		
Revenue above the TABOR limit	($29.7 million)	($14.8 million)
Earned Income Tax Credit	*($89.3 million)*	*$94.9 million*
Income Tax Rate Reduction		
Sales Tax Refund	*$59.6 million*	*($109.7 million)*

Source: Legislative Council Staff Forecast, December 2014.

* 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 2015-16 to correct for previous under-refunds.

State Expenditures

General Fund expenditures will increase $137,092 and 1.5 FTE in FY 2016-17, and $283,571 and 4.7 FTE in FY 2017-18. Because the deduction will first appear on the income tax form to be remitted April 15, 2017, for tax year 2016, no expenditures are required in FY 2015-16. Expenditures are summarized in Table 2.

Table 2. Expenditures Under SB 15-068		
Cost Components	**FY 2016-17**	**FY 2017-18**
Personal Services	$62,011	$194,303
FTE	1.5 FTE	4.7 FTE
Operating Expenses, Capital Outlay, and Contractor Costs	$57,762	$34,218
Centrally Appropriated Costs*	$17,319	$55,050
TOTAL	**$137,092**	**$283,571**

** Centrally appropriated costs are not included in the bill's appropriation.*

Assumptions. Expenditures for the Taxpayer Services Division in the Department of Revenue (DOR) will increase $74,257 and 1.4 FTE in FY 2016-17, and $135,331 and 3.2 FTE in FY 2017-18. These costs are for the review of deductions claimed and for the taxpayer call center. Expenditures assume that approximately 256,000 taxpayers will claim the deduction in tax year 2016, growing 1.9 percent annually, and that the DOR will review 5 percent of claims at a rate of about 25 minutes per review.

Expenditures for the DOR's Executive Director's Office will increase by $5,640 and 0.1 FTE in FY 2016-17, and $12,687 and 0.3 FTE in FY 2017-18. These costs are for the processing of tax return documentation submitted with returns that cannot be read with an optical scanner, assuming that 159 documents can be viewed each hour.

The DOR's contractor and document management expenses will increase $39,876 in FY 2016-17 and $16,114 in FY 2017-18. These costs are associated principally with the development, coding, testing, and validation of software associated with the new deduction. Document management costs, including those for preparation, scanning, and shredding, are assumed to scale with the number of documents received.

Finally, expenditures for the DOR's Tax, Audit, and Compliance Division will increase $64,389 and 1.2 FTE in FY 2017-18.

Centrally appropriated costs. 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 estimated in the fiscal note for informational purposes and summarized in Table 3.

Table 3. Centrally Appropriated Costs Under SB 15-068*		
Cost Components	**FY 2016-17**	**FY 2017-18**
Employee Insurance (Health, Life, Dental, and Short-term Disability)	$12,013	$37,640
Supplemental Employee Retirement Payments	$5,306	$17,410
TOTAL	**$17,319**	**$55,050**

**More information is available at: http://colorado.gov/fiscalnotes*

Effective Date

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

State and Local Government Contacts

Higher Education   Regulatory Agencies   Revenue