



*Colorado Legislative Council Staff*  
**STATE**  
**FISCAL IMPACT**

**Drafting Number:** LLS 06B-2075  
**Prime Sponsor(s):** Rep. McGihon

**Date:** July 6, 2006  
**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 IN THE ABSENCE OF A VALIDATED TAXPAYER IDENTIFICATION NUMBER.

<b>Fiscal Impact Summary</b>	<b>FY 2006/07</b>	<b>FY 2007/08</b>
<b>State Revenues</b>		
General Fund	Potential Increase	Potential Increase
<b>State Expenditures</b>		
General Fund		
<b>FTE Position Change</b>	0.0 FTE	0.0 FTE
<b>Effective Date:</b> January 1, 2007		
<b>Appropriation Summary for FY 2006/07:</b> None Required		
<b>Local Government Impact:</b> 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). In addition, individuals who pay anyone for services are required to withhold state income taxes unless the person making the payment has a validated TIN from the person whom is paid for the service.

The bill creates a verification portal in the Governor's Office of Innovation and Technology that enables a trade, business, or individual to access a database to verify whether a TIN is valid.

**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 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. 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 payor (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 a 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. Individuals are held to the same withholding requirements whenever they pay for a service and fail to receive a validated TIN. 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, business, or individual 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, businesses, or individuals who would make payments to non-employees and persons for services. Furthermore, it is unknown whether a trade, business, or individual will be *able to determine* whether the non-employee providing the service or other individual is using a correct TIN unless the trade, business, or individual paying for the services is notified by the IRS that the payee submitted an incorrect TIN. It is unknown whether a trade, business, or individual 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 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**

The bill creates a verification portal in the Governor's Office of Innovation and Technology that enables a trade, business, or individual to access a database to verify whether a TIN is valid. Thus far, no state expenditures have been identified by the Governor's Office of Innovation and Technology or the Department of Revenue. 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