Referendum H
Limiting a State Business Income Tax Deduction

Referendum H proposes a change to the Colorado statutes that:

- increases state income taxes owed for some businesses that deduct wages or other compensation paid to unauthorized aliens; and
- defines an unauthorized alien as a person who is not eligible under federal immigration law to work in the United States.

Summary and Analysis

How do business income taxes work? Like individuals, businesses pay taxes based on the amount of income they earn. In determining the amount of income on which federal taxes are owed, federal law allows businesses to deduct all expenses that are considered ordinary and necessary in conducting business, including wages. These deductions lower the amount of federal taxes owed. Federal law does not specifically exclude wages paid to unauthorized aliens from a business' income tax deductions. State income taxes are based on federal taxable income. Therefore, any deductions claimed on the federal form also lower the amount of state income taxes owed.

How does Referendum H affect state income taxes? Beginning January 1, 2008, Referendum H requires a business to disclose the amount of wages or other compensation paid to unauthorized aliens that it deducted as an expense on its federal income tax return. Referendum H increases the business' state taxable income by this amount, which results in a higher state income tax bill. This requirement applies only to annual wages or other compensation paid of $600 or more per worker. Furthermore, the requirement applies only in cases where the business knew at the time of hiring that it was hiring an unauthorized alien.

Arguments For

1) Referendum H is part of a broad strategy for addressing the illegal immigration problem at the state level. It targets the employment of unauthorized aliens, which is the root cause of illegal immigration. As long as job opportunities for unauthorized aliens exist, the incentive to come to Colorado or overstay visas will persist.

2) By discouraging the hiring of unauthorized aliens, Referendum H reduces the financial advantage that a business gains when it pays lower wages to unauthorized aliens. As a result, it provides a more competitive environment for businesses that pay higher

wages to legal workers. By reducing the number of jobs available to unauthorized aliens, more job opportunities will be open to Colorado residents.

Arguments Against

1) Referendum H will likely have little or no impact on illegal immigration. In fact, the proposal only increases taxes if a business voluntarily discloses that it paid wages to unauthorized aliens. Furthermore, Referendum H would not impact a business that pays for services in cash or pays wages to an unauthorized alien, who was hired using fraudulent documentation. As a result, no business in Colorado is likely to pay higher taxes. Finally, there is little incentive to stop hiring unauthorized aliens because a business can get a federal tax break worth at least five times as much as the additional taxes owed to Colorado under this proposal.

2) Illegal immigration is a national issue, and therefore it is the responsibility of the federal government to enforce and protect the country's borders. Hiring unauthorized aliens is already against the law, which means that the issue Referendum H tries to address would not exist if current laws were enforced.

Estimate of Fiscal Impact

Referendum H may increase state income tax collections. Increased tax collections are expected to be minimal because Referendum H does not apply in a variety of circumstances, such as wages paid in cash or employment gained using fraudulent documents, and compliance is expected to be inconsistent. If the state collects more than $150,000 in any budget year as a result of Referendum H, the state is required to refund the excess amount back to taxpayers. A small expenditure for the Department of Revenue will be necessary for computer programming in order to add a line on the state income tax form.

State Spending and Tax Increases

The state constitution requires that the following fiscal information be provided when a tax increase question is on the ballot:

1. the estimated or actual state spending under the constitutional spending limit for the current year and each of the past four years with the overall percentage and dollar change;
2. for the first full fiscal year of the proposed tax increase, an estimate of the maximum dollar amount of the tax increase and of state fiscal year spending without the increase.

Table 1 shows the dollar amount of state spending under the constitutional spending limit. Table 2 shows the revenue expected from the increased income taxes and

state fiscal year spending with and without these taxes for 2009, the first full fiscal year for which the increase would be in place.

Table 1. State Spending

	Actual 2003	Actual 2004	Actual 2005	Preliminary 2006	Estimated 2007
State Spending	$7.713 Billion	$8.333 Billion	$8.311 Billion	$8.053 Billion	$8.332 Billion
Four-Year Dollar Change in State Spending: $619 Million					
Four-Year Percent Change in State Spending: 8.0 Percent					

The numbers in Table 1 show state spending from 2003 through 2006 for programs that were subject to the constitutional spending limit during those years. However, the constitution allows a program that operates similar to a private business to become exempt from the limit if it meets certain conditions. Because some programs have done this during the last five years, the numbers in Table 1 are not directly comparable to each other. Furthermore, Referendum C, which was passed by voters in 2005, allows the state to spend money above the limit that it otherwise would have refunded to taxpayers. If numbers are adjusted for both of these factors, the four-year dollar change is $2.163 billion and the four-year percent change is 30.7 percent.

Table 2. State Fiscal Year Spending and the Proposed Tax Increase

	2009 Estimate
State Spending without New Taxes	$9,221.17 million
New Income Tax Increase	$0.15 million
State Spending with New Taxes	$9,221.32 million