1st Draft

Referendum C
TABOR Refunds

The proposed amendment to the *Colorado Revised Statutes*:

- allows the state to spend all revenue collected, eliminating TABOR refunds, for the next five years;
- reduces TABOR refunds after five years by establishing a new spending base equal to the maximum revenue collected in any year during the initial five-year period;
- allows the new spending base to increase annually by inflation plus population growth; and
- specifies that revenue retained be used to fund health care, public education, and transportation projects.

Background

Constitutional limit on state revenue. Colorado's state government has a variety of budgetary limitations, including a balanced budget requirement, limits on the state's ability to borrow money, and revenue and spending limits. One of these limits, commonly known as TABOR or the Taxpayer's Bill of Rights, caps the amount of money the state can keep and spend each year. The money capped by TABOR accounts for about 60 percent of total state revenue. It does not include revenue from the federal government or state government-run businesses, such as the Colorado State Fair. TABOR limits the annual increase in state revenue to inflation plus the percentage change in state population. Any money collected above this cap is refunded to taxpayers. Under TABOR, the state may ask voters to retain money it collects above the cap.

Colorado has experienced both strong economic growth and a recession since 1992 when TABOR was adopted. The state first collected revenue above the limit in budget year 1996-97 and continued this trend for the next four years. In 2001, the state experienced a recession and did not collect money above the cap for three budget years. During the downturn, lower revenue collections caused the state spending limit to fall. This lowering of the limit is commonly call the "ratchet-down" effect. The state's economy has begun to recover. The combination of an economic recovery and a lower limit will cause the state to once again collect revenue above its limit.

Table 1 illustrates these points. For example, in Year 1, if the state collects $100 and its spending limit is $100, the state keeps all the money it collects and there is no refund. If the limit increases to $105 in Year 2, and the state collects $110, then $5 is refunded to taxpayers.

In Year 3 the state can keep $110, but a recession occurs and it collects $90, so there is no refund. In Year 4, the economy recovers and the state collects $105. The limit in Year 4 can only increase to $95 from the $90 collected in Year 3. In Year 4 the state refunds $10 because of the ratchet-down effect. In addition, the state refunds more money in Year 4 than in Year 2, even though it collects less revenue. Finally, without the ratchet-down effect in Year 4, the state would keep the $105 it collects. In this case, the limit is $115, rather than $95.

Table 1: An Example of the TABOR Limit Under Good and Bad Economic Times
(Inflation Plus Population Growth is Assumed to be 5% Per Year)

	Year 1	**Year 2**	**Year 3**	**Year 4 with Ratchet Down**	**Year 4 without Ratchet Down**
State Revenue Collections	$100	$110	$90	$105	$105
State Spending Limit	100	105	110	95	115
TABOR Refunds	0	5	0	10	0

TABOR refunds. Money collected above the state spending cap is refunded to taxpayers. The state legislature determines how the money is refunded. There are currently 15 methods to refund money. The particular refund methods that are used in any given year depend on the amount of money being refunded. If enough money is available to fund a method, the refund is made. Any remaining money is refunded through a sales tax refund located on the state income tax form. Appendix A lists the 15 methods; the number of taxpayers who qualified during 2001, the last year the state refunded money; and the average amount refunded to each qualified taxpayer. The methods are listed in the order in which they are available.

The sales tax refund is distributed according to income. Table 2 shows the estimated average sales tax refund and the highest and lowest sales tax refunds for the next five years. The actual dollar amounts could be higher or lower, depending on the economy. The total refund received is the sum of the sales tax refund plus any other refunds for which the taxpayer qualifies.

Table 2
Estimated Sales Tax Refunds

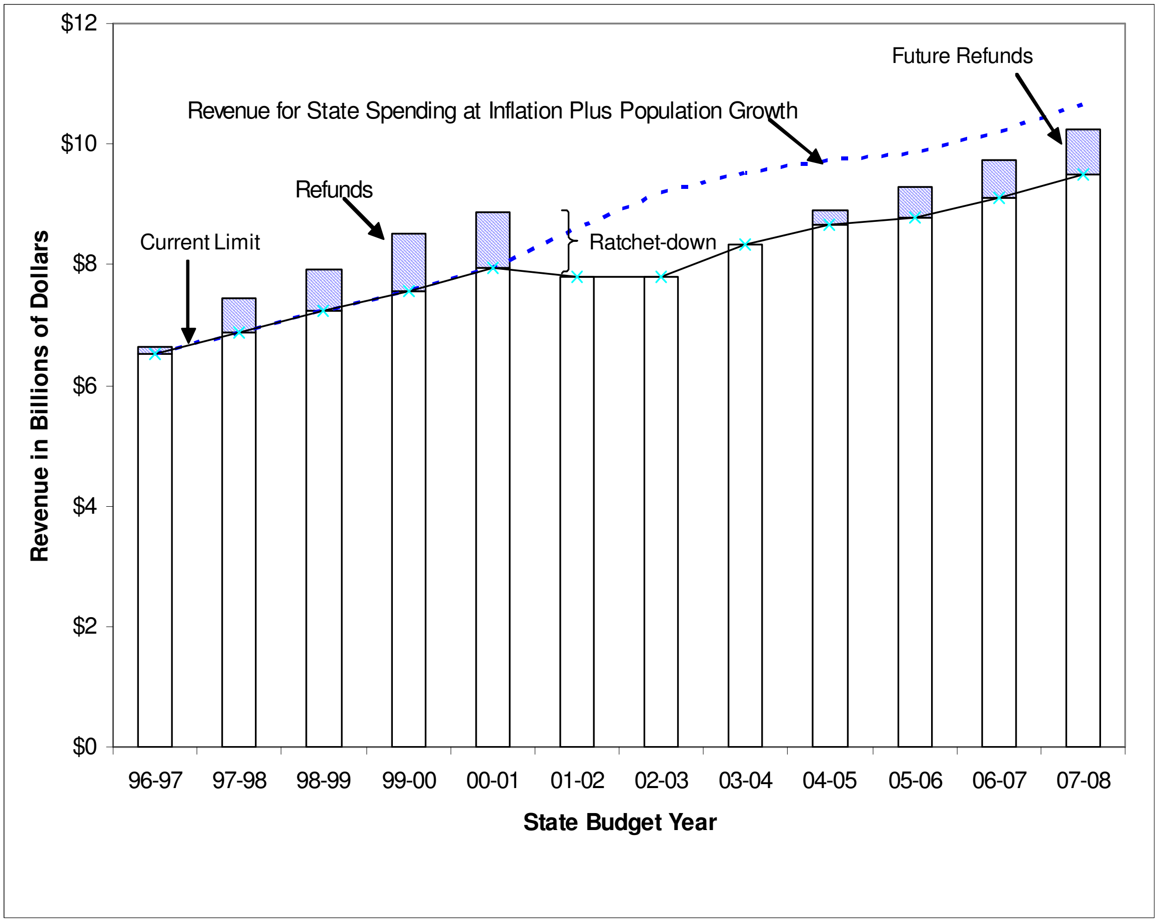
	STATE BUDGET YEAR					
	2006-07	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**TOTAL**
Lowest	$35	$53	$88	$79	$95	$350
Highest	$102	$154	$258	$231	$276	$1,021
Average	$49	$74	$124	$111	$133	$491

TABOR refunds are different from state income tax refunds. A taxpayers receives a state income tax refund when tax payments are greater than the amount of taxes owed. TABOR refunds occur only when the state collects money above its spending cap.

Provisions of Referendum C. Referendum C has three major provisions. First, it increases the amount of money the state may spend and increases its spending limit for future years. From July 1, 2005, through June 30, 2010, the measure allows the state to keep all the money it collects. Legislative economists estimate that the measure will permit state government to keep approximately $3.7 billion dollars more than the current limit allows during this five-year period. The exact amount of revenue retained as a result of this measure could be higher or lower, depending on the future strength of the economy.

Figure 1 shows how the limit has operated and is projected to operate from budget years 1996-97 through 2007-08. The solid line is the state spending limit, the dotted line is the limit without the ratchet down caused by the recession, and the shaded area is the refund. The state is expected to again collect money above the cap beginning in budget year 2004-05.

Figure 1
TABOR Limit and Refunds



Second, beginning in budget year 2010-11, the measure eliminates the ratchet-down effect and allows the state to keep a portion of the money that would have been refunded to taxpayers under TABOR. The new level of revenue the state is allowed to keep is the maximum amount collected in any of the first five years, adjusted for inflation and population growth each year thereafter.

Third, if the state collects enough money, the measure allows the state to keep an additional $100 million per year, reducing refunds by the same amount, beginning in budget year 2010-11. The additional money is required to be used to repay debt permitted by Referendum D. Referendum D allows the state to borrow up to $2.1 billion to be used primarily for transportation and capital projects in public education facilities.

Passage of Referendum C results in other changes to state law. Under current law, low-income families receive an income tax credit for child care expenses when the state collects money above the limit. Passage of Referendum C eliminates this child care tax credit for at least five years. It also results in a permanent tax credit for certain charitable contributions. In addition, beginning in budget year 2010-11, a new TABOR refund method is created that reduces the individual and corporate income tax rate from 4.63 percent to 4.5 percent. As with other refund methods, it is in effect in years in which the state collects enough money above the limit and it reduces the amount of money distributed through other refund methods.

How will the money be spent? The additional money must be spent one-third each on:

- health care for low-income, disabled, and elderly Coloradans and reducing health insurance premiums;
- preschool through twelfth grade public education; and
- community colleges and other public institutions of higher education.

The influx of money will also result in more revenue for transportation projects. In addition, if Referendum D passes, the state legislature can use a portion of the money to make debt payments under Referendum D.

The measure requires legislative staff to prepare an annual report detailing how the money is spent.

Arguments For

1) This measure provides money for critical investments in Colorado's future: improving the safety of roads and schools, providing better health care for Colorado families, and supplying an educated workforce for Colorado businesses. These investments are necessary to retain and generate new jobs in the state. Based on income, Colorado now ranks in the bottom ten states for funding higher education and elementary education. The condition of the state's roads and highways are also below the national average. For example, the Colorado Department of Transportation reports that 39 percent of the state's roads are in poor condition. Repairing highways now is cheaper than replacing them later.

2) Without raising taxes, this measure provides the state with the money to fund programs and services that were cut during the recent recession. Colorado will still be in the bottom ten states in terms of total state taxes paid per person. If voters do not approve this measure, the state will have to continue to trim its budget by reducing funding for items such as higher education, programs that assist seniors like the senior homestead exemption, and programs that benefit low-income families and the disabled.

3) This measure allows the state to recover from economic downturns while maintaining voters' rights to approve future tax increases. Under current limits, the state can never recover from a downturn. In the past few years, the state has added students and prisoners, and experienced more traffic congestion while state revenue fell. Even under this measure, the state will be spending less in the future than inflation and population growth would have allowed since 2001.

Arguments Against

1) Referendum C is effectively a tax increase. It eliminates TABOR refunds for five years and reduces them each year thereafter. The state will be able to spend roughly $3.7 billion that belongs to taxpayers. This reduction in private spending may dampen the economic recovery that began in 2003, making the state a less desirable place for business relocation. The average taxpayer will give up $1,163 over the next five years, which could be better used by Colorado's citizens.

2) This measure allows for an expansion of state spending without being specific about how the money will be spent. The broad spending categories outlined in the measure cover almost all aspects of state government. Thus, the money could be spent for any purpose. The measure is an attempt to get voter approval for spending on health care and public schools, when the money may actually be used elsewhere.

3) The perceived budget shortfall could be handled in other ways. Since TABOR passed in 1992, state spending has increased each year. Rather than spending more money, the state could save money by eliminating inefficiencies, consolidating government functions, privatizing certain services, and reforming the state purchasing system.

Estimate of Fiscal Impact

State impacts. The measure is estimated to increase state revenue by $3.7 billion over the next five years. Table 3 summarizes the annual estimated revenue the state can keep and spend under Referendum C.

Table 3. Estimated Revenue

State Budget Year:	2005-06	2006-07	2007-08	2008-09	2009-10	TOTAL
Additional Revenue Retained Under Ref. C	$507 million	$653 million	$836 million	$823 million	$923 million	$3,741 million
Additional Revenue as a Percentage of Total Revenue	6.0%	7.4%	8.9%	8.4%	9.0%	8.0%

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Beginning in budget year 2010-11, the measure allows the state to retain and spend a capped amount of state revenue. The amount the state can keep is defined as the maximum revenue collected in any of the previous five years, increased by inflation plus population growth each year thereafter.

APPENDIX A

Other TABOR Refund Methods

Type of Refund	Number of Taxpayers Claiming Refund in FY 2000-01	Average Amount of Refund in FY 2000-01
Earned Income Credit	210,942	$156
Foster Care	431	$487
Business Personal Property Tax /A	77,726	$1,291
Capital Gains for CO Assets Purchased Before 1994	9,296	$5,433
Child Care Credits	194,924	$131
Research and Development	/C	/C
Lower Motor Vehicle Registration Fees	/D	$7
High Technology Scholarship Program	38	$88
Pollution Control Equipment	0	$0
Contribution to Telecommunication Education	/C	/C
Trucks at 0.01 Percent Sales Tax Rate	/B	/B
Interest, Dividends, and Capital Gains	1,055,713	$42
Agriculture Cooperative Tax Credit	237	$2,138
Health Benefit Plans	6,442	$376
Capital Gains for CO Assets Purchased after 1994	5,967	$4,636

/A 42,651 taxpayers received less than $200, while 250 taxpayers received more than $40,588

/B Data unavailable

/C New method that was not available in 2001

/D Estimated average refund per vehicle registration