2nd Draft

Referendum C
State Spending

The proposed amendment to the *Colorado Revised Statutes*:

- allows the state to keep all the money it collects for the next five years and spend it on health care, public education, and transportation projects;
- eliminates the TABOR refunds that taxpayers receive when the state collects more than it is allowed to spend for the next five years and reduces refunds thereafter;
- takes the highest amount of money the state collects in any year during the next five years and calculates state spending from that amount for all future years; and
- allows this amount to increase annually by inflation plus population growth.

Background

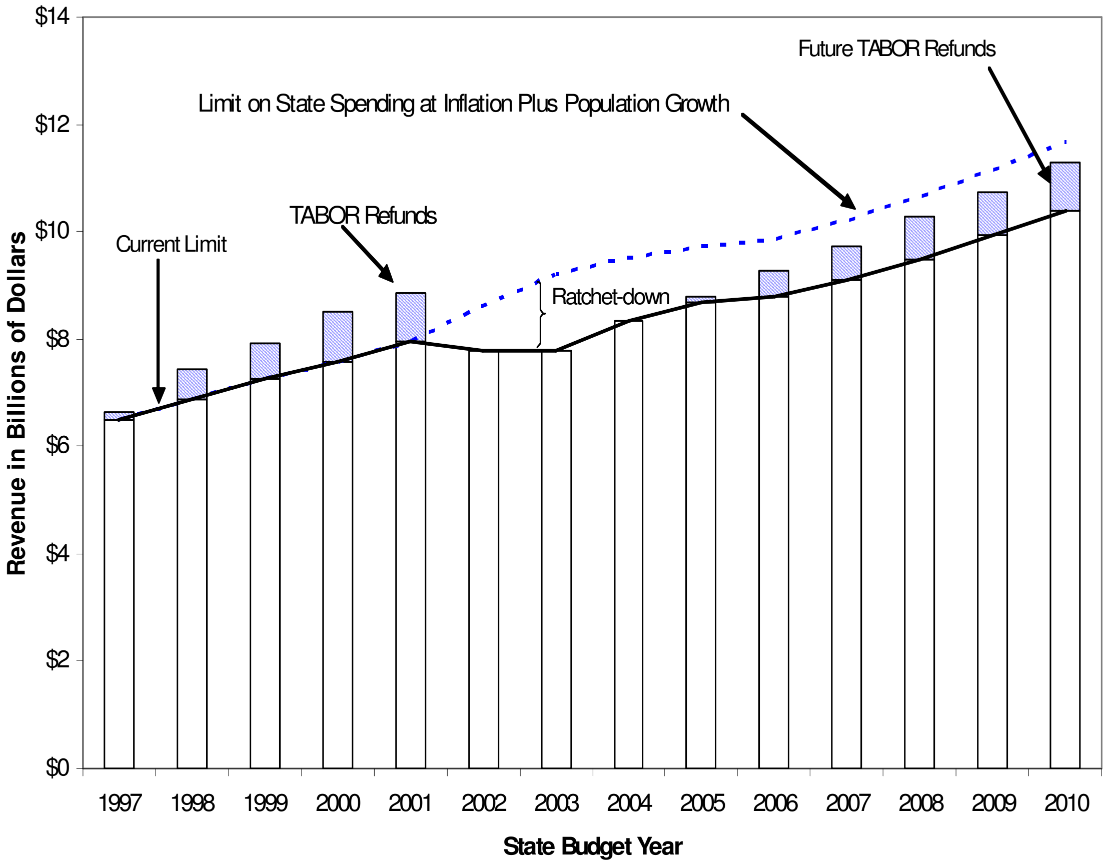
Constitutional limit on state revenue. TABOR, or the Taxpayer's Bill of Rights, caps the amount of money the state may keep and spend each year. TABOR limits the annual increase in most state revenue to inflation plus the percentage change in state population. Any money collected above this cap is refunded to taxpayers, unless the voters allow the state to keep it. Referendum C asks voters if the state may keep additional money in the future.

In the last half of the 1990s, the state collected money above the limit for five consecutive years. For instance, in 2001, the state was allowed to keep $7.9 billion, but $8.9 billion was collected. The difference of about $1.0 billion was refunded to taxpayers.

When the state collects less money than the limit allows, there are no refunds. In the following year, the limit is calculated from the amount of money collected in the prior year. For example, the state experienced a recession during 2001 and the amount of money collected in 2002 was $7.8 billion, while the limit was $8.1 billion. The limit in the following year grew from the $7.8 billion collected in the prior year, not the previous limit of $8.1 billion. This lowering of the limit is known as the "ratchet-down" effect. The amount the state can spend under TABOR is now below where it would be if it had grown by inflation plus population each year.

Figure 1 shows how the TABOR limit has operated and is projected to operate from 1997 through 2010. The solid line is the state spending limit, the dotted line shows the limit without the ratchet down, and the shaded area is the TABOR refund. As a result of the recession, state revenue and the spending limit dropped by $1.1 billion. The state is expected to collect money above the current limit beginning in 2005.

Figure 1



TABOR Limit and Refund

How does Referendum C change state spending? Referendum C has three major provisions. First, it allows the state to keep and spend all the money it collects for five years beginning July 1, 2005. The new money is required to be spent on:

- transportation projects;
- 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.

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Legislative economists estimate that the state will keep approximately $3.7 billion more than the current limit allows during the five-year period. The exact amount of revenue retained could be higher or lower, depending on the economy. Legislative staff is required to prepare an annual report detailing how the money is spent.

Second, beginning in 2011, Referendum C eliminates the ratchet-down effect and allows the state to keep a portion of the money that would be refunded to taxpayers. State spending will again be limited by TABOR's spending cap of inflation plus population growth. All money collected above the limit will be refunded to taxpayers.

Third, if the state collects enough money, Referendum C allows the state to keep up to an additional $100 million per year, reducing refunds by the same amount, beginning in 2011. The additional money may be used to repay debt permitted by Referendum D. If passed by the voters, 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. If Referendum C does not pass, Referendum D cannot take effect.

What happens to the money if Referendum C fails? It is returned to taxpayers through TABOR refunds. TABOR refunds are different from state income tax refunds. TABOR refunds occur when the state collects money above its spending cap. A taxpayer receives a state income tax refund when the taxpayer pays more in state income taxes than he or she owes.

The legislature, with approval of the governor, determines how the money is refunded. There are currently 16 methods to refund money. Almost all taxpayers receive the sales tax refund. Taxpayers are expected to receive an average of $491 in sales tax refunds over the next five years, which is estimated to be 42 percent of all TABOR refunds. It is distributed across six income groups. Table 2 shows the estimated sales tax refund for a taxpayer in the highest and lowest income groups, and the average sales tax refund for all taxpayers for 2007 to 2011.

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Table 2
Estimated Sales Tax Refunds Per Taxpayer

Income Group	2007	2008	2009	2010	2011	TOTAL
Lowest	$35	$53	$88	$79	$95	$350
Highest	$102	$154	$258	$231	$276	$1,021
Average	$49	$74	$124	$111	$133	$491

Examples of the remaining 15 refunds include a reduction in vehicle registration fees, a rebate for property taxes paid by businesses, and a credit for child care. The total refund a taxpayer receives is the sales tax refund plus any of the other 15 methods for which a taxpayer qualifies. Of the remaining 15 methods, the particular ones used in any given year depend on the amount of money being refunded. While the sales tax refund was distributed to almost 2.8 million taxpayers in 2001, each of the other 15 methods were distributed to a much smaller number of taxpayers. For 2007 through 2011, the other 15 methods are expected to account for about 58 percent of all TABOR refunds. Appendix A contains more information on the refund methods.

Other impacts of Referendum C. 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 allows a tax credit for certain charitable contributions for taxpayers who do not claim itemized deductions on income tax forms. In addition, beginning in 2011, a new TABOR refund method is created that reduces the individual and corporate income tax rate from 4.63 percent to 4.50 percent. As with other refund methods, it is in effect for years in which the state collects enough money above the limit, and it reduces the amount of money distributed through other refund methods.

Arguments For

1) Referendum C 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 generate new jobs and retain existing jobs in the state. Based on income, Colorado ranks among the bottom ten states for funding K-12 and higher education. In addition, 39 percent of Colorado's roads and highways are in poor condition. Repairing highways now is cheaper than replacing them later.

2) Without raising taxes,Referendum C provides the state with the money to fund programs and services that were cut during the recent recession. Colorado will still rank among the bottom ten states in total state taxes paid per person. If voters do not approve Referendum C, the state will have to continue to reduce 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. Referendum C simply uses the same provisions of TABOR that have already been used in many communities across Colorado to ask voters to retain additional money.

3) Referendum C allows the state to recover from economic downturns while preserving the right of citizens to vote on all future tax increases. Under current limits, the state can never fully recover from an economic downturn. In the past few years, the state has added students and prisoners, and experienced more traffic congestion while state revenue fell. Even if Referendum C passes, the state will be spending less in the future than inflation and population growth would have allowed since 2001. After five years, spending growth will again be limited to inflation plus population growth, and the state will still have the strictest spending limits in the country.

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 could be better used by Colorado's citizens and businesses. This reduction in private spending may dampen the economic recovery that began in 2003, making the state a less desirable place for business relocation. When the $3.7 billion is divided by the number of Colorado taxpayers, it amounts to $1,163 over five years.

2) Referendum C allows state spending to expand without being specific about the programs for which the money will be spent. The broad spending categories outlined in Referendum C cover 83 percent of state government. The new money could replace current spending on health care and public schools, essentially allowing the money to be spent for any purpose. The legislature can change the spending priorities anytime after the election.

3) The perceived budget shortfall could be handled in other ways. TABOR allows government to grow by no more than inflation plus population, but it does not mandate it. It is acceptable for government to grow at a slower rate. Since TABOR passed in 1992, state spending has increased each year. Rather than spending more, the state could save money by eliminating inefficiencies, consolidating government functions, privatizing certain services, and reforming the state purchasing system. Slower growth could encourage greater government productivity and efficiency.

Estimate of Fiscal Impact

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

Table 3. Estimated Increase in State Revenue from Referendum C

State Budget Year:	2006	2007	2008	2009	2010	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 Capped by TABOR	6.0%	7.4%	8.9%	8.4%	9.0%	8.0%

Beginning in 2011, Referendum C is estimated to increase state revenue by $923 million, increased annually by inflation plus population growth. If Referendum D passes, the state will also be allowed to keep an additional $100 million annually beginning in 2011.

APPENDIX A
TABOR Refund Methods and Amounts Distributed in FY 2000-01

Sales Tax Refund Federal Adjusted Gross Income Group (income tiers in 2001)	Estimated Number of Taxpayers in FY 2000-01	Average Amount Per Taxpayer in FY 2000-01
Less than $26,000	949,357	$144
$26,001 to $53,000	816,139	$187
$53,001 to $78,000	474,271	$220
$78,001 to $103,000	248,190	$252
$103,001 to $126,000	112,248	$283
More than $126,000	196,482	$451
Total Sales Tax Refund	**2,796,687**	**$206**

Other Types of Refunds	Number of Taxpayers Claiming Refund in FY 2000-01	Average Amount Per Taxpayer 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