HB 20-1203

Legislative Council Staff
Nonpartisan Services for Colorado's Legislature

REVISED FISCAL NOTE

(replaces fiscal note dated March 3, 2020)

Drafting Number: LLS 20-0595
Prime Sponsors: Rep. Sirota; Gray
Sen. Gonzales

Date: May 18, 2020
Bill Status: House Appropriations
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Bill Topic: **EITC, CHILD TAX CREDIT, AND INCOME DEFINITION**

Summary of Fiscal Impact:

- ☒ State Revenue
- ☒ State Expenditure
- ☐ State Transfer
- ☐ TABOR Refund
- ☐ Local Government
- ☐ Statutory Public Entity

Beginning tax year 2021, the bill creates a state income tax addition equal to the amount of a taxpayer's federal qualified business income deduction, activates the state child tax credit, and expands the state earned income tax credit. On net, it will decrease state revenue and increase state expenditures on an ongoing basis.

Appropriation Summary: For FY 2020-21, the bill requires an appropriation of $337,493 to the Department of Revenue.

Fiscal Note Status: This fiscal note reflects the introduced bill, as amended by the House Finance Committee. It has been revised to reflect the May 2020 LCS forecast and other new information.

Table 1
State Fiscal Impacts Under HB 20-1203

		FY 2020-21	FY 2021-22	FY 2026-27
Revenue	General Fund	($33.7 million)	($57.8 million)	($155.6 million)
	Total	**($33.7 million)**	**($57.8 million)**	**($155.6 million)**
Expenditures	General Fund	$337,493	$362,821	$61,584
	Centrally Appropriated	$93,391	$144,811	$24,683
	Total	**$430,884**	**$507,632**	**$86,267**
	Total FTE	**4.5 FTE**	**7.0 FTE**	**1.2 FTE**
Transfers		-	-	-
TABOR Refund		-	-	Not estimated

Summary of Legislation

Beginning in tax year 2021, the bill makes three changes to the state income tax code. These changes are described below.

State addition for qualified business income. The bill requires taxpayers who claim the federal income tax deduction for qualified business income to add back the amount they claimed for the purpose of computing their Colorado taxable income.

State child tax credit. Under current law, the state child tax credit becomes available if Congress enacts the Marketplace Fairness Act of 2013 or similar legislation. The bill repeals the conditional availability of the credit and allows the credit to qualifying taxpayers beginning in tax year 2021.

The credit is available for single income tax filers with less than $75,000 in federal adjusted gross income (AGI) and for joint filers with less than $85,000 in federal AGI, provided that they claimed the federal child tax credit and/or the additional child tax credit for a child under the age of six. The credit is refundable, meaning that the amount of the credit that exceeds a taxpayer's state income tax liability is paid to the taxpayer. The amount of the credit is based on the taxpayer's filing status and federal AGI as shown in Table 2. Two taxpayers who are married and may file taxes jointly, but choose to file separately, may only claim the credit on one return per year.

Table 2
Amounts of the Colorado Child Tax Credit

Single Filers with an AGI...	Joint Filers with an AGI...
Less than $25,000, the amount of the credit is 30 percent of the federal credit claimed.	Less than $35,000, the amount of the credit is 30 percent of the federal credit claimed.
Between $25,001 and $50,000, the amount of the credit is 15 percent of the federal credit claimed.	Between $35,001 and $60,000. the amount of the credit is 15 percent of the federal credit claimed.
Between $50,001 and $75,000, the amount of the credit is 5 percent of federal credit claimed.	Between $60,001 and $85,000, the amount of the credit is 5 percent of federal credit claimed.

State earned income tax credit. Under current law, the state earned income tax credit (EITC) is equal to 10.00 percent of the amount of the federal EITC. The bill increases the value of the state credit to 20.12 percent of the federal credit.

Background

Federal qualified business income deduction. For tax years 2018 through 2025, current federal law allows taxpayers who earn income from ownership of some sole proprietorships, partnerships, limited liability corporations treated as sole proprietorships or partnerships for tax purposes, and S corporations ("pass-through entities") to deduct 20 percent of such income when computing their federal taxable income. For taxpayers whose income exceeds an inflation-adjusted threshold in federal law, additional limitations apply concerning the nature of the business and the amount it pays in wages. For tax year 2020, the threshold is $163,300 for single filers or $326,600 for joint filers.

State income tax is paid on Colorado taxable income, which is equal to federal taxable income except as modified by state law. Under current law, taxpayers who take the qualified business income deduction reduce their federal taxable income, thereby reducing their Colorado taxable income. These taxpayers receive a Colorado income tax benefit equal to 4.63 percent, the state tax rate, of their federal deduction, or 0.926 percent (20 percent times 4.63 percent) of their business income from qualified pass-through entities.

Federal and state child tax credits. Beginning in 2018, married couples filing jointly with AGI under $400,000 or single filers with AGI under $200,000 may claim a federal child tax credit for a qualifying child under the age of 17. The amount of the credit is $2,000 per qualifying child. If the total amount of the credit is greater than the taxpayer's federal income tax liability, the taxpayer may take the additional child tax credit, which is refundable up to $1,400 per qualifying child.

The state child tax credit was created pursuant to Senate Bill 13-001 and becomes available upon Congressional enactment of the Marketplace Fairness Act of 2013 or similar legislation. The Marketplace Fairness Act of 2013 was not adopted; it would have allowed each state member of the Streamlined Sales and Use Tax Agreement to require out-of-state retailers, including online retailers, to collect and remit state sales taxes.

Federal and state earned income tax credits. The federal EITC is available for taxpayers with earned income, such as income from wages or salaries, disability benefits received prior to the minimum retirement age, and some business income, whose earned income and AGI both fall below thresholds set in federal law. Thresholds depend on a taxpayer's filing status and number of qualifying children. For example, for 2020, a taxpayer filing singly or as a head of household is able to claim the credit if their income falls below $15,820 with zero children, $41,756 with one child, $47,440 with two children, or $50,954 with three or more children. Benefits likewise depend on a taxpayer's AGI, filing status, and number of qualifying children. For 2020, the maximum credit amount ranges from $538 for taxpayers with one child to $6,660 for taxpayers with three or more children.

Under current law, Colorado taxpayers are able to claim a refundable state EITC equal to 10 percent of their federal EITC.

Assumptions

Qualified business income addition. The addition to Colorado taxable income for qualified business income deducted at the federal level will increase state income taxes for 2021 through 2025.

On March 5, 2020, the Internal Revenue Service (IRS) first released data on national-level amounts of qualified business income deductions taken for tax year 2018. Data were grown consistent with economic expectations in the May 2020 Legislative Council Staff forecast and apportioned to account for Colorado's expected share of U.S. business proprietors' income in 2021. The amount added back for this deduction is expected to have increased in 2019, to decrease significantly in 2020 consistent with an economic recession, and to increase thereafter.

The federal qualified business income deduction is available through tax year 2025. For 2026 and subsequent years, this provision of the bill is not expected to increase state revenue or expenditures because the federal deduction will no longer be available.

Child tax credit. Activating the state child tax credit will reduce state income taxes beginning in 2021.

Estimates for the population of eligible claimants and the revenue impact are based on Colorado taxpayers who claimed the federal child tax credit and/or the federal additional child tax credit for a child under age 6 in 2016. Taxpayer populations in each filing status and AGI category are adjusted based on rates of growth or decline anticipated consistent with economic expectations in the May 2020 LCS forecast. Specifically, the eligible population is expected to have remained relatively flat through 2019, to grow significantly during 2020 consistent with an economic recession, and to increase thereafter.

Earned income tax credit. Increasing the amount of the EITC will reduce state income taxes beginning in 2021.

Estimates for the population of eligible claimants and the revenue impact are based on Colorado taxpayers who claimed the state EITC in tax years 2015, 2016, and 2017. The eligible population is adjusted consistent with economic expectations in the May 2020 LCS forecast. Specifically, the eligible population is expected to remain constant through 2019, to grow significantly during 2020 consistent with an economic recession, and to increase thereafter.

Expansion of the state EITC is not expected to motivate additional taxpayers to file state income tax returns in order to claim the credit, as eligible taxpayers who are aware of the credit already have a financial incentive to claim it. To the extent that taxpayers are incentivized to file returns, eligible populations and credit amounts will be greater than estimated.

State Revenue

The bill is expected to decrease state revenue by $33.7 million in FY 2020-21 and by $57.8 million in FY 2021-22. These estimates represent the net impact of the revenue increase expected to result from the state addition for federally deducted qualified business income, and the revenue decreases expected to result from activation of the state child tax credit and expansion of the EITC. The decrease for FY 2020-21 represents a half-year impact for tax year 2021 on an accrual accounting basis. The bill decreases income tax revenue, which is subject to TABOR.

Beginning in tax year 2026, the components of the bill that implement and expand tax credits will continue to decrease revenue with no corresponding increase from the addition for federally deducted qualified business income. This is because the federal qualified business income deduction ends after tax year 2025. Tables 1 and 3 show larger revenue decreases in FY 2026-27 because they present the bill's fiscal impact relative to current law. Under current law, the federal qualified business income deduction expires after 2025. As a result, only the tax credit provisions of the bill will impact state revenue beginning in 2026, unless the federal deduction is extended.

State revenue impacts are presented in Table 3.

Table 3
State Revenue Impacts Under HB 20-1203*

	FY 2020-21	FY 2021-22	FY 2026-27
General Fund Revenue Impacts			
Qualified Business Income Addition	$52.3 million	$115.9 million	**
State Child Tax Credit	($43.2 million)	($87.0 million)	($77.9 million)
State Earned Income Tax Credit	($42.8 million)	($86.8 million)	($77.7 million)
Net Revenue Impact	**($33.7 million)**	**($57.8 million)**	**($155.6 million)**

* *Totals may not sum due to rounding.*
** *Federal deduction expires after 2025.*

Because the estimate captures the net revenue impact of three offsetting policy changes, a different impact than estimated for any single component could result in a more significant positive or negative revenue impact for the bill as a whole. Estimates in this fiscal note contain additional uncertainty because available data do not fully capture changes in taxpayer behavior as a result of changes to federal tax law that took effect beginning in 2018. The economic impacts of COVID-19 on the amount of qualified business income added back, and on the eligible populations for the EITC and child tax credit, contribute to additional uncertainty.

State Expenditures

The bill is expected to increase state expenditures in the Department of Revenue (DOR) by $430,884 and 4.5 FTE in FY 2020-21 and $507,632 and 7.0 FTE in FY 2021-22 through FY 2025-26. Expenditures are for the implementation and administration for the tax policy changes in the bill and are shown in Table 4. Expenditures will decrease after FY 2025-26 as the DOR will no longer be required to administer the qualified business income addition. Costs for FY 2026-27 and subsequent years are not specifically enumerated in Table 4 but are summarized in Table 1.

Table 4
Expenditures Under HB 20-1203

	FY 2020-21	FY 2021-22
Department of Revenue		
Personal Services	$229,712	$352,219
Operating Expenses	$7,560	$9,450
Capital Outlay Costs	$68,200	-
Computer Programming and Testing	$31,755	-
Document Management	$266	-
Tax Data Management and Reporting	-	$1,152
Centrally Appropriated Costs*	$93,391	$144,811
Total Cost	**$430,884**	**$507,632**
Total FTE	**4.5 FTE**	**7.0 FTE**

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

Tax administration. Personal services, operating, capital outlay, and document management costs are for tax administration in the DOR. Specifically, the bill is expected to increase tax examiner workload in the Tax Audit and Compliance Division to ensure that taxpayers comply with the requirement that deducted qualified business income be added back, and in the Division of Taxpayer Services to communicate with taxpayers regarding the state child tax credit and ensure that returns claiming the credit are filed correctly.

Roughly 80 percent of the expected workload increase is related to the qualified business income addition, and roughly 20 percent is for implementation of the child tax credit. The estimate for FY 2020-21 assumes a January 1, 2021, start date and the General Fund paydate shift. As shown in the rightmost column of Table 1, the workload increase attributable to the bill is expected to be reduced beginning in FY 2026-27 when the department will no longer be responsible for administration of the qualified business income addition. Workload to administer the expanded EITC can be accomplished within existing appropriations.

The document management cost, $266, is paid to the Department of Personnel and Administration using funds reappropriated from the DOR.

Computer programming and testing. The bill requires one-time expenditures to program and test changes to DOR's GenTax software system. Programming is performed by a contractor and tested by the department. Programming is expected to require $24,075, or 107 hours at the contract rate of $225 per hour. Testing will require $7,680, or 320 hours at a rate of $24 per hour.

Data management and reporting. Costs for database management and reporting in the DOR's Office of Research and Analysis are estimated at $1,152 annually beginning in FY 2021-22.

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. These costs, which include employee insurance, supplemental employee retirement payments, and leased space, are estimated to be $93,391 in FY 2020-21 and $144,811 in FY 2021-22.

TABOR refunds. Under the May 2020 LCS Economic and Revenue Forecast, the state is not expected to collect revenue above the TABOR limit in either FY 2020-21 or FY 2021-22, and refund obligations are not anticipated for these years. The bill does not change expectations concerning refunds to taxpayers.

Effective Date

The bill takes effect 90 days following adjournment of the General Assembly sine die, assuming no referendum petition is filed.

State Appropriations

For FY 2020-21, the bill requires a General Fund appropriation of $337,493 to the Department of Revenue with 4.5 FTE. Of this amount, $266 should be reappropriated to the Department of Personnel and Administration.

State and Local Government Contacts

Personnel Revenue