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MEMORANDUM

TO: Mike Spalding and Marty Neilson

FROM: Legislative Council Staff and Office of Legislative Legal Services

DATE: October 16, 2017

SUBJECT: Proposed initiative measure 2017-2018 #62, concerning state income tax

Section 1-40-105 (1), Colorado Revised Statutes, requires the directors of the Colorado Legislative Council and the Office of Legislative Legal Services to "review and comment" on initiative petitions for proposed laws and amendments to the Colorado constitution. We hereby submit our comments to you regarding the appended proposed initiative.

The purpose of this statutory requirement of the directors of Legislative Council and the Office of Legislative Legal Services is to provide comments intended to aid proponents in determining the language of their proposal and to avail the public of knowledge of the contents of the proposal. Our first objective is to be sure we understand your intent and your objective in proposing the amendment. We hope that the statements and questions contained in this memorandum will provide a basis for discussion and understanding of the proposal.

An earlier version of this proposed initiative, proposed initiative 2017-2018 #52, was the subject of a memorandum dated September 15, 2017. Proposed initiative 2017-2018 #52 was discussed at a public meeting on September 20, 2017. The substantive and technical comments and questions raised in this memorandum will not include comments and questions that were addressed at the earlier meeting, except as necessary to fully understand the issues raised by the revised proposed initiative. However, the prior comments and questions that are not restated here continue to be relevant and are hereby incorporated by reference in this memorandum.

Purposes

The major purposes of the proposed amendment to the Colorado Revised Statutes appear to be:

1. To reduce the number of lines on the state income tax form.
2. To modify the state's income tax return filing requirements, including the format of forms, deadlines, penalties, and audit processes.
3. To dismiss all pending state income tax criminal cases and render void all prior state income tax criminal cases.
4. To lower the rate of Colorado state income tax from 4.63% to 4.6%, and additionally, to reduce the income tax rate by 0.1% in the next six general election years.
5. To allow all taxpayers to deduct an amount equal to the income tax credits claimed during 2018 and all tobacco settlement revenue, all state registration fees over \$10 per vehicle, all non-federal revenue to state enterprises started after 2000 without voter approval, and all excess revenue retained under Referendum C.

Substantive Comments and Questions

The changes to the proposed initiative previously submitted as 2017-2018 #52 raise the following substantive comments and questions:

1. What is the proponents' intent in changing "one civil audit and one civil fine" to "civil cases and civil fines"? Does this mean that there cannot be any audits? Is it possible for a taxpayer to be subject to more than one civil case or more than one civil fine in one income tax year?
2. With your addition of the definition for "residents", and the specification that "Residents may list that [Line 2] amount (doubled for joint returns) or less.", it is unclear whether the proposed initiative requires anyone other than residents to file the income tax return described in the proposed initiative.
 - a. Is the new return intended to apply to C corporations, S corporations, partnerships, or other pass through entities?
 - b. Is the new return intended to apply to nonresidents or part-year residents? If so, may those other entities or other types of filers not list

the Line 2 amount? If such filers may not list the Line 2 "flat dollar amount", what would the Line 2 flat dollar amount be for such filers?

- c. Does your definition of "residents" exclude corporations and other taxable entities by use of the word "adult"? Does this definition mean that minors who earn an income do not need to file an income tax return?

3. The following questions pertain to what the proposed initiative lists as "Line 2":

- a. What is the proponents' intent in changing the equation for the flat dollar amount to be multiplied by "resident returns" as opposed to all returns?
- b. Does this change mean that a nonresident return does not get a flat dollar amount in Line 2?
- c. Is it correct that the equation for the flat dollar amount is as follows:

(Flat dollar amount) x (the number of all resident returns) = (state income tax credits in 2018) + (state tobacco settlement revenue for that tax year) + (state registration fees over \$10 per vehicle) + (all non-federal revenue to state enterprises started after 2000 without voter approval) + (all excess revenue retained by use of Referendum C)

4. The following questions relate to the general question about what the proponents intend to qualify as a state income tax credit in 2018:

- a. Does this include income tax credits that C corporations and S Corporations are entitled to?
- b. Is it only those income tax credits that taxpayers would actually be entitled to claim in 2018 or do those that are earned in 2018 but cannot be claimed and must be carried forward to future income tax years also qualify?
- c. Can the proponents provide any more information about what qualifies as a state income tax credit in 2018?

5. Does the proponents' use of "voter approval" in the proposed initiative refer to section 20 of article X of the state constitution, or TABOR?

6. Subsection (4) of TABOR only requires voter approval for "any new tax, tax rate increase, mill levy above that for the prior year, valuation for assessment ration increase for a property class, or extension of an expiring tax, or a tax policy change directly causing a net tax revenue gain to any district" or the "creation of any multiple-fiscal year direct or indirect district debt or other financial obligation . . .". The creation of an enterprise does not require voter approval.
 - a. What does "all non-federal revenue to state enterprises started after 2000 without voter approval" mean? Do you really just mean "all non-federal revenue to state enterprises started after 2000"?
7. Why should revenue from the tobacco settlement be distributed to all resident taxpayers?
8. Why should revenue from vehicle registration fees be distributed to all resident taxpayers?
9. Why should revenue from enterprises enacted after 2000 be distributed to all resident taxpayers? Why is revenue from enterprises enacted in 2000 and prior years omitted?
10. Why should revenue retained under Referendum C be distributed to all resident taxpayers? Why is the mechanism in the initiative preferable to simply repealing Referendum C?
11. In the previously submitted Initiative #52, Line 2 also included an amount for excess revenue required to be refunded under TABOR. This initiative does not include this requirement. Is that intentional?
 - a. May the state continue to issue TABOR refunds using income tax returns under this initiative, or do proponents intend that the state issue refunds required under TABOR some other way?
12. Audited financial statements for state fiscal year 2015-16 indicate that state revenue from individual and corporate income taxpayers totaled \$7.2 billion in that year. This amount is net of income tax credits. In the same fiscal year, revenue from the tobacco master settlement agreement totaled \$92.3 million, vehicle registration fees totaled \$462.6 million, revenue to enterprises started

after 2000 totaled \$9.3 billion, and revenue retained under Referendum C totaled \$2.4 billion. The amount for enterprises includes federal revenue but does not include revenue to the Colorado Healthcare Affordability and Sustainability Enterprise enacted in 2017.

- a. If this proposed initiative had been in effect in 2016, it is likely that the total amount to be included on Line 2 of all income tax returns would have exceeded the total amount to be included on Line 1 of the returns. Do the proponents intend that this initiative make net state income tax receipts negative?
- b. For taxpayers for whom the amount to be included on Line 2 exceeds the tax liability to be included on Line 1, do the proponents intend that the Department of Revenue issue a refund on Line 4, or that the amount on Line 2 reduce a taxpayer's tax liability to zero?
- c. If the proponents intend that the amount by which Line 2 exceeds Line 1 be refunded to taxpayers, and the total amount of refunds exceeds total state income tax revenue, from what revenue source should the state issue a refund?
- d. Audited financial statements for state fiscal year 2015-16 indicate that gross General Fund revenue totaled \$10 billion, and that General Fund revenue from non-income tax sources totaled \$3.3 billion after accounting for income tax revenue diverted to the State Education Fund. If the amount of refunds required from the General Fund is greater than the total amount of General Fund revenue collected from other sources, does the state treasurer have the authority to move money from other funds to the General Fund in order to issue all of the refunds required?
- e. Assuming that, under the initiative, most taxpayers' tax liability is either zero or negative, would most taxpayers have any "prepaid state income tax" to subtract in Line 3? Typically withholding tables reflect an understanding of what a taxpayer's tax liability might be, but if that's zero for most taxpayers, is withholding even necessary?

13. The following questions pertain to subsection (4) of the proposed initiative:

- a. Is it the proponents' intent that the tax rates be as follows?
 - i. 2019 = 4.6%
 - ii. 2020 and 2021 = 4.5%
 - iii. 2022 and 2023 = 4.4%
 - iv. 2024 and 2025 = 4.3%
 - v. 2026 and 2027 = 4.2%
 - vi. 2028 and 2029 = 4.1%
 - vii. 2030 and every income tax year thereafter = 4.0%

- b. What happens if during that period there is an effort to obtain voter approval to increase the income tax rate, let's say to 6%? That 6% rate would be for the first year and three income tax years thereafter. Assuming there is no effort to extend that expiring income tax rate, does the income tax rate go back to what it was before the increase? And then does the automatic 0.1% decrease keep happening every general election year until it reaches 4%? But what if that takes longer than six general election cycles?

Technical Comments

The following comments address technical issues raised by the form of the proposed initiative. These comments will be read aloud at the public meeting only if the proponents so request. You will have the opportunity to ask questions about these comments at the review and comment meeting. Please consider revising the proposed initiative as suggested below.

1. It is standard drafting practice to set off nonessential phrases (i.e., introductory, parenthetical, or prepositional phrases) with commas.
2. When the text of the law includes a definition, the headnote for the section should read as follows: "39-22-130. Income tax – definitions."