STATE INCOME TAX REFUND DEDUCTIONS

EVALUATION SUMMARY

APRIL 2019
2019-TE12

THESE EVALUATIONS WILL BE INCLUDED IN COMPILATION REPORT SEPTEMBER 2019

	STATE INCOME TAX REFUND DEDUCTION FOR INDIVIDUALS, ESTATES, AND TRUSTS	STATE INCOME TAX REFUND DEDUCTION FOR CORPORATIONS
YEAR ENACTED	1964	1964
REPEAL/ EXPIRATION DATE	None	None
REVENUE IMPACT	$47.7 million for individuals (TAX YEAR 2015); unable to determine for estates and trusts	Less than $51.4 million (TAX YEAR 2015)
NUMBER OF TAXPAYERS	445,000 individuals; unable to determine for estates and trusts	Less than 2,800
AVERAGE TAXPAYER BENEFIT	$107 for individuals; unable to determine for estates and trusts	Could not determine
IS IT MEETING ITS PURPOSE?	Yes	Yes

WHAT DO THESE TAX EXPENDITURES DO?

The State Income Tax Refund Deductions allow individuals, estates, trusts, and corporations to deduct from their federal taxable income refunds or credits for overpayment of state income taxes that were included in their federal gross income when computing their Colorado taxable income.

WHAT IS THE PURPOSE OF THESE TAX EXPENDITURES?

Statute does not explicitly state the purpose of the State Income Tax Refund Deductions. We inferred that the purpose of these deductions is to prevent state taxation of state refunds and credits that are included in taxpayers' federal gross income.

WHAT DID THE EVALUATION FIND?

We determined that these deductions are generally accomplishing their purpose since taxpayers are aware of them and use them as intended to prevent being taxed on state refunds and credits due to overpayment of income taxes.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider reviewing the state income tax add-back provision for individuals, estates, and trusts due to changes in federal law that establish a $10,000 cap for the state and local tax deduction. State law does not indicate whether taxpayers should apportion these deductions among state and local real property taxes, personal property taxes, and income or sales taxes for the purposes of determining their state tax liability.

STATE INCOME TAX REFUND DEDUCTIONS

EVALUATION RESULTS

WHAT ARE THESE TAX EXPENDITURES?

This evaluation covers two parallel income tax deductions: (1) State Income Tax Refund Deduction for Individuals, Estates, and Trusts [Section 39-22-104(4)(e), C.R.S.], and (2) State Income Tax Refund Deduction for Corporations [Section 39-22-304(3)(f), C.R.S.] (State Income Tax Refund Deductions). These tax expenditures allow Colorado taxpayers to reconcile discrepancies caused by the interaction between Colorado and federal tax laws when taxpayers overpay their Colorado income taxes. House Bill 64-1003 created both of these deductions in 1964, and they have remained largely unchanged since then.

Colorado uses federal taxable income as the starting point for determining Colorado taxable income for all taxpayers. Federal taxable income is the amount on which a taxpayer's federal tax liability is based and reflects any federal deductions, which taxpayers subtract from federal gross income when calculating federal taxable income. However, because Colorado's tax laws do not exactly conform to federal tax laws, certain adjustments must be made to federal taxable income to determine a taxpayer's Colorado taxable income. Specifically, federal law [26 USC 164(a)] allows individuals, estates, trusts, and corporations that itemize deductions on their federal income tax returns, to deduct from their federal gross income certain state and local taxes paid during the year. However, Colorado does not permit individuals, estates, and trusts to deduct any state income taxes paid for the purposes of determining Colorado taxable income, and corporations are only allowed to deduct other state income taxes. Therefore, statutes [Sections 39-22-104(3)(d) and 39-22-304(2)(d), C.R.S.] require individuals, estates, trusts, and corporations that deduct state income taxes on their federal income tax returns to add back all or part of the state income tax deductions to federal taxable income when computing their Colorado taxable income. EXHIBIT 1.1 shows this calculation as it relates to state income taxes.

EXHIBIT 1.1.
TREATMENT OF STATE TAXES FOR THE PURPOSES OF CALCULATING FEDERAL TAXABLE INCOME AND COLORADO TAXABLE INCOME

Federal Gross Income

-

FEDERAL DEDUCTIONS [1]

=

Federal taxable income

+

STATE INCOME TAXES INCLUDED IN FEDERAL DEDUCTIONS

=

Colorado Taxable Income

SOURCE: Office of the State Auditor analysis of federal and Colorado taxable income calculations.
[1] Federal deductions include the amount of state and local taxes paid during the year.

However, Colorado's requirement that taxpayers add back the amount of state income taxes deducted from federal income when calculating Colorado taxable income creates a potential discrepancy in the following tax year if taxpayers overpay their state income taxes and receive a state income tax refund. Overpayment of individual income taxes is common and typically occurs when the taxpayer's estimated tax payments or withholding exceed the amount of tax due for the tax year. When a taxpayer overpays their state income taxes, the State issues the taxpayer a refund or credit for the overpayment amount in the following year, after the taxpayer has filed their tax return. To the extent that the taxpayer deducted state income taxes on their federal return and the deduction reduced the taxpayer's federal tax liability, federal law [26 USC 61] requires some or all of the state refund or credit to be added back to federal gross income for the tax year in which the refund was actually received, which is typically the following year. This is because the taxpayer received a larger federal deduction than they should have in the first year since the amount deducted was based on the original amount of state taxes paid, prior to the refund or credit. A discrepancy occurs in this situation because the state tax refund or credit must be included in federal taxable income for the following year and thus, would also be included in the taxpayer's Colorado taxable income for the following year. This means that the refund or credit gets taxed by the State. EXHIBIT 1.2 illustrates how this discrepancy occurs.

EXHIBIT 1.2.
EXAMPLE DEMONSTRATING THE TAXATION OF THE STATE INCOME TAX REFUND BY THE STATE WITHOUT THE STATE INCOME TAX REFUND DEDUCTION

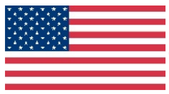
		TAX YEAR 1	TAX YEAR 2
	Federal Gross Income (Tax Year 2 Includes State Refund Amount)	$1,000	$1,010
-	Federal Deduction for State Income Taxes Paid	-$50	-$50
=	Federal Taxable Income	$950	$960
ADD BACK:	Federal Deduction for State Income Taxes Paid	+ $50	+50
=	Colorado Taxable Income	$1,000	$1,010
State Refund for Amount Overpaid in State Income Taxes in Year 1		$10	
TAX PAID ON THE REFUND AMOUNT			$0.46[1]

SOURCE: Office of the State Auditor analysis of federal and Colorado taxable income calculations

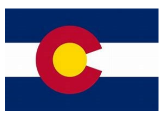
[1]Calculated at state income tax rate of 4.63 percent multiplied by the amount of the state income tax refund included in federal taxable income.

The State Income Tax Refund Deductions allow taxpayers to reconcile this discrepancy. These tax expenditures allow taxpayers to deduct the amount of the state refund or credit included in federal gross income when calculating their Colorado taxable income for the following year (i.e., the year the refund was received). Specifically, individuals, estates, and trusts may subtract a refund or credit for overpayment of income taxes imposed by Colorado or any other taxing jurisdiction, to the extent it was included in federal taxable income. Corporations may deduct only refunds or credits for overpayment of income taxes imposed by Colorado, to the extent they were included in federal taxable income. Pass-through entities, such as partnerships, limited liability companies, and S-corporations, are not subject to income tax at the entity-level in Colorado. Rather, the partners, members, or shareholders are subject to income tax at the individual-level and can use these deductions on their individual income tax returns. EXHIBIT 1.3 provides a summary of this calculation.

**EXHIBIT 1.3.
CALCULATING COLORADO TAXABLE INCOME WITH A FEDERAL STATE AND LOCAL TAX DEDUCTION AND STATE INCOME TAX REFUND**



Federal Gross Income (Includes State Income Tax Refund) - Itemized Deductions (Including State and Local Tax Deduction) = Federal Taxable Income



Federal Taxable Income + All State Income Taxes Deducted on Federal Returns (Individuals, Estates, Trusts) or Colorado Income Taxes Deducted on Federal Returns (Corporations) - Any State Income Tax Refund Included in Federal Taxable Income (Individuals, Estates, Trusts) or Colorado Income Tax Refund Included in Federal Taxable Income (Corporation) = Colorado Taxable Income

SOURCE: Office of the State Auditor analysis of federal and Colorado taxable income calculations.

Individuals claim the State Income Tax Refund Deduction on Line 1 ("State Income Tax Refund") of the Subtractions from Income Schedule (Form DR 0104AD). Estates and trusts claim the deduction on Line 5 ("Other Subtractions") of the Colorado Fiduciary Income Tax Return (Form DR 0105). C-corporations claim the deduction on Line 13 ("Other Subtractions") of the Colorado Corporation Income Tax Return (Form DR 0112).

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURES?

Statute does not explicitly identify the intended beneficiaries of the State Income Tax Refund Deductions. Based on the statutory language of the deduction and interactions between federal and Colorado tax laws, we inferred that the intended beneficiaries of the deductions are Colorado taxpayers that itemize state income tax deductions on their federal tax returns and subsequently receive state income tax refunds or credits for overpayment of income taxes.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of the State Income Tax Refund Deductions. Based on our review of federal and state statutes, legislative history, Department of Revenue taxpayer guidance documents, and discussions with Certified Public Accountants (CPAs), we inferred that the purpose of these deductions is to prevent refunds and credits from being taxed by the State because they are included in taxpayers' federal gross income. Furthermore, because these deductions were created with the same legislation [House Bill 64-1003] that transitioned Colorado from calculating its own state income tax base to using the federal income tax base as the starting point for determining Colorado taxable income, we determined that these deductions are structural tax expenditures that reconcile the federal and Colorado tax systems.

ARE THE TAX EXPENDITURES MEETING THEIR PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that these deductions are generally accomplishing their purpose since taxpayers are aware of them and use them as intended to prevent being taxed on state refunds and credits due to overpayment of income taxes.

Statute does not provide quantifiable performance measures for these deductions. Therefore, we created and applied the following performance measure to determine the extent to which the State Income Tax Refund Deductions are meeting their purpose:

PERFORMANCE MEASURE: *To what extent are Colorado taxpayers using the deductions to prevent state refunds and credits due to overpayment of state income taxes from being taxed?*

RESULT: We estimate that approximately 94 percent of the individuals eligible for the State Income Tax Refund Deduction claimed it in Tax Year 2015 (the most recent year that data were available). To prepare our estimate, we used Department of Revenue data showing that about 413,000 full-year resident individual taxpayers claimed the Income Tax Refund Deduction. We compared that number to Internal Revenue Service Statistics of Income data, which indicated that approximately 439,000 individuals in Colorado overpaid their state income taxes and included the refund in their Tax Year 2015 federal gross income, and thus, would have likely qualified for the deduction.

Furthermore, it appears that eligible individual taxpayers are generally aware of the deduction. According to tax return preparers we contacted, tax return preparers in Colorado are well aware of the deductions, so eligible taxpayers who use a tax return preparer are very likely to claim them. Additionally, for individual taxpayers who prepare their own returns, Department of Revenue Form DR 104AD and Revenue Online, the Department of Revenue's electronic tax return filing service, clearly indicate where to claim this deduction. TurboTax, a tax preparation software that taxpayers can use to prepare and file their own taxes, automatically deducts state tax refunds from federal taxable income when preparing a Colorado return if the taxpayer filled out their federal tax return on TurboTax.

The Certified Public Accountants (CPAs) we spoke with also indicated that tax return preparers for corporations are well aware of the deduction. Although most corporations are unlikely to use the deduction because they use accrual basis accounting and accrue the exact amount of taxes that they owe, those that use cash basis accounting, may overpay their taxes, receive a refund, and therefore use the deduction. However, we were unable to determine the number of corporations that claimed this deduction because the Colorado Corporation Income Tax Return

(Form DR 0112) combines the Income Tax Refund Deduction with several other deductions on a line for "Other Subtractions." In Tax Year 2015, almost 50,000 corporations filed income tax returns in Colorado, and approximately 2,800 filled out the line for "Other Subtractions." Therefore, up to 6 percent of corporations may have claimed the deduction, although we lacked the data necessary to say definitively the proportion of these taxpayers that took it.

We were also unable to determine how many estate and trust taxpayers claimed the deduction because the Colorado Fiduciary Income Tax Return (Form DR 0105) combines the State Income Tax Refund Deduction with several other deductions on a line for "Other Subtractions." Additionally, the combined figure from the "Other Subtractions" line of the return is not retrievable from GenTax, the Department of Revenue's tax processing system.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURES?

According to Department of Revenue taxpayer data, individual taxpayers claimed approximately $1.0 billion in State Income Tax Refund Deductions in Tax Year 2015, which resulted in a $47.7 million reduction in state revenue.

The Department of Revenue was unable to provide specific data on the total amount claimed under the State Income Tax Refund Deductions by corporations and the revenue impact attributable to those claims. However, Department of Revenue data indicate that in Tax Year 2015, corporations claimed approximately $1.1 billion on the "Other Subtractions" line of the Corporation Income Tax Return (Form DR 0112), which resulted in foregone revenue of $51.4 million to the State. This line includes the State Income Tax Refund Deduction for Corporations plus nine other income tax deductions. Based on our conversations with CPAs regarding how corporations accrue and deduct their taxes and due to the fact that it is likely that the other deductions included on the reporting line have a significant revenue impact as well, we would expect the amount attributable to the State Income Tax Refund Deduction for Corporations to be substantially less than $51.4 million.

The Department of Revenue was also unable to provide us with specific data on the total amount claimed under the State Income Tax Refund Deduction by estates and trusts and the revenue impact attributable to those claims. The Colorado Fiduciary Income Tax Return (Form DR 0105) combines the State Income Tax Refund Deduction with eight other deductions on a line for "Other Subtractions." However, the total amount reported on the "Other Subtractions" line of the DR 0105 is not retrievable from GenTax. Therefore, we are unable to provide a maximum possible impact for the State Income Tax Refund Deduction for estate and trust claims.

It is likely that the revenue impact of the State Income Tax Refund Deductions will decrease for Tax Years 2018 through 2025 due to recent federal tax law changes. Specifically, the 2017 Tax Cuts and Jobs Act [Pub. L. 115-97] established a federal $10,000 state and local tax deduction limit for individual, estate, and trust taxpayers and raised the federal standard deduction available to individual taxpayers from $6,350 ($12,700 for jointly filed returns) to $12,000 ($24,000 for jointly filed returns), increased annually for inflation, for Tax Years 2018 through 2025. These changes will likely result in fewer individual taxpayers itemizing deductions on their federal income tax returns and fewer individuals claiming the state and local tax deduction, which is an itemized deduction for Tax Years 2018 through 2025. As a result, fewer taxpayers will have a need and/or qualify for the State Income Tax Refund Deductions.

Although we lacked data to estimate the potential decrease in revenue impact due to changes in federal tax law, it appears that the decrease could be substantial. The Tax Foundation estimated that prior to the passage of the 2017 Tax Cuts and Jobs Act, approximately 30 percent of national filers itemized their deductions and that less than 10 percent are expected to do so under the new law. In Tax Year 2015, 34 percent of Colorado full-year resident individual taxpayers itemized deductions on their federal income tax returns, which was similar to national percentages. If the Tax Foundation's prediction is correct and Colorado's filing patterns generally follow national patterns, the number of taxpayers who itemize their deductions will decrease more than 66 percent. This would mean that 14 percent or less of Colorado individual taxpayers would be expected to itemize their federal deductions. Since individual taxpayers must itemize their federal deductions in order to qualify for the State Income Tax Refund Deduction, it appears likely that there will be a corresponding decrease in its use.

The volume of corporations claiming the State Income Tax Refund Deduction should not change significantly due to recent federal tax law changes because the standard deduction increase only applies to individual taxpayers, and the state and local tax deduction limit only applies to individual, estate, and trust taxpayers.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURES HAVE ON BENEFICIARIES?

If these deductions were eliminated, it could result in taxpayers incurring a larger Colorado tax liability when they overpay their state income taxes, to the extent that the taxpayers itemize state income tax deductions on their federal returns and refunds or credits are included in federal gross income. EXHIBIT 1.4 shows the state tax liability for a hypothetical individual taxpayer who itemized deductions for federal tax purposes under three scenarios: (1) if overpayment of state taxes did not occur, (2) if overpayment occurred and the taxpayer took the State Income Tax Refund Deduction, and (3) if overpayment occurred and the taxpayer did not take the State Income Tax Refund Deduction.

EXHIBIT 1.4.
INDIVIDUAL TAXPAYER SCENARIOS WITH AND WITHOUT OVERPAYMENT OF STATE TAXES AND WITH AND WITHOUT THE STATE INCOME TAX REFUND DEDUCTION

	If Overpayment Did Not Occur During the Prior Year	If Overpayment Occurred, With Deduction	If Overpayment Occurred, Without Deduction
State Income Tax Refund for Overpayment of State Income Taxes in the Prior Tax Year	$0	$630	$630
Other Federal Gross Income	+$100,000	+ $100,000	+ $100,000
Federal State Income Tax Deduction	- $5,000	- $5,000	- $5,000
Federal Taxable Income	= $95,000	= $95,630	= $95,630
State Add-back of Federal State Income Tax Deduction	+ $5,000	+ $5,000	+ $5,000
State Income Tax Refund Deduction		- $630	
Colorado Taxable Income	= $100,000	= $100,000	= $100,630
Colorado Tax (Colorado Taxable Income x 4.63 percent)	$4,630	$4,630	$4,659

SOURCE: Office of the State Auditor analysis of Sections 39-22-104(4)(e) and 39-22-304(3)(f), C.R.S.

As EXHIBIT 1.4 demonstrates, the result of a taxpayer taking the State Income Tax Refund Deduction is the same as if the overpayment of taxes had not occurred. If overpayment of state income taxes occurs, the taxpayer includes the refund amount in their federal gross income, and the State Income Tax Refund Deduction is not taken, the taxpayer in this example would incur a $29 (less than 1 percent) higher Colorado tax liability.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES OR THROUGH OTHER PROGRAMS?

Of the 39 states (excluding Colorado) and the District of Columbia that have a broad-based income tax that uses federal taxable income or adjusted gross income as a starting point for calculating state taxable income for individuals, estates, and trusts, at least 35 states and the

District of Columbia (90 percent) have a state income tax refund deduction or exclusion for individuals, estates, and trusts.

Of the 43 states (excluding Colorado) and the District of Columbia that have a broad-based corporate income tax that uses federal taxable income as the starting point for calculating state taxable income, at least 26 states and the District of Columbia (61 percent) have a similar deduction or income exclusion for state income tax refunds included in federal gross income.

We did not identify any other Colorado tax expenditures, federal tax provisions, or programs with a similar purpose.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURES?

The Department of Revenue was not able to provide us with data for the estates, trusts, and corporations that claimed the State Income Tax Refund Deductions. Currently, estate and trust taxpayers claim the deduction on Line 5 ("Other Subtractions") of the Colorado Fiduciary Income Tax Return (Form DR 0105), which also includes several other deductions. C-corporations claim the deduction on Line 13 ("Other Subtractions") of the Colorado Corporation Income Tax Return (Form DR 0112), which also includes several other deductions. In all cases, taxpayers are required to submit explanations for the deductions taken as other subtractions, but these explanations are not captured by GenTax.

Due to these limitations, we were unable to determine how many estate, trust, or corporation taxpayers claimed these deductions. Additionally, we were unable to provide a revenue impact attributable to the estates, trusts, and corporations claiming this deduction.

To address these limitations, the Department of Revenue would have to create new reporting lines on the DR 0105 and DR 0112 and then capture and house the data collected on those lines in GenTax, which would require additional resources (see the Tax Expenditures Overview

Section of the Office of the State Auditor's *September 2018 Tax Expenditures Compilation Report* for additional details on the limitations of Department of Revenue data and the potential costs of addressing the limitations).

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO REVIEW THE STATE INCOME TAX ADD-BACK PROVISION FOR INDIVIDUALS, ESTATES, AND TRUSTS [SECTION 39-22-104(3)(d), C.R.S.] FOR TAX YEARS 2018 TO 2025 TO ADDRESS CHANGES TO FEDERAL TAX LAW. Specifically, the 2017 Tax Cuts and Jobs Act [Pub. L. 115-97] established a $10,000 state and local tax deduction limit for individuals, estates, and trusts for Tax Years 2018 to 2025. Prior to Tax Year 2018, there was no limit on the amount of state and local taxes that could be deducted. Federal law [26 USC 164] allows taxpayers to deduct state and local real property taxes, personal property taxes, and income or sales taxes, but does not designate the order in which the deductions must be taken or require that the full amount of taxes incurred be deducted. Colorado statute [Section 39-22-104(3)(d), C.R.S.] requires that only state income taxes taken as a federal deduction be added back to federal taxable income when calculating Colorado taxable income, but does not address how taxpayers should apportion the state and local taxes for the purposes of determining their state tax liability with the federal $10,000 state and local tax deduction limit in place. If a Colorado taxpayer itemized deductions and chose to deduct only property taxes on their federal income tax return and the taxpayer subsequently receives a state income tax refund, the taxpayer would not be required to include the state income tax refund in their federal gross income in the year the refund is received. Consequently, the taxpayer would not need/qualify for the State Income Tax Refund Deduction.

For federal tax purposes, a taxpayer with high property and state income taxes may choose to deduct only property taxes if they have $10,000 or more in property taxes to reach the federal limit. In this case, the taxpayer would have no state income tax add-back and would have a lower state tax liability than, for example, if they chose to deduct their state income taxes on their federal return.

EXHIBIT 1.5 illustrates the impact on the Colorado taxable income and tax liability of a hypothetical individual taxpayer who itemized deductions for federal tax purposes under three scenarios: (1) prior to the enactment of the federal $10,000 state and local tax deduction limit, (2) current law assuming the taxpayer chooses to deduct only local property taxes on their federal return to reach the $10,000 deduction limit, and (3) current law assuming the taxpayer chooses to deduct only state income taxes on their federal return to reach the $10,000 deduction limit.

**EXHIBIT 1.5.
INDIVIDUAL TAXPAYER SCENARIOS WITH DIFFERENT STATE INCOME TAX ADD-BACK PROVISIONS**

Taxpayer's State and Local Real Property Taxes	$12,000
Taxpayer's State Income Taxes	$25,000
Taxpayer's Federal Itemized State and Local Tax Deduction[1]	$10,000

COLORADO TAX CALCULATION

	PRIOR TO $10,000 DEDUCTION LIMIT	CURRENT LAW ASSUMING TAXPAYER DEDUCTS ONLY LOCAL PROPERTY TAXES ON FEDERAL RETURN	CURRENT LAW ASSUMING TAXPAYER DEDUCTS ONLY STATE INCOME TAXES ON FEDERAL RETURN
Income Before Federal State and Local Tax Deductions	$500,000	$500,000	$500,000
Federal State and Local Tax Deductions	-$37,000	-$10,000	-$10,000
Federal Taxable Income	$463,000	$490,000	$490,000
State Add-back of State Income Taxes Deducted Federally	+$25,000	+$0	+$10,000
Colorado Taxable Income[2]	$488,000	$490,000	$500,000
Colorado Tax Liability (Colorado Taxable Income x 4.63 percent)	$22,594	$22,687	$23,150

SOURCE: Office of the State Auditor analysis of the state income tax add-back provision in Section 39-22-104(3)(d), C.R.S.

[1] Scenarios exclude other itemized federal deductions in order to isolate the impact of the state and local tax deduction.

[2] For simplification purposes, this example requires no state modifications under Section 39-22-104, C.R.S., or Article 22, except the state income tax add-back.

As EXHIBIT 1.5 demonstrates, under current law, taxpayers can minimize their Colorado tax liability by not deducting their state income taxes on their federal return if they have sufficient local property tax liability to reach the $10,000 federal limit on the state and local tax deduction. Therefore, the federal limit creates a relative advantage for taxpayers with high local property taxes, for example taxpayers who own large or multiple properties. These taxpayers would also be less likely to qualify for the State Income Tax Refund Deduction because they would have less in state income taxes deducted from their federal return that could have later been subject to a state income tax refund inclusion on their federal returns. Taxpayers who paid less local property taxes would be at a relative disadvantage because they would need to deduct more in state income taxes to reach the $10,000 federal cap and would then be required to add back more of their federal deduction when calculating their Colorado taxable income. These taxpayers would be more likely to qualify for the State Income Tax Deduction because they are more likely to have deducted state income taxes that were later subject to a state income tax refund inclusion on their federal return.

Because the federal cap on state and local tax deductions was not in place when the General Assembly created the State Income Tax Refund Deduction and the State's current law regarding what federal deductions taxpayers must add back to their federal taxable income to calculate their Colorado taxable income, it may want to consider whether to address the potential difference in Colorado taxable income based on how taxpayers choose to deduct state and local taxes when filing their federal returns. For example, the General Assembly could require that taxpayers add back some portion of the state income taxes they *could have* deducted on their federal return, up to $10,000.

It is important to note that this issue is more likely to impact higher-income taxpayers who itemize their deductions and have more than $10,000 in state and local tax liabilities. Most individuals in Colorado would likely not be impacted because they either use the standard deduction on their federal return or because they have less than $10,000 in state and local taxes to deduct when itemizing their federal deductions. In addition, under current law, the federal state and local tax deduction limit may increase taxpayers' taxable income overall, at both the federal and state level. Therefore, some taxpayers may be likely to pay more in taxes under the current law than they would have prior to the federal deduction limit, regardless of how they choose to structure their state and local tax deduction.