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FISCAL NOTE

Drafting Number: LLS 18-0392 **Date:** February 14, 2018
Prime Sponsors: Rep. Kraft-Tharp; Wist **Bill Status:** House Business
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Bill Topic: MARKET SOURCING FOR BUSINESS INCOME APPORTIONMENT

- Summary of Fiscal Impact:**
- State Revenue
 - TABOR Refund
 - State Expenditure
 - Local Government
 - State Transfer
 - Statutory Public Entity

This bill changes how multi-state corporate income taxpayers apportion income from the sales of services and intangible property to Colorado. This bill may increase corporate income tax revenue or decrease corporate income tax revenue. It will also increase expenditures in the Department of Revenue. These revenue impacts are ongoing.

Appropriation Summary: No appropriation is required.

Fiscal Note Status: This fiscal note reflects the introduced version of the bill.

**Table 1
State Fiscal Impacts Under HB 18-1185**

		FY 2018-19	FY 2019-20
Revenue	General Fund	(\$2.9 million) to \$8.6 million	(\$6.1 million) to \$18.3 million
Expenditures	General Fund	-	\$260,659
	Centrally Appropriated Costs		\$42,508
	Total	-	\$303,167
	Total FTE	-	3.0 FTE
Transfers		-	-

Summary of Legislation

This bill changes the apportionment method for corporations that do business in multiple states. Under current law, income from the sale of services and intangible property is apportioned based on where the income-producing activity is performed. This bill changes the sourcing rules so that the income is apportioned based on where the income-producing activity is used or delivered.

The Office of Economic Development and International Trade (OEDIT) is required to prepare a report by January 1, 2024, describing the economic impacts of adopting this bill.

Background

Apportionment factor. Corporate income is apportioned to Colorado based on the percent of sales that occur in Colorado relative to total sales of the corporation. This factor is called the apportionment factor, which is applied to federal taxable income to determine taxable income for Colorado corporate income taxes. Every state that has a corporate income tax uses an apportionment factor for corporations with income in multiple states. Various methods and factors are used to determine how income should be apportioned.

State Revenue

This bill may increase or decrease corporate income tax revenue. In FY 2018-19, the corporate income tax revenue impact is between a \$2.9 million decrease and an \$8.6 million increase. In FY 2019-20, the corporate income tax revenue impact will be between a \$6.1 million decrease and an \$18.3 million increase. The actual revenue impact depends on the business activity of each individual taxpayer currently paying corporate income taxes and any additional businesses that would file under the new sourcing rules. Revenue impacts are ongoing.

Assumptions. The Department of Revenue (DOR) provided summary data for all Colorado taxpayers that apportion income for 2011 through 2015. Using these data, the apportionment factor for income from services, intangible property, and copyrights was compared to Colorado's share of the U.S. gross domestic product for service-producing industries, 1.8 percent. This 1.8 percent share approximates the Colorado share of income received by services producing industries, a share expected to be similar to the apportionment factor under this bill. In three of the five years, the 1.8 percent factor would be lower than current law, reducing the amount of taxable income apportioned to Colorado. This reduction in taxable income would result in a 1.0 percent reduction in corporate income taxes. In two of the five years, the apportionment factor would increase, resulting in an annual corporate tax revenue increase of 3.0 percent. These changes were applied to the December 2017 Legislative Council Staff corporate income tax forecast to calculate the revenue impacts for FY 2018-19 and FY 2019-20.

A revenue increase or a revenue decrease is consistent with other states that have adopted a similar sourcing definition for apportioning income. Between 1996 and 2015, 15 states adopted a sourcing definition similar to that under House Bill 18-1185. Of those states, four underperformed a national baseline for corporate income tax revenue, compared with 11 states that outperformed the baseline.

TABOR Refund

The bill increases or decreases state revenue subject to TABOR in FY 2018-19 and in FY 2019-20. State revenue is not currently expected to exceed the TABOR limit in either year and no refund is required. Therefore, the bill is not expected to impact TABOR refunds in these years. However, refunds in future years when the state next collects a TABOR surplus will be increased or reduced.

State Expenditures

This bill will increase state General Fund expenditures in the Department of Revenue by \$303,167 in FY 2019-20 and by \$311,058 in FY 2020-21. These impacts are ongoing.

Department of Revenue. The DOR is responsible for administering the corporate income tax, including performing audits of out-of-state companies. This bill will increase the number of corporations without an office in Colorado with a filing liability. The department will need 3.0 FTE in the discovery and audit section to identify out-of-state taxpayers that should be filing corporate income tax returns under the new sourcing rules. Currently, the audit and discovery section uses state records to find non-filers. The new sourcing rules will require using additional data sources such as IRS data, data from other states, and other available sources of information to identify taxpayers that have a filing liability. The DOR will perform more audits of out-of-state companies, which will increase travel expenses totaling \$22,000 in FY 2019-20 and \$44,000 in FY 2020-21 and future years.

**Table 2
Expenditures Under HB 18-1185**

Cost Components	FY 2018-19	FY 2019-20	FY 2020-21
Department of Revenue			
Personal Services	-	\$205,500	\$205,500
Operating Expenses and Capital Outlay Costs	-	\$16,959	\$2,850
Travel Costs	-	\$22,000	\$44,000
Leased Space	-	\$16,200	\$16,200
Centrally Appropriated Costs*	-	\$42,508	\$42,508
FTE – Personal Services	-	3.0 FTE	3.0 FTE
Total	-	\$303,167	\$311,058
Total FTE	-	3.0 FTE	3.0 FTE

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

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 and supplemental employee retirement payments, are estimated to be \$42,508 in FY 2019-20 and \$42,508 in FY 2020-21.

Office of Economic Development and International Trade. The OEDIT is required to prepare a report by January 1, 2024, describing the economic impacts of adopting this bill. This will result in a one-time workload increase in FY 2023-24 which can be accomplished with existing appropriations.

Effective Date

The bill takes effect August 8, 2018, if the General Assembly adjourns on May 9, 2018, as scheduled, and no referendum petition is filed. The bill applies to tax payments starting in 2019.

State and Local Government Contacts

Information Technology OEDIT Revenue