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# Fiscal Note

**Drafting Number:** LLS 21-0892 **Date:** June 2, 2021  
**Prime Sponsors:** Rep. Ortiz; Van Winkle **Bill Status:** House Finance  
 Sen. Kolker; Woodward **Fiscal Analyst:** Jeff Stupak | 303-866-5834  
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**Bill Topic:** STATE & LOCAL TAX PARITY ACT FOR BUSINESSES

**Summary of Fiscal Impact:**

<input type="checkbox"/> State Revenue	<input type="checkbox"/> TABOR Refund
<input checked="" type="checkbox"/> State Expenditure	<input type="checkbox"/> Local Government
<input type="checkbox"/> State Transfer	<input type="checkbox"/> Statutory Public Entity

The bill allows pass-through businesses to elect to pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2022. The bill will increase state expenditures beginning in FY 2021-22.

**Appropriation Summary:** For FY 2021-22, the bill requires an appropriation of \$2,385,316 to the Department of Revenue.

**Fiscal Note Status:** The fiscal note reflects the introduced bill.

**Table 1**  
**State Fiscal Impacts Under HB 21-1327**

		Budget Year FY 2021-22	Out Year FY 2022-23
<b>Revenue</b>		-	-
<b>Expenditures</b>	General Fund	\$2,385,316	\$3,646,442
	Total FTE	26.0 FTE	48.4 FTE
<b>Transfers</b>		-	-
<b>TABOR Refund</b>		-	-

## Summary of Legislation

Pass-through businesses, such as sole proprietorships, partnerships, and S-corporations, do not pay the corporate income tax. Rather, any profits generated by the business are “passed through” to the owners of the business and subsequently taxed at the individual level. This bill allows partnerships and S-corporations to elect to pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2022.

## Background

The federal Tax Cuts and Jobs Act of 2017 placed a temporary \$10,000 annual cap on the federal income tax deduction for state and local taxes (“SALT” deduction) for individual income taxpayers. No cap exists for this deduction for C-corporations. The cap is set to expire on December 31, 2025. This bill allows Colorado owners of partnerships and S-corporations to avoid the cap on the federal deduction by filing taxes at the entity level instead of the individual level.

## Assumptions

Based on federal tax data, Colorado filers with an approximate adjusted gross income of \$150,000 and up tend to reach the federal SALT deduction cap. Based on Colorado state tax data, approximately 18 percent of Colorado taxpayers with business income have an adjusted gross income in this range. As such, this fiscal note assumes that approximately 18 percent of pass-through businesses will elect to file at the entity level to bypass the SALT deduction limit. This results in an estimated 56,064 businesses in tax year 2022 and 58,085 businesses in tax year 2023 electing to pay their state income taxes at the entity level. The fiscal note assumes that on average pass-through businesses have five individual partners, based on data from the Colorado Department of Revenue.

## State Revenue

The bill is not expected to affect state revenue. Under Colorado law, taxpayers are required to add back any state and local taxes deducted at the federal level to their Colorado taxable income. As such, total Colorado taxable income is not expected to change under this bill.

## State Expenditures

The bill is expected to increase General Fund expenditures in the by \$2,385,316 and 26.0 FTE in FY 2021-22, and by \$3,646,442 and 48.4 FTE in FY 2022-23 and subsequent years through FY 2025-26 when the cap expires under federal law. Expenditures are summarized in Table 2 and described below.

**Table 2  
Expenditures Under HB 21-1327**

	FY 2021-22	FY 2022-23
<b>Department of Revenue</b>		
Personal Services	\$1,344,766	\$2,475,466
Operating Expenses	\$38,340	\$65,340
Capital Outlay Costs	\$173,600	-
GenTax Programming	\$66,375	-
Computer and User Acceptance Testing	\$98,991	-
Data Reporting	\$1,600	-
Form Changes, Scanning, and Data Entry	\$102,346	\$67,004
Centrally Appropriated Costs	\$559,298	\$1,038,632
<b>Total Cost</b>	<b>\$2,385,316</b>	<b>\$3,646,442</b>
<b>Total FTE</b>	<b>26.0 FTE</b>	<b>48.4 FTE</b>

**Department of Revenue.** The bill is expected to increase expenditures for the department by \$2.4 million and 26.0 FTE in FY 2021-22, and by \$3.6 million and 48.4 FTE in FY 2022-23 and subsequent years. Personal services account for the largest portion of the increased expenditures in the department. Under current practices, pass-through entity tax returns are generally not reviewed by the department as there is no tax liability at the entity level. Under this bill, the department will have to review all pass-through tax returns that opt to file at the entity level. Additionally, the department will have to cross verify the individual tax returns of the pass-through owners to ensure that the proper subtractions and additions are made on these returns. In tax year 2022, this fiscal note assumes that approximately 56,000 pass-through businesses will opt to file at the entity level, which includes approximately 280,000 individual owners. Given the significant change in policy, it is also expected that the bill will increase error rates by taxpayers, driving additional work load.

Other costs for the department are related to programming the department's GenTax software, software and related user acceptance testing, tax form changes performed in the Department of Personnel and Administration using reappropriated DOR funds, and data reporting in the DOR's Office of Research and Analysis.

**Centrally appropriated costs.** Pursuant to fiscal note and Joint Budget Committee policy, centrally appropriated costs for bills involving more than 20 FTE are appropriated in the bill, rather than through the annual budget process. These costs, which include employee insurance and supplemental employee retirement payments for Department of Revenue, are estimated to be \$559,298 in FY 2021-22 and \$1,038,632 in FY 2021-22.

### **Effective Date**

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

## State Appropriations

For FY 2021-22, the bill requires a General Fund appropriation of \$2,385,316 to the Department of Revenue, and 26.0 FTE. Of this amount, \$102,346 are to be reappropriated to the Department of Personnel and Administration.

## State and Local Government Contacts

Information Technology  
Personnel

Local Affairs  
Revenue