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M E M O R A N D U M

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TO: Interested Persons

FROM: Larson Silbaugh, Economist, (303) 866-4720

SUBJECT: Impact of "The American Taxpayer Relief Act of 2012" on the December 2012 Economic and Revenue Forecast

Summary

The American Taxpayer Relief Act of 2012 (Act) addressed uncertainties related to federal tax policy by extending most of the Bush-era individual and corporate income tax provisions for the middle class. In general, the Act is consistent with assumptions made during the preparation of the Legislative Council Staff December 2012 revenue forecast. The expiration of a few tax provisions will increase Colorado General Fund revenue above that expected in the December forecast. The December economic forecast also assumed that the federal debt ceiling would be raised and automatic spending cuts would be dealt with in the first quarter of 2013.

This memo includes an overview of the Act, a discussion of the major assumptions made while preparing the December forecast, and the impact of the Act on expectations for Colorado General Fund revenue.

Overview of the Act

The American Taxpayer Relief Act of 2012, passed on January 1, 2013, avoided most of the tax increases that would have occurred with the expiration of the Bush-era tax cuts. The act:

- maintains the Bush-era tax rates on income less than $400,000 ($450,000 for families);
- increases the top marginal tax rate to 39.6 percent for income above those amounts;

- preserves many of the individual and corporate income tax credits and deductions that were in place in 2012;
- increases the income level to which the alternative minimum tax applies, and indexes this amount for inflation;
- increases the maximum estate tax rate for estates over $5 million dollars, adjusted for inflation, to 40 percent from 35 percent, and eliminates the state estate tax credit;
- extends emergency unemployment benefits through 2013;
- maintains reimbursement rates for doctors caring for Medicare patients; and,
- postpones for two months the automatic budget cuts, known as sequestration, that were scheduled to occur starting January 2, 2013.

The Act did not extend the 2 percent payroll tax cut or raise the federal debt ceiling.

December 2012 Forecast Assumptions

The *economic* forecast was prepared based on the assumption that federal lawmakers would reach an agreement on federal tax and spending policies and raise the debt ceiling in the first quarter of 2013. The Act addressed uncertainty around tax policy. In separate legislation, Congress raised the debt ceiling through May 19th, but the December forecast made the assumption that the threat of a federal default would be taken off the table until at least mid-2014. A compromise on spending will also need to be reached to be consistent with the assumptions made in the December economic forecast.

The *revenue* forecast was prepared assuming a continuation of 2012 federal individual income, corporate income, and estate tax policies. The forecast assumed that emergency unemployment benefits and the payroll tax would not be extended. In general, the assumptions made for the Colorado revenue forecast are consistent with the Act; although specific tax policies that differed between the assumptions made in the December revenue forecast and the Act are discussed in following sections of this memo.

Overall Impact on Economic Outlook

The December economic outlook assumed that three areas of federal fiscal policy would be resolved in the first quarter of 2013: taxes, the debt ceiling, and automatic spending cuts. The Act eliminated many of the tax increases that were scheduled to occur at the start of 2013. Congress passed legislation so that the debt ceiling would not apply until May 19th, eliminating the threat of a federal government default until then, but the forecast assumed that the threat of default would be eliminated until at least 2014. The temporary increase in the debt ceiling delays the threat of a default to later in 2013, rather than eliminating it, which would have been consistent with the forecast assumptions. The third outstanding issue is federal spending. The automatic spending cuts known as the sequester are scheduled to take effect March 1st, and the authority to fund many government programs expires March 27th. If either of these is allowed to occur, it would slow economic growth relative to what was anticipated in the forecast. The reaction from consumers, investors, and businesses could impact broader economic conditions and reduce General Fund revenue by a greater amount than the direct revenue impact of the Act.

Changes to federal tax policy thus far are broadly consistent with the assumptions used to prepare the December forecast. The March forecast will be prepared with the most recent data available at that time. This includes changes to federal spending, but also data reflecting economic activity in the later part of 2012 and the first part of 2013.

Impact of the Act on the General Fund Revenue Forecast

Table 1 shows the impact of the Act on the December revenue forecast. Table 2 on page 5 shows the December General Fund revenue estimates updated for the impact of the Act. A discussion of the difference between the Act's provisions and the assumptions used to prepare the forecast for each Colorado General Fund revenue source begins on page 8.

Table 1
Impact of the American Taxpayer Relief Act of 2012 on Colorado General Fund Revenue
Millions of Dollars, Current as of February 28, 2013

Revenue Source	FY 2012-13	FY 2013-14	FY 2014-15
Estate Tax (Federal Estate Tax Returns to Pre-2006 Form)	No Impact: Consistent with Forecast		
Corporate Income Taxes			
Accelerated Expensing and Bonus Depreciation	0.0	105.7	157.1
All Other Corporate Income Tax Provisions	2.2	4.0	3.6
Subtotal: Corporate Income Taxes	**$2.2**	**$109.8**	**$160.6**
Individual Income Taxes			
Alternative Minimum Tax Not Indexed for Inflation	No Impact: Consistent with Forecast Assumptions		
All Other Individual Income Tax Provisions	23.5	49.9	53.5
Subtotal: Individual Income Taxes	**$23.5**	**$49.9**	**$53.5**
Sales and Use Taxes			
Emergency Unemployment Benefits	1.3	0.6	0.0
Expiration of Payroll Tax Cut	No Impact: Consistent with Forecast		
Subtotal: Sales and Use Taxes	**$1.3**	**$0.6**	**$0.0**
Total	**$27.0**	**$160.3**	**$214.1**

Source: Legislative Council Staff analysis of nationwide estimates released by the Congressional Budget Office and Joint Committee on Taxation.
Note: An explanation for each item on this table begins on page 8.

Impact on General Fund Overview

The following paragraphs describe the General Fund budget after incorporating the impact of the Act. Table 3 on page 6 shows the General Fund overview updated with the revenue impacts from the Act.

FY 2012-13. The FY 2012-13 General Fund budget is in balance. Assuming the $514.7 million surplus from FY 2011-12 is not spent but carried forward into FY 2013-14, revenue is expected to be $811.8 million higher than the amount budgeted to be spent or retained in reserve. Pursuant to House Bill 12-1388, the $811.8 million surplus will be transferred to the State Education Fund at the end of the fiscal year. If the state spends some of this money, the transfer will be reduced correspondingly. This estimate is $27.0 million higher than was expected in the December forecast because of the direct revenue impact of the Act.

The $811.8 million transfer to the State Education Fund is displayed as an expenditure from the General Fund in Table 3, even though the money actually has not been appropriated and will not have been spent at the time of transfer. Excluding the transfer in both FY 2011-12 and FY 2012-13, total General Fund expenditures increased 7.8 percent in FY 2012-13. General Fund operating appropriations, a subset of General Fund expenditures, are currently budgeted to increase 5.8 percent.

FY 2013-14. After adjusting General Fund revenue upward by $160.3 million as a result of the Act, revenue is expected to be $927.1 million higher in FY 2013-14 than what would be needed to fund General Fund operating appropriations and the statutorily required reserve at the same level as was budgeted in FY 2012-13. This amount is equal to 10.5 percent of total expenditures (excluding the State Education Fund transfer) in FY 2012-13. Because a budget has not yet been enacted for FY 2013-14, Table 3 shows operating appropriations in FY 2013-14 at the same level currently budgeted in FY 2012-13. Therefore, the $927.1 million figure would be lower if adjusted to account for expenditure pressures resulting from inflation and caseload growth.

Impact on the TABOR Situation

Table 4 on page 7 shows estimates for TABOR revenue, the TABOR Limit/Referendum C Cap, and revenue retained as a result of Referendum C through FY 2014-15. The Referendum C cap will equal $11.4 billion in FY 2012-13, and revenue subject to TABOR is expected to be $849.1 million below the cap, or $27.0 million closer to the cap than was expected in December. In FY 2013-14, revenue subject to TABOR is expected to be $11.3 billion, $528.1 million below the Referendum C cap. Revenue will not be sufficient to produce a TABOR refund through at least FY 2014-15, the end of the forecast period, when revenue subject to TABOR is expected to be $345.7 million below the cap, or $214.1 million closer to the cap than anticipated in December.

Table 2
December 2012 General Fund Revenue Estimates
Updated for the American Taxpayer Relief Act of 2012
(Dollars in Millions)

Category	Actual	Percent	Estimate	Percent	Estimate	Percent	Estimate	Percent
Sales	$2,093.2	2.4	$2,227.9	6.4	$2,320.4	4.2	**$2,416.0**	**4.1**
Use	200.6	5.6	225.2	12.2	237.5	5.5	**253.4**	**6.7**
Cigarette	39.5	0.5	39.0	-1.2	37.5	-4.0	**35.9**	**-4.2**
Tobacco Products	16.0	16.1	15.6	-3.0	16.1	3.6	**16.6**	**2.9**
Liquor	38.4	5.3	39.4	2.6	40.4	2.6	**42.2**	**4.6**
TOTAL EXCISE	$2,387.7	2.8	$2,547.0	6.7	$2,651.9	4.1	**$2,764.2**	**4.2**
Net Individual Income	$5,011.6	11.5	$5,149.3	2.7	$5,505.5	6.9	**$5,913.7**	**7.4**
Net Corporate Income	486.5	23.5	518.4	6.6	650.0	25.4	**717.9**	**10.4**
TOTAL INCOME TAXES	$5,498.1	12.4	$5,667.7	3.1	$6,155.4	8.6	**$6,631.6**	**7.7**
Less: Portion diverted to the SEF	-407.5	10.0	-425.1	4.3	-451.9	6.3	**-474.0**	**4.9**
INCOME TAXES TO GENERAL FUND	$5,090.6	12.6	$5,242.6	3.0	$5,703.6	8.8	**$6,157.5**	**8.0**
Estate	0.3	NA	0.0	NA	0.0	NA	**0.0**	**NA**
Insurance	197.2	4.0	206.2	4.5	221.6	7.5	**232.7**	**5.0**
Pari-Mutuel	0.6	14.2	0.5	-15.0	0.5	-4.0	**0.4**	**-13.0**
Investment Income	13.6	71.5	15.2	11.9	16.4	7.9	**17.3**	**6.0**
Court Receipts	2.6	-27.6	2.2	-15.0	2.0	-10.0	**1.8**	**-10.0**
Gaming	20.3	-0.5	20.4	0.0	20.5	0.3	**20.5**	**0.0**
Other Income	23.1	8.5	18.9	-18.3	19.5	3.3	**20.7**	**6.0**
TOTAL OTHER	$257.6	5.9	$263.3	2.2	$280.4	6.5	**$293.4**	**4.6**
GROSS GENERAL FUND	**$7,736.0**	**9.2**	**$8,052.9**	**4.1**	**$8,635.9**	**7.2**	**$9,215.1**	**6.7**
REBATES & EXPENDITURES:								
Cigarette Rebate	$11.2	1.9	$11.4	1.7	$11.0	-4.0	**$10.5**	**-4.2**
Old-Age Pension Fund	92.5	1.2	94.4	2.1	84.0	-11.0	**89.2**	**6.2**
Aged Property Tax & Heating Credit	7.2	5.2	7.2	0.1	7.1	-1.0	**7.0**	**-1.0**
Older Coloradans Fund	8.0	0.0	9.2	14.8	8.0	-12.9	**8.0**	**0.0**
Old Age Supplemental Medical Care	2.9	0.0	0.0	-100.0	0.0	0.0	**0.0**	**0.0**
Interest Payments for School Loans	0.7	-16.3	0.6	-10.8	1.7	179.9	**1.8**	**6.0**
Fire and Police Pension Association	9.7	125.4	14.6	50.3	30.0	105.9	**30.0**	**0.0**
Amendment 35 GF Expenditures	0.9	0.2	0.9	0.9	0.9	-2.2	**0.8**	**-3.2**
TOTAL REBATES & EXPENDITURES	**$133.0**	**5.5**	**$138.2**	**4.0**	**$142.7**	**3.2**	**$147.4**	**3.3**

Totals may not sum due to rounding. NA = not applicable. NE = not estimated.

SEF = State Education Fund.

Table 3
December 2012 General Fund Overview
Updated for the American Taxpayer Relief Act of 2012
(Dollars in Millions)

		FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15
FUNDS AVAILABLE		**Actual**	**Estimate**	**Estimate**	**Estimate**
1	Beginning Reserve	$156.7	$795.8	$297.5	$1,224.6
2	General Fund Nonexempt Revenue	6,261.5	6,724.0	6,918.5	7,232.3
3	General Fund Exempt Revenue (Referendum C)	1,474.5	1,328.9	1,717.4	1,982.9
4	Transfers to Other Funds	(5.0)	(4.6)	(1.6)	(1.6)
5	Transfers from Other Funds	143.0	2.1	2.2	2.2
6	**Total Funds Available**	**$8,030.7**	**$8,846.3**	**$8,934.0**	**$10,440.4**
7	Percent Change	8.8%	10.2%	1.0%	16.9%
EXPENDITURES		**Actual**	**Budgeted**	**Estimate /A**	**Estimate /A**
8	General Fund Appropriations	7,027.9	7,438.1	7,438.1	7,438.1
9	Rebates and Expenditures *(Line 28 of Table 5)*	133.0	138.2	142.7	147.4
10	Reimbursement for Senior and Disabled Veterans Property Tax Cut				
11	Capital Construction Transfers				
12	Transfers to the State Education Fund and State Public School Fund /B	59.0	811.8	0.0	0.0
13	Accounting Adjustments	(36.1)	NE	NE	NE
14	**Total Expenditures**	**$7,234.8**	**$8,548.8**	**$7,709.4**	**$7,706.2**
15	Percent Change	0.1%	18.2%	-9.8%	-0.04%
BUDGET SUMMARY		**Actual**	**Estimate**	**Estimate /A**	**Estimate /A**
16	**Amount Available for Expenditure** *(Line 6 minus Line 21)*	**7,749.6**	**8,548.8**	**8,636.5**	**10,142.9**
17	Dollar Change	524.8	799.2	87.7	1,506.4
18	Percent Change	7.3%	10.3%	1.0%	17.4%
RESERVE		**Actual**	**Budgeted**	**Estimate /A**	**Estimate /A**
19	Year-End General Fund Reserve	795.8	297.5	1,224.6	2,734.2
20	Year-End Reserve As A Percent of Appropriations	11.3%	4.0%	16.5%	36.8%
21	Statutorily-Required Reserve /B	281.1	297.5	297.5	297.5
22	Reserve in Excess or (Deficit) of Statutory Reserve	$514.7	$0.0	$927.1	$2,436.7
23	*Percent Change in General Fund Appropriations*	*3.0%*	*5.8%*	*NE*	*NE*
24	Addendum: TABOR Reserve Requirement	308.2	317.3	337.5	356.1
25	Addendum: 5% of Colorado Personal Income Appropriations Limit	10,231.2	10,627.3	11,270.5	11,676.3
26	Addendum: Amount Directed to State Education Fund Per Amendment 23	407.5	425.1	451.9	474.0

Totals may not sum due to rounding. NE = Not Estimated.

/A Because the budgets for FY 2013-14 and FY 2014-15 have not yet been enacted, this analysis assumes General Fund appropriations as budgeted for FY 2012-13 (line 8) will occur in FY 2013-14 and FY 2014-15 Therefore, line 23 shows the amount of money available for expenditure in FY 2013-14 and FY 2014-15 above the amount budgeted to be spent in FY 2012-13 .

/B Transfers pursuant to HB 12-1338.

Table 4
December 2012 TABOR Revenue Limit and Retained Revenue
Adjusted for the American Taxpayer Relief Act of 2012
(Dollars in Millions)

	Preliminary FY 2011-12	Estimate FY 2012-13	Estimate FY 2013-14	Estimate FY 2014-15
TABOR Revenue:				
General Fund /A	$7,720.4	$8,023.8	$8,606.7	$9,185.9
Cash Funds	2,552.8	2,552.5	2,644.8	2,683.8
Total TABOR Revenue	**$10,273.2**	**$10,576.3**	**$11,251.5**	**$11,869.7**
Revenue Limit				
Allowable TABOR Growth Rate	2.0%	5.1%	3.1%	3.7%
Inflation (from prior calendar year)	1.9%	3.7%	1.7%	2.1%
Population Growth (from prior calendar year) /B	0.1%	1.4%	1.4%	1.6%
TABOR Limit Base	$8,798.7	$9,247.4	$9,534.1	$9,886.8
Voter Approved Revenue Change (Referendum C)	$1,474.5	$1,328.9	$1,717.4	$1,982.9
Total TABOR Limit / Referendum C Cap	$10,870.9	$11,425.4	$11,779.6	$12,215.4
Retained/Refunded Revenue				
Revenue Retained under Referendum C /C	$1,474.5	$1,328.9	$1,717.4	$1,982.9
Total Available Revenue	**$10,273.2**	**$10,576.3**	**$11,251.5**	**$11,869.7**
Revenue To Be Refunded to Taxpayers	$0.0	$0.0	$0.0	$0.0

Totals may not sum due to rounding.

/A These figures differ from the General Fund revenues reported in other tables because they net out revenue that is already in the cash funds to avoid double counting and include transfers of revenue from TABOR enterprises into TABOR district boundaries.

/B The population growth rate used to calculate the FY 2011-12 limit reflects a downward adjustment of about 1.3 percentage points for an overcount of population during the decade between 2000 and 2010.

/C Revenue retained under Referendum C is referred to as "General Fund Exempt" in the budget and the General Fund Overview.

Explanation of Impact on Individual Revenue Sources

Estate Tax

Elimination of the state estate tax credit. The Colorado estate tax is tied to a credit allowed by the federal government against the federal estate tax. The credit, equal to the amount of estate taxes paid to a state, allowed Colorado to collect state estate tax revenue without increasing the combined federal-state estate tax liability for taxpayers. Since 2006, there has been no federal estate tax credit, but it was scheduled to return in 2013. The Act permanently extended the current estate tax structure without a state estate tax credit.

> ***Impact.*** Had the state estate tax credit returned, the Colorado estate tax was estimated to generate $45.0 million in General Fund revenue in FY 2012-13 and $94.0 million in FY 2013-14. Without the credit, there will be no Colorado estate tax collections. Table 1 shows no impact because the Act is consistent with the assumptions made in the forecast.

Corporate Income Tax

Accelerated expensing and bonus depreciation. Bonus depreciation allows corporations to lower taxable income by depreciating some of the value of certain investments earlier than otherwise would have been allowed. Bonus depreciation has been allowed since 2008, and has been regularly extended as a temporary measure to encourage business investment. This provision was extended through 2013, but is currently scheduled to expire in 2014. This will raise federal taxable corporate income relative to the assumptions made in the forecast starting in tax year 2014. Tax returns filed beginning in 2014 will "recapture" the bonus depreciation claimed in the first year, so corporate taxable income will be higher than it would have been had the 2012 tax policy been continued.

> ***Impact.*** The expiration of accelerated expensing and bonus depreciation starting in 2014 is estimated to increase Colorado corporate income tax collections $105.7 million in FY 2013-14 and $157.1 million in FY 2014-15 above the December forecast. Bonus depreciation and accelerated expensing has been allowed at the federal level each year since 2008, so it has been built into the tax base used to prepare the forecast.

Other Corporate Income Tax Provisions. Some minor changes to corporate income taxes were also allowed to expire in the Act. Corporate taxable income will increase because of tax provisions impacting the treatment of donations of books and computers to schools, the depreciation of race horses, depletion of oil and gas wells, the dispensation of electricity transmission equipment, and the expensing of brownfield remediation.

> ***Impact.*** These minor corporate income tax changes have been built into the corporate income tax base, so the federal tax changes will increase forecasted Colorado corporate income tax collections $2.2 million in FY 2012-13 and $4.0 million in FY 2013-14.

Individual Income Tax

The Alternative Minimum Tax. The Alternative Minimum Tax (AMT) is a parallel individual income tax system that disallows certain itemized deductions for taxpayers with sufficiently high income levels. The income levels were set in statute in the 1970's and had not been adjusted for inflation, so many additional taxpayers would have been required to pay the AMT in tax year 2013. The Act increased the AMT limit to 2012 levels and tied it to inflation.

> ***Impact.*** If the AMT had not been increased to 2012 levels and adjusted for inflation, Colorado individual income taxes would have increased by an estimated $230.9 million in FY 2012-13 and $325.4 million in FY 2013-14. The Act continued 2012 tax policy, and thus Table 1 shows no impact.

Other individual income tax provisions. Of the numerous individual income tax changes that were set to take effect starting January 1, 2013, only one will impact Colorado individual income tax collections. The value of itemized deductions for taxpayers with more than $250,000 ($300,000 joint filers) will be reduced, which increases federal taxable income. In addition, the emergency unemployment benefits that were extended are taxable income.

> ***Impact.*** Capping the value of itemized deductions for taxpayers with more than $250,000 in Adjusted Gross Income and the extension of emergency unemployment benefits will increase taxable income by an estimated 0.9 percent per year starting in 2013. This increase in taxable income will increase Colorado individual income tax collections by $23.5 million in FY 2012-13 and $49.9 million in FY 2013-14 above the amount forecast in December.

Sales and Use Tax

Extension of emergency unemployment benefits. Emergency unemployment benefits were extended, and thus some consumers in Colorado will receive unemployment benefits in 2013 that would have otherwise expired. The December forecast assumed that emergency unemployment benefits would expire at the end of 2012.

> ***Impact.*** The continuation of emergency unemployment benefits will increase personal income, which will increase sales taxes. Accounting for the percentage of income spent on housing and non-taxable retail sales, about 31.8 percent of emergency unemployment benefits will be spent on taxable goods. This will increase sales tax collections by about $1.3 million in FY 2012-13 and $0.6 million in FY 2013-14.

Expiration of the payroll tax cut. The employee portion of the payroll tax will increase from 4.2 percent to 6.2 percent in 2013. This increase will reduce disposable income for all wage earners in Colorado, which will decrease the amount of taxable purchases that taxpayers would otherwise make.

> ***Impact.*** The economic forecast was prepared assuming that the payroll tax would not be extended, reducing disposable income and Colorado retail trade. Colorado retail trade is used to forecast sales tax collections, so the December sales tax forecast implicitly includes the expiration of the payroll tax cut. Therefore, Table 1 shows no impact of this measure.