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TABOR REFUND MECHANISMS

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This issue brief provides information on mechanisms used to refund revenue in excess of the state's constitutional spending limit. For information on the state spending limit and how it is calculated, please refer to Issue Brief 14-03A.

The spending limit established in the Taxpayer's Bill of Rights (TABOR) has capped state revenue during 15 of the last 20 fiscal years. To date, there have been six years in which revenue exceeded the spending limit, most recently during FY 2004-05. The legislature may determine statutorily how the excess revenue is refunded. Over the course of TABOR's history, there have been 21 different refund mechanisms. Under current law, there are three: the six-tier sales tax refund, the earned income tax credit (EITC) refund mechanism, and the temporary income tax rate reduction. A description of each refund mechanism follows.

State revenue forecasts do not anticipate any TABOR refunds through at least FY 2015-16, the last year of the revenue forecasting period. However, the difference between the forecast and the projected limit is within forecast error in both FY 2014-15 and FY 2015-16, indicating that a refund is possible.

Figure 1 shows how a TABOR surplus would be refunded under current law based on the size of the surplus. Amounts are for FY 2014-15, based on the June 2014 Legislative Council Staff forecast.

Six-Tier Sales Tax Refund

This refund mechanism allows taxpayers to receive a state sales tax refund based on where their adjusted gross income falls within six adjusted gross income tiers. The Department of Revenue sets the income level for each tier so that all tiers contain the same number of taxpayers. It then computes the dollar amount of each tier's refund by allocating to each tier a proportion of the total amount to be refunded equal to the tier's share of state taxable income. The refund is distributed to the six tiers when the TABOR surplus is large enough to support at least a $15 refund for each Colorado income taxpayer. If the surplus is less than $15 per taxpayer, an equal refund is provided to each taxpayer, regardless of income.

The six-tier sales tax refund mechanism can be viewed as both the first and the last refund mechanism. It may be the first and only refund triggered in a year when the TABOR surplus is not sufficient to trigger other mechanisms. This was the case in FY 2004-05. In years when the surplus is large enough to trigger other refund mechanisms, the sales tax refund distributes any revenue beyond what is refunded by the other mechanisms.

EITC Refund Mechanism

The Colorado EITC is based on the federal EITC, which provides a tax credit to individuals who work but do not earn high incomes. Qualifying Colorado taxpayers may receive up to 10 percent of the federal credit amount in years of revenue surplus. Colorado taxpayers who claim the federal credit may claim the state credit. To qualify for the EITC in tax year 2013, earned income and adjusted gross income for individuals must each be less than:

- $46,227 ($51,567 married filing jointly) with three or more qualifying children;
- $43,038 ($48,378 married filing jointly) with two qualifying children;
- $37,870 ($43,210 married filing jointly) with one qualifying child; or
- $14,340 ($19,680 married filing jointly) with no qualifying children.

The EITC refund mechanism is triggered when the surplus exceeds a threshold amount. The threshold is increased each year by the growth in Colorado personal income. In FY 2014-15, if the amount of the refund exceeds $97.7 million, the EITC will be triggered.

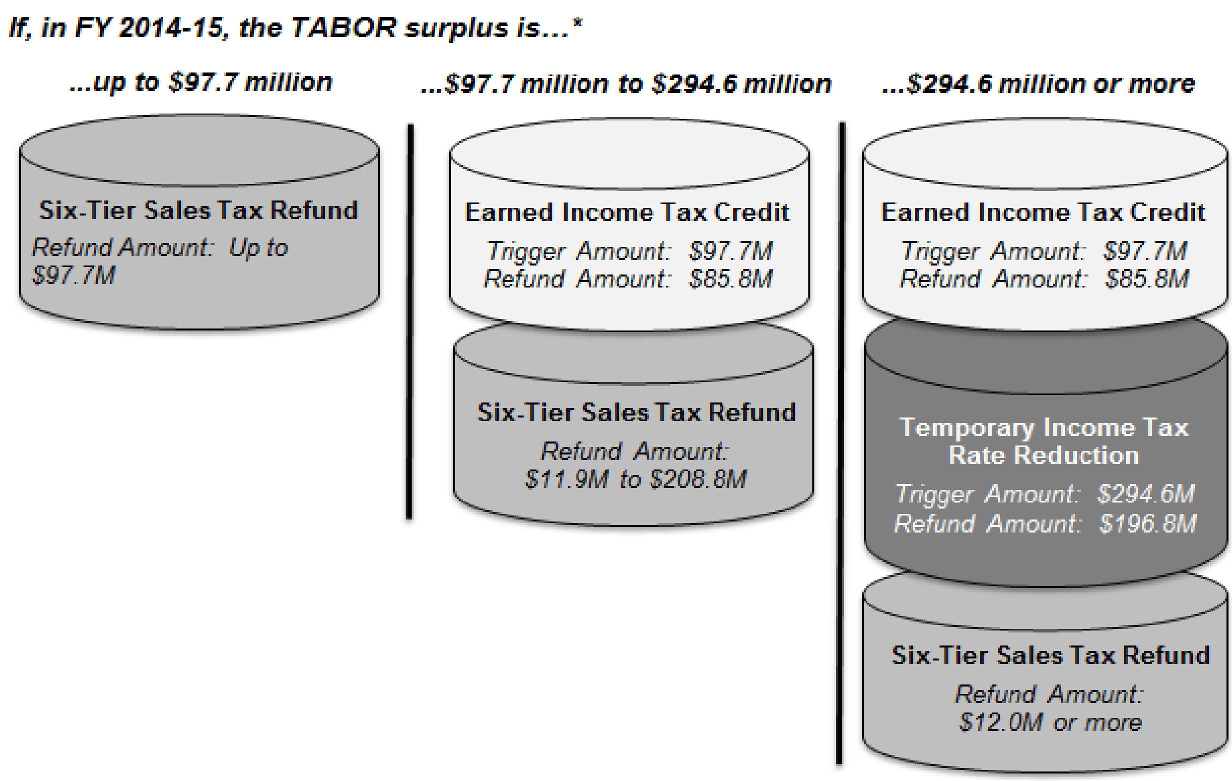
Senate Bill 13-001 establishes a permanent EITC to replace the EITC refund mechanism. The permanent EITC begins the year following the first year the EITC refund mechanism is triggered.

Temporary Income Tax Rate Reduction

Under the temporary income tax rate reduction mechanism, the state income tax rate would be temporarily reduced from the current rate of 4.63 percent to 4.50 percent. The rate reduction will occur in the tax year following the fiscal year in which there is a surplus. For example, if there were a surplus in FY 2014-15, the income tax rate would be reduced in tax year 2015, and would return to 4.63 percent in tax year 2016.

The temporary income tax rate reduction is triggered when the state experiences a surplus equal to at least the EITC refund mechanism trigger plus the projected amount of the income tax rate reduction. As Figure 1 shows, this amount is projected to be $294.6 million for FY 2014-15 (a $196.8 million tax rate reduction plus the $97.7 million EITC threshold).

Figure 1. Example Refund Scenarios Under Current Law



Source: Dollar amounts are based on the June 2014 Legislative Council Staff forecast.
**This figure is for illustrative purposes. Revenue is not expected to exceed the Referendum C cap in FY 2014-15. If there were to be a TABOR surplus in FY 2014-15, the refund would occur in FY 2015-16 for tax year 2015.*