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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 21 fiscal years. To date, there have been six years in which revenue exceeded the spending limit, most recently during FY 2004-05. However, state revenue is expected to exceed the spending limit in FY 2014-15 and subsequent years.

The legislature determines 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.

The March 2015 Legislative Council Staff revenue forecast expects TABOR refunds to begin in tax year 2015. Figure 1 shows how TABOR surpluses forecast in FY 2014-15, FY 2015-16, and FY 2016-17 will be refunded. However, the difference between the revenue forecast and the projected spending limit is within forecast error, introducing the possibility that refunds may not occur as soon as anticipated. Alternatively, the amount of the TABOR surplus may be larger than forecast, triggering different refund mechanisms than those shown in Figure 1.

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 among six adjusted gross income tiers. State law requires the Department of Revenue to distribute the money among the six tiers as it was distributed for the tax year 1999 sales tax refund. 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, and is expected to be the case in FY 2014-15. 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 2015, earned income and adjusted gross income for individuals must each be less than:

- $47,747 ($53,267 married filing jointly) with three or more qualifying children;
- $44,454 ($49,974 married filing jointly) with two qualifying children;
- $39,131 ($44,651 married filing jointly) with one qualifying child; or
- $14,820 ($20,330 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.

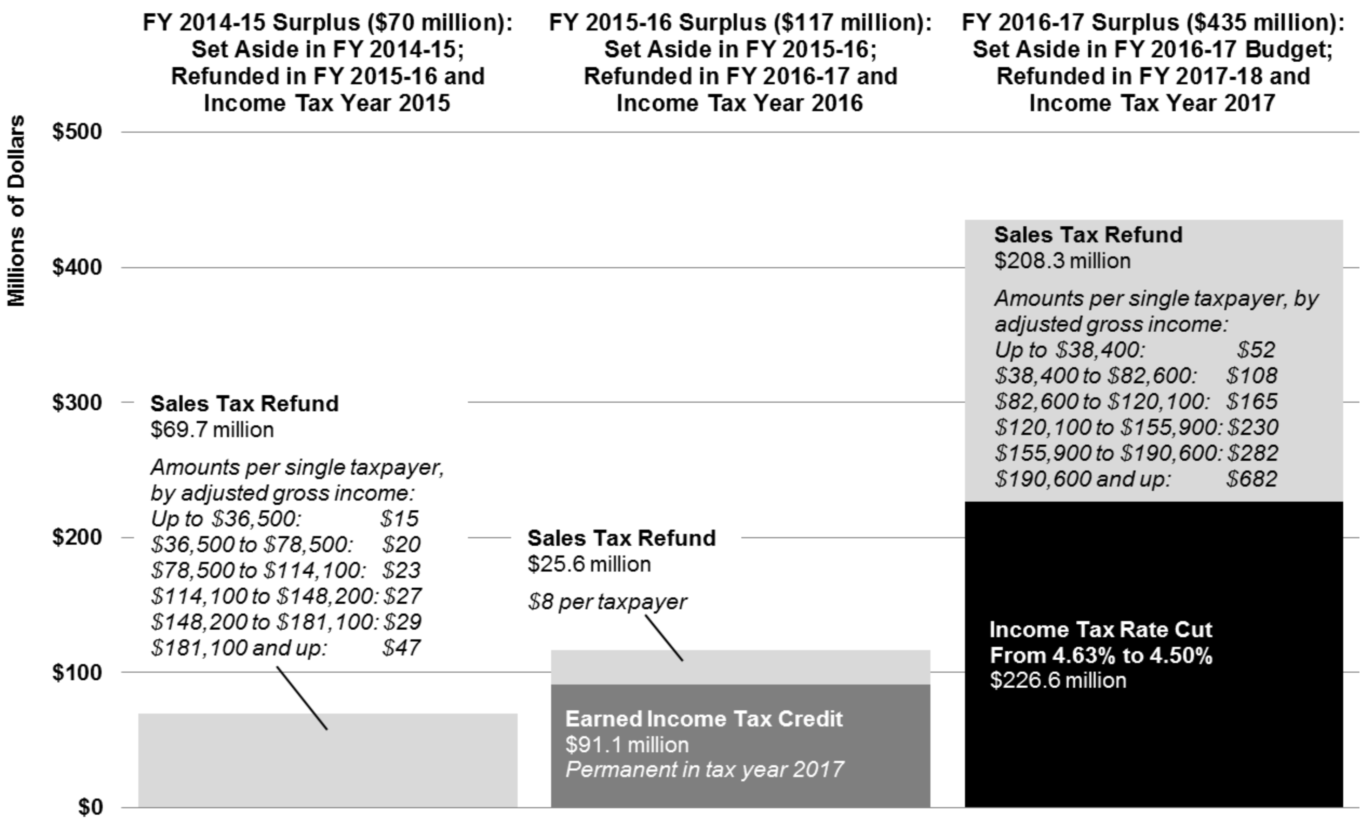
Senate Bill 13-001 establishes a permanent EITC to replace the EITC refund mechanism. The permanent EITC begins the year following the first year the EITC refund mechanism is triggered.

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 occurs in the tax year following the fiscal year in which there is a surplus. For example, if the reduction were triggered in FY 2014-15, the income tax rate would be reduced in tax year 2015. It would return to 4.63 percent in tax year 2016 unless the rate reduction were also triggered for that year.

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. Once the EITC becomes permanent, the temporary income tax rate reduction is triggered when the surplus reaches the projected amount of the income tax rate reduction. As shown in Figure 1, this is projected to occur in FY 2016-17.

Figure 1. TABOR Refunds Expected for FY 2015-16, FY 2016-17, and FY 2017-18



Source: March 2015 Legislative Council Staff Forecast.