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THE FEDERAL JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT'S IMPACT ON COLORADO AND TAXPAYERS

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On May 28, 2003, the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 was signed into law. The new law includes several federal tax reduction measures, many of which temporarily accelerate tax reductions that were part of the federal Economic Growth and Tax Relief Reconciliation Act of 2001. The tax provisions under the 2001 law are scheduled to be repealed after 2010. This *Issue Brief* explains the recent federal tax law changes, including their impact on state tax revenue and on individuals and businesses. It also provides information on the state fiscal assistance provided under the new law.

Federal Tax Changes Impacting State Revenue

Colorado's income taxes are based on federal taxable income. Thus, when the federal government makes changes to definitions of income, exemptions, or deductions, the changes affect Colorado's tax revenue. Three of the tax measures that were enacted impact federal taxable income and thus state taxable income. The business tax incentive measures, including the business equipment expensing and the bonus depreciation provisions, will have the most significant direct impact on state revenue. Changes to the federal alternative minimum tax will also directly impact state revenue.

Table 1 provides a summary of the estimated direct impacts of the act on state revenue. Following the table is an explanation of each tax policy change. If the tax cuts are repealed as scheduled, the state will see a corresponding increase in revenue after the repeal date of each provision. While no attempt is made to quantify the amount, the state will see a partially offsetting increase in sales and other tax revenues as people and businesses in the state spend their tax savings on goods, services, and investments.

Table 1: Jobs and Growth Tax Relief Reconciliation Act of 2003 Estimated Impact on Colorado Revenue
(*in millions*)

Fiscal Year	Business Equipment Expensing	Bonus Depreciation Allowance	Alternative Minimum Tax	Total
2002-03	($1.7)	($6.0)	($0.2)	($7.9)
2003-04	(3.9)	(47.0)	(0.3)	(51.2)
2004-05	(5.2)	(26.0)	(0.2)	(31.4)
Total	($10.8)	($79.0)	($0.7)	($90.5)

Source: Legislative Council Staff estimates

Business equipment expensing. Under federal tax law, business equipment investments generally cannot be claimed fully as an expense in the first year, but instead must be spread over the useful lifetime of the equipment. However, the law does allow businesses to immediately deduct a certain amount of the cost of qualifying equipment investments as an expense in the first year. Under the new law, the amount that may be immediately deducted is increased from $25,000 to $100,000 for tax years 2003 through 2005. The amount of annual investment qualifying for this immediate deduction begins to phase out for businesses with purchases in excess of $400,000, which is an increase from its prior level of $200,000. These dollar limitations are indexed for inflation beginning in 2004. This provision will impact federal taxable income and is estimated to reduce state revenue by about $10.8 million through June 2005.

Bonus depreciation allowance for certain business property. The first-year bonus depreciation provision allows for the cost of business equipment to be reduced for purposes of computing depreciation allowances in the year of purchase and later years. The new law increases the first-year bonus depreciation deduction from 30 percent to 50 percent of the cost of business equipment that is acquired after May 5, 2003, and before January 1, 2005. The first-year bonus depreciation is determined after any deduction under the business equipment expensing provision is taken. However, not all investments qualify for both. The expansion of the bonus depreciation impacts federal taxable income and thus Colorado taxable income. It will reduce state revenue by about $79 million through June 2005.

Alternative minimum tax exemption. The alternative minimum tax (AMT) is a tax some individuals have to pay in addition to the regular income tax. It is intended to ensure that higher income individuals who use special tax benefits pay at least a minimum amount of tax. Colorado has had an AMT for individual taxpayers since 1987 that is based on federal alternative minimum taxable income. The new law increases the federal AMT exemption amount in tax years 2003 and 2004 by $9,000, to $58,000 for married taxpayers filing joint returns and surviving spouses. For single taxpayers, the exemption is increased by $4,500, to $40,250. The increased exemption ends for tax year 2005. These exemptions will pass through to the state AMT and will reduce state revenue by about $693,000 during the affected years.

State Fiscal Assistance

The new law includes $20 billion in one-time fiscal assistance to states. The package includes $10 billion in federal money for state Medicaid programs and $10 billion to be used by states to support essential government services or to cover the costs of complying with unfunded federal mandates. Colorado's share is approximately $238.6 million: $92.3 million in increased federal assistance for Medicaid and $146.3 million in assistance for providing government services. Table 2 shows the amount of money the state is estimated to receive annually from the fiscal assistance package under the new federal law.

Table 2: Estimated Fiscal Assistance for Colorado
(*millions of dollars*)

	FY 2002-03	FY 2003-04	Total
Increased Medicaid Match	$17.8	$74.5	$92.3
Flexible Assistance	73.1	73.1	146.3
Total	$90.9	$147.6	$238.6

Source: Federal Funds Information for States

Federal Tax Reductions Impacting Individuals

Individual income tax rate reductions. Under the 2001 federal tax legislation, the top four income tax rates were scheduled to be gradually reduced until the reductions are repealed on December 31, 2010. The new tax law accelerates these rate reductions. Since Colorado's income tax system is not dependent on the federal tax brackets, the federal rate changes will not directly impact state tax collections. Table 3 shows the changes in the rates for the top four tax brackets as they were scheduled under the 2001 law compared with the new rates under the 2003 law.

Table 3: Federal Income Tax Rate Schedules under the 2001 and 2003 Tax Laws

Federal Income Tax Rate Schedule under 2001 Law				
Calendar Year	28% Rate Changed To:	31% Rate Changed To:	36% Rate Changed To:	39.6% Rate Changed To:
2001 through 2003	27%	30%	35%	38.6%
2004 through 2005	26%	29%	34%	37.6%
2006 through 2010	25%	28%	33%	35%
Federal Income Tax Rate Schedule under 2003 Law				
2003 through 2010	25%	28%	33%	35%

Source: Joint Committee on Taxation, U.S. Congress

The enactment of the federal tax law in 2001 added a sixth tax bracket of 10 percent for the first $6,000 of taxable income for a single person, $10,000 for a head of household, and $12,000 for a married couple. Table 4 shows the taxable income amounts of the 10 percent bracket that were scheduled under the 2001 law and the accelerated amounts under the 2003 law.

Table 4: Taxable Income Levels for the 10 Percent Bracket

	2001 Law		2003 Law	
Calendar Year	Single Filers	Married Filers	Single Filers	Married Filers
2003 and 2004	$6,000	$12,000	$7,000	$14,000
2005 through 2007	$6,000	$12,000	$6,000	$12,000
2008 through 2010	$7,000	$14,000	$7,000	$14,000

Table 5 shows the new federal income tax rates and corresponding tax year 2003 income bracket amounts under the new law.

Table 5: 2003 Federal Income Tax Rates and Brackets under the 2003 Tax Law

Single Taxpayers		
Income Over	But Not Over	Rate
$0	$7,000	10%
7,000	28,400	15
28,400	68,800	25
68,800	143,500	28
143,500	311,950	33
$311,950	—	35
Married Taxpayers Filing Jointly		
Income Over	But Not Over	Rate
$0	$14,000	10%
14,000	56,800	15
56,800	114,650	25
114,650	174,700	28
174,700	311,950	33
$311,950	—	35

Source: The Tax Foundation

Accelerated increase in the child credit. Table 6 shows the amounts of the federal child credit that were scheduled under the 2001 law compared with the 2003 tax law.

Table 6: Federal Child Tax Credit Under the 2001 and 2003 Tax Laws

Calendar Year	Credit under 2001 Law	Credit under 2003 Law
2003 and 2004	$600	$1,000
2005 through 2008	700	700
2009	800	800
2010	1,000	1,000

Source: Joint Committee on Taxation, U.S. Congress

Beginning July 2003, the additional $400 child credit will be paid in advance to qualifying taxpayers. Congress is currently debating whether to extend this additional credit amount to more taxpayers. Because this credit is applied to taxes owed at the federal level and not to income as used on the Colorado income tax form, there is no corresponding direct impact on Colorado tax collections.

Accelerated marriage penalty relief. The "marriage penalty" is the difference between the tax married couples pay and the amount they would have paid as two single individuals. The new law accelerates the scheduled changes under the 2001 law that reduced the marriage penalty. First, it raises the standard deduction amount for married couples filing jointly to twice the amount for single taxpayers for tax years 2003 and 2004. This will allow a non-itemizing married couple to exclude the same amount of income from taxation as two single people. This change will not directly impact Colorado tax revenue because the state enacted its own marriage penalty tax relief that increased the standard deduction amount in 1999 (House Bill 99-1003).

The law also extends the 15 percent tax rate to $56,800 of taxable income for married couples filing jointly, double the amount for single taxpayers. This change will be in effect for tax years 2003 and 2004. Again, there is no direct impact on Colorado because the federal tax rates are not used in Colorado. Both of these changes will revert back to being phased in between 2005 and 2009 as provided for under the 2001 law.

Reduced individual capital gains tax rates. The new federal law reduces the maximum 20 percent tax rate on long-term capital gains to 15 percent. For lower income persons the rate is reduced from 10 to 5 percent, and then to zero in 2008. The new rates apply to capital gains realized on or after May 6, 2003, and before January 1, 2009. These federal rate reductions do not apply to state taxes on capital gains. However, the lower tax rates may induce some taxpayers to an earlier realization of their gains. Thus, Colorado may have an indirect revenue increase from this capital gains rate reduction.

Reduced individual dividend tax rates. Under the new law, dividends received by individuals from domestic and qualified foreign corporations generally will be taxed at the same rates that apply to capital gains. For example, the top rate will be 15 percent, down from a rate of 38.6 percent. This provision applies to dividends received for the 2003 through 2008 tax years. In 2008, the lower rate would drop from 5 percent to zero, and in 2009, dividend income will again be taxed the same as most other income. These reductions do not directly impact the state; however, there may be a revenue gain if businesses increase their dividends to stockholders.