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MEMORANDUM

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TO: Interested Persons

FROM: Greg Sobetski, Economist, 303-866-4105

SUBJECT: History of TABOR Refund Mechanisms

Summary

This memorandum provides background information on current and past statutory mechanisms used to refund state revenue collected in excess of the spending limit contained in the Taxpayer's Bill of Rights (TABOR). TABOR allows the state to use "any reasonable method" for refunds, including temporary tax credits or rate reductions.

The General Assembly has created and repealed various mechanisms to refund the state TABOR surplus. In total, 20 refund mechanisms have existed in statute at some point. Seventeen of these have been repealed, and three remain in law as of the end of FY 2014-15. Table 1 on page 9 provides a history of the mechanisms used to refund all TABOR surpluses collected to date.

Colorado's Constitutional Spending Limit

TABOR,[1] approved by voters in 1992, limits annual growth in state spending. A constitutional formula calculates a state spending limit for each fiscal year by multiplying a base amount by inflation and population growth. The base amount is the lesser of the prior year's spending limit or actual revenue. The formula adds voter-approved revenue changes into the limit calculation.[2]

Spending limit = previous year's base × (annual change in inflation and population)
+ voter-approved revenue changes

In practice, the limit on state fiscal year spending functions as a limit on the amount of revenue the state can collect and retain from certain sources because adding funds to a reserve is considered spending for the purpose of the limit calculation. TABOR identifies certain

[1] Colo. Const. art. X, § 20.
[2] Colo. Const. art. X, § 20 (7)(a).

sources of revenue as being exempt from the limit, including gifts, federal funds, collections for another government, employee pension contributions and pension fund earnings, transfers, damage awards, property sales, and revenue to enterprises.[3]

Referendum C. Passed by voters in 2005, Referendum C is a permanent voter-approved revenue change. Referendum C created a five-year "timeout period" between FY 2005-06 and FY 2009-10. During this time, the state was allowed to spend or save the full amount of revenue it collected, effectively setting the spending limit equal to revenue.[4] Beginning in FY 2010-11, Referendum C allows the state to keep revenue up to a capped amount, known as the Referendum C cap. The cap is equal to the highest amount of revenue collected in a single fiscal year during the timeout period, adjusted by inflation and population growth each year thereafter.[5] The cap is grown from the prior year's cap irrespective of whether state revenue was above or below the cap during that year. Because revenue peaked in FY 2007-08, the amount of revenue collected during that fiscal year became the base for computing the cap in subsequent years.

Referendum C requires that revenue retained under the referendum be spent only on health care, public education, transportation, and local fire and police pensions.[6] For additional information on the TABOR limit and the Referendum C cap, refer to Legislative Council Staff Issue Brief 15-14, "Colorado's Constitutional Spending Limit."

Refunds of excess revenue. The constitution requires that revenue collected above the limit for a given fiscal year be refunded to taxpayers in the following fiscal year.[7] The constitution does not require use of any particular refund mechanism, but allows the General Assembly to select "any reasonable method for refunds[…], including temporary tax credits or rate reductions."[8] Further, the constitution does not require that excess revenue be refunded proportionately "when prior payments are impractical to identify or return."[9]

The General Assembly has enacted a total of 20 refund mechanisms since TABOR's adoption in 1992, of which three remain in current law. Senate Bill 10-212 repealed all other TABOR refund mechanisms in law at the time of its passage. Descriptions of current and past TABOR refund mechanisms are included below. Table 1 on page 9 provides a history of mechanisms used to refund all TABOR surpluses collected to date.

TABOR Refund Mechanisms in Current Law

There are three TABOR refund mechanisms in current state law:

- the six-tier sales tax refund;
- the earned income tax credit; and
- the temporary income tax rate reduction.

[3]Colo. Const. art. X, § 20 (2)(d) and (e).
[4]Section 24-77-103.6 (1), C.R.S.
[5]Section 24-77-103.6 (6) (b)(I)(B), C.R.S.
[6]Section 24-77-103.6 (2), C.R.S.
[7]Colo. Const. art. X, § 20 (7)(d).
[8]Colo. Const. art. X, § 20 (1).
[9]Colo. Const. art. X, § 20 (1).

Six-tier sales tax refund. The six-tier sales tax refund[10] is available on income tax returns. It allows taxpayers to receive a refund of sales tax revenue based on where their adjusted gross income falls among six adjusted gross income tiers. When the amount to be refunded via the sales tax refund mechanism is large enough to support at least $15 per taxpayer, the Department of Revenue is required to distribute the amount among the tiers as it was distributed for the sales tax refund in tax year 1999. If the amount to be refunded 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 last refund mechanism. It may be the first and only refund mechanism triggered in a year when the TABOR surplus is not sufficient to trigger the other mechanisms, as was the case in FY 2004-05. In years when the surplus is large enough to trigger the other refund mechanisms, the sales tax refund distributes any excess revenue beyond what is refunded by the other mechanisms. Per the Office of the State Controller's FY 2014-15 revenue certification, the state TABOR surplus totaled $150.0 million in FY 2014-15. Of this, $85.7 million is expected to be refunded via the earned income tax credit, and the remaining $67.9 million[11] is expected to be refunded via a six-tier sales tax refund averaging $22 per taxpayer.

Prior to the six-tier sales tax refund mechanism, the General Assembly had approved similar three-tier and four-tier sales tax refund mechanisms. House Bill 99-1001 created the current six-tier sales tax refund, which was first used to refund the FY 1998-99 TABOR surplus in tax year 1999.

***Earned income tax credit*.** The Colorado earned income tax credit (EITC)[12] is based on the federal EITC, which provides a tax credit to individuals who work but do not earn high incomes. Colorado taxpayers who qualify for the federal credit may claim a state credit equal to up to 10 percent of the federal credit amount. 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 TABOR surplus exceeds an amount equal to a $50 million threshold set for FY 1999-00, grown each year by Colorado personal income. Per the Office of the State Controller's FY 2014-15 revenue certification, the state TABOR surplus totaled $150.0 million in FY 2014-15, exceeding the $97.7 million required to trigger the EITC. The EITC will be available on 2015 income tax forms to refund approximately $85.7 million of the FY 2014-15 surplus.

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. Because the EITC was triggered as a refund mechanism in tax year 2015, the credit will become available as a permanent tax credit beginning tax year 2016. It will not be used to refund TABOR surpluses collected in FY 2015-16 or subsequent years.

[10]Sections 39-22-2001, 39-22-2002, and 39-22-2003, C.R.S.
[11] Includes a $3.6 million correction for previous underrefunds.
[12]Section 39-22-123, C.R.S.

A state EITC equal to 8.5 percent of the federal EITC was first created as a TABOR refund mechanism pursuant to House Bill 99-1383. House Bill 00-1049 increased the value of the state EITC to 10 percent of the federal EITC. The EITC was used in tax years 1999, 2000, and 2001 to refund TABOR surpluses collected in FY 1998-99, FY 1999-00, and FY 2000-01.

Temporary income tax rate reduction. Under the temporary income tax rate reduction mechanism, the state income tax rate is 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 was 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 amount 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.

The temporary income tax rate reduction was created under House Bill 05-1194. It has not yet been used as a TABOR refund mechanism.

History of TABOR Refund Mechanisms

Seventeen of the 20 TABOR refund mechanisms created by the General Assembly have been repealed; these are described below. Table 1 on page 9 summarizes the mechanisms used to issue the seven state TABOR refunds for surpluses collected between FY 1996-97 and FY 2014-15. The thresholds noted to trigger a specific refund mechanism were increased each year by the annual percent change in Colorado personal income.

Business personal property tax refund. Enacted pursuant to House Bill 99-1311, this refund was available on income tax returns to taxpayers who paid business personal property tax during the fiscal year for which the refund was allowed. The amount of the refund was equal to the amount of business personal property tax paid up to $500, plus 13.37 percent of business personal property tax paid in excess of $500. House Bill 01-1287 increased the cap for the full refund from $500 to $700 and increased the percentage of tax refunded above $700 from 13.37 percent to 16.00 percent. The refund became available if the state TABOR surplus exceeded a $170 million threshold in FY 1999-00.

The refund was available in tax years 1999 through 2001 to refund TABOR surpluses collected in FYs 1998-99, 1999-00, and 2000-01. In these years, $79.0 million, $78.5 million, and $99.8 million, respectively, were refunded via the business personal property tax refund.

***Foster care expenses income tax credit*.** Enacted pursuant to House Bill 01-1313, this credit was available to each resident individual taxpayer operating a foster care home who incurred nonreimbursed expenses in connection with the operation of the home. The credit was capped at $500 per home, and became available if the state TABOR surplus exceeded a $200 million threshold in FY 2001-02. The credit was available in tax year 2001 to refund the FY 2000-01 TABOR surplus, and refunded $200,000.

Child care expenses income tax credit. Colorado offers this tax credit in all years; however, an expanded version of the credit was available as a TABOR refund mechanism until it was repealed by Senate Bill 10-212. Pursuant to House Bill 00-1351, the expanded credit was available to taxpayers able to claim a child care expenses tax credit on their federal income tax return, provided that their adjusted gross income remained below $64,000. The expanded credit was equal to 70 percent of the amount claimed on the taxpayer's federal tax return, plus $300 for each qualifying child 12 years of age or younger. The base tax credit is available in all years, but the expanded credit was used as a refund mechanism if and only if the state was required to refund a TABOR surplus.

The expanded credit was available in tax years 2000 and 2001 to refund TABOR surpluses collected in FYs 1999-00 and 2000-01. In these years, $20.4 million and $25.5 million, respectively, were refunded via the expanded credit.

Interest, dividends, and capital gains income tax deduction. Enacted pursuant to House Bill 99-1137, this deduction was available to taxpayers earning income from interest, dividends, and net capital gains. Under HB 99-1137, the amount of the deduction was capped at $1,200 per taxpayer for a single tax year. The cap was raised to $1,500 per taxpayer pursuant to House Bill 00-1171. The deduction became available if the state TABOR surplus exceeded a $350 million threshold in FY 2000-01.

The deduction was available in tax years 2000 and 2001 to refund the TABOR surpluses collected in FYs 1999-00 and 2000-01. In these years, $44.9 million and $44.3 million, respectively, were refunded via the deduction.

Income tax deduction for capital gains on assets purchased prior to 1994. Enacted pursuant to House Bill 99-1237, this deduction was available to taxpayers earning income from capital gains on assets purchased prior to May 9, 1994. Under preexisting law, capital gains on assets purchased on or after May 9, 1994, and held for at least five years, were not computed as taxable income. HB 99-1237 extended the deduction to capital gains purchased prior to May 9, 1994, if the state TABOR surplus exceeded a $260 million threshold in FY 1999-00.

The deduction was available in tax years 2000 and 2001 to refund the TABOR surplus collected in FYs 1999-00 and 2000-01. In these years, $111.5 million and $50.5 million, respectively, were refunded via the deduction.

Income tax deduction for capital gains on assets sold in 2001 and later. Enacted pursuant to House Bill 00-1209, this deduction was available to taxpayers earning income from capital gains on transactions occurring on or after January 1, 2001. In order to qualify for the deduction, the taxpayer must have held the asset for a period of more than one year and less than five years; assets held for more than five years qualified for a deduction available under preexisting law. HB 00-1209 extended this deduction if the state TABOR surplus exceeded a $430 million threshold in FY 2000-01. The deduction was available in tax year 2001 to refund the FY 2000-01 TABOR surplus, and refunded $27.7 million.

Motor vehicle registration fee reduction. Enacted pursuant to House Bill 00-1227, this fee reduction was available for registrants of all vehicles. Registration fees for passenger vehicles were reduced to $2.50 and registration fees for other vehicles were reduced by 25 percent. Vehicle registration fees are paid to the Highway Users Tax Fund (HUTF). To offset the reduction in transportation funds resulting from the registration fee reduction, the State Treasurer diverted an increased share of state sales and use tax revenue to the HUTF. The reduction became available if the state TABOR surplus exceeded a $330 million threshold in FY 2000-01. The reduction was available in FY 2001-02 to refund the FY 2000-01 TABOR surplus, and refunded $34.0 million.

Heavy-duty truck sales and use tax rate reduction. Enacted pursuant to House Bill 00-1259, this rate reduction was available to sellers or users of trucks with gross vehicle weight ratings of 26,000 pounds or greater. When in effect, the sales and use tax on heavy-duty trucks was reduced from the 2.90 percent rate assessed on other tangible personal property to 0.01 percent. The rate reduction became available if the state TABOR surplus exceeded a $350 million threshold in FY 2000-01. The reduction was available in FY 2001-02 to refund the FY 2000-01 TABOR surplus, and refunded $5.2 million.

Agricultural value-added income tax credit. Enacted pursuant to House Bill 01-1086, this credit was available to eligible applicants for agricultural value-added tax credits. Credits were awarded by the Colorado Agricultural Value-Added Development Board in an amount equal to 50 percent of the applicant's investment in value-added agricultural cooperatives, up to $15,000 per applicant and $1.5 million per project. The credit became available if the state TABOR surplus exceeded a $400 million threshold in FY 2001-02. The credit was available in tax year 2001 to refund the FY 2000-01 TABOR surplus, and refunded $0.5 million.

Pollution control equipment sales and use tax exemption. Enacted pursuant to House Bill 00-1257, this exemption was available to sellers or users of pollution control equipment certified by the Division of Administration in the Department of Public Health and Environment (CDPHE). CDPHE was permitted to certify equipment used to eliminate, reduce, or prevent air, water, or other environmental pollution. Equipment for which a certificate was obtained could be sold or used without being assessed state sales or use tax, though local jurisdictions could continue to levy their own taxes. The exemption became available if the state TABOR surplus exceeded a $350 million threshold in FY 2000-01.

The exemption was available in FYs 2000-01 and 2001-02 to refund the TABOR surpluses collected in FYs 1999-00 and 2000-01, respectively. In FY 2000-01, the exemption refunded $1.9 million. No taxpayers claimed the exemption in FY 2001-02.

Private health care income tax credit. Enacted pursuant to House Bill 00-1104, this credit was available to taxpayers who obtained private health insurance and who were not covered by an individual health benefit plan or an employee or group health benefit plan during the tax year for which the credit was claimed. The credit was available only to taxpayers with adjusted gross incomes of less than $25,000, or $35,000 for residents with dependents. The credit was refundable and capped at $500 per taxpayer. It became available if the state TABOR surplus exceeded a $400 million threshold in FY 2000-01.

The credit was available in tax years 2000 and 2001 to refund the TABOR surpluses collected in FYs 1999-00 and 2000-01. In these years, $2.8 million and $2.4 million, respectively, were refunded via the credit.

Rural health care provider income tax credit. Enacted pursuant to House Bill 00-1063, this credit was available to health care professionals practicing in rural health care professional shortage areas. The nonrefundable credit was equal to one-third of the balance owed on the provider's student loan and allowed any unused credit to be carried forward for a period of ten years. It became available if the state TABOR surplus exceeded a $285 million threshold in FY 2000-01.

The credit was available in tax years 2000 and 2001 to refund the TABOR surpluses collected in FYs 1999-00 and 2000-01. In these years, $0.1 million and $0.2 million, respectively, were refunded via the credit.

Charitable contributions income tax deduction. Enacted pursuant to House Bill 00-1053, this deduction was available to taxpayers who made more than $500 in charitable contributions but took the standard deduction, rather than the itemized deduction, on their federal income tax return. The deduction was equal to the amount of contributions in excess of $500 that the taxpayer could have claimed as an itemized deduction on a federal return. The deduction became available if the state TABOR surplus exceeded a $350 million threshold in FY 2000-01. House Bill 05-1125 lowered the threshold to $100 million in FY 2006-07. Under Senate Bill 10-212, the deduction is no longer a TABOR refund mechanism but is instead a permanent deduction available on state income tax returns. The deduction was available in tax year 2001 to refund the FY 2000-01 TABOR surplus, and refunded $2.9 million.

Income tax credit for contributions to individual development accounts. Enacted pursuant to House Bill 00-1361, this credit was available to taxpayers who made matching contributions to individual development accounts. Taxpayers with adjusted gross incomes less than or equal to 200 percent of the federal poverty level could create accounts to finance postsecondary education, and taxpayers with adjusted gross incomes less than or equal to 80 percent of the area median income could create accounts to finance the purchase of a home. Money deposited in accounts was eligible to be matched with donor contributions, and donors were eligible to receive the tax credit if the state incurred a sufficient TABOR surplus. The credit was equal to 25 percent of donor contributions, up to $100,000, and the total amount of credit allowed to all donors was capped at $5 million for a single tax year. The credit became available if the state TABOR surplus exceeded a $190 million surplus in FY 2000-01. The credit was available in tax year 2001 to refund the FY 2000-01 TABOR surplus, and refunded $10,816.

High Technology Scholarship Program income tax credit. Enacted pursuant to House Bill 00-1355, this credit was available to taxpayers contributing to the Colorado High Technology Scholarship Program. The credit was equal to 25 percent of contributions, but not to exceed 15 percent of the taxpayer's income tax liability. The credit became available if the state TABOR surplus exceeded a $330 million threshold in FY 2000-01. The credit was available in tax year 2001 to refund the FY 2000-01 TABOR surplus, and refunded $3,343.

Research and development property sales and use tax refund. Enacted pursuant to House Bill 01-1081, this refund would have been available to taxpayers who paid sales and use tax on tangible personal property used in Colorado for scientific research and development. For FY 2004-05 and subsequent years, the refund would have been equal to the amount of sales and use tax paid on research and development property. The refund was to become available if the state TABOR surplus exceeded a $358.4 million threshold in FY 2001-02. Because the state did not collect a sufficiently large TABOR surplus while the refund was in statute, it never became available.

Income tax credit for contributions to the Colorado Institute of Technology. House Bill 00-1052 created an income tax credit equal to 15 percent of contributions made by taxpayers to the Colorado Institute for Telecommunication Education. However, before the credit became available, Senate Bill 00-183 repealed and reenacted the statutory authority for the institute, changing its name to the Colorado Institute of Technology. Since the Colorado

Institute for Telecommunication Education no longer existed in statute, no credits were allowed to be taken for contributions that were made during the 2001 income tax year, when the TABOR surplus would have otherwise triggered the credit. House Bill 02-1059 updated the statute with the correct name. The credit was to become available if the state TABOR surplus exceeded a $350 million threshold in FY 2000-01. Because the state did not collect a sufficiently large TABOR surplus while the corrected credit was in statute, it never became available.

Table 1
TABOR Refund Mechanisms Used to Refund All TABOR Surpluses to Date
(dollars in millions; columns indicate the fiscal year when the surplus was collected)

TABOR Refund Mechanisms in Current Law							
	FY 1996-97	**FY 1997-98**	**FY 1998-99**	**FY 1999-00**	**FY 2000-01**	**FY 2004-05**	**FY 2014-15***
(Six-Tier) Sales Tax Refund	$136.8	$569.8	$623.3	$749.2	$576.7	$41.1	$67.9
Earned Income Tax Credit	Only the sales tax refund existed prior to the 1999 session.		26.4	31.0	32.9		85.7
Income Tax Rate Reduction							
Historical TABOR Refund Mechanisms							
	FY 1996-97	**FY 1997-98**	**FY 1998-99**	**FY 1999-00**	**FY 2000-01**	**FY 2004-05**	**FY 2014-15***
Business Personal Property Tax	Only the sales tax refund existed prior to the 1999 session.		79.0	78.5	99.8		These mechanisms were repealed under SB 10-212 or prior legislation.**
Foster Care Expenses Credit					0.2		
Child Care Expenses Credit				20.4	25.5		
Interest, Dividends, and Capital Gains				44.9	44.3		
Capital Gains Assets before 1994				111.5	50.5		
Capital Gains Sales beginning 2001					27.7		
Motor Vehicle Registration Fee					34.0		
Heavy-Duty Truck Sales and Use Tax					5.2		
Agricultural Value-Added Credit					0.5		
Pollution Control Equipment Sales Tax				1.9	0.0		
Private Health Care Credit				2.8	2.4		
Rural Health Care Provider Credit				0.1	0.2		
Charitable Contributions Deduction					2.9		
Individual Development Accounts					<0.1		
High Technology Scholarship Program					<0.1		
Research and Development Sales Tax			Mechanism never became available.				
Contributions - CO Inst. of Technology			Mechanism never became available.				

Sources: Department of Revenue, Office of the State Controller, Office of the State Auditor, and Legislative Council Staff.
**Anticipated, based on audited FY 2014-15 revenue certification and September 2015 Legislative Council Staff forecast.*
***The charitable contributions deduction was converted to permanent tax expenditure under SB 10-212.*