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**MEMORANDUM**

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January 4, 2009

**TO:** Interested Persons

**FROM:** Kate Watkins, Economist, 303-866-6289

**SUBJECT:** TABOR Refund Mechanisms

This memorandum provides information on Taxpayer Bill of Rights (TABOR) refund mechanisms, which refund revenue in excess of the TABOR limit to Colorado taxpayers.

**TABOR Refund Mechanisms**

Article X, Section 20 of the Colorado Constitution requires that revenue in excess of the Taxpayer Bill of Rights (TABOR) limit be refunded to taxpayers. The General Assembly may statutorily determine how this "surplus" revenue is refunded. At the end of the 2009 legislative session, there were 15 refund mechanisms, each of which is described below. Table 1 on page 5 shows the TABOR surplus revenue dollar amounts that trigger each of the 15 refund mechanisms. All but two refund mechanisms (the temporary income tax rate reduction and the six-tier sales tax refund) are triggered by a statutorily-defined dollar threshold which is increased by Colorado personal income growth each year.

***Temporary Income Tax Rate Reduction.*** House Bill 05-1194 created a new TABOR refund mechanism where, starting with income tax year 2011, the state income tax rate will be temporarily reduced from the current rate of 4.63 percent to 4.50 percent when the state experiences a revenue surplus large enough to support the rate reduction.

The temporary income tax rate reduction reduces the refund amount available for other refund mechanisms, where all other refund mechanisms will only be triggered if a TABOR surplus is sufficient enough to meet threshold amounts *after* the income tax rate reduction is fully funded. For example, the earned income tax credit (EITC) would only

be triggered if the FY 2010-11 TABOR surplus exceeds \$217.2 million (\$133.7 million to fund the temporary income tax rate reduction plus the \$83.4 million EITC threshold).<sup>1</sup> Once available, this mechanism will be prioritized before all other refund mechanisms.

***Six-Tier Sales Tax Refund.*** This refund mechanism allows individuals to receive a state sales tax refund based on six modified federal adjusted gross income tiers and the filing status of the taxpayer. The Department of Revenue sets the dollar amount of each tier and each tier's refund based on set percentages of the refund and taxpayers in each tier. For the six-tier sales tax refund to be available, the TABOR surplus must be large enough to support a \$15 refund for each Colorado taxpayer. This amount, as shown in Table 1, is estimated to equal \$44.9 million in FY 2010-11.

In terms of prioritization, this mechanism can be viewed as both the first and the last refund mechanism. Because it has the lowest dollar amount to trigger a refund, it may be the first and only refund triggered in a year when the 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 thresholds, the six-tier sales tax refund mechanism refunds any surplus revenue remaining after the other refunds.

***Earned Income Tax Credit (EITC).*** The Colorado EITC “piggybacks” off of 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 TABOR surplus years. Colorado taxpayers who claim the federal credit may claim the state credit. In tax year 2008, the federal credit could be claimed by certain taxpayers with modified federal adjusted gross incomes less than:

- \$38,646 (\$41,646 if married filing jointly) with two or more qualifying children;
- \$33,995 (\$36,995 if married filing jointly) with one qualifying child; and
- \$12,880 (\$15,880 if married filing jointly) with no qualifying children.

***Exemption for Certain Charitable Contributions.*** This refund mechanism allows individuals who claim the basic standard deduction on their federal income tax return to subtract charitable contributions in excess of \$500 from federal taxable income on their state income tax return.

***Foster Care Income Tax Credit.*** This refund mechanism allows an income tax credit to taxpayers who incur non-reimbursed expenses in connection with providing foster care to children under 18 years of age.

***Business Personal Property Tax Refund.*** This refund mechanism allows businesses to receive a refund equal to 100 percent of the first \$700 in personal property taxes paid, plus 16 percent of the tax paid in excess of \$700.

***Child Care Expenses Income Tax Credit.*** Colorado taxpayers already receive a child care credit and a child tax credit, though these credits are not TABOR refund mechanisms. As a TABOR refund mechanism, the existing child care tax credit is increased from 50 percent to 70 percent of

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<sup>1</sup>Dollar amounts are based on the December 2009 Legislative Council Staff forecast.

the amount claimed on the individual's federal tax return and the qualifying population is expanded to those with federal adjusted gross incomes greater than \$60,000, but less than \$64,001. Additionally, the existing child tax credit for children under six years of age is increased from \$200 to \$300 and the income limitations are expanded in the same manner as for the child care tax credit. The age limit is expanded to 12 years of age for children who are cared for in their own family-operated child care home that is either licensed or legally exempt from licensing requirements.

***Sales and Use Tax Refund for Research and Development.*** This refund mechanism provides a refund of sales and use tax paid on purchases of tangible personal property used predominantly for research and development in the state.

***Reduction of Motor Vehicle Registration Fees.*** This refund mechanism reduces annual registration fees for motor vehicles. The fee for registering a passenger vehicle is reduced to \$2.50 and the fee for registering other vehicles is reduced by 25 percent.

***High Technology Scholarship Credit.*** This refund mechanism provides a 25 percent income tax credit for donations made to the Colorado High Technology Scholarship Program. The credit cannot exceed 15 percent of the amount of income tax due. Partnerships, S corporations, and other pass-through entities that donate to the scholarship program can allocate the credit to the entity's partners or shareholders in proportion to the partners' or shareholders' distributive shares of income from the entity. The program provides scholarships to in-state students earning high-technology related certificates or degrees.

***Exclusion of Interest, Dividend, and Capital Gains Income.*** Individuals may deduct the lesser of \$1,500 or their total amount of interest, dividend, and capital gains income on their state income tax return. Joint filers are allowed to deduct up to \$3,000 of such income. House Bill 00-1171 increased the amount of the exclusion from the original \$1,200 and \$2,400 amounts.

***Sales and Use Tax Exemption for Pollution Control Equipment.*** This refund mechanism is for a sales and use tax exemption for purchases of equipment installed or used to detect, eliminate, reduce, or prevent air, water, or other environmental pollution.

***Sales and Use Tax Rate Reduction on Commercial Trucks.*** This refund mechanism reduces the sales and use tax rate on the sale of commercial trucks, truck tractors, tractors, or semitrailers with a gross vehicle weight rating in excess of 26,000 pounds, to 0.01 percent.

***Agriculture Value-Added Development Fund Program.*** A board within the Department of Agriculture is authorized to offer tax credits, loans, and equity investments to eligible agricultural value-added cooperatives and other eligible agricultural businesses. The board may assess a fee to applicants for financial assistance and other services. This refund mechanism provides income tax credits that may be earned through value-added investments or purchased from the board.

***Private Health Benefit Plan Credit.*** This refund mechanism allows Colorado residents to claim an income tax credit for amounts paid for health benefit plans. The credit is restricted to individuals, spouses, and dependents who obtain private medical/health insurance and who were not covered by an individual health benefit plan or an employee or group health benefit plan during any portion of the income tax year immediately preceding the income tax year for which the credit is

being claimed. The credit is limited to residents whose federal adjusted gross income does not exceed \$25,000 for individuals with no dependents; \$30,000 for two individuals with no dependents filing a joint return, or two married individuals with no dependents filing separate returns; and \$35,000 for resident individuals with dependents. The maximum credit is limited to \$500, is not refundable to the taxpayer, and cannot be carried forward.

**Table 1**  
**Projected TABOR Surplus Mechanism Trigger Amounts**  
*(Dollars in Millions)*

Colorado Revised Statute	TABOR Surplus Refund Mechanism	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
39-22-627	Temporary Income Tax Rate Reduction <sup>1</sup>	NA	NA	NA	\$133.7	\$142.8	\$153.2
39-22-2001, 39-22-2002 and 39-22-2003	Six-Tier Sales Tax Refund <sup>2</sup>	\$42.8	\$43.6	\$44.3	\$44.9	\$45.7	\$46.6
<b>Mechanisms Triggered by a Statutorily Defined Threshold Amount</b>							
39-22-123	Earned Income Tax Credit	\$76.2	\$80.7	\$84.7	\$83.4	\$85.4	\$88.3
39-22-104	Exemption for Certain Charitable Contributions	\$107.0	\$113.4	\$119.0	\$117.2	\$119.9	\$124.1
39-22-127	Foster Care Expense Tax Credit	\$256.7	\$272.0	\$285.4	\$281.1	\$287.6	\$297.7
39-22-124	Business Personal Property Tax Refund	\$259.1	\$274.4	\$287.9	\$283.7	\$290.2	\$300.4
39-22-119	Child Care Expenses Income Tax Credit	\$409.3	\$433.8	\$455.2	\$448.2	\$458.6	\$474.6
39-26-602	Research and Development Property Sales and Use Tax Refund	\$460.1	\$487.6	\$511.7	\$503.8	\$515.4	\$533.4
42-3-305 and 24-75-216	Motor Vehicle Registration Fee Reduction	\$465.8	\$493.5	\$518.0	\$510.1	\$521.8	\$540.1
39-22-523	High Technology Scholarship Program Credit	\$465.8	\$493.7	\$518.0	\$510.1	\$521.8	\$540.1
39-22-104	Interest, Dividends and Capital Gains Exclusion	\$494.0	\$523.3	\$549.1	\$541.0	\$553.4	\$572.8
39-26-502	Pollution Control Equipment Refund	\$494.0	\$523.3	\$549.1	\$541.0	\$553.4	\$572.8
39-26-106	Reduced Sales and Use Tax on Trucks	\$494.0	\$523.3	\$549.1	\$541.0	\$553.4	\$572.8
39-22-527 and 39-22-528	Agricultural Value Added Tax Credit	\$513.5	\$544.0	\$570.8	\$562.3	\$575.2	\$595.3
39-22-125	Private Health Care Tax Credit	\$564.6	\$598.2	\$527.7	\$618.3	\$632.5	\$654.6
<b>Colorado Personal Income Growth Factor</b>		<b>1.0703</b>	<b>1.0595</b>	<b>1.0493</b>	<b>0.9887</b>	<b>1.0261</b>	<b>1.0343</b>

Source: Legislative Council Staff projections based on the December 2009 economic forecast.

<sup>1</sup> The temporary income tax rate reduction is not effective until FY 2010-11, at which point it will be prioritized before all other mechanisms. At that time, all other refund mechanisms will be triggered when the surplus is large enough to fund the temporary income tax rate reduction *and* the threshold amount of other mechanisms.

<sup>2</sup> In terms of prioritization, this mechanism can be viewed as both the first and the last refund mechanism. Because it has the lowest dollar amount to trigger a refund (equal to a refund of \$15 to all Colorado taxpayers), it may be the first and only refund triggered in a year when the 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 thresholds, the six-tier sales tax refund mechanism refunds any surplus revenue remaining after the other refunds.