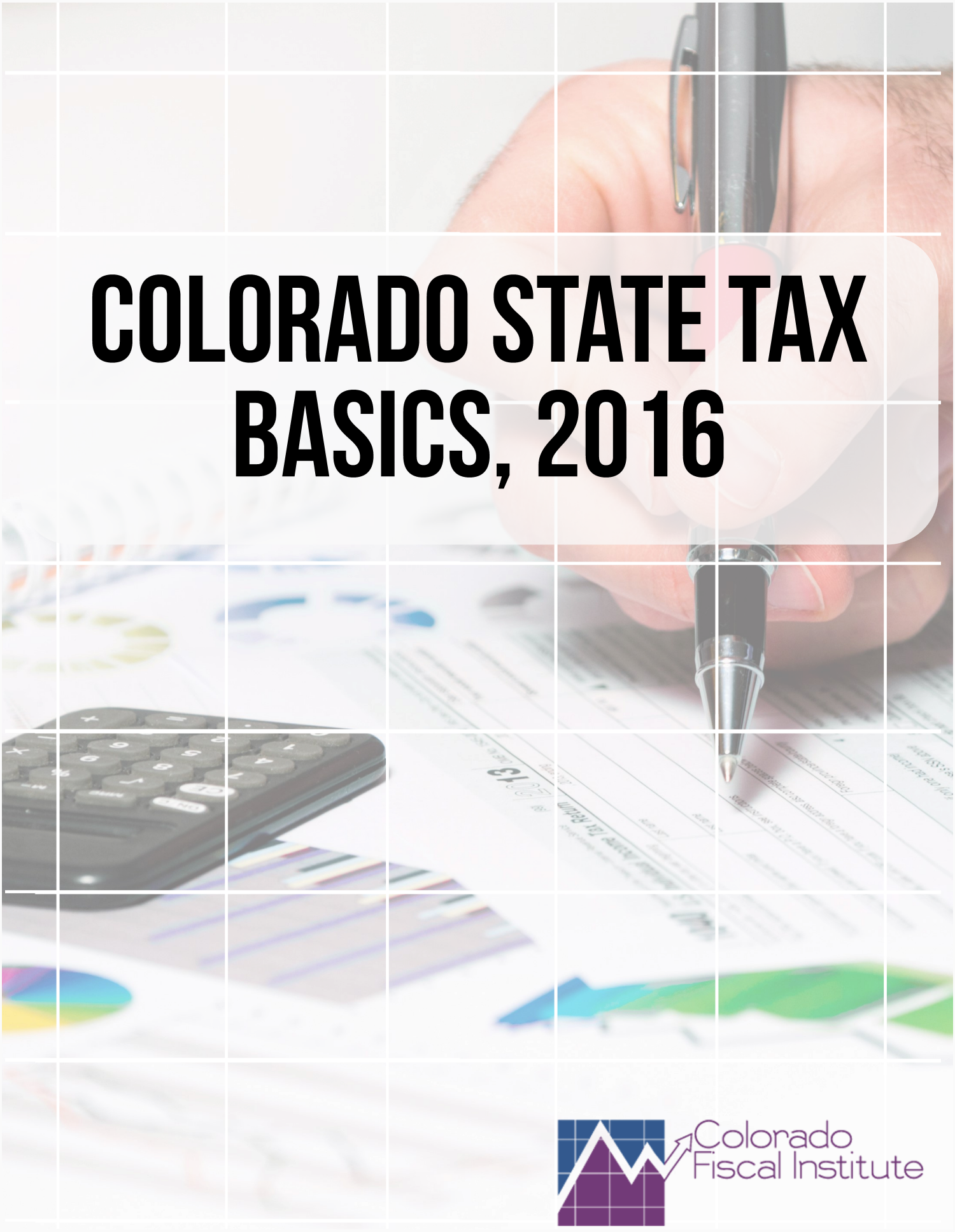

COLORADO STATE TAX BASICS, 2016

Colorado Fiscal Institute

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CHAPTER 1: FUNDAMENTALS OF A GOOD TAX SYSTEM

A tax system is a set of rules and regulations that allow a government to collect the revenue needed to fund public services. The National Conference of State Legislatures (NCSL) has articulated a set of principles that help define a good tax policy structure[1]. The following analysis evaluates Colorado's tax system using the NCSL tax principles.

PRINCIPLE ONE: PROVIDE ADEQUATE AND TIMELY REVENUE

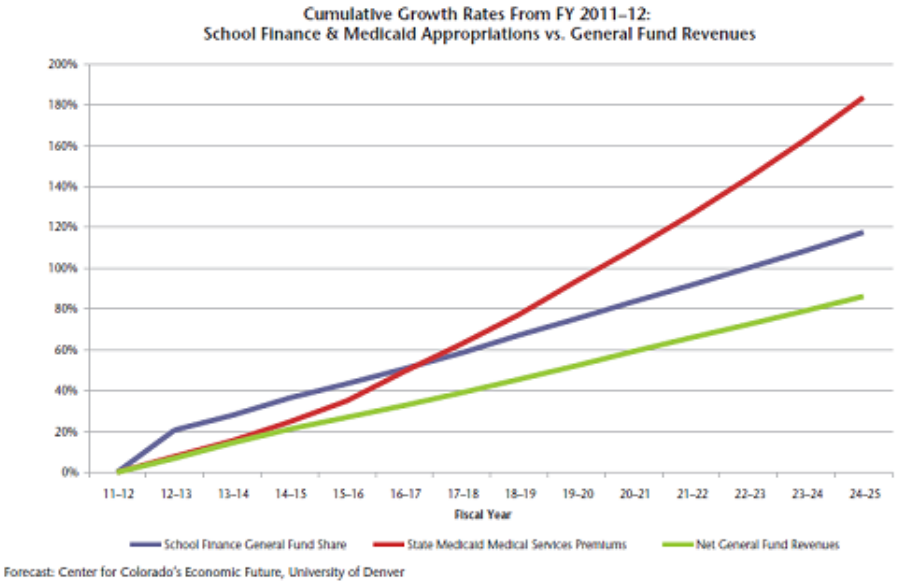
Revenue Adequacy

The purpose of a tax system is to raise adequate revenue to fund public services. Adequacy is measured by whether the system generates sufficient revenue to fund legislatively-enacted priorities. These priorities typically include K-12 education, health, human services and corrections.

Inherent in this principle is the notion that the need for public services should drive the collection of tax revenue. Certain states (such as Colorado with the implementation of the Taxpayer's Bill of Rights, or TABOR) have ignored this, flipping the principle on its head and capping funding based on a formula that attempts to define the need for public services based on a defined amount of revenue.

Unfortunately, this "reversed accounting" system has created a funding deficit that is projected to worsen in the future. A 2011 study conducted by the University of Denver states that even with a strong economic recovery from the Great Recession and sustained job growth over the next decade, Colorado will not produce adequate revenue to support Medicaid funding and public schools, let alone the other programs funded through the General Fund, such as higher education and corrections[2]. The study forecasts

Figure 1



Forecast: Center for Colorado's Economic Future, University of Denver

1 This is a condensed summary of the principles. For a complete listing and a more in-depth discussion, please see: Snell, Ronald, "New Realities in State Finance," *The National Conference of State Legislatures*, Washington D.C., 2004.

2 Financing Colorado's Future: An Analysis of the Fiscal Sustainability of State Government, University of Denver Center for Colorado's Economic Future, April 2011 at http://www.du.edu/economicfuture/documents/CCEF_ReportPhase1.pdf.

that over the next 15 years, the state's annual spending on Medicaid will nearly triple and the funding required for public education will more than double. Meanwhile the General Fund will only grow 86 percent.

Adequacy is an issue for nearly every major area of the state budget. The Colorado Department of Transportation estimates that the state needs to increase funding by $2.1 billion annually to accommodate growth and maintain the current transportation system.[3]

Schools are facing a billion dollar shortfall in state funds as well. The Colorado School Finance Project predicts that an additional $2.9 billion dollars is needed annually to provide all Colorado students with a sufficient education (defined as 100 percent proficiency).[4] This doesn't even include maintenance and construction of school buildings and facilities.

However, no increases in funding are anticipated. Even in the health sector, where current revenues will likely support funding at 2007 levels, funding is decidedly inadequate. Health care coverage in Colorado left roughly 353,000 people uninsured in 2014. This equates to 6.7 percent of Coloradans. [5]

Revenue Timeliness

A good tax system must also ensure that revenues remain adequate over time. A tax system's revenues are inadequate when its portfolio of taxes grows at a slower rate than the cost of maintaining public services. The formula contained in Colorado's TABOR amendment guarantees that state revenue increases more slowly than the economy by forcing rebates of revenue collected in excess of per capita inflationary increases. TABOR also promises a shortfall in revenue since the price of items purchased by state government increases faster than the Consumer Price Index ("CPI"). Traditionally, annual increases in the CPI have been below the increase in costs associated with public purchases, such as health care and education.[6] When costs exceed available revenue, reductions in service levels occur.

Long-term structural changes in the economy can also reduce tax revenue. For example, the sales tax is a large source of revenue for Colorado (estimated to be just over 27 percent of General Fund revenue collections in FY 2015-16).[7] However, the amount of revenue Colorado collects from the sales tax has been decreasing because of the shift in personal consumption from taxed goods to untaxed services. This means that over time, revenue collected from sales taxes will support fewer and fewer public services even with a constant sales tax rate.

The second component of adequacy over time involves revenue timeliness. This principle is important because it allows states to account for and weather the impact of cyclical economic changes.

Successful balancing strategies include a diverse tax portfolio and a budget reserve to stabilize cyclical variations.

Colorado's state tax system is heavily dependent on income tax and on capital gains taxes due

3 THE NEXT STEP: To maintain and improve Colorado's transportation system, Move Colorado, March 26, 2010 at http://movecolorado.org/news_room/assets/perspectives/nextstep.pdf.

4 Investing in P-12 Education and Achieving State Education Requirements, 2008, Colorado School Finance Project, accessed January 7, 2011 at http://www.cosfp.org/AdeqUpdate/AdequacyWork/InvestingInEducation.pdf.

5 Colorado Health Access Survey, Colorado Health Institute, September 2015 at http://www.coloradohealthinstitute.org/uploads/postfiles/CHAS/2015_CHAS_for_Web_.pdf.

6 BLS Statistics were used for a 15 year comparison of the Higher Education Price Index, the Employment Cost Index and the Medical Care Cost Index with the Consumer Price Index for Denver, Boulder Greeley.

7 Budget in Brief, Colorado General Assembly Joint Budget Committee, FY 2015-16, at http://www.tornado.state.co.us/gov_dir/leg_dir/jbc/FY15-16BIB.pdf.

primarily to the large amount of investment-dependent income in Colorado.[8] Colorado is one of the top 10 states most heavily dependent on income tax. This results in greater volatility in revenue since the incomes of top earners, which comprise a large portion of state tax collections, tend to be more susceptible to economic booms or busts.

Additionally, Colorado ranks 10th highest in capital gains dependence among the 41 states with an income tax.[9] Such a heavy dependence on capital gains revenue means that shocks to the stock market can have devastatingly volatile consequences for revenue in Colorado. This effect was evident during the economic downturn in 2001, when Colorado's drop in tax revenue was one of the steepest in the country. A similar trend was identified in the more recent economic downturn in 2009.

One impediment to adequacy over time is the practice of designating a particular revenue source for a specific expenditure, commonly called "earmarking." Earmarking often restricts or prevents flexible allocations of tax revenue across spending priorities.

These restrictions prevent governments from making adjustments to ensure stable revenue amidst changing economic conditions. A high-quality revenue system minimizes the use of tax earmarking.

Colorado relies heavily on earmarked revenue to finance public services. For example, the K-12 education system receives state funding from a special education fund that is funded by an earmark of 0.33 percent of state taxable income.[10] Similarly, all revenues generated from the Colorado Lottery are earmarked to support state parks, recreation, open space, conservation education and wildlife projects. [11]

PRINCIPLE TWO: DISTRIBUTE BURDENS EQUITABLY

A successful tax system distributes the cost of public services equitably amongst taxpayers. Two fundamental principles of equitable taxation are "vertical equity" and "horizontal equity."

Vertical Equity

A tax system displays vertical equity when it fairly distributes taxes among people with different incomes. One way to distribute taxes fairly is to distribute the cost of public services based on a taxpayer's ability to pay. Another way is to require that taxpayers pay taxes proportionately, which means paying an equal percentage of taxes relative to their income.

The vertical equity (or inequity) of a tax system is characterized by the distribution of taxes among people in different circumstances. A tax system can be defined as either "progressive" or "regressive."

A progressive tax system increases taxation as incomes increase. A regressive tax system, on the other hand, is one where low-income earners pay a greater share of their incomes in taxes than do those with high incomes.

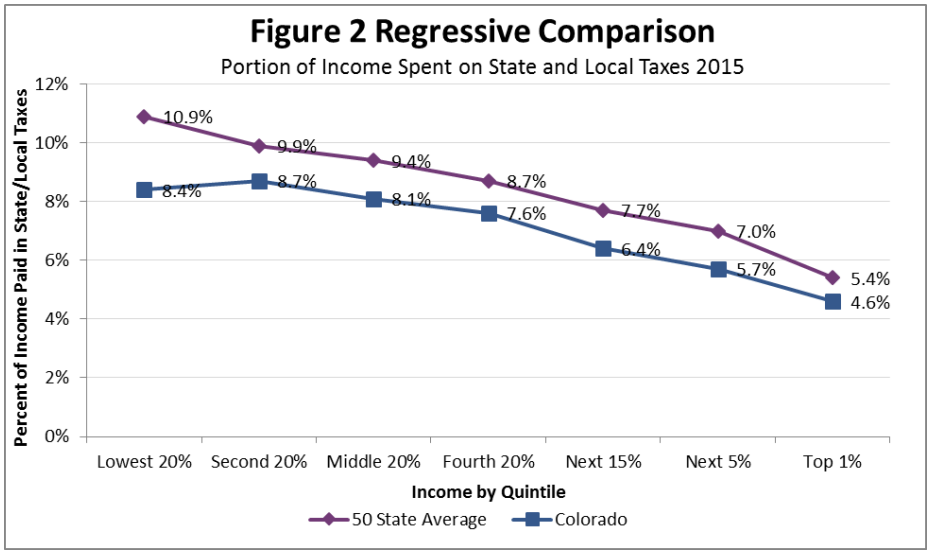
The combined state and local tax systems of most states are regressive. State income taxes that are based on the progressive federal income tax are progressive; however, sales and excise taxes are regressive as are property taxes. Overall, Colorado's tax system is regressive, although it is comparably less regressive than the average U.S.

8 Povich, Elaine S., *Volatile Income Tax Revenues Stump States,* Stateline, The Pew Charitable Trusts, October 13, 2014 at http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2014/10/13/volatile-income-tax-revenue-stumps-states

9 Dadayan, Lucy and Boyd, Donald, *April "Surprises" More Surprising than Expected*, State Revenue Special Report, The Nelson A. Rockefeller Institute of Government, June 2014 at http://www.rockinst.org/pdf/government_finance/state_revenue_report/2014-06-12-Special_Report.pdf.

10 Amendment 23, Great Education Colorado, accessed January 10, 2011 at http://www.greateducation.org/statistics-faqs/funding-faqs/amendment-23/.

11 Where the Money Goes, Colorado Lottery, accessed January 10, 2011 at http://www.coloradolottery.com/index.cfm/ID/69/Where-the-Money-Goes/



state and local tax system. In Colorado, those making the least pay a higher proportion of their income in taxes than those in the highest income groups.

Horizontal Equity

Horizontal equity is the distribution of taxes among people with the same income. The general principle is that those with similar circumstances should have similar tax obligations.

Colorado's tax system includes tax provisions that benefit one segment of the population and disadvantage another. One of the most prevalent of those provisions is the business personal property tax. Businesses that rely heavily on high-valued machinery and equipment pay significantly more in property taxes than businesses that require little to no capital equipment.

This kind of disparity results in horizontal inequities.

PRINCIPLE THREE: PROMOTE ECONOMIC EFFICIENCY AND GROWTH

In general, the central purpose of collecting taxes is to raise revenue. However, tax policy is often used to promote or incentivize certain behaviors. For example, excise taxes may be used to discourage certain behaviors that have public and social costs. Using tax policy to steer economic behavior can be considered economically inefficient because a large portion of tax breaks go to people and businesses for doing what they would have done anyway.

How a state tax system affects economic growth is an important policy consideration. When considering taxes on individuals and businesses, the usual concern is over tax policies so significant that they would cause taxpayers to move from, or avoid locating in, a state or that would cause them to shop across state borders. Yet, when evaluating its competitive position, a state should be aware that tax policy is only one consideration in business location decisions. The quality of publicly provided services is often a more important consideration.

Colorado's tax system includes many sales tax exemptions, income tax credits and other tax expenditures valued at close to $4.7 billion annually.[12] Many more income tax exemptions and special deductions are not reported at the state-level since they are applied to the calculation of federal taxable income. As will be discussed in detail later, Colorado's taxable income is based on federal taxable income. Thus, federal exemptions and deductions, such as student loan interest deductions and the deduction for moving expenses, cost Colorado

income tax revenue even though they are not enacted by the state.

PRINCIPLE FOUR: BE SIMPLE AND PROFESSIONALLY ADMINISTRATED

A good tax system should be designed simply. Simplicity minimizes administrative collections costs and taxpayer compliance costs. It also reinforces confidence in the fairness of a tax system by reducing evasion.

Certainty

A key part of simplicity is certainty. Certainty requires that the number and types of changes made to a tax system will be kept to a minimum. Individuals and businesses should not be subject to frequent changes in tax rates or tax base because it interferes with economic choices and the ability to develop long-term financial plans. As a corollary, in states such as Colorado where changes in rates require voter approval, a large number of tax-generating initiatives will decrease political capital for achieving tax revenue adequacy.

Colorado's tax system has remained fairly constant over time. The Taxpayer's Bill of Rights (TABOR) amendment restricts changes in the tax system by requiring voter approval for tax increases and new taxes that generate net increases in revenue. Since TABOR's passage in 1992, the state of Colorado has enacted only one significant tax increase — a tobacco tax increase approved in 2005.

Tax Administration

Our current revenue system is dependent on voluntary compliance. Voluntary compliance requires professional tax administration. Tax administration involves assessing and collecting taxes owed. Professional and uniform tax administration, both throughout the state and within individual jurisdictions, enhances the effectiveness of voluntary compliance. Tax evasion is a quantitatively significant phenomenon that affects the adequacy, equity, economic efficiency and simplicity of administration of a tax system.

The problem of tax evasion also raises challenging questions about the appropriate design of the tax compliance system. Questions include how many resources should be devoted to auditing suspected evaders and for which taxes, how these resources should be allocated across classes of taxpayers and how many resources should be devoted to taxpayer assistance versus monitoring.

PRINCIPLE FIVE: ENSURE ACCOUNTABILITY

Notice and Transparency

The essence of accountability is that tax laws should be explicit and transparent. Truth-in-taxation policies that require clearly written notices to taxpayers and hearings on tax policy changes are simple methods of providing accountability. For state governments, tax expenditure reports are another way of enhancing accountability. A tax expenditure report shows the costs, expressed in lost tax revenue, of a tax credit or exemption that is intended to benefit specific taxpayers or encourage a public policy goal. In addition to identifying the revenue lost from certain tax preferences, tax expenditure reports may also provide data that can be used to evaluate the effectiveness and efficiency of tax policies.

Accountability in a larger sense means that policymakers examine the costs and benefits of using revenue measures to put policies into effect. Since the budget process makes expenditures explicit, the ideal revenue system includes tax expenditures as a direct appropriation in the budgetary system. However, tax policy will

12 *Colorado Tax Profile and Expenditure Report 2014,* Colorado Department of Revenue at https://www.colorado.gov/pacific/sites/default/files/2014_final_1.pdf.

inevitably continue to be used toward other policy objectives. Therefore, lawmakers have a responsibility to ensure that tax policies produce their intended effect and do so at a reasonable cost. Earmarked funds, tax expenditures and all other special tax preferences should be reviewed regularly to assess their efficiency and effectiveness as policy measures.

Colorado produces few reports on government accountability and transparency, although there have been improvements over the past couple of years. One major improvement is the addition of a biennial tax expenditure report and tax overview called the *Colorado Tax Pro6ile and Expenditure Report.*[13] This report, made permanent by legislation in 2014, was first produced in 2013 and will be produced every other year from now on. This report includes a listing of all tax expenditures, information on who pays taxes in the state, and other data gathered from Colorado tax returns.

Another useful resource is the State Taxpayer Accountability Report (STAR). The STAR report is produced annually by the Office of the State Controller and summarizes the fiscal operations in the state.[14] The Colorado Department of Treasury also provides a resource for taxpayers to track where their tax dollars go based on their income. [15]

Too often, the effects of legislative action on revenue collection or the distribution of tax responsibility are unknown or unclear. This approach to tax policy has led to the increased number of credits and exemptions and increased complexity and administration costs without a clear demonstration of the resulting benefit.

Colorado Fiscal Institute Tax Principles:

The Colorado Fiscal Institute (CFI) promotes tax and budget policies that are effective, efficient, equitable, transparent and accountable. Each year, CFI takes positions on new legislation that affects the sustainability and equity in Colorado's state budget and tax system. The staff examines each bill using a set of principles developed from National Conference of State Legislatures guidelines that reflect our mission of sound fiscal policy that improves the well-being of individuals, communities and the state as a whole.

CFI'S PRINCIPLES FOR EVALUATING TAX CREDITS, DEDUCTIONS AND EXEMPTIONS

1. **Is the tax expenditure effective?** When evaluating a new tax credit, deduction or exemption, CFI considers whether it has been proven to meet a targeted goal. CFI also considers the return on investment from the tax expenditure when compared to the benefit and cost of investing in other state priorities.
2. **Is the tax expenditure economically efficient?** CFI evaluates all tax expenditures from an economic standpoint. A good tax expenditure will produce the intended outcome without significant additional cost or disruption to public spending or the economy. CFI also considers the behavior the tax expenditure is intended to incentivize and if this behavior would occur anyway. Tax expenditures are often used to incentivize certain behaviors but should never be given to reward behavior that would have happened anyway.
3. **Is the tax expenditure equitable?** Equity in evaluating tax expenditures focuses on who

13 Found here: https://www.colorado.gov/pacific/sites/default/files/2012.pdf

14 Found here: http://www.colorado.gov/dpa/dfp/sco/STAR/star.htm

15 Found here: http://www.colorado.gov/taxtracks/

benefits from the favored tax treatment proposed by the credit, deduction or exemption. All tax expenditures create winners and losers in the tax system, and CFI evaluates the impact of the expenditure in two ways. First, we consider horizontal equity, which occurs when similarly situated taxpayers are treated in a similar manner. Second, CFI assesses vertical equity, or who pays taxes in light of who currently shoulders the largest tax responsibility. CFI evaluates the equitable distribution of the tax benefit based on ability to pay and other principles of equity.

4. **Will the tax expenditure be regularly reviewed and evaluated?** Tax expenditures, just like any general fund appropriation, need regular review to evaluate whether they are working and to let taxpayers know how their money is being used. In order to determine if a tax expenditure is achieving its targeted goal and is the best use of taxpayer dollars, they must be reviewed and evaluated regularly based on a clear set of objectives. CFI always considers the measures of transparency and accountability that are included in any new tax expenditure or economic incentive.

5. **Will the tax expenditure lift up the middle class?** The middle class in Colorado is still struggling to recover from the recent recession. Tax expenditures can impact this recovery by either supporting targeted middle-class growth, or by shifting support to other priorities. CFI considers whether a credit supports middle-class families and an economy that works for everyone.

TAX COLLECTIONS IN COLORADO

In 2014, the state of Colorado collected $10.8 billion in tax revenue.[16] This is a 5.3 percent increase from the previous year, when revenue collections reached $10.3 billion.

The chart below shows a 10-year history of tax collections in Colorado. Colorado's tax collections have largely tracked federal tax collections. One exception occurred after the 2001 recession, when declining capital gains and tax reductions implemented by the Colorado General Assembly led to a steep drop in state tax revenue. Since that time, Colorado's tax collections per $1,000 of personal income gradually increased with economic growth until 2009, when tax collections decreased more than 25 percent with recession. This decline was 10 percent greater than the average decline in tax collections in the United States. [17]

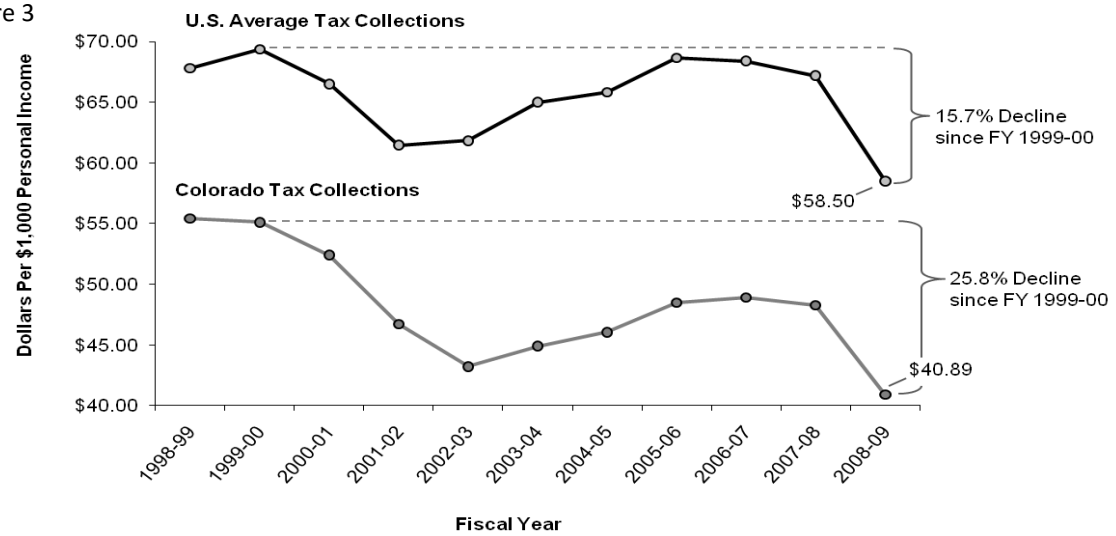
Table 1 shows the change in Colorado taxes per $1,000 of income between FY 1998-99 to FY 2012 -13. Colorado's decrease in tax revenue has been fairly uniform across all the types of taxes that the state collects. The largest decrease in taxes paid per $1,000 of income is in motor fuels tax collection (30 percent).

Table 1 15-Year Comparison of Tax Collections in Colorado

	FY 1998-99	FY 2012-13	Change
Individual Income	$23.69	$22.29	-6%
Sales and Use	$14.73	$10.30	-30%
Corporate Income	$2.54	$2.83	11%
Motor Fuel	$4.35	$2.55	-41%
Alcohol	$0.22	$0.16	-27%
Tobacco	$0.57	$0.76	33%

Colorado collects taxes to fund basic government programs through the General Fund. Individual and corporate income taxes and sales and use taxes make up more than 97 percent of General

Figure 3



16 Colorado Department of Revenue 2014 Annual Report, Colorado Department of Revenue, at https://www.colorado.gov/pacific/sites/default/files/2014%20Annual%20Report1.pdf

17 Kirk, Ron, *Colorado's Revenue and Tax Structure Power Point presentation*, Colorado Reform Roundtable Fiscal Reform Subcommittee meeting, Aug. 6, 2010.

Fund revenue. Currently, individual income taxes make up the largest portion of General Fund revenues (64 percent).[18]

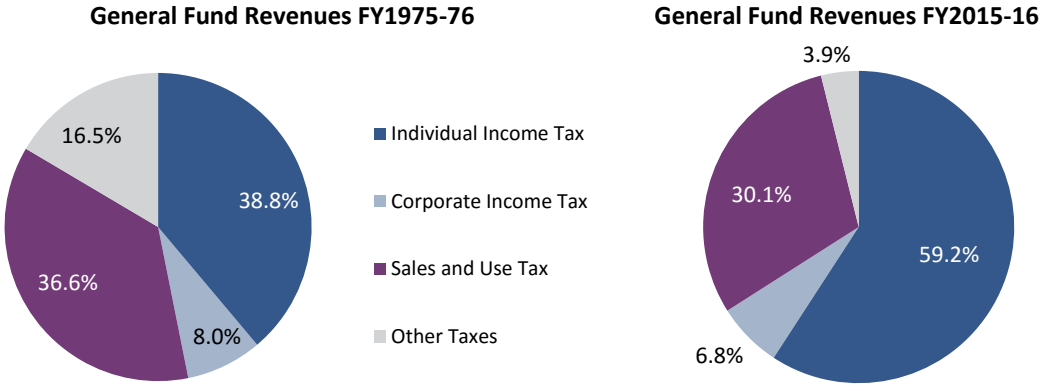
Income taxes have not always played such an important role in financing public services in Colorado. While the general portfolio of taxes has remained the same, in 1975, individual income tax only made up 38 percent of the General Fund. Several reasons account for this shift. First, sales tax collections have decreased as a result of many sales tax exemptions that were enacted in the late 1970s and early 1980s when the state had significant budget surpluses. These exemptions were never repealed, unlike the many income tax reductions enacted in the late 1970s and early 1980s that were largely repealed to help the state's budget during the recession. A second reason for the shift is that federal tax reform broadened the tax base upon which individual income taxes are levied. Since Colorado uses federal taxable income as its starting point for the calculation of Colorado's income tax base (discussed later in more detail), the broadening of the federal tax base increased the state's reliance on individual income taxes.

HOW COLORADO TAXES RANK IN COMPARISON TO OTHER STATE

There are two primary ways of comparing states in terms of revenues. The first is the per capita measure, which is derived by dividing total government revenue by total population. The second method relates revenue to total personal income (wages, salaries, dividends, interest, etc.). The most prevalent rankings measure taxes per $1,000 of income.

Measuring revenue relative to personal income shows taxes relative to wealth. By contrast, measuring revenue on a per capita basis does not take into account ability to pay. The "per $1,000 of income" approach allocates taxes to those who pay them, in proportion to how much is paid. A "taxes per capita" approach spreads total taxes across the entire population (including children, institutionalized populations and other non-taxpayers) and assumes equal distribution of taxes for all individuals. The personal income calculation generally results in a lower ranking for Colorado than the per capita calculation.

Figure 4



Source: Joint Budget Committee, Legislative Council

18 *Budget in Brief*, Colorado General Assembly Joint Budget Committee, FY 2015-16.

By any measure, though, taxes are low in Colorado. Colorado's total state taxes, per $1,000 of income, rank sixth from the bottom (45th) in the nation. North Dakota has the highest and New Hampshire the lowest.

Table 2 (page 11) shows tax rankings for various taxes.

WHO PAYS COLORADO TAXES?

Examining how Colorado ranks in comparison to other states is one method of analyzing our tax system. Another way to evaluate it is by analyzing the percentage of income paid in taxes by individuals in various income brackets. The Institute of Taxation and Economic Policy (ITEP) produces a report that analyzes the amount of each type of tax paid by each income quintile.[19] The results show that the highest share of income paid in taxes (8.7 percent) is paid by those in the lowest income brackets — those making less than $42,000 per year — while the top 1 percent of all Colorado taxpayers pays the lowest percentage of their income in taxes (see Table 3, page 11, and Figure 5).

The combined state and local tax rate for the top one percent of Colorado families — with average incomes of $1.8 million — is 5.6 percent, before accounting for the tax savings from federal itemized deductions. After the federal offset, the effective tax rate is only 4.6 percent.[20] The average tax rate on families in the middle of the income distribution — those earning between $42,000 and $62,000 — is 8.5 percent before the federal offset and 8.1 percent after. This is nearly double the effective rate that the richest Coloradans pay. The tax rate on the poorest Colorado families — those in the bottom two quintiles, earning less than $42,000 — is the highest of all. At 8.7 percent, it is more than twice the effective rate on the very wealthy.

The ITEP report also reveals inherent in Colorado's tax system. While income taxes are slightly progressive because they are based on a progressive federal income tax, property tax and sales taxes are regressive and result in those with the lowest incomes paying more in taxes than those with higher incomes. This is an example of vertical inequity.

However, Colorado is not the most regressive of all states. In fact, despite the fact that Colorado's tax system is regressive overall, Colorado allows large federal deductions and exemptions, making Colorado's flat-rate income tax structure more progressive than other states with a similar tax

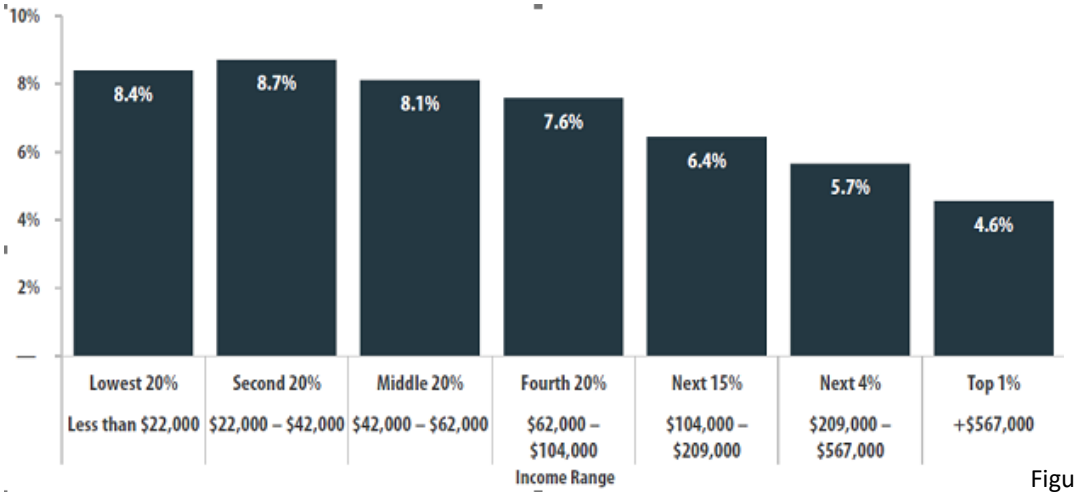


Figure 5

19 *Who Pays? A Distributional Analysis of the Tax Systems of all 50 States (5th Edition),* Institute of Taxation and Economic Policy, January 2015 at http://www.itep.org/whopays/full_report.php.

20 The *Federal Deduction Offset* accounts for the exporting of a taxpayers state taxes to their federal tax burden through an itemized deduction.

Table 2 How Selected State Taxes in Colorado Compare per $1,000 of Income (FY 2013-14)					
	Colorado		50 State Average		
	Rank	Tax Level	High	Low	Average
Total State Taxes	45 of 50	$46.30	$155.24	$33.08	$60.09
Sales and Use	44 of 45	$10.30	$43.74	$0.00	$18.83
Individual	26 of 43	$22.29	$41.39	$0.00	$21.58
Corporate	29 of 46	$2.83	$10.79	$0.00	$3.21
Motor Fuel	38 of 50	$2.55	$6.62	$1.08	$2.88
Alcohol	43 of 50	$0.16	$1.03	$0.06	$0.43
Tobacco	39 of 50	$0.76	$3.12	$0.15	$1.17

Source: U.S. Census Bureau and Bureau of Economic Analysis

Table 3 Who pays by quintile

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Top 20%		
					Next 15%	Next 4%	TOP 1%
Income Range	Less than $22,000	$22,000 – $42,000	$42,000 – $62,000	$62,000 – $104,000	$104,000 – $209,000	$209,000 – $567,000	$567,000 or more
Average Income in Group	$12,300	$30,600	$51,300	$79,800	$140,300	$317,800	$1,779,900
Sales & Excise Taxes	5.3%	4.6%	3.6%	3.0%	2.2%	1.3%	0.7%
General Sales—Individuals	2.6%	2.4%	2.0%	1.7%	1.3%	0.8%	0.5%
Other Sales & Excise—Ind.	0.8%	0.5%	0.4%	0.3%	0.2%	0.1%	0.0%
Sales & Excise on Business	2.0%	1.6%	1.3%	1.0%	0.7%	0.4%	0.2%
Property Taxes	2.4%	2.1%	2.3%	2.0%	2.0%	1.7%	1.4%
Property Taxes on Families	2.3%	2.0%	2.2%	1.9%	1.8%	1.2%	0.4%
Other Property Taxes	0.1%	0.1%	0.1%	0.2%	0.2%	0.5%	0.9%
Income Taxes	0.7%	2.1%	2.6%	3.1%	3.2%	3.4%	3.5%
Personal Income Tax	0.7%	2.1%	2.6%	3.1%	3.2%	3.3%	3.4%
Corporate Income Tax	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
Total Taxes	**8.4%**	**8.8%**	**8.5%**	**8.1%**	**7.4%**	**6.4%**	**5.6%**
Federal Deduction Off-set	–0.0%	–0.1%	–0.4%	–0.6%	–0.9%	–0.8%	–1.0%
OVERALL TOTAL	**8.4%**	**8.7%**	**8.1%**	**7.6%**	**6.4%**	**5.7%**	**4.6%**

structure. Even "low tax" states can be highly regressive — the determining factor is the amount of tax on the lowest income brackets in relation to the highest.

It should be noted though, that while the lowest-income Coloradans pay the highest percentage of their income in taxes, the highest-income Coloradans pay the largest bulk of taxes overall. Colorado taxpayers with income of more than $100,000 pay more than 65 percent of all of the taxes collected in the state. [21]

Tax Rates

Another important component of the Colorado tax system is the tax rate. There are two different ways to define the tax rate. The "nominal" or "marginal" tax rate is the rate that is multiplied by the tax base to yield the amount of tax. Essentially, the nominal tax rate is the stated tax rate. In Colorado, the nominal tax rate is 4.63 percent for income taxes and 2.9 percent for sales and use taxes.

By contrast, the "effective" tax rate is the amount of tax paid as a percentage of a taxpayer's total tax responsibility. This is considered a more accurate measure for comparing taxes because it takes into account the differing tax bases of different taxpayers. Effective tax rates are typically lower than marginal rates because most tax systems have some forms of deductions, exclusions, credits and other adjustments that are taken into account when using this measure of taxes. The chart above from the Colorado Department of Revenue shows Colorado effective tax rates in 2010 (Figure 6) . [22]

Tax expenditures are revenues foregone because a provision of the tax code permits certain taxpayers to pay less tax than they would pay under a baseline tax system. They include deductions and exclusions from tax liability, reduced tax rates, tax credits, tax deferrals, tax exemptions and tax refunds.

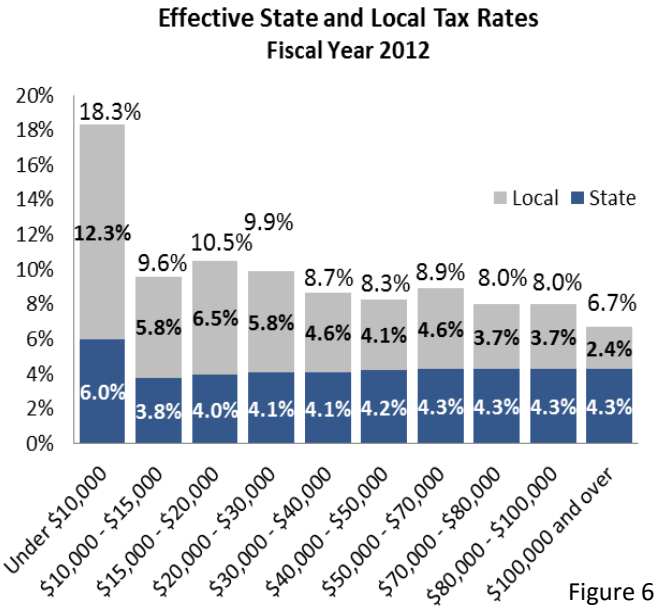


Figure 6

WHAT DOESN'T GET PAID – THE EFFECT OF TAX EXPENDITURES

Tax expenditures are tools that policymakers use to align public finance with social and economic goals. They are often utilized to address market failures and to promote social equity. While tax expenditures can prove useful for promoting certain economic outcomes, the resulting increase in the complexity of tax laws often means higher administrative and compliance costs, and market distortions.

Tax expenditures also reduce the tax base. As a result, government revenues may need to be raised from other sources and/or tax rates may need to increase in order to provide substitute revenues to finance government services. For instance, in Colorado in 2013, annual sales tax expenditures reduced revenues by $3.97 billion.[23] In comparison, total sales tax collections were $2.19 billion.[24] The amount of money that is given away in tax expenditures directly reduces the revenues available for public investments.

Figure 7 shows what happens if tax expenditures

21 CFI analysis of *Colorado Tax Profile and Expenditure Report 2014*
22 *Colorado Tax Profile & Expenditure Report 2014.*

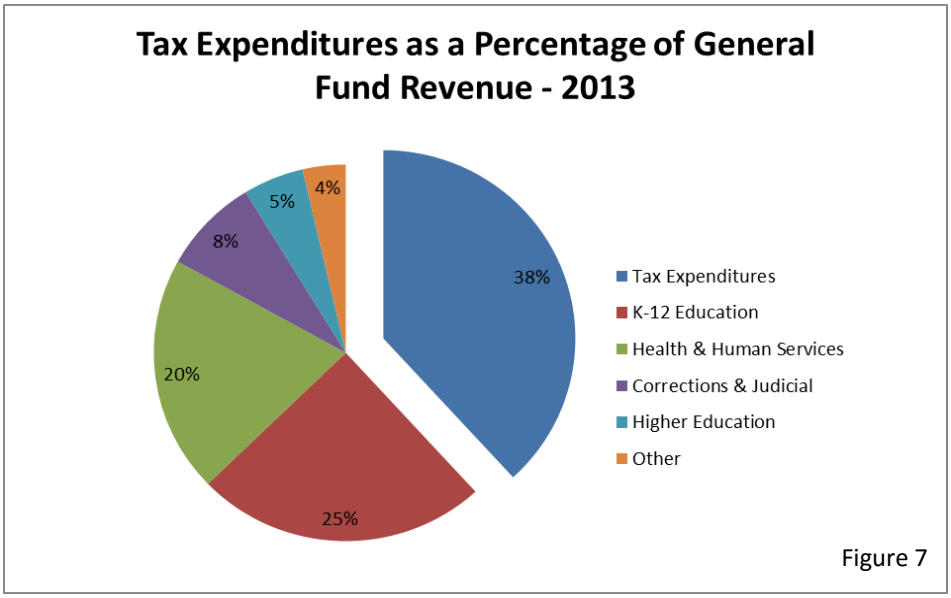


Figure 7

were added to total General Fund appropriations for 2013. The amount of revenue spent on tax expenditures would then be equal to 38 percent of the total General Fund. It would almost equal the amount of revenue appropriated for all health and human services and would be greater than spending for all corrections, higher education and other government services combined.

23 *Colorado Tax Profile & Expenditure Report 2014.*
24 *Colorado Department of Revenue 2014 Annual Report.*

CHAPTER THREE: COLORADO'S TAX PORTFOLIO

STATE TAXES: INCOME TAX

The income tax has become the largest tax source that funds Colorado's state government. In 2014, income tax receipts accounted for just under 60 percent of total tax collections.[25] Nationally, income taxes represented only 41 percent of tax collections. [26]

History of the Income Tax in Colorado

Now the state's largest revenue source, the personal income tax was originally adopted by the voters via a constitutional referendum in 1936. This was more than two decades after the 16th Amendment to the federal constitution that authorized a national income tax. At the end of the 1930's, income tax receipts were small in terms of total tax collections. Motor fuel, sales and use and liquor taxes each accounted for more state tax revenue than income taxes.

In the first full-year of collections, slightly more than three-fifths of the $2.8 million in total collections was from individual income tax. Corporate income taxes accounted for the other $1.8 million. The legislature allocated 65 percent of the tax revenues to the state General Fund for the first two years. Since this time in 1947, all income tax collections have been allocated to the General Fund.

In 1937, income tax rates ranged from 1 percent on the first $1,000 of income to 6 percent on income more than $10,000. The top rate was increased in 1947 to 10 percent for incomes over $11,000. In 1960, the rates were increased to 3 percent for the first $1,000 but reduced to 9 percent for income over $10,000.

The income tax system in Colorado was designed by the legislature until the early 1960s. In 1962, voters adopted a constitutional amendment that allowed the legislature to define income tax law by reference to federal tax law. The Colorado Income Tax Act of 1964 made the federal adjusted gross income the basis for determining Colorado income. Specific modifications and exemptions were incorporated into legislation between 1964 and 1987. In that year, 1987, as a response to federal tax changes, a new income tax act was adopted by the General Assembly. That act established a single tax rate of 5 percent for individuals and corporations, as well as simplification in terms of tax preparation. The Taxpayer's Bill of Rights (TABOR) amendment, adopted in 1992, codified the requirement that the same rate apply to both individuals and corporations.

The income tax rate was subsequently reduced to 4.75 percent in 1999 and 4.63 percent in 2000. This is the current tax rate. Referendum C, adopted by the voters in 2005, allows the income tax rate to decline to 4.5 percent under specified circumstances after 2010.

Income Tax "Coupling"

Like most states, Colorado's income tax system is "coupled" with the federal income tax system. This means Colorado taxpayers begin with federal taxable income when calculating how much tax is owed on their Colorado state tax return. As such, Colorado's income tax system automatically incorporates all federal tax provisions that occur "above the line" or before the calculation of federal taxable income.

25 *Colorado Department of Revenue 2014 Annual Report.*

26 *State Government Tax Collections: 2013,* United States Census Bureau, accessed June 26, 2015 at http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk.

While this coupled system contributes to the simplicity of the state income tax system, it also can result in reduced state revenue based solely on congressional tax policy changes. The considerations of federal tax policymakers are often different or in conflict with Colorado's needs. Federal tax policy is not specifically tailored to unique state conditions.

Colorado, along with all other states, has the option to insulate portions of its internal tax code from federal income tax changes by "decoupling." Decoupling simply means state tax provisions do not follow the federal tax code without active adoption by the state legislature. To date, Colorado has not decoupled from any portions of the federal tax code.

Individual Income Taxes

Colorado currently has a flat tax rate of 4.63 percent. Seven other states also have a flat (or single) individual income tax rates, as opposed to graduated rates. Thirty -three states have graduated individual income tax rates that range from 0.5 percent to 13.3 percent. Seven states have no individual income tax and two states tax only dividends and interest income at a flat rate.[27]

Colorado's individual income tax generated $5.6 billion in 2014.[28] As stated above, the individual income tax share of the General Fund has grown over time. In 1975, individual income taxes made up 39 percent of the General Fund, while in 2015, individual income taxes are estimated to account for 64 percent of the General Fund.[29]

Colorado ranks 26th out of 43 states for individual income taxes when measured by $1,000 of personal income. Colorado's total tax amount per $1,000 of income ($22.29) was higher than the national average of $21.58 for the 43 states with an individual income tax.

While a flat rate on taxes tends to be regressive, Colorado's individual income tax remains fairly progressive since it is tied to the progressive federal tax code. Income earners who make less than $22,000 per year pay 0.7 percent of their income in individual income taxes while the top 1 percent of Colorado earners (those making $567,000 or more) pay an average of 3.4 percent.[30] However, those making more than $100,000 annually pay 65 percent of total taxes in the state and only make up about 18 percent of all taxpayers.[31]

Corporate Income Taxes

Colorado's corporate income tax rate is 4.63 percent, the same as the individual income tax rate. Thirty-one states, including Colorado, have a flat corporate income tax rate. Colorado is the second lowest behind Kansas, while Pennsylvania is the highest. Twelve states have a graduated corporate income tax. The lowest rate of any bracket is 1 percent and the highest is 12 percent.[32]

To determine the amount of money taxed at the state level, Colorado business returns begin with federal taxable income. At the federal level, a business subtracts its federal deductions from its gross receipts to calculate federal taxable income. Federal taxable income is then "apportioned" — or allocated — among the states in which the business operates to determine a business's tax liability in states where business income is generated.

States use a variety of methods to apportion income. In 2008, the Colorado Legislature voted to make Colorado a single-sales factor apportionment state. This means when a business is apportioning its federal taxable income among states, it assigns to Colorado the share of its federal taxable income that is proportionate to the percentage of total sales made in the state. Other states use factors such as property owned in the state, number of employees in the state and actual presence in the state to determine state tax liability. Federal taxable income is apportioned to Colorado entirely based on the amount of sales a business has in the state.

Corporate income tax collections yielded $717 million

27 State Individual Income Tax Rates, Federation of Tax Administrators, February 2015 at http://www.taxadmin.org/fta/rate/ind_inc.pdf.
28 Colorado Department of Revenue 2014 Annual Report.
29 Budget in Brief, Colorado General Assembly Joint Budget Committee, FY 2015-16.
30 Who Pays? A Distributional Analysis of the Tax Systems of all 50 States.
31 Colorado Tax Profile and Expenditure Report 2014
32 Range of State Corporate Income Tax Rates, Federation of Tax Administrators, February 2015 at http://www.taxadmin.org/fta/rate/corp_inc.pdf.
33 Colorado Department of Revenue 2014 Annual Report.

in 2014. This is an increase of one percent from 2013.[33] Corporate income tax revenue makes up 11 percent of income tax collections and 7.3 percent of General Fund revenue collections in Colorado. [34]

Colorado ranks 29th out of 46 states for corporate income taxes per $1,000 of income. The national average for all 46 states is $3.21.[35] Colorado businesses pay $2.83.[36] Currently, there is no information on who pays these taxes by industry or business type.

STATE TAXES: EXCISE TAX

Sales and Use Tax

In 2014, Colorado collected a little over $2.6 billion in state sales and use tax revenues.[37] This was an eight percent increase from the prior year. Yet, the percentage of the General Fund that is made up of sales and use tax collections has been declining. In 1976, sales and use taxes generated 37 percent of the General Fund. In 2015, sales and use taxes are estimated to generate 30 percent.[38] The reasons for the decrease include an increased number of sales and use tax exemptions, an increase in untaxed e-commerce and a shift from the purchase of taxable goods to untaxed services.

Colorado is also one of 32 states where local governments collect sales and use taxes. Changes in the state sales and use tax base affect local sales tax collections. Those effects vary depending on whether the locality is a "home rule" jurisdiction. Local sales taxes are discussed in the section of this paper about local taxes.

Colorado's sales tax ranks 44th of 45 states per $1,000 of personal income. Five states have no state sales tax. The average amount of sales tax paid by all states is $18.83 per $1,000 of income. Colorado taxpayers pay $10.30. [39]

Sales and use taxes are the most regressive form of taxes in the Colorado tax system. The lowest quintile of taxpayers pays 5.3 percent of their income in sales tax while the highest 1 percent of earners pays only 0.7 percent.[40] One of the reasons for the disparity is the fact that lower-income taxpayers are more likely to spend all of their income each month, and therefore be subject to more sales taxes, than those with a higher income who save more. Lower-income families also tend to purchase more taxable goods and fewer untaxed services than higher-income individuals.

History of Sales and Use Tax in Colorado

Following the national trend, Colorado increased its reliance on excise taxes in the 20th Century. Preceded by a "privilege" tax on insurance companies (1883), an inheritance tax (1901), and a motor fuel tax (1919), the state's first general sales tax law was enacted as the "Emergency Retail Sales Tax Act of 1935," which levied the first excise tax on general retail sales of tangible personal property. Although the act was scheduled to expire in 1937, the Old Age Pension Amendment, initiated in 1936, earmarked 85 percent of the proceeds of the sales tax and rendered the new temporary tax permanent. When the 1935 law was enacted, a service tax was also imposed on professional and personal services, but increasing opposition from professional groups led to its repeal in 1945.

34 *Budget in Brief*, Colorado General Assembly Joint Budget Committee, FY 2015-16.
35 Kirk, *How Colorado Compares in State and Local Taxes.*
36 Ibid.
37 *Colorado Department of Revenue 2014 Annual Report.*
38 *Budget in Brief*, Colorado General Assembly Joint Budget Committee, FY 2015-16.
39 Kirk, Colorado's Revenue and Tax Structure Power Point presentation.
40 *Who Pays? A Distributional Analysis of the Tax Systems of all 50 States.*

To prevent circumvention of the sales tax, a use tax was also added in 1937, imposing a 2 percent levy on tangible personal property purchased outside Colorado and brought into the state for storage, use or consumption. The use tax rate in Colorado is the same as the sales tax rate.

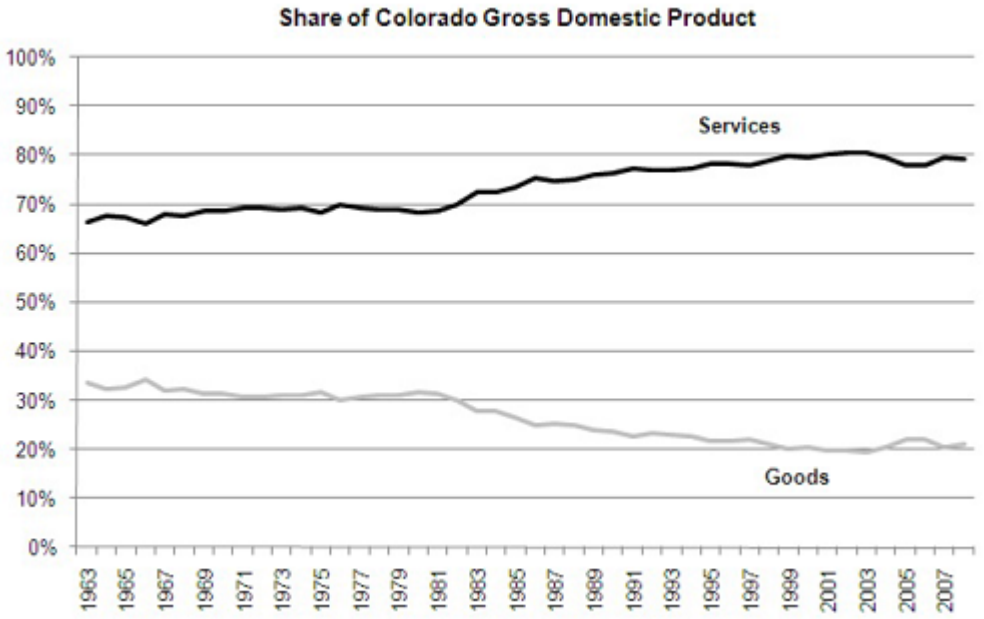


Figure 8

Sales Tax Rate

The 1935 act imposed a tax rate of 2 percent on the sales price of tangible personal property, unless the property became a component part of a manufactured product. Gasoline and special fuels were also exempt. The rate was raised to 3 percent in 1965, and for 15 months during 1983 and 1984, was temporarily raised to 3.5 percent due to a budgetary shortfall. The rate then reverted back to 3 percent on Aug. 1, 1984.

Effective January 1, 2001, the rate was lowered to 2.9 percent due to the state repeatedly collecting more revenue than was allowed under the Taxpayer's Bill of Rights (TABOR). This was viewed as an alternative to a general refund, allowing a direct benefit to those who specifically paid the sales or use tax in proportion to the amount paid, rather than refunding the same amount to everyone in the state.

Sales Tax Base

The sales tax base is defined as taxable sales of tangible personal property, plus telephone/ telegraph services, gas and electric service for commercial consumption, prepared food or drink, and lodging accommodations. There are a variety of sales that are not taxable because the transaction is exempt from the tax, to promote either parity within an industry, social equity or a desirable behavior. The two largest taxable sales that are exempt from sales tax are the sales and purchase of component parts of a manufactured product and the sale of food for domestic home consumption (i.e., groceries).[41]

Taxing Services

Since the enactment of the state sales tax on goods, much of consumer spending has shifted as the service industry has grown rapidly in Colorado and across the country. There is now more money spent on services than goods in Colorado. Figure 8, from Colorado Legislative Council, shows that in 1963, just more than 65 percent of Colorado's economic output was attributable to non-taxable services compared to 2008, when services comprised almost 80 percent of state output.

Colorado's sales tax base includes only 14 services.[42] According to Colorado Legislative

41 *State Income Tax Credits, Rebates, and Modifications & State Sales and Use Tax Exemptions.*

42 Sigalla, Fiona, *Sales Tax on Services*, Colorado Legislative Council Memorandum, January 29, 2010 at http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application/pdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251607101016&ssbinary=true.

Council, all other states include more services than Colorado in their sales tax mix, with the highest number of services taxed being in Hawaii at 166.[44] The most commonly taxed services by all states are: tuxedo rentals; photocopying/ photofinishing; printing; software; event admissions; cellular and intrastate telephone utilities; and leases and rentals (Table 4) .

Table 4 **Services Commonly Taxed in Other States and Subject to Colorado State Sales Tax**

	Number of States Currently Taxing
Hotels, Motels, Lodging Houses	50
Printing	45
Rental of Video Tapes for Home Viewing	45
Photo Finishing	44
Cellular Telephone Services - Residential Use	44
Intrastate Telephone - Industrial Use	43
Cellular Telephone Services - Industrial Use	43
Intrastate Telephone - Residential Use	41
Long Term Automobile Lease	40
Tuxedo Rental	38
Service Contracts Sold at the Time of Sale	32
Welding Labor (Fabrication and Repair)	31
Computer Software - Modifications to Canned Program	29
Trailer Parks - Overnight Rentals	29

Source: Federation of Tax Administrators

Sales Tax Exemptions

There were a total of 86 exemptions from state sales and use taxes in Colorado in 2013 accounting for $3.97 billion in revenue.[45] The top three exemptions from sales and use taxes are the exemption for sales by wholesalers to retailers, the purchase of component parts of manufactured products, and the purchase of food for home consumption. The top three exemptions account for more than half of exempted revenue.[46]

Vendor Credit

In Colorado, vendors (retail businesses) are required to collect sales tax from customers and remit it to the Department of Revenue. If a vendor properly complies with this requirement, they are eligible for a tax credit against some of the tax they were required to remit.

Colorado has one of the most generous vendor credits in the country because it is not subject to any ceiling. In 2008, Colorado lost more than $68.5 million in revenue as a result of the vendor credit.[47] Thirteen percent of that lost revenue went to just one retailer - Walmart.

In 2009, the vendor tax credit was temporarily suspended as a budget-balancing measure.[48] The suspension was estimated to increase revenue by more than $71 million dollars in FY 2010-11.[49] The suspension expired at the end of 2011.

The vendor credit was reinstated by the General Assembly for 2012. It was reinstated at 2.2 percent and has now been increased to 3.3 percent.

Internet Sales Tax

In recent years, internet sales have become a growing source of lost revenue for Colorado and other states with sales taxes. Current law says that states may only require the collection of sales taxes by

businesses with a physical presence, or "nexus" in the state. In practice, this means that internet retailers without warehouses, offices or stores in Colorado are not required to collect Colorado sales taxes on sales to people in the state. As more and more Coloradans shop online, this loophole becomes a bigger and bigger problem for the state budget.

In 2010, the Colorado legislature attempted to mitigate the problem of lost sales tax revenue from internet sales. Effective March 1, 2010,

44 *Financing Colorado's Future: An Analysis of the Fiscal Sustainability of State Government*
45 *Colorado Tax Profile and Expenditure Report 2014*
46 Ibid.
47 Materra, Philip and McIlvaine, Leigh, *Skimming the Sales Tax: How Wal-Mart and other Big Retailers (Legally) Keep a Cut of the Taxes We Pay on Everyday Purchase*, Good Jobs First, Novemner 2008 at http://www.goodjobsfirst.org/sites/default/files/docs/pdf/skimming.pdf.
48 Colorado Senate Bill 09-212 accessed January 10, 2011 at http://www.leg.state.co.us/clics/clics2009a/csl.nsf/fsbillcont3/9908363968A6ECCB87257551005B26B5?open&file=212_enr.pdf
49 Scanlon, Terry, *2011-12 budget presents a test for new leadership: Don't fail Colorado communities,* Colorado Fiscal Policy Institute, Nov. 10, 2010 at http://www.cclponline.org/uploads/files/ritter_final_budget_brief.pdf.

House Bill 10-1193 stipulated that any retailer not collecting sales tax in Colorado must inform Colorado customers that, while sales tax is not being collected by the retailer, use taxes may still be owed on their purchases. Specifically, the law requires a non-collecting Internet retailer to: (1) inform customers of their use tax obligation at the time of purchase, (2) provide customers with a year-end summary of purchases for use tax purposes, and (3) supply a similar report showing an annual total to the Colorado Department of Revenue.

Since its passage, Colorado's internet sales tax law has been debated in court. In 2012, a U.S. District Court determined that the law was unconstitutional, but the ruling was overturned by the 10th Circuit Court of Appeals based on a jurisdictional challenge. In February of 2014, the Denver U.S. District Court ruled for a preliminary injunction preventing the state from enforcing the law. The law is currently headed to the United States Supreme Court, although the issue for review is only who has jurisdiction to decide the fate of the law.

Colorado is not the first state to confront the problem of internet sales tax loss. Several other states, including New York and North Carolina, have passed laws attempting to compel the collection of sales tax on internet purchase. As a result, Congress is currently considering legislation, known as the Marketplace Fairness Act, which would allow states to require internet sellers not physically located in their state to collect taxes on online and catalog purchases made by consumers in the state.

Severance Taxes

Colorado's severance tax was created in 1977 with the intent to recapture portions of the state's "wealth endowment" that was lost due to the excavation and extraction of nonrenewable resources.[50] Revenue collected was to be held in a trust to help offset the cost of mitigating negative impacts from nonrenewable resource development. [51]

Severance tax revenue is divided evenly between the Department of Natural Resources and the Department of Local Affairs. Each department uses funding from severance taxes differently. The Department of Natural Resources uses the funding for water projects, for natural resources-related programs and for low-income energy assistance. The Department of Local Affairs distributes its funding to local governments to offset the impact of natural resource extraction.

Colorado's severance tax is levied on the value of extracted natural resources. More than 81 percent of the severance tax revenue comes from natural gas. The remaining severance tax revenue is from oil, coal and other minerals. Colorado's severance tax also incorporates a tax credit to offset taxes paid on resources at the local level. Since producers pay a local property tax on extracted resources, the state allows 87.5 percent of local property taxes paid to be credited against severance tax liability.[52]

Severance tax collections in 2013 were $282 million.[53] Severance tax collections are projected to be $125.2 million, or 4.4 percent of cash fund collections in FY 2015-16.[54]

When the combined state severance tax and the

50 Schrock, Jason, *Severance Tax and FML Revenue,* Colorado Legislative Council Memorandum, Dec. 30, 2008 at http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application percent2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251606227916&ssbinary=true.

51 Ibid.

52 *2012 Colorado Severance Tax Forms and Instructions,* Colorado Department of Revenue, accessed October 28, 2014 at http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251831829880&ssbinary=true.

53 *Colorado Department of Revenue 2014 Annual Report.*

54 *Budget in Brief*, Colorado General Assembly Joint Budget Committee, FY 2015-16.

55 Kirk, *How Colorado Compares in State and Local Taxes.*

local property tax is considered, Colorado ranks second to last of all states that have severance taxes and fourth among the five western states that have a severance tax, including Wyoming, New Mexico, Oklahoma and Utah.[55]

Motor Fuels Tax

A motor fuels tax was enacted in 1919 as part of the Colorado Constitution. Gasoline, gas blends and special fuels such as diesel, bio-diesel, kerosene, liquefied petroleum gases and natural gas are all taxable under this article of the constitution. The tax rate on motor fuels and special fuels has not increased since 1991 and 1992, respectively.

Colorado has two primary motor fuels taxes and a motor vehicle registration fee. Colorado's two motor fuels taxes include a fuel excise tax (also known as the gas tax) of 22 cents per gallon on all non-diesel motor fuel sold and a diesel fuel tax of 20.5 cents per gallon.

The combination of those three sources raised $1.1 billion for transportation services in 2014.[56] The funds collected from these three sources go into the Highway Users Tax Fund, although they are essentially cash funds. Transportation-related taxes and fees are estimated to make up 41.4 percent of the total 2015-16 cash fund collections.[57]

Colorado ranks 38th out of 50 states in fuel taxes. Coloradans pay $2.55 per $1,000 of income on motor fuel taxes. The national average is $2.88.[58]

Cigarette Taxes

Cigarette taxes were enacted in 1964 as part of the Colorado Constitution. The tax rate was last increased in 2004 to 84 cents per 20 cigarettes with the passage of Amendment 35, which earmarked the revenue as follows:

- 46 percent to increase access to health insurance for children and working families
- 19 percent to support community clinics that provide primary health care services to low-income, uninsured patients
- 16 percent to fund comprehensive tobacco education, prevention and cessation programs
- 16 percent to support prevention, detection and treatment programs for cancer, chronic pulmonary disease and cardiovascular disease
- 3 percent to the General Fund to support the Old-Age Pension fund and municipal and county governments for health-related expenses.

In comparison with other states, Colorado has a relatively low rank of 395th in the nation in cigarette tax collections per $1,000 of income.[60] The national average is $1.17 and Coloradans pay $0.76. In 2014, approximately $194 million was collected by the state as a result of this tax levy.[61]

Alcohol Taxes

Shortly after the repeal of prohibition, Colorado enacted a statute imposing a liquor tax. Colorado has one of the lowest liquor tax rates in the country. Per $1,000 of income, liquor tax collections in Colorado rank 43rd nationally.[62] Coloradans pay $0.16 per $1,000 of income in alcohol taxes, while the national average is $0.43. Tax rates on liquor vary based on the type of beverage, from 8 cents per gallon on beer to 60.26 cents per liter on spirits. This tax levy brought in $48 million in tax collections for the state in 2014.[63]

56 *Colorado Department of Revenue 2013 Annual Report.*
57 *Budget in Brief*, Colorado General Assembly Joint Budget Committee, FY 2015-16.
58 Kirk, *How Colorado Compares in State and Local Taxes.*
59 *Amendment 35 Implementation: Upholding the Promise to Voters,* Colorado Children's Campaign, Feb. 1, 2005 at http://www.coloradokids.org/file_download/31501a8d-dc60-47a0-bae2-23ebedc1e59b.
60 Kirk, *How Colorado Compares in State and Local Taxes.*
61 *Colorado Department of Revenue 2014 Annual Report.*
62 Kirk, *How Colorado Compares in State and Local Taxes.*
63 *Colorado Department of Revenue 2014 Annual Report.*

Marijuana Taxes

In 2000, Colorado voters passed Amendment 20 to the Colorado Constitution, which established a caregiver-patient system for medical marijuana and permitted qualifying patients or caregivers to possess six marijuana plants or two ounces of useable marijuana for medical purposes. In 2007, a Denver district judge ruled that this violated state law. In response, the Colorado General Assembly passed HB 10-1284, which established a framework for medical marijuana centers (dispensaries), cultivation facilities and manufacturers of edible marijuana products.

In 2012, Colorado and Washington were the first two states to approve measures allowing recreational cultivation and use of marijuana among adults 21 years of age or older within each state.

Both medical marijuana and recreational marijuana are taxed in Colorado, but at different rates. Medical marijuana is typically taxed at a much lower rate than recreational because medical marijuana is subject to just state and local sales taxes. Recreational marijuana is subject to state and local sales tax and also to a 15 percent excise tax and a special state sales tax rate of 10 percent. Additionally, each city can apply higher tax rates to recreational marijuana. For example, the Denver sales tax rate is 3.62 percent for medical marijuana and 7.12 percent for recreational marijuana.[64] The effect is compounded by state and district taxes. The final rate for medical marijuana in Denver is 7.62 percent, compared to the recreational rate of 21.12 percent.[65]

As of November 2015, marijuana taxes, licenses and fees have generated close to $60 million.[66]

In November of 2015, voters passed Proposition BB. This allows the state to retain and spend tax dollars collected generated by marijuana sales that were subject to a TABOR refund because of an odd rule in TABOR surrounding tax estimates by legislative council. The money that is retained by the state will be spent on school construction and other state programs.

STATE TAXES: OTHER TAXES

While the taxes listed above generate the most significant amount of revenue for the state, there are several other taxes that complete the Colorado state tax portfolio.

Gaming Taxes

Gaming is a self-contained ("cash-funded") state function that receives no tax dollars for operations or expenses. There are 40 casinos in Colorado including two tribal casinos, seven casinos in Central City, 17 casinos in Black Hawk and 14 casinos in Cripple Creek. Gaming is taxed and regulated by the Department of Revenue.

A graduated tax is imposed upon limited gaming retailers and operators. The amount of tax paid is dependent on the adjusted gross proceeds (AGP) from gaming. The AGP tax rate is between 0.25 and 20 percent of AGP. In 2014, Colorado casinos grossed $746 million and paid $106 million in taxes (effective rate of 14 percent).[67]

Proceeds from gaming go into the Limited Gaming Fund. The Limited Gaming Fund Supports the following (determined by Constitution):

- 28 percent to the State Historical Society (used for historic preservation and restoration)

64 *Market Size and Demand for Marijuana in Colorado,* Prepared by the Marijuana Policy Group for the Colorado Department of Revenue, 2014 at https://www.colorado.gov/pacific/sites/default/files/Market%20Size%20and%20Demand%20Study%2C%20July%209%2C%202014%5B1%5D.pdf.

65 *City and County of Denver Colorado Tax Guide, Topic No. 93, Tax Rates and Rounding,* City and County of Denver, January 1, 2014 at http://www.denvergov.org/Portals/571/documents/TaxGuide/Tax%20Rates%20and%20Rounding%20-%2093.pdf

66 State of Colorado Marijuana Taxes, Licenses, and Fees Transfers and Distribution, November 2015 at https://www.colorado.gov/pacific/sites/default/files/1015%20Marijuana%20Tax%2C%20License%2C%20and%20Fees%20Report.pdf

67 *Gaming in Colorado: Fact Book and 2014 Abstract,* Colorado Division of Gaming, accessed January 5, 2016 at https://www.colorado.gov/pacific/sites/default/files/2014%20Fact%20Book%20and%20Abstract%20FINAL.pdf.

- 12 percent to Gilpin and Teller counties
- 10 percent to Cripple Creek, Central City and Black Hawk
- 50 percent to the General Fund

In 2008, Colorado voters passed Amendment 50. The measure was a citizen initiative which allowed $100 maximum bets, the addition of craps and roulette and permitted casinos to remain open 24 hours a day. The amendment also required voter approval for any increase in gaming tax rates.[68]

Beginning in 2010, the proceeds from the implementation of Amendment 50 have been distributed as follows:

- 78 percent to the Colorado Community College system
- 12 percent to Gilpin and Teller Counties
- 10 percent to the towns of Cripple Creek, Central City and Black Hawk

In 2014, Amendment 50 distributions totaled $8.3 million. Community colleges received $6.5 million.[69]

Estate and Inheritance Taxes

The Colorado estate tax, based on the federal estate tax, was phased out beginning Dec. 31, 2004, due to federal tax law changes.

Regulatory and Business Taxes

Regulatory taxes on the licensing of businesses, including sales licenses, liquor licenses, cigarette licenses and special fuels licenses and permits generated more than $72 million in 2014.[70] The largest revenue generating activities in this category include an underground storage tank surcharge ($33 million) and PUC utility supervision fees ($10 million).[71]

LOCAL TAXES

Colorado is one of the most fiscally decentralized states in the nation. It is one of only four states in which the state government generates less tax revenue than the local governments.[72] Revenue collections by Colorado state government rank 47th per $1,000 of income.[73] However, revenue collections by state and local governments combined move Colorado to 44th.[74]

This pattern of weak state government has been reinforced by various constitutional revenue limits adopted in the past two decades. TABOR's constitutionally mandated elections on all tax rate changes and its revenue limit, which forces government spending to lose pace with the growth in the economy, has affected state finances dramatically. Local governments have had more opportunity and success in securing public support for retaining money collected above the revenue limit and for increasing tax rates.

Property and sales taxes are the major source of local tax revenue. According to Legislative Council, local governments' tax collections rank 8th out of states that collect taxes locally. Local governments in every state collect property taxes, and local governments in all but 15 states collect sales taxes.[75] In 2008, local (municipal, county, school and special districts) taxes accounted for 51 percent of combined state and local taxes.[76]

68 *Amendment 50*, Colorado Department of Revenue, Division of Gaming, accessed January 10, 2011 at http://www.colorado.gov/cs/Satellite/Rev-Gaming/RGM/1218795716371.
69 *Gaming in Colorado: Fact Book and 2014 Abstract.*
70 Colorado Department of Revenue 2014 Annual Report
71 Ibid.
72 *Taxpayer Report*: *How Colorado Compares*, *State Taxes and Spending (2006 Edition)*, Center for Tax Policy, accessed January 10, 2011 at http://www.centerfortaxpolicy.org/reports/How_Colorado_Compares.pdf.
73 *Kirk, How Colorado Compares in State and Local Taxes.*
74 Ibid.
75 Ibid.
76 Ibid.

P*roperty Taxes*

Colorado collects property taxes on the assessed value of both residential and commercial property. All of the revenues generated by property taxes remain at the local level. This revenue goes to pay for schools, roads, fire protection, police and other local services.

Property tax is collected on the taxable value of a property. In Colorado, the value of property that is taxed is not the market or the actual value; it is the "assessed value." The assessed value is a percentage of the actual value that is determined by applying the "assessment rate." The assessment rate in Colorado is 29 percent for commercial property and the residential rate is set by the legislature during odd-numbered years. The current residential rate is 7.96 percent.

Once the assessed value is determined, a "mill levy" rate is applied to calculate taxes owed. Each local entity determines what revenue is required to operate their budget. They then divide the total amount needed by the assessed value to determine their mill levies for the year. A property owner's total mill levy is the total of their county, city, school district and any other special districts' mill levies. The total mill levy is multiplied by assessed value to determine the total amount of property tax that is due.

History of Colorado Property Tax

When Colorado entered into the union in 1876, state government tax sources were limited to property taxes and some forms of excise taxes. Local governments were heavily dependent upon property taxes for revenue. Yet Colorado's constitution limited the amount the state government could levy to four mills for general purposes and an additional one mill for buildings at state educational institutions.

The state of Colorado levied a property tax until 1964, when HB 64-1005 repealed all statutes dealing with state levied property taxation. Since that time, property tax revenues have been levied exclusively at the local level for school districts, cities, counties, special and other districts and junior college districts. TABOR precludes the ability for the state to levy a property tax. It states, "No new state real property tax or local district income tax shall be imposed."[77]

In a memo to the Joint Finance Committee on Jan. 13, 2000, the Colorado Division of Property Taxation outlined the history of property assessments from the time of statehood to the present. The memo presented the many attempts by the General Assembly to require specified assessment levels by county assessors in order to provide equity within and among the counties. Those attempts continued until the 1980's. According to the memo, in 1941, the total assessed value of the state was 8.6 percent less than the 1913 valuation despite an estimated 50 percent increase in actual values.

The impacts of the Great Depression along with replacement of some property taxes with income tax and specific ownership tax on motor vehicles were factors contributing to this decline. For example, there was a reduction in value due to the repeal of the property tax on intangibles and motor vehicles. However, there was also a replacement of this revenue with the imposition of income taxes and specific ownership taxes on vehicles. In addition, various state statutes that increased state aid for schools from counties with low values also contributed to lower assessments by county assessors. Thus, assessors were given an incentive to value property low in order to receive increased state aid for schools. In 1956, a constitutional amendment was adopted that exempted household personal property from taxation. The '60s and '70s were marked by

77 *Article X, section 20 of the Colorado Constitution, provision (8) (a)*

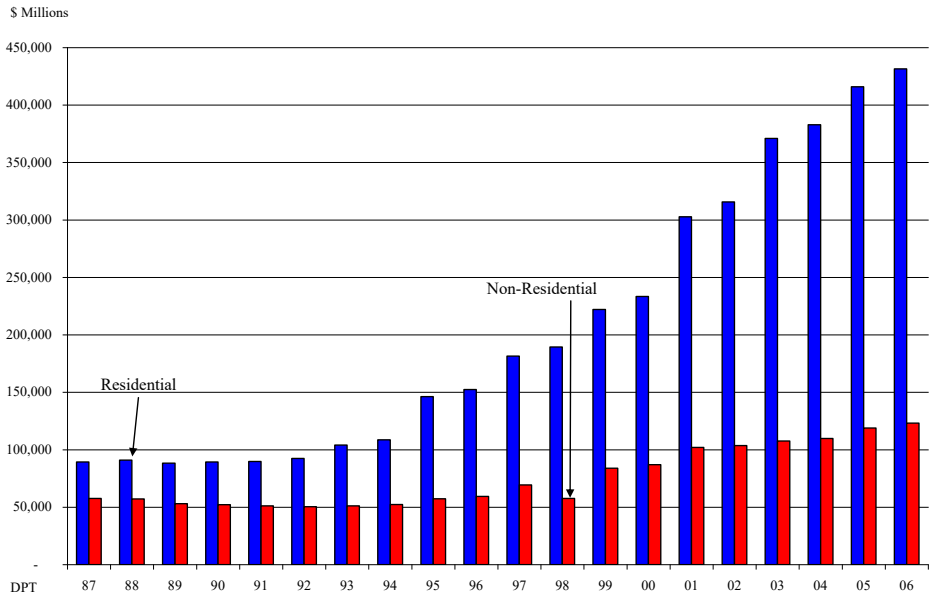
further attempts to provide for equalized values and updating assessments. The General Assembly would delay orders by the State Board of Equalization out of fear of property tax revolts taking place in various parts of the state.

Finally, in 1982, HCR 1005 changed the system of property taxation in the state. This amendment required, "appropriate consideration of cost, market and income approaches to value, with exceptions for agricultural, mine and oil and gas, and residential properties." Agricultural land would be valued according to the earning or productive capacity of the land. Producing natural resources values would be based on the value of unprocessed material, and residential values would be determined by a cost and market approach. The Senate provision, now known as the Gallagher Amendment, required a constant ratio of property tax collections between residential and non-residential property before and after reappraisals. The maximum assessment rate for most non-residential property was set at 29 percent. The maximum residential assessment rate was set at 21 percent and the rate would be allowed to float up or down in order to maintain the ratio. Following the adoption of this amendment, reassessment of property is now conducted every two years.

Increased oversight of the assessment process, together with a payback provision for under-assessed property, ultimately brought about equalization in values among the counties. The General Assembly was required to undertake a study of the assessor's valuations to ensure compliance with the new provisions. This is still conducted through an annual statewide property assessment study under the direction of the Colorado Legislative Council. If any county is found not to be in compliance, the state Board of Equalization must issue an order of reappraisal and the county must pay back to the state any excess aid to schools or payments made to school districts, including interest. Beginning in 1983, the state Board of Equalization began issuing orders to counties to force compliance either through reappraisals or paybacks. The Gallagher Amendment of 1982 was a significant step in bringing equalization in property values and assessments up to date.

Figure 9

Actual Value: Residential and Non-residential, 1987-2006

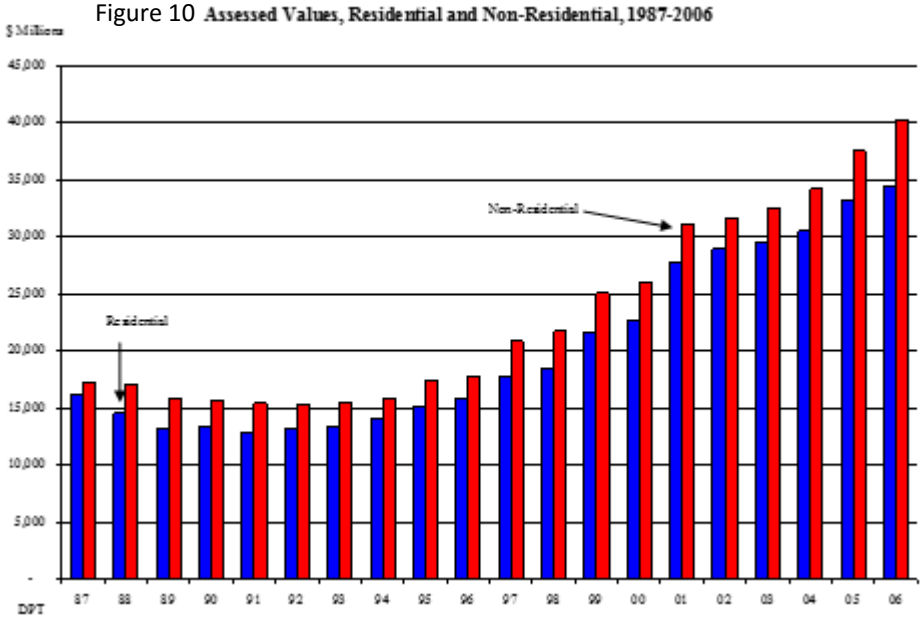


Figures 9 and 10 show what has happened in terms of actual value and assessed value. Figure 9 shows that total actual values rose from $147 billion in 1987 to $555 billion in 2006. Residential actual values jumped from $89 billion to $432 billion for that period. Non-residential actual values jumped from $58 billion to $123 billion. Residential values grew at a much faster rate than non-residential in terms of actual values.

Figure 10 (page 25) shows the growth in assessed values during the past 20 years. Total assessed

values increased from $33 billion in 1987 to $74.5 billion in 2006. Residential assessed values rose from $16 billion to $34 billion and non-residential assessed values increased from $17 billion to more than $40 billion. Non-residential property is assessed primarily at 29 percent of actual value, while residential is assessed on a floating rate, which declined from 18 percent to less than 8 percent by 2006.

Figure 10 **Assessed Values, Residential and Non-Residential, 1987-2006**



The Gallagher Amendment

As mentioned previously, the Gallagher Amendment established a ratio between residential and non-residential assessed values. Most non-residential property assessments were fixed at 29 percent of actual value and residential properties were set at 21 percent of actual value. However, the ratio between the two was to remain roughly 55 percent to 45 percent, respectively, after each reassessment. Since implementation in 1987, the ratio has shifted slightly to 53 percent to 47 percent as a result of new residential construction. Table 5 shows the change in the residential assessment rate since implementation in 1987, as provided by the Department of Property Taxation's 2013 Annual Report.[78]

The Division of Property Taxation's Annual Report also provides an estimate of the shift from residential to non-residential property as a result of the Gallagher Amendment's continuous lowering of the residential assessment rate.[79] The estimates are based on a fixed residential assessment rate of 21 percent. The estimates show a cumulative total of $15.96 billion in property taxes shifted to non-residential property during the last two decades.

The following charts show how the Gallagher ratio affected residential and non-residential property. Figure 11 shows residential and non-residential actual property values as a percentage of income. After declining at first, residential values began a rise from less than 150 percent of income to nearly 250 percent a

Years	Table 5: Residential Assessment Rate
Prior to 1983	30.0%
1983-1986	21.0%
1987	18.0%
1988	16.0%
1989-90	15.0%
1991-92	14.4%
1993-94	12.9%
1995-96	10.4%
1997-2000	9.7%
2001-02	9.2%
2003-14	8.0%

77 *Article X, section 20 of the Colorado Constitution, provision (8) (a)*

78 *State of Colorado 2013 Forty-Third Annual Report,* Department of Local Affairs, Division of Property Taxation, May 15, 2014 at http://dola.colorado.gov/dpt/publications/docs/2013_Annual_Report/2-Website-EntireManual.pdf.

79 Ibid.

decade later. Non-residential values also declined in the beginning, but remained constant thereafter. This shows the tremendous growth in residential values compared with non-residential values during that last 20 years.

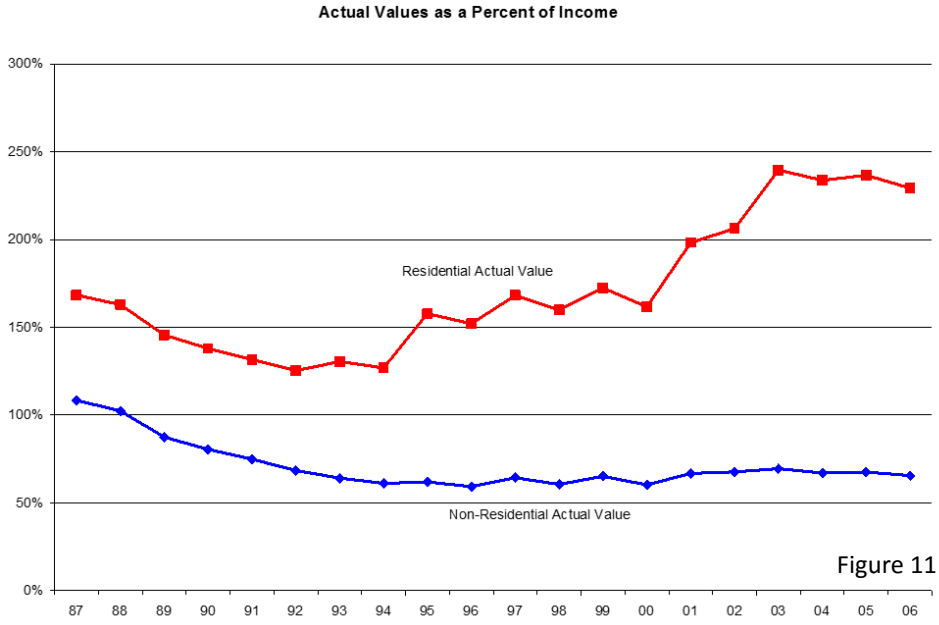


Figure 11

To compare, Figure 12 shows assessed value changes as a percentage of income for both residential and non-residential property. Both residential and non-residential assessed values declined and then remained fairly constant throughout the rest of the period. The impact of the Gallagher Amendment is clearly illustrated by the difference between residential actual values and residential assessed values.

Property Tax Collections

Property taxes are a significant revenue source for funding local public services in Colorado. In 2013, property tax collections comprised 60 percent of local government tax revenue in Colorado, totaling more than $7 billion. [80]

Colorado ranks 27th out of 50 states that collect local property taxes.[81] Property taxes in Colorado are $29.82 per $1,000 of income.[82] Colorado's property taxes are regressive. Colorado families that earn less than $20,000 per year pay 2.4 percent of their income in property taxes, while those in the top 1 percent of all earners pay only 1.4 percent.[83]

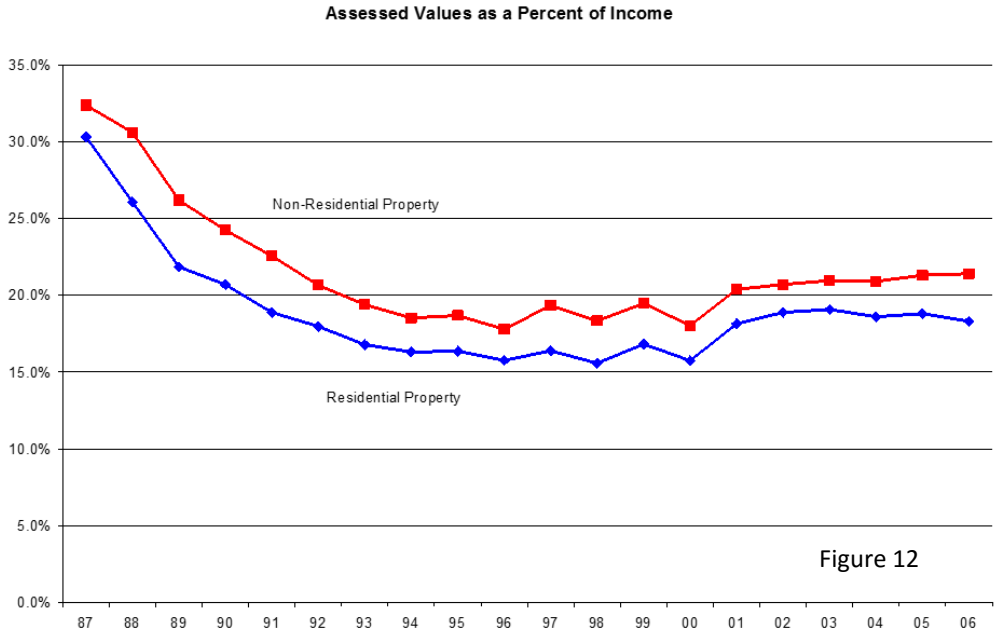


Figure 12

Business Personal Property Taxes

Local governments also collect a business personal property tax. Business personal property is all the assets owned and used by a business. In Colorado, it includes machinery,

80 CFI analysis of United States Census Bureau data found here: http://www.census.gov/govs/local/
81 Kirk, *How Colorado Compares in State and Local Taxes.*
82 Ibid.

furniture, computers and "state assessed personal property," which is defined as cable lines, pipelines and utility lines.

Forty-one states tax at least some business personal property, however, it is very difficult to compare business personal property tax in Colorado to the tax in other states because property is taxed and valued in a large variety of ways.[84]

The Colorado business personal property tax is assessed on the actual value (market value) of all the assets owned and used by a business that are valued at more than $4,000. In 2009, there was $11.7 billion in personal property assessed value statewide, which represents about 11.9 percent of the state's total assessed property value. This equates to approximately $820 million in business personal property tax revenue for local governments.[85]

Roughly 84,000 local business paid business personal property tax in 2003. Of these businesses, 1 percent of these companies paid 74 percent of the tax, and 25 percent of these companies paid 96 percent of the total business personal property tax.[86]

In an attempt to reduce the business personal property tax on small business, several exemptions have been adopted. Business personal property with an acquisition cost of less than $250 or a shelf life under one year is not taxed. Also, agricultural machinery and business inventory is not taxed. Businesses are not required to pay business personal property tax if the total actual value of the property is assessed at $7,000 or less (2014). This exemption, based on HB08-1225, will increase over time as follows:

Year	Table 6 Property Tax Exemption – Tax not imposed on property valued at less than:
Prior to 2009	$2,500
2009 - 2010	$4,000
2011 – 2012	$5,500
2013 – 2014	$7,000
2015 and later	Adjusted biennially to account for inflation

In the 2014 session, the General Assembly also added an income tax credit against business personal property tax paid by businesses that have $15,000 or less in business personal property tax, but are above the exempted threshold ($7,000 for 2014).

The business personal property tax funds local governments. In 2003, more than half of business personal property tax revenues went toward funding school districts. The remaining revenues were distributed between counties, cities and special districts.[87]

County reliance on the business personal property tax varies dramatically. For example, in Hinsdale County, the business personal property tax makes up 1.87 percent of total assessed value, while in Morgan County, the tax makes up 44.16 percent. Since business personal property tax is assessed on power plants and pipelines, rural counties are generally more dependent than urban counties.[88]

83 *Who Pays? A Distributional Analysis of the Tax Systems of all 50 States.*
84 *Business Personal Property Tax in Other States,* Colorado Legislative Council Memorandum, Aug. 19, 2004 at http://www.colorado.gov/cs/Satellite?blobcol=urldata&blobheader=application/pdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1251599410195&ssbinary=true.
85 Herreid, Todd, *Business Personal Property Tax,* Colorado Legislative Council Memorandum, October 13, 2010 at http://cospl.coalliance.org/fez/eserv/co:8439/ga42b962010internet.pdf.
86 Ibid.
87 Ibid.
88 Ibid.