Colorado State Tax Basics

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Colorado Fiscal Institute

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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. In addition to these principles, the Colorado Fiscal Institute (CFI) also evaluates tax proposals on the basis of equity, specifically race, class, and gender equity. Many policies such as sales taxes and revenue limits have historical roots in racist tax policies designed to discriminate against Black people specifically, as well as other people of color. Though tax policy has been used as a tool for oppression, it can likewise be used as a powerful tool for racial justice.

FIVE PRINCIPLES OF A GOOD TAX SYSTEM

1. Provide Adequate and Timely Revenue
2. Distribute Tax Responsibilities Equitably
3. Promote Economic Efficiency and Growth
4. Simple and Professionally Administered
5. Ensure Accountability

PRINCIPLE 1: Provide Adequate and Timely Revenue

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 care, and human services among others. Inherent in this principle is the notion that the need for public services should drive the collection of tax revenue. Certain states, including Colorado with its TABOR amendment, 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.

A good tax system must also ensure that revenues remain adequate over time. A tax system's revenues are inadequate over time when its portfolio of taxes grows at a slower rate than the cost of maintaining public services. TABOR's revenue limit formula guarantees state revenue will increase 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 state government purchases will increase faster than the Consumer Price Index (CPI). Traditionally, annual increases in CPI have been below the increase in costs associated with public investments like health care and education.[2]

Colorado's tax system is currently generating revenues that exceed the constitutional spending limit imposed by TABOR, which means the state is in a rebate situation and in Colorado is projected to refund a record $1.9 billion in FY 2021-2022. Over the next three fiscal years, Colorado will return $5.6 billion. Some of this will be offset by federal funding in response to the pandemic, but those federal dollars have requirements on when and how the money can be spent. Revenue that would otherwise be part of the state General Fund won't be available to modernize government services, restore reductions forced by the last three recessions, or invest in critical infrastructure and public services that Coloradans are leaning on more than ever.

PRINCIPLE 2: Distribute Tax Responsibilities Equitably

A successful tax system distributes the cost of public services equitably among residents and businesses. 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 person's ability to pay. Another way is to require taxes be paid proportionately, which means paying an equal percentage of taxes relative to 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-wage workers pay a greater share of their incomes in taxes than those with high incomes. The combined state and local tax systems of most states are regressive. State income taxes based on the progressive federal income tax are progressive; however, sales and excise taxes, as well as property taxes, tend to be regressive.

Overall, Colorado's tax system is regressive—people who earn the lowest incomes pay the highest overall state and local tax rates, and vice versa. This regressivity is comparable to the average U.S. state and local tax system.

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 several tax provisions that benefit one segment of a population and disadvantage another in similar circumstances. 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 3: Promote Economic Efficiency and Growth

In general, the central purpose of collecting taxes is to raise revenue for public services and investment that support state economies and promote the well-being of residents and communities. To that end, tax policy is often used to promote or incentivize certain behaviors deemed to be desirable and discourage others. For example, excise taxes may be used to discourage certain behaviors that create public and social costs, such as smoking. Tax credits for electric vehicles are used to incentivize consumers to purchase vehicles that reduce air pollution. When using tax policy to steer economic behavior lawmakers should ensure that the credit or other incentive is economically efficient and does not merely provide tax benefits to people or businesses for doing what they would have done anyway.

How a state tax system affects economic growth is also 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, such as well-maintained roads and high-quality education systems is often a more important consideration.

Colorado's tax system also includes many sales tax exemptions, income tax credits, and other tax expenditures valued at close to $6.5 billion annually.[3] 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, meaning federal exemptions and deductions cost Colorado income tax revenue even though they are not enacted by the state.

PRINCIPLE 4: Be Simple and Professionally Administered

A good tax system should be designed simply. Simplicity minimizes costs of administration and individual and business 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.

Colorado's tax system has remained fairly constant over time. TABOR restricts changes in the tax system by requiring voter approval for tax increases and new taxes that generate net increases in revenue. Since 1992, the state of Colorado has enacted only a handful of statewide tax increases.

On two separate occasions, Colorado voters increased the taxes on cigarettes and tobacco. In 2004, Colorado voters approved Amendment 35 that increases cigarette and tobacco taxes—a 64-cent increase on a pack of cigarettes to 84 cents a pack. The revenue was designated for health care services and tobacco education. In 2020, voters approved Proposition EE, which increased cigarette and tobacco taxes from $0.84 to $1.94 per pack. The rates will continue to increase until FY 2027-28.

In 2012, voters made Colorado the first state in the country to authorize the sale of cannabis for recreational use by adults aged 21 and over. Subsequent ballot initiatives in 2013 and 2015 reaffirmed an excise tax on recreational cannabis and a special sales tax, and allowed Colorado to keep the tax revenue generated by those two taxes.

Tax Administration

Our current revenue system is dependent on voluntary compliance, which 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 administrative simplicity 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 5: Ensure Transparency

The essence of accountability is that tax laws should be explicit and transparent. Truth-in-taxation policies that require clearly written public notices 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 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 resources 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 Profile and Expenditure Report.[4] This report,

made permanent by legislation in 2014, was first produced in 2013 and is produced every other year. 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.

Other useful resources are the state auditor's tax expenditure reports.[5] SB16-014 directed the Office of the State Auditor (OSA) to conduct evaluations of all state tax expenditures, including the expenditure's purpose and intended beneficiaries, whether the expenditure is accomplishing its goal, the economic costs and benefits of the expenditure, similar expenditures in other states, other government, nonprofit, or business programs accomplishing the goals of the expenditure, recommendations for changes in administration or law to facilitate data collection, and the performance measures used to complete the evaluation. The OSA is almost through its five year schedule to evaluate every Colorado state tax expenditure, and is due to finish by the end of 2022.[6]

A third resource is the State Taxpayer Accountability Report (STAR).[7] The STAR report is produced annually by the Office of the State Controller and summarizes the fiscal operations in the state. The Colorado Department of Treasury also provides a resource for Coloradans to track where their tax dollars go based on their income called "Tax Tracks."[8]

Finally, a recent change in state law allowed for lawmakers to request "demographic notes" on legislation. These Legislative Council analyses, similar to fiscal notes attached to bills, provide lawmakers and the public with information about how specific groups of people will be affected by legislation. Demographic notes can help lawmakers evaluate how tax policies will affect Coloradans of different demographic groups before those decisions are made. By having these data available during legislative debates and public hearings, lawmakers can consider the ways tax policies might affect people based on income, race and ethnicity, gender, and geography. These analyses can be important tools for using tax policy to achieve greater equity.

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 an increased number of credits and exemptions and increased complexity and administration costs without a clear demonstration of the resulting benefit. Colorado is taking steps to ensure the public has resources to evaluate its tax expenditures.

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TAX EXPENDITURE PRINCIPLES

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. CFI's staff examines each bill using a set of principles developed from the NCSL guidelines that reflect our mission to advance tax, budget, and economic policies that promote equity and widespread economic prosperity.

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.

3. Is the tax expenditure equitable?

Is the tax expenditure equitable? Equity in evaluating tax expenditures focuses on whether the credit, deduction, or exemption is targeted at people and communities who need it most. CFI evaluates the effect of the expenditure in two ways. First, we consider vertical equity, or how much taxpayers pay in taxes based on their income. Second, CFI assesses horizontal equity, which occurs when similarly situated taxpayers are treated in a similar manner.

4. Will the tax expenditure be regularly reviewed and evaluated?

Tax expenditures, just like any General Fund appropriation, need regular review and evaluation based on a clear set of objectives to determine whether they are working and to let taxpayers know how their money is being used. CFI always considers the measures of transparency and accountability that are included in any new tax expenditure or economic incentive.

5. Will the tax credit increase or decrease income or racial inequality?

Tax policy is an essential tool in combating wealth and income inequality and the concentrations of wealth in the hands of only a few. Such concentration of wealth hampers the overall strength and vitality of the economy as a whole. Moreover, tax policy has historically been used to produce large disparities in wealth by race, ethnicity, and gender that persist today. CFI evaluates whether the policy will worsen these inequities or be used as a tool to improve them.

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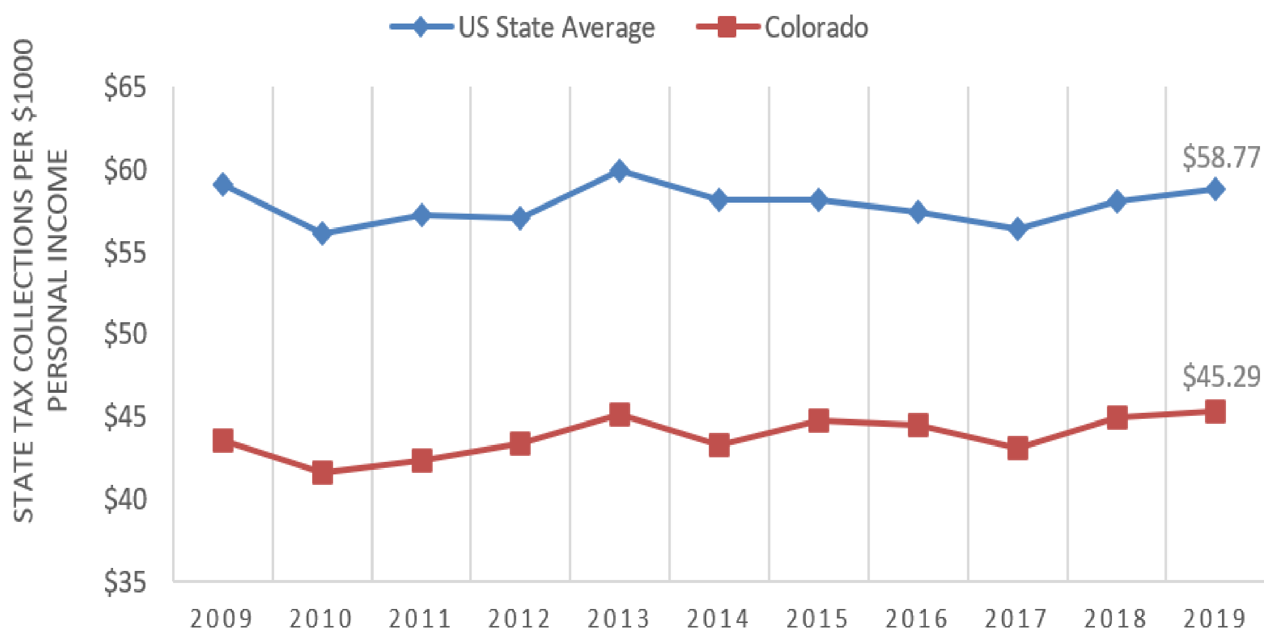
Colorado's Tax System

Tax Collection in Colorado

The Colorado Joint Budget Committee estimates that the state of Colorado will collect 34.3 billion in tax revenue in FY2021-22.



Colorado collects taxes to fund public services through the General Fund. Individual and corporate income taxes, along with sales and use taxes, make up more than 97 percent of General Fund revenue. Currently, individual income taxes make up roughly two-thirds of General Fund revenues.

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 rapidly due to the rise of internet sales, which were not taxed until 2019, and due to changes in consumer behavior that favored purchases of services (untaxed) over goods (taxed). Additionally, as state legislative and Congressional tax expenditures increased,[9] both income and sales tax bases have decreased.

Insurance premium taxes and estate taxes, both of which used to make up more of Colorado's tax revenue, have been eroded by policy changes. The insurance premiums tax policy, adopted early in statehood, has changed many times. The state estate tax was eliminated in 2004, resulting in a rapid decline in revenue in the proceeding years.

Federal tax reform, which broadened the tax base upon which individual income taxes are levied, also played a role. Since Colorado uses federal taxable income as its starting point for the calculation of Colorado's income tax base, the broadening of the federal tax base increased the state's reliance on individual income taxes.

How Colorado Ranks

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 (e.g. wages, salaries, dividends, and interest). 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 consider ability to pay. The "per $1,000" 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.

By any measure, though, taxes are low in Colorado. Colorado's total state taxes, per $1,000 of income rank eighth from the bottom (43rd) in the nation. North Dakota has the highest and New Hampshire has the lowest. The chart below shows tax rankings for all types of taxes:

State-Only Tax Rankings

Colorado Below National Average in All Tax Categories					
	Colorado		50 State Average		
	Rank	Tax Level	High	Low	Average
Total State Taxes	47 of 50	$45.93	$114.30	$34.90	$59.30
Sales Taxes	44 of 45	$17.33	$63.52	$6.16	$27.59
Individual Income	24 of 43	$23.65	$44.69	$0.00	$22.49
Corporate Income	36 of 46	$2.30	$7.28	$0.00	$3.15
Motor Fuel	42 of 50	$1.96	$5.85	$0.84	$2.78
Alcohol	43 of 50	$0.14	$0.96	$0.06	$0.38
Tobacco	45 of 50	$0.55	$2.37	$0.2	$1.02
Motor Vehicle License Fees	30 of 50	$1.33	$4.23	$0.07	$1.54

Source: U.S. Census Bureau and Bureau of Economic Analysis, per $1,000 of income (FY 2018-19)

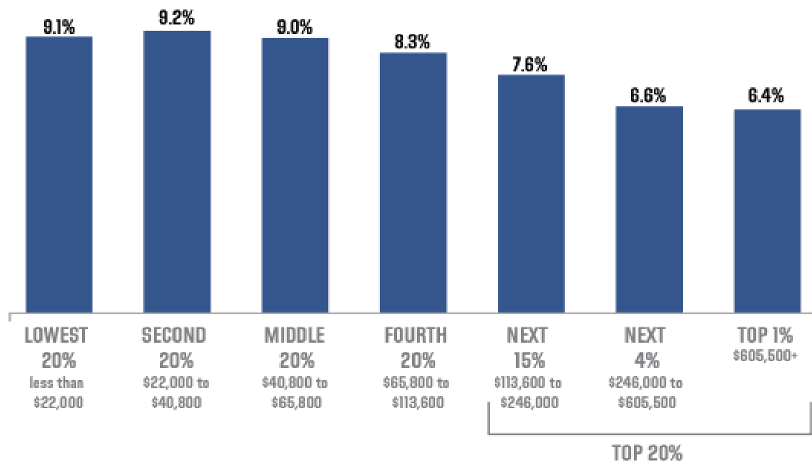
Who Pays Colorado?

When it comes to evaluating who pays taxes, there are two different kinds of tax rates to evaluate: the "nominal" tax rate, and the "effective" tax rate. In Colorado, the nominal tax rate for income taxes is a flat 4.55 percent for all income levels, 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. In Colorado, as in most states with flat income tax rates, the effective tax rates for higher income brackets are lower than those in lower income brackets. This is due to the regressive nature of sales and property taxes, and the inability of a flat income tax to make up for those inequities.

According to Institute of Taxation and Economic Policy (ITEP) analysis of effective tax rates by income quintile by state, Coloradans who earn less than $22,000 a year pay a 9.1 effective rate, whereas the top 1 percent of Colorado families with average incomes of $1.8 million pay only a 6.4 percent effective rate. The average tax rate on families in the middle of the income distribution, those earning between $40,800 and $65,800, is 9 percent.

Wealthy Pay Lowest Share of Income in Total State and Local Taxes



Source: Institute on Taxation and Economic Policy

These effective rates differ so widely in Colorado despite our single-rate income tax because Colorado state and local governments overly rely on sales and use taxes. This is an example of vertical inequity.

3

Colorado's Tax Portfolio

Income Tax

The income tax is the largest tax source that funds Colorado's state government.

History of Income Tax in Colorado

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 1930s, 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 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

History of Income Tax in Colorado

between 1964 and 1987. In 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. Since 1992, TABOR has banned individual and corporate income from being taxed at different rates.

The income tax rate was subsequently reduced to 4.75 percent in 1999, 4.63 percent in 2000, and 4.55 in 2020. 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 & Rolling Conformity

Colorado's income tax system is "coupled" with the federal income tax system. This means Coloradans begin determining their state income tax liability by using their federal taxable income, as determined on their federal tax return. Colorado's income tax system automatically incorporates all federal tax provisions that occur "above the line" or before the calculation of federal taxable income.

Colorado is one of only seven states that is coupled to federal taxable income. Most states calculate their taxes owed beginning with federal adjusted gross income, which is determined before above-the-line deductions. While Colorado's coupled system contributes to the simplicity of the state income tax system, it can also 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.

Furthermore, Colorado experiences full and immediate impacts from federal changes. This is because Colorado has "rolling conformity" with federal tax laws, which means that federal tax changes apply to Colorado law immediately. The majority of other states that begin with federal taxable income have "static conformity," which means that state tax codes are fixed to the federal tax code as of a specific point in time, such as January 1, 2017 for Arizona. 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 would simply mean state tax provisions would not follow the federal tax code without active adoption by the state legislature.

Individual Income Taxes

Ten other states also have single-rate individual income taxes, as opposed to graduated rates. 32 states have graduated individual income tax rates that range from 0.33 percent to 12.3 percent. Eight states have no individual income tax and New Hampshire only taxes dividends and interest income. Colorado's individual income tax is anticipated to generate $7.59 billion in FY2021-22. Colorado's total income tax amount per $1,000 of income ($23.65) was higher than the national average of $22.49 for the 42 states with an individual income tax, putting it at 24 out of 42 states for individual income tax amount per $1,000 of income. This does not include the compounding effect of other taxes and their overall effects on Coloradans.

Corporate Income Taxes

Like the individual state income tax rate, Colorado's corporate income tax rate is 4.55 percent. 44 states levy corporate income taxes, while six states had none, and 30 states, including Colorado, have a single-rate corporate income tax. Colorado has the fourth lowest corporate income tax rate, while Pennsylvania has the highest. 14 states have a graduated corporate income tax. The lowest rate of any bracket is 1 percent and the highest is 11.5 percent. Four states have no corporate income tax and two states have alternative corporate tax systems.

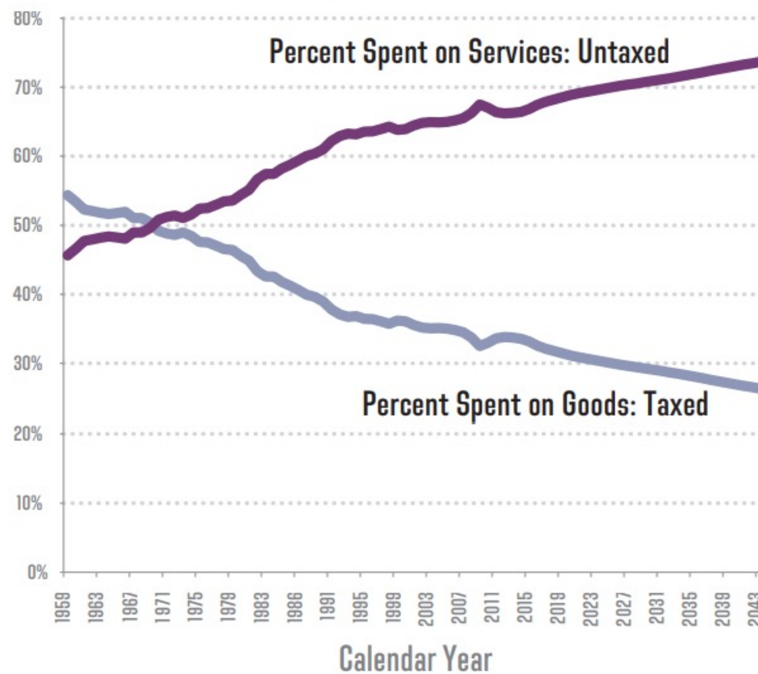
To determine the amount of money taxed at the state level, Colorado business returns begin with federal taxable income. At the federal level, a business subtracts its federal deductions from its gross receipts to calculate federal taxable income. Federal taxable income is then "apportioned"—or allocated—among the states in which the business operates to determine business tax liability in states where business income is generated. States use a variety of methods to apportion income. In 2008, lawmakers 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 proportional 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 are expected to yield $660 million in FY2021-22. Corporate income tax revenue makes about 6 percent of General Fund revenue collections in Colorado. Colorado ranks 36th out of 44 states for corporate income taxes per $1,000 of income. The national average for all 44 states with corporate income tax is $3.15. Colorado businesses pay $2.30.

Excise Tax

Sales and Use Tax

In FY 2021-22, Colorado will collect $3.2 billion in state sales and use tax revenues, 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 2022, sales and use taxes are estimated to generate 27 percent. 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.

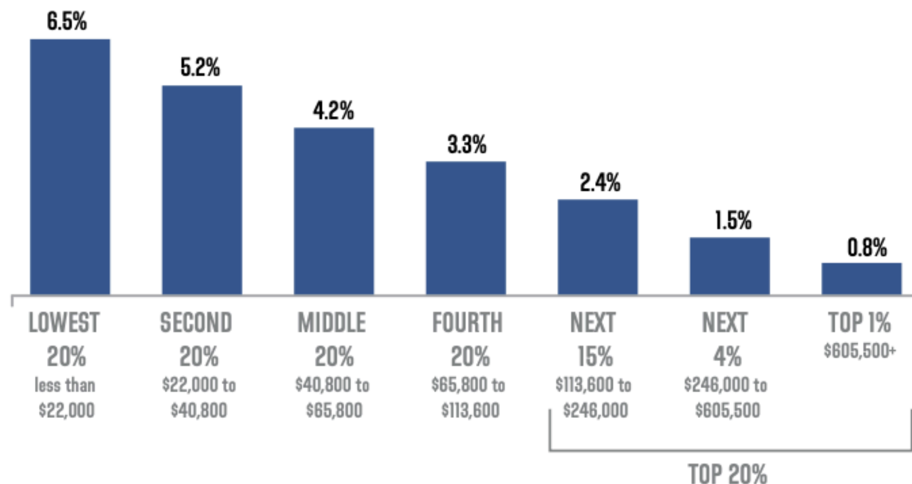


Source: Colorado Futures Center, U.S. Bureau of Labor Statistics and Moody's Economy.com

Sales and Use Tax

Colorado is also one of 37 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 $27.59 per $1,000 of income. Colorado taxpayers pay $17.33.

Sales and use taxes are the most regressive form of taxes in the Colorado tax system. The lowest quintile of Coloradans pays 6.5 percent of their income in sales tax while the highest 1 percent of earners pays only 0.8 percent. One of the reasons for the disparity is the fact that lower-wage workers 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. Families who earn low incomes 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.

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.

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 to 3 percent on Aug. 1, 1984.

Effective Jan. 1, 2001, the rate was lowered to 2.9 percent due to the state repeatedly collecting more revenue than was allowed under 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 and 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. There are a total of 84 exemptions from state sales and use taxes in Colorado in 2022, accounting for $5.4 billion in revenue. The four largest exemptions from state sales and use tax are the exemptions for component parts used in manufacturing, food for domestic consumption, gasoline, and livestock.

Vendor Credit

In Colorado, retail businesses (vendors) are required to collect sales tax from customers and remit it to the state revenue department. 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. Thirteen percent of that lost revenue went to just one retailer: Wal-Mart.

In 2009, the vendor tax credit was temporarily suspended as a budget-balancing measure. The suspension expired at the end of 2011. In 2019, vendors collecting sales tax received 3.33 percent of state sales tax collections. In 2020 that rate rose to 4 percent with a cap.

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. According to Legislative 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. 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. If Colorado extended its sales tax base to include personal services, even the most conservative estimates show that sales tax revenue would increase by 18 to 29 percent and would continue to increase between 19 and 33 percent annually.

Internet Sales Tax

In the 21st century, 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 has grown into a 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, House Bill 10-1193 stipulated that any retailer not collecting sales tax in Colorado must inform Colorado customers

Internet Sales Tax

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. The Direct Marketers Association, whose membership includes internet giants like Amazon and eBay, filed a lawsuit claiming that the 2010 law violated constitutional prohibitions against imposing an "undue burden" on businesses. But after years of battling in federal and state courts, in December of 2016, the U.S. Supreme Court declined to hear an appeal to the most recent ruling by the 10th Circuit Court of Appeals. This resulted in a binding decision allowing the law to be upheld.

Since this time, Colorado's internet sales tax law has been adopted as the model law for other states by the Multistate Tax Commission. Several other states are looking to Colorado as they create similar laws in their local jurisdictions.

Severance Tax

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. Revenue collected was to be held in a trust to help offset the cost of mitigating negative impacts from nonrenewable resource development.

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.

Severance tax collections in FY2019-20 were $114.5 million.

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.

Colorado's 22 cent per gallon gas tax ranked 42nd among states in 2021. Coloradans pay $1.96 per $1,000 of income on motor fuel taxes. The national average is $2.78. In 2021 the governor signed into law SB21-260, marking the passage of the most comprehensive transportation funding bill in several decades. The bill is set to increase funding for transportation by $5.4 billion over the first 10 years through a combination of federal fund transfers, new fees on gasoline, electric vehicles, home deliveries and rideshare trips. The bill imposes a per-gallon fee on gasoline and diesel fuel to pay for road usage, and on diesel fuel only for vehicles' impacts on bridges and tunnels. The fees are phased in from FY 2022-23 through FY 2031-32. These new fees begin at 2 cents per gallon and are increased incrementally to reach 8 cents per gallon in FY 2028-29, and are set to grow with highway construction inflation after that. It also includes a 27-cent fee on retail deliveries and a 30-cent fee on rideshare apps like Uber. It also raises registration fees on electric vehicles and decreases some registration fees for two years.

Colorado charges two motor fuels taxes and motor vehicle registration fees. The combination of these sources raised almost $1 billion for transportation services in FY 2020-21. The funds collected go primarily into the Highway Users Tax Fund, although they are essentially cash funds.

Cigarette and Tobacco Taxes

Cigarette taxes were enacted in 1964 as part of the Colorado Constitution. The tax rate was increased with Amendment 35 in 2005 and last increased in 2020 from 84 cents to $1.94. Revenues are dedicated to health and education programs. In comparison with other states, Colorado has a relatively low rank of 45th in the nation in tobacco tax collections per $1,000 of income. The national average is $1.02 and Coloradans pay 55 cents. In FY 2020-21, approximately $232.9 million was collected by the state as a result of this tax levy.

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. Coloradans pay 14 cents per $1,000 of income in alcohol taxes, while the national average is 38 cents. Tax rates on liquor vary based on the type of beverage, from 8 cents per gallon on beer to $2.28 per gallon on spirits. This tax levy brought in roughly $53.4 million in tax collections for the state in FY 2020-21.

Cannabis (Marijuana)

In 2000, Colorado voters passed Amendment 20 to the Colorado constitution, which established a caregiver-patient system for medical cannabis and permitted qualifying patients or caregivers to possess six cannabis plants or two ounces of usable cannabis 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 cannabis centers (dispensaries), cultivation facilities, and manufacturers of edible cannabis products.

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

Both medical and recreational cannabis are taxed in Colorado, but at different rates. Medical cannabis is typically taxed at a much lower rate because it is only subject to state and local sales taxes. Recreational cannabis is subject to state and local sales tax and to a 15 percent excise tax and a special state sales tax rate of 10 percent. Additionally, each city can ask voters for higher tax rates for recreational cannabis. For example, the Denver sales tax rate is 3.65 percent for medical cannabis and 7.15 percent for recreational.

In FY 2020-21, cannabis taxes, licenses, and fees generated more than $426.3 million. In November of 2015, voters passed Proposition BB. This allows the state to retain and spend tax dollars generated by cannabis sales that were subject to a TABOR refund because of a 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.

Other State 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. During the first 25 years of gaming in Colorado, casinos paid over $2.1 billion in gaming tax revenues to the state on $15.7 billion in adjusted gross revenues.

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)
- 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.

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 FY 2019-20, Amendment 50 distributions totaled $29 million. Community colleges received $11.9 million.

In 2020, Colorado voters approved Amendment 77, which allows individual cities and casinos to set their own betting limits.

Regulatory and Business Taxes

Regulatory taxes on the licensing of businesses, including sales licenses, liquor licenses, cigarette licenses and special fuels licenses and permits also generate millions of dollars in revenue. The largest revenue generating activities in this category include an underground storage tank surcharge and Public Utility Commission utility supervision fees.

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.

Local Taxes

Colorado is one of the most fiscally decentralized states in the nation. It is one of only five states in which the state government generates less tax revenue than the local governments. Colorado's size of local government ranks it the 8th highest among states. Revenue collections by state government rank 43rd per $1,000 of income. However, revenue collections by state and local governments combined move Colorado to 31st.

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.

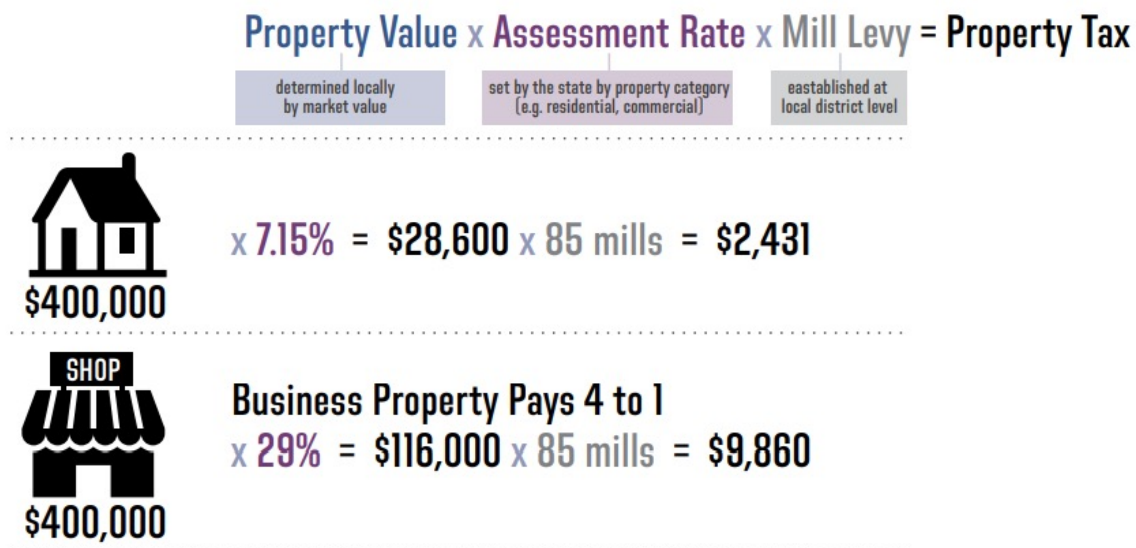
Property and sales taxes are the major source of local tax revenue. Local governments in every state collect property taxes, and local governments in all but 15 states collect sales taxes. In 2019, local (municipal, county, school, and special districts) taxes accounted for 51 percent of combined state and local taxes.

Property Taxes

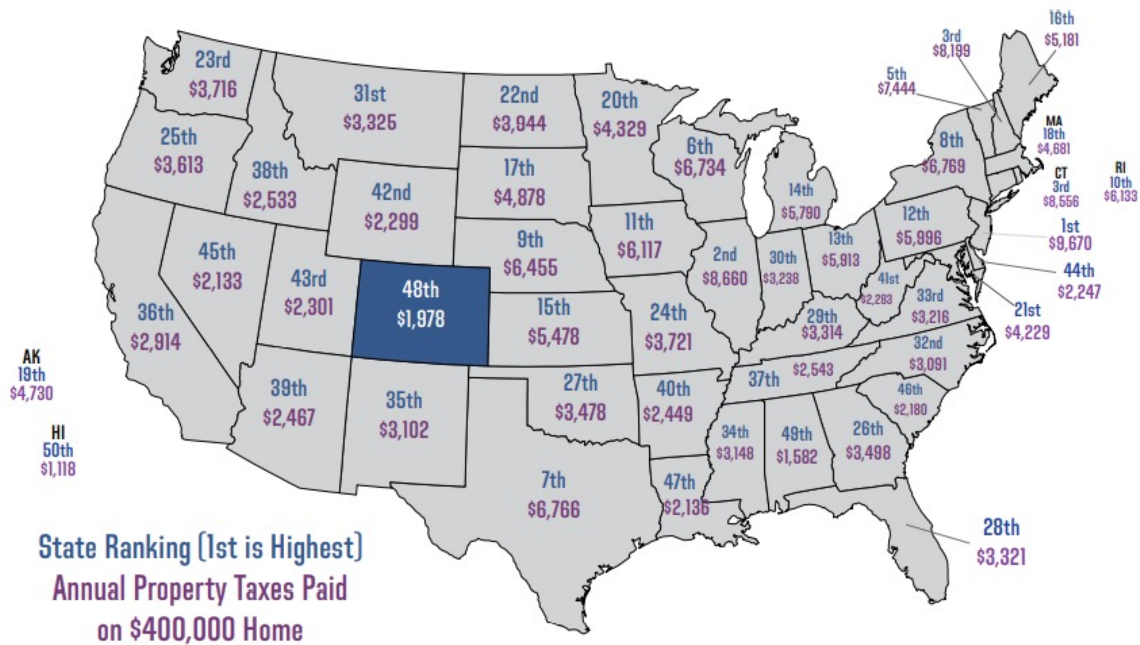
Colorado collects property taxes on the assessed value of both residential and commercial property. All the revenues generated by property taxes remain at the local level. This revenue goes to pay for schools, roads, public safety, and other local services.

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 7.15 percent. From 1982 to 2020, the assessment rates were set by the Gallagher Amendment, which was repealed by voters in 2020.

Once the assessed value is determined, a "mill levy" rate is applied to calculate taxes owed. 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.



Property taxes on homes in Colorado are taxed as some of the lowest in the country. The graphic above estimates what a $400,000 house in each state would pay on average in property taxes. Only two states have lower property taxes on their homes than in Colorado.



Property Tax Collections

Property taxes are a significant revenue source for funding local public services in Colorado. In 2020, property tax collections totaled $11.37 billion. About half of property tax went to schools ($5.96 billion). While $2.6 billion went to county budgets, $2.27 billion went to special district budgets, and $535 million was revenue that funded cities.

Colorado's property taxes are regressive, though not as dramatically regressive as sales taxes. Colorado families that earn less than $20,000 per year pay 2.5 percent of their income in property taxes, while those in the top 1 percent of all earners pay 1.9 percent.

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

41 states tax at least some business personal property. However, comparing business personal property tax in Colorado to the tax in other states is difficult because property is taxed and valued in a wide variety of ways.

In the 2021 session, the General Assembly passed HB21-1312, which increased the business personal property threshold to $50,000, lowering the total number of businesses required to pay business personal property tax to 40,000.

In 2020, personal property accounted for 12.39 percent of Colorado's property tax base. County reliance on the business personal property tax varies dramatically. For example, in Hinsdale County, the business personal property tax makes up 1.96 percent of total assessed value, while in Morgan County, the tax makes up 46.34 percent. Since business personal property tax is assessed on power plants and pipelines, rural counties are generally more dependent than urban counties.

Local Sales Taxes

Many cities and counties impose their own local sales and use tax on purchases and transactions within their boundaries. The Colorado Department of Revenue, in addition to collecting state sales and use tax, collects sales tax on behalf of many cities and counties. These are referred to as "state-collected" jurisdictions. Most Colorado counties that impose sales tax are state-collected; however, Broomfield and Denver counties collect their own county sales tax.

Cities which have enacted a "home-rule" charter, and which have elected to administer their own local sales and use taxes, are referred to as "self-collected" or "self-administered." Self-administered jurisdictions have the right to establish their own regulations regarding those goods and services upon which to impose their local sales and use taxes.

In 2019, local sales tax revenues were about $5.4 billion. This amount equals 32.7 percent of the $16.5 billion in taxes collected at the local level annually. Colorado ranks 3rd highest out of states that collect local sales taxes (per $1,000 of income).

Endnotes

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 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.

3 Colorado Tax Profile and Expenditure Report 2020

4 https://cdor.colorado.gov/data-and-reports/tax-profile-and-expenditure-reports

5 https://leg.colorado.gov/agencies/office-state-auditor/2021-tax-expenditure-evaluation-reports

6 https://leg.colorado.gov/node/1147261

7 STAR LINK HERE

8 https://apps.colorado.gov/apps/treasury/taxpayer/profile/

9 More than 70 percent of the 231 credits, exemptions, and deductions on the books in 2021 were adopted after 1976..