COLORADO
Fiscal Institute

LEGISLATIVE RECAP

2026

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A Billion-Dollar Drought That Didn't Fall From the Sky

By now, you've probably heard that Colorado lawmakers began the 2026 legislative session staring at a roughly $1.5 billion hole in the state budget.

The headlines made it sound like a force of nature. A dry year. An unavoidable shortage. One of those unfortunate acts of fiscal weather that simply descends upon us, leaving lawmakers to ration resources and hope for a better forecast next year. And to be fair, Colorado's actual drought is very real. Snowpack is at just 19% of the historical median, which, in case you're not fluent in the technical terminology of ecologists and statisticians, is: not good.

But Colorado's budget drought is a different story. Unlike the state's water shortage, this one didn't fall from the sky.

What Dried Up the Budget

A big chunk of the gap can be pinned on H.R. 1, President Trump's whimsically dubbed "the One Big Beautiful Bill Act," which is a bit like calling a storm "Sunny Delight." The bill opened new corporate tax breaks, and because Colorado copies key parts of federal tax law, Washington's choices became Colorado's problem almost immediately. Those breaks flowed straight into our tax code like water through a busted pipe, draining revenue and blowing a roughly $1 billion hole in the budget almost overnight.

At the same time, a court ruling in Lakewood affecting telecommunications providers limited the state's ability to respond, effectively handcuffing efforts to close newly created loopholes. And in a twist that felt almost too on the nose for a drought-themed year, lawmakers also debated data centers, massive facilities that consume enormous amounts of electricity and water, prompting important questions such as, "Should we encourage this?" and "How thirsty is the internet, exactly?"

Still, this was not an unavoidable catastrophe. Colorado's budget drought is largely self-inflicted, created by years of policy choices, structural limitations, and fiscal rules that restrict how and when the state can use its own resources.

Who Pays When Colorado's Coffers Runs Dry

When the state budget dries up, it is not corporations that are asked to go without. It is families. It is kids. It is schools, health care, child care, housing support, and the public services Coloradans rely on every day. A budget gap may look like a number on paper, but in real life, it shows up as higher costs, fewer supports, and more pressure on the people already doing the most with the least.

Our Objective: Turn the Tax Code Back Toward Families

The governor's pen cannot summon a blizzard, top off the reservoirs, or convince your favorite ski resort that 55 degrees is still "powder weather." But it can help turn Colorado's tax code back toward working families. That's why CFI spent the session asking a simple question: Whose lawn is Colorado's tax code really watering?

After H.R. 1 drained state revenues and pushed Colorado below the threshold needed to fund the Family Affordability Tax Credit for tax years 2026 through 2028, CFI worked alongside advocacy and community partners to push four bills designed to bring relief to working families. Together, these bills aimed to shore up Colorado's revenue reservoirs, plug a few leaks in the tax code, and move the state closer to a permanent FATC that does not dry up every time Washington hands out another round of corporate tax breaks.

- HB26-1221: Prioritizing Working Families
- HB26-1222: Mitigating the Harm from H.R. 1
- HB26-1223: Downloadable Software Taxpayer Equity
- HB26-1289: Tax Code Cleanup

Why It Mattered: The FATC Was Working

Losing the original FATC passed in 2024 for three years is no small loss. An evaluation by Appalachian State University and Washington University in St. Louis found that the Family Affordability Tax Credit on its own was associated with a roughly 20% reduction in child poverty. Combined with Colorado's Child Tax Credit and Earned Income Tax Credit, child poverty fell by nearly 40%.

In other words, just as families were reaching for a little extra financial oxygen, Congress turned off the tap.

The Scorecard

What follows is a scorecard for the bills we backed to stop watering corporate lawns and start investing in Colorado families.

CFI's Legislative Tax Package

Rather than relying on a single bill, this package used four targeted proposals to patch leaks in Colorado's tax base, turn the state's tax code back toward working families, and move Colorado closer to a permanent Family Affordability Tax Credit.

We worked with lawmakers to introduce four bills to respond to the revenue drought triggered by H.R. 1, effectively patching the leaks it opened in Colorado's tax base and restoring state control so our tax code reflects Colorado values, not decisions made in Congress. Because of these loopholes and Colorado's revenue trigger, H.R. 1 effectively routed about $1 billion to corporations while drying up the state's expanded EITC and FATC for working families. Our top-priority bills this session aimed to reverse that.

(STATUS: POSTPONED INDEFINITELY)

HB26-1221: PRIORITIZING WORKING FAMILIES

The bill would have raised revenue by limiting several corporate tax breaks, including deductions for executive compensation and the use of net operating losses. That revenue would have funded a new refundable child tax credit for families, with the credit amount set to roughly match the additional revenue collected.

(STATUS: POSTPONED INDEFINITELY)

HB26-1222: MITIGATING HARM FROM H.R. 1

The bill would have de-linked our tax code from new and increased federal deductions from H.R. 1, such as full expensing of equipment, interest, and research costs, that previously reduced Colorado taxable income. These changes would have recaptured hundreds of millions of dollars in state revenue by limiting corporations' ability to take large upfront write-offs and instead requiring those deductions to be spread over time. The additional revenue would have been redirected to an expanded, refundable Family Affordability Tax Credit.

(STATUS: PASSED)

HB26-1223: DOWNLOADABLE SOFTWARE TAXPAYER EQUITY

The bill creates a new refundable child tax credit based on a family's income and the number and ages of their children, with the total credit amount tied to the revenue raised elsewhere in the bill. It also begins taxing many downloaded software purchases starting in 2027 by repealing a current sales tax exemption for standardized software because goods shouldn't be taxed differently based on the method of delivery. This bill was amended in the Senate to also include a two-year sales tax vendor credit for restaurants during their busiest months, June through September, as well as a permanent credit on the sales tax on energy use for restaurants.

(STATUS: PASSED)

HB26-1289: TAX CODE CLEAN-UP

Regular evaluation and maintenance of the tax code are critical to a high-quality tax system. The Colorado Office of the State Auditor regularly reviews tax credits, deductions, and exemptions, along with other tax provisions, and recommends closing loopholes, streamlining delivery, reevaluating purpose, and eliminating outdated or ineffective policies. This bill makes technical changes to existing credits and eliminates others to improve the consistency and efficiency of Colorado's tax code.

Mirages in the Desert

Not every bill we followed this session was part of CFI's legislative package. But each responded to the same underlying challenge: how to keep Colorado's reservoirs of public funding from running dry.

Risky Revenue Schemes

With state funds running dry and the Trump administration and Congress damming the flow of federal dollars to Colorado for everything from education to child care to the environment, lawmakers floated a series of untested schemes to raise money for basic services.

One bill, SB26-180, Investment Performance Authority, would have created a new special-purpose authority empowered to invest enterprise and other state revenues in high-risk, high-yield investments to fund Colorado's Child Care Assistance Program, or CCAP, which helps low-income families pay for child care. While CCAP does face a funding crisis, especially after the U.S. Department of Health and Human Services targeted Colorado and froze program funding, CFI opposed SB26-180.

The bill sought to bypass the constitutional, statutory, and policy guardrails that govern how the state treasurer invests public dollars, gambling that riskier investments could generate enough market returns to backfill programs such as CCAP. Those protections exist for a reason: to safeguard public funds, manage risk, preserve liquidity, and maintain long-term solvency. That's why we joined the state treasurer, labor allies, and environmental partners in opposition.

Colorado also operates several state-run enterprises that CFI helped establish and has worked to protect, most notably the Paid Family and Medical Leave Insurance (FAMLI) program. CFI believed SB26-180 posed a serious legal threat to FAMLI by jeopardizing its enterprise status and potentially destabilizing the fund. Even supporters acknowledged the bill would not generate money for the Colorado Child Care Assistance Program for years, nor would it raise enough dedicated revenue to solve the crisis. The bill ultimately died in Senate Appropriations.

The Wrong Solution to the Right Problem

Another phantom funding fix emerged in HB26-1327, Large Employer Medicaid Support Fee, which would have imposed a $2,300 fee on large employers for each employee enrolled in Medicaid. The bill aimed to ensure that employers whose low wages leave workers reliant on public programs paid more of their fair share, while helping address a $1.5 billion budget deficit driven largely by rising Medicaid costs.

Despite those laudable goals, CFI opposed HB26-1327 as the wrong solution to the right problem. Similar employer assessments in other states have led companies to cut pay and benefits or restructure jobs in ways that hurt workers. With new federal Medicaid work requirements set to take effect next year, CFI believed the bill could cost some workers both their jobs and health coverage, especially in rural communities. The bill was projected to raise only about $20 million annually, doing little to close the budget deficit or expand access to affordable, high-quality health care.

A Thirst for Subsidies

Despite Colorado's revenue drought, the Capitol also saw the arrival of one of the biggest water hogs of all: data centers. HB26-1030, Data Center and Utility Modernization, would have created an unlimited sales and use tax exemption for up to 30 years to attract large-scale data center development to Colorado. With few meaningful labor, energy, or environmental protections attached, CFI opposed the bill.

Building Better Guardrails

CFI instead supported SB26-102, Large Load Data Centers, which would have established stronger guardrails for data center development in Colorado. The bill required responsible energy and water use, strong environmental protections, binding community benefit agreements, robust public siting processes, and consumer protections for utility ratepayers, all without offering a runaway subsidy.

Over time, negotiations reshaped the bill to include a narrower sales and use tax exemption designed to incentivize best practices and secure baseline labor and environmental protections. CFI pushed to add meaningful caps and controls on the incentive, ultimately moving into opposition when those protections proved impossible to secure.

Clouds on the Horizon

The competing data center bills were negotiated until the final week of session, when both met the same fate: death at the hands of their sponsors. But drought conditions or not, this issue is not going away. Artificial intelligence, automation, faster networking, and emerging industries are fueling demand for data centers, and the companies behind them will keep demanding massive tax breaks to come to Colorado.

Mirage Solutions

This session, we saw would-be rainmakers offer budget gimmicks and desperate gambles within a system that forbids new revenue, even as need continues to grow. These were only a few examples. There were also raids on cash funds, proposals for greater stock market exposure, and discussions of selling public assets such as the state pension fund, Pinnacol Assurance. None of these proposals offered real solutions to Colorado's very real fiscal challenges.

Immigration

Immigrants are vital to Colorado's economy and communities, contributing more than $54 billion annually to the state's economic output and helping meet workforce needs in industries such as health care, agriculture, technology, and hospitality.

That is why CFI pays close attention to immigration policy. When immigrant families have access to health care, legal protections, and economic opportunity, Colorado's economy and communities are stronger. The legislative winds carried this session's tumbleweed to immigration policy, where lawmakers were forced to navigate both the promise of stronger protections and the reality of a tightening budget.

Colorado has made important strides in recognizing the essential role immigrants play in our state. But as budget pressures intensified and the fiscal landscape grew drier, some programs and protections came under strain.

Even as the fiscal climate grows hotter and drier, Colorado lawmakers continue to strengthen the channels that allow immigrant families to put down roots, contribute fully, and help build a more prosperous future for everyone.

- SB26-005, Rights Violation in Immigration Enforcement Remedy: This bill established that anyone whose rights are violated during an immigration enforcement action may sue the person or agency responsible.
- HB26-1431, Competency for Occupational Licensure Portability: This bill opened new pathways for foreign-trained professionals to join Colorado's workforce by allowing qualified individuals to apply for occupational licenses regardless of immigration status.
- SB26-178, Health Insurance Affordability Measures: In a needed move to address health care needs, the legislature passed SB26-178, which provides new revenue sources for the Health Insurance Affordability Enterprise. The enterprise funds critical health care programs, including OmniSalud, which provides undocumented Coloradans with a safe way to compare affordable health insurance plans and enroll on a secure online platform. Specifically, the bill directs the enterprise to issue up to $100 million in bonds and transfers $40 million from the Marijuana Tax Cash Fund. SB26-178 was a needed surge of dollars to address Colorado's ever-growing health care funding drought.
- Cover All Coloradans: This program, which provides health coverage to qualifying immigrant children and pregnant people, exceeded expectations by about $14 million in its first year, a reminder that when more families can finally access care, the reservoir needs to be large enough to meet the demand.
- SB26-121, Overtime Threshold for Agricultural Employees: This bill increased the overtime threshold for agricultural workers from 48 to 56 hours per week. That means farmworkers, many of whom are immigrants and the backbone of Colorado agriculture, will now have to work even longer before earning overtime pay.

Looking Toward the November Ballot

A Chance of Rain for Colorado Schools

SB26-135 is on its way to this year's ballot. If approved, the measure will de-Bruce money above the TABOR cap equal to the state's K-12 spending for 10 years, essentially negating the effects of the arbitrary spending cap TABOR imposes. Lawmakers will use the money to fund a new positive factor, which will amount to a 2% increase in K-12 education funding each year for the next decade. Money beyond this 2% increase for K-12 education will be transferred to the General Fund. Importantly, the measure does not affect the expanded Earned Income Tax Credit and Family Affordability Tax Credit; the credits will be preserved in years with enough revenue to fund them.

Education funding in Colorado is a never-ending debate. TABOR simply does not allow us to fund K-12 education at the levels we should. To ensure every Coloradan has access to a quality education, we need large-scale fiscal reform. Though it will not provide new revenue for schools, this measure offers much-needed flexibility and the ability to make consistent improvements to our education system.

Diverting the Stream

Also of interest is HB26-1430. This bill was introduced in response to a separate ballot measure Coloradans may weigh in on this November: Initiative 175, State Revenue Supporting Road Transportation. Initiative 175 would amend the constitution to lock up $700 million from the General Fund and gas taxes for automotive transportation. Importantly, the measure provides no new money to meet this requirement. Instead, it explicitly diverts dollars from multimodal transportation, such as transit and bicycles.

HB26-1430 passed in an attempt to negate the impact of this measure if voters approve it, but it will reduce revenue from the gas tax and Division of Motor Vehicles fees in the process, which, oddly enough, would free up General Fund dollars during years of large TABOR refunds.

Initiative 195: An Oasis in Sight

There might, at last, be an oasis in sight. It comes in the form of a policy that 28 states and the federal government have already adopted: a graduated income tax. Initiative 195 would replace Colorado's flat income tax, making the state tax code more equitable by adjusting tax rates based on ability to pay. Under the proposal, 97% of Coloradans would pay the same or less, while the top 2% to 3% would pay a little more. The Protect Colorado's Future coalition is currently collecting signatures to place the measure on the 2026 ballot.

Initiative 195 is projected to raise $2 billion to $2.7 billion annually to support health care, child care, and K-12 education. Those dollars could be used to increase teacher pay, expand affordable pathways to higher education, replace lost federal Medicaid funding, support rural hospitals and clinics, help make child care more affordable and more. It would also help rebalance Colorado's tax code after the federal changes in H.R. 1 left ordinary Coloradans in the lurch while delivering additional tax giveaways to the wealthiest households.

In a state plagued by a funding drought, there has been no shortage of policies promising to open an endless faucet of much-needed resources, only to turn out to be mirages. Even this year, CFI and our partners encountered several ideas that ultimately fell short. Some posed long-term risks, some created legal concerns, and others simply failed to raise meaningful new revenue.

The graduated income tax is not a silver bullet, nor will it undo three decades of compounding fiscal challenges overnight. But it would provide a significant new source of sustainable revenue and give Colorado the flexibility to pursue bold solutions. It asks the most prosperous among us to contribute more to the health and success of the state that helped make their prosperity possible.

It is time to stop patching a broken system and asking working families to do more with less year after year. Instead of letting billions of dollars leak out of our tax code, or flow to server farms teaching artificial intelligence to generate eight-fingered cowboys eating sushi, Colorado can capture more of the wealth created here and invest it in the people and communities that make this state work.

Initiative 195 is the first step toward ending Colorado's artificial budget drought.
Visit Protect Colorado's Future to learn more about Initiative 195 and find out how to get involved.