



Legislative
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FISCAL NOTE

Drafting Number: LLS 20B-0022
Prime Sponsors: Rep. McKean

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Bill Status: House Finance
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Bill Topic: **MODIFY CERTAIN TAX EXPENDITURES IN HB 20-1420**

Summary of Fiscal Impact:

| | |
|---|--|
| <input checked="" type="checkbox"/> State Revenue | <input type="checkbox"/> TABOR Refund |
| <input checked="" type="checkbox"/> State Expenditure | <input type="checkbox"/> Local Government |
| <input type="checkbox"/> State Transfer | <input type="checkbox"/> Statutory Public Entity |

This bill repeals or delays all of the state income tax policy changes enacted in HB 20-1420. It reduces state revenue, on net, in FY 2020-21 and FY 2021-22 and increases state revenue, on net, beginning in FY 2022-23. It requires one-time implementation expenditures in FY 2020-21 and thereafter reduces expenditures for tax administration.

Appropriation Summary: For FY 2020-21, the bill requires an appropriation of \$17,000 to the Department of Revenue. For FY 2021-22, the bill decreases the required appropriation for the Department of Revenue by \$548,755.

Fiscal Note Status: This fiscal note reflects the introduced bill.

Table 1
State Fiscal Impacts Under HB 20B-1019

| | | FY 2020-21 <i>(current year)</i> | FY 2021-22 | FY 2022-23 |
|---------------------|------------------------|-------------------------------------|-------------------------|-----------------------|
| Revenue | General Fund | (\$104.1 million) | (\$49.1 million) | \$28.3 million |
| | Total | (\$104.1 million) | (\$49.1 million) | \$28.3 million |
| Expenditures | General Fund | \$17,000 | (\$548,755) | (\$439,963) |
| | Centrally Appropriated | - | (\$179,520) | (\$179,374) |
| | Total | \$17,000 | (\$728,275) | (\$619,337) |
| | Total FTE | - | (8.5 FTE) | (8.5 FTE) |
| Transfers | | - | - | - |
| TABOR Refund | | - | - | - |

Summary of Legislation

The bill repeals or delays all of the income tax policy changes that were enacted in HB 20-1420. Each of these provisions is explained below.

CARES provisions. The federal Coronavirus Aid, Relief, and Economic Security Act (CARES Act) expanded certain federal income tax deductions for tax years 2018 through 2020. HB 20-1420 required additions to Colorado taxable income that reversed the effect of the expanded CARES Act deductions for tax year 2020. HB 20B-1019 repeals the additions enacted in HB 20-1420, effectively restoring the following CARES Act deductions for state tax purposes for tax year 2020:

- the expanded federal net operating loss deduction for pass-through businesses in Section 2303 of the CARES Act;
- the excess business loss deduction for pass-through business owners above the limit imposed in the Tax Cuts and Jobs Act (TCJA), under Section 2304 of the CARES Act; and
- the business interest income deduction for pass-through business owners and C corporations above the limit imposed in the TCJA, under Section 2306 of the CARES Act.

HB 20B-1019 also removes the requirement in state law that net operating loss deductions for 2018 and later tax years be limited by provisions in the TCJA that had been relaxed in the CARES Act.

Qualified business income. For 2021 and 2022, current state law enacted in HB 20-1420 requires business owners who claim a federal qualified business income deduction, as allowed under the TCJA, to add back the amount of the deduction when computing their state taxable income, if their adjusted gross income exceeds \$500,000 (for single filers) or \$1,000,000 (for married taxpayers filing jointly). HB 20B-1019 delays the add back requirement so that it applies for tax years 2024 and 2025, rather than 2021 and 2022.

Earned income tax credit. Beginning in 2021, current law enacted in HB 20-1420 extends the Colorado earned income tax credit (EITC) to taxpayers who do not have a valid social security number, or whose dependents do not have a valid social security number. HB 20B-1019 repeals this provision, so that the Colorado EITC continues to be allowed only to taxpayers with valid social security numbers.

Beginning in 2022, HB 20-1420 increases the value of the Colorado EITC from 10 percent to 15 percent of the federal EITC. HB 20B-1019 delays this increase so that it applies beginning in 2025.

State Revenue

The bill decreases General Fund revenue for two years by the following estimated amounts:

- for the current FY 2020-21, a decrease of \$104.1 million; and
- for FY 2021-22, a decrease of \$49.1 million.

For later years, the bill increases General Fund revenue by the following estimated amounts:

- for FY 2022-23, an increase of \$28.3 million;
- for FY 2023-24, an increase of \$98.7 million;
- for FY 2024-25, an increase of \$118.7 million;

- for FY 2025-26, an increase of \$58.7 million; and
- for FY 2026-27 and later years, an increase of \$17.5 million annually.

All of the bill's revenue impacts are for income taxes, which are subject to TABOR. Table 2 presents the bill's estimated revenue impacts through FY 2023-24. The bill's effects on revenue are discussed below.

Table 2
Revenue Impacts Through FY 2023-24 Under HB 20B-1019*

| | FY 2020-21 <i>(current year)</i> | FY 2021-22 | FY 2022-23 | FY 2023-24 |
|------------------------------|-------------------------------------|-------------------------|-----------------------|-----------------------|
| Income Tax Provisions | | | | |
| CARES Section 2303 | (\$5.0 million) | ** | ** | ** |
| CARES Section 2304 | (\$72.8 million) | (\$17.7 million) | \$0 | \$0 |
| CARES Section 2306 | (\$2.0 million) | (\$5.4 million) | \$0 | \$0 |
| Qualified Business Inc. | (\$29.9 million) | (\$61.4 million) | (\$31.5 million) | \$38.9 million |
| EITC - Eligibility | \$5.6 million | \$14.3 million | \$17.5 million | \$17.5 million |
| EITC - Credit Percentage | - | \$21.1 million | \$42.3 million | \$42.3 million |
| Total | (\$104.1 million) | (\$49.1 million) | \$28.3 million | \$98.7 million |

* Totals may not sum due to rounding.

** Indeterminate revenue decrease, see discussion below.

CARES provisions. Table 2 presents expected revenue decreases because the bill eliminates additions in current law that would offset 2020 federal income tax deductions that were increased in the CARES Act. The estimated decreases are consistent with the estimated increases that were presented in the final fiscal note for HB 20-1420.

For tax year 2021 and subsequent years, the bill decreases state revenue because it restores for the purposes of the state income tax a provision in CARES Section 2303 that had relaxed the limitation on net operating loss deductions. The CARES Act allows taxpayers to use a loss carried forward from an earlier tax year to reduce taxable income by up to 80 percent of taxable income calculated before application of the net operating loss deduction, the qualified business income deduction, and the foreign-derived income deduction. HB 20-1420 required taxpayers to include the latter two deductions when performing this calculation, allowing them to reduce their taxable income only by up to 80 percent of taxable income calculated before application of the net operating loss deduction. HB 20B-1019 reverses this change.

For taxpayers who take the qualified business income deduction and/or the foreign-derived income deduction, and who carry forward sufficiently large net operating losses to reduce taxable income by more than 80 percent, this bill will allow a larger tax deduction and therefore decrease revenue. Data and information are not currently available to calculate this impact, as the qualified business income deduction was first allowed in 2018 and federal taxpayer-level information remains unavailable. The provision is assessed as causing an indeterminate ongoing revenue decrease relative to what would otherwise have been expected under current law as enacted by HB 20-1420.

Qualified business income deduction. Table 2 presents the revenue decrease expected to result from the elimination of the state income tax addition to offset the federal qualified business income deduction for tax years 2021 and 2022. The revenue decreases for FY 2020-21 and

FY 2022-23 represent half-year impacts on an accrual accounting basis. The bill will increase state income tax revenue for FY 2023-24, FY 2024-25, and FY 2025-26 by delaying the addback to apply for tax years 2024 and 2025. The estimate shown in Table 2 for FY 2023-24 represents a half-year impact for 2024 on an accrual accounting basis. Relative to the HB 20-1420 fiscal note, estimates have been updated and are now based on data for actual federal deductions claimed by Colorado taxpayers for tax year 2018.

Earned income tax credit. Table 2 presents revenue increases expected to result from not extending the state EITC to taxpayers without valid social security numbers beginning in tax year 2021 and from not increasing the state EITC to 15 percent of the federal EITC beginning in tax year 2022. Estimates are based on state data for actual credits allowed for tax year 2017, as well as for state income tax filers using an individual taxpayer identification number (ITIN) in lieu of a social security number with incomes in the EITC eligibility range.

HB 20B-1019 delays the increase in the state EITC percentage until tax year 2025; as such, this provision is expected to have no fiscal impact beyond FY 2025-26. The revenue increase from canceling ITIN filer eligibility continues for all future years.

State Expenditures

The bill requires a General Fund expenditure of \$17,000 for the current FY 2020-21. It decreases General Fund expenditures by \$728,275 and 8.5 FTE for FY 2021-22, and by \$619,337 and 8.5 FTE for FY 2022-23. Expenditures are summarized in Table 3 and discussed below.

**Table 3
Expenditures Under HB 20B-1019**

| | FY 2020-21 (current year) | FY 2021-22 | FY 2022-23 |
|----------------------------------|------------------------------|--------------------|--------------------|
| Department of Revenue | | | |
| Personal Services | | (\$424,630) | (\$423,006) |
| Operating Expenses | | (\$12,555) | (\$11,475) |
| Capital Outlay Costs | | (\$55,800) | - |
| Computer Programming and Testing | \$17,000 | (\$51,162) | (\$874) |
| Data Reporting | | (\$4,608) | (\$4,608) |
| Centrally Appropriated Costs* | | (\$179,520) | (\$179,374) |
| Total Cost | \$17,000 | (\$728,275) | (\$619,337) |
| Total FTE | - | (8.5 FTE) | (8.5 FTE) |

* Centrally appropriated costs are not included in the bill's appropriation.

Department of Revenue. The bill requires expenditures of \$13,500 for computer programming and \$3,500 for software testing for FY 2020-21 only. CARES Act-related income tax additions for tax year 2020 have already been programmed in the department's GenTax software system and will require additional programming and testing to remove.

For FY 2021-22 and FY 2022-23, the bill decreases department expenditures that would otherwise be required for:

- the addition of personnel (6.1 FTE in FY 2021-22 and 6.7 FTE in FY 2022-23) in the department's taxpayer service section to review claims for the state EITC expected to be made by taxpayers without social security numbers, and to communicate with those taxpayers about the credit;
- the addition of personnel (2.4 FTE in FY 2021-22 and 1.8 FTE in FY 2022-23) in the department's tax audit and compliance section to review and administer the required addback for the federal qualified business income deduction;
- computer programming and testing for the expanded EITC and the addback for the federal qualified business income deduction; and
- expenditures for data tracking and reporting in the department's office of research and analysis.

The bill is expected to decrease expenditures in all future years by repealing current law allowing the Colorado EITC to taxpayers without valid social security numbers, which is expected to require 6.7 FTE annually to administer under current law. For FY 2024-25 and FY 2025-26, the expenditure decrease will be partially offset by computer programming and testing costs and the addition of staff to review and administer the addback for the federal qualified business income deduction for tax years 2024 and 2025.

Centrally appropriated costs. Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. These costs, which include employee insurance, supplemental employee retirement payments, and leased space, are estimated to be \$179,520 in FY 2021-22 and \$179,374 in FY 2022-23.

TABOR refund. The bill changes income tax revenue, which is subject to TABOR. The September 2020 LCS forecast projects that state revenue will remain below the TABOR limit through at least FY 2022-23, and that the state will not be required to issue TABOR refunds through at least FY 2023-24. The bill does not change these expectations concerning refunds to taxpayers.

Technical Note

The bill repeals current law additions to taxable income for the 2020 tax year, for which filing is scheduled to begin in January 2021. It may not be possible to accomplish required changes to computer systems and tax forms by January, in which case the bill could delay the opening of 2020 income tax filing until a later date.

Effective Date

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

State Appropriations

For FY 2020-21, the bill requires a General Fund appropriation of \$17,000 to the Department of Revenue. For FY 2021-22, the bill requires that the General Fund appropriation to the Department of Revenue be decreased by \$548,755, with a reduction of 8.5 FTE.

State and Local Government Contacts

Information Technology

Personnel

Revenue