HB 26-1221

Fiscal Note

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

HB 26-1221: TAX EXPENDITURE ADJUSTMENTS

Prime Sponsors:
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Sen. Amabile; Wallace

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Fiscal note status: The revised fiscal note reflects the introduced bill, as amended by the House Finance Committee.

Summary Information

Overview. The bill modifies an existing tax expenditure, creates a new corporate income tax addback, and establishes a new income tax credit.

Types of impacts. The bill is projected to affect the following areas on an ongoing basis:

- State Revenue
- State Expenditures
- TABOR Refunds

Appropriations. No appropriation is required.

Table 1
State Fiscal Impacts

Type of Impact	Budget Year FY 2026-27	Out Year FY 2027-28	Out Year FY 2028-29
State Revenue	$0	$0	$0
State Expenditures	$0	$449,635	$230,480
Transferred Funds	$0	$0	$0
Change in TABOR Refunds	$0	$0	$0
Change in State FTE	0.0 FTE	3.9 FTE	2.5 FTE

Fund sources for these impacts are shown in the tables below. The bill has offsetting positive and negative impacts on state revenue; see Table 1A and State Revenue section.

Table 1A
State Revenue

Fund Source	Budget Year FY 2026-27	Out Year FY 2027-28	Out Year FY 2027-28
General Fund from Other Provisions	$0	$62.9 million	$124.1 million
General Fund from EFAC	$0	-$62.9 million	-$124.1 million
Cash Funds	$0	$0	$0
Federal Funds	$0	$0	$0
Total Revenue	**$0**	**$0**	**$0**

Table 1B
State Expenditures

Fund Source	Budget Year FY 2026-27	Out Year FY 2027-28	Out Year FY 2027-28
General Fund	$0	$370,099	$180,725
Cash Funds	$0	$0	$0
Federal Funds	$0	$0	$0
Centrally Appropriated	$0	$79,536	$49,755
Total Expenditures	**$0**	**$449,635**	**$230,480**
Total FTE	**0.0 FTE**	**3.9 FTE**	**2.5 FTE**

Summary of Legislation

The bill modifies an existing corporate tax deduction, and creates a new corporate income tax addback and a new individual income tax credit, as discussed below.

Executive Compensation Addback

Beginning in tax year 2027, the bill requires corporate taxpayers claiming a federal deduction for compensation of officers under Section 162(m) of the Internal Revenue Code to add back any amount exceeding $250,000 when calculating their state taxable income.

Colorado Net Operating Loss Deduction

Current federal law limits deductible net operating losses (NOL) to 80 percent of taxable income. Beginning in tax year 2027, for state tax purposes, the bill reduces deductible NOLs to 70 percent of Colorado taxable income. The increment that the bill makes nondeductible must be added back on the taxpayer's state income tax return.

The bill also specifies that losses incurred after January 1, 2027, may be carried forward for up to 10 tax years. NOLs incurred before this date may continue to carry forward for up to 20 years.

Expanded Family Affordability Credit

The bill creates an expanded family affordability credit (EFAC) for Coloradans who are, or would be, eligible under current law. The credit is refundable, meaning any amount by which the credit exceeds a taxpayer's tax liability is refunded to the taxpayer.

The credit amount depends on the estimated amount of the state revenue increase that results from the new employee remuneration addback, the repeal of the AMT credit, and modifications to the NOL deduction. In each year's December forecast, Legislative Council Staff (LCS) must determine the maximum dollar amounts of the EFAC so that the projected aggregate total of tax credits claimed equals the revenue increase attributable to the other provisions of the bill. Additionally, the Department of Revenue (DOR) is required to submit a report to the LCS detailing the revenue increase attributable to the bill from the previous income tax year, two weeks prior to the December 2027 economic and revenue forecast, and each subsequent December forecast.

Background

Executive Compensation Deductions

The federal Internal Revenue Code permits corporations to deduct salaries and wages paid to employees, including executives. Section 162(m) limits this deduction to $1 million for "covered employees" which include executive and financial officers of the corporation. Starting in 2027, this expands to include the five highest paid executive officers. In 2022, corporations submitting federal IRS Form 1120 reported nearly $564 billion in such deductions nationwide.

Corporations with total receipts of $500,000 or more that claim the executive compensation deduction must file IRS Form 1125-E. In 2022, 76 percent of corporations that claimed the deduction were also required to file a Form 1125-E, representing $427 billion in deductions.

Colorado Net Operating Loss Deduction

A business may claim a NOL deduction when its business expenses exceed taxable income. Under current state law, losses from 2018 onward are capped at 80 percent of Colorado taxable income, with a 20 year carry forward period.

Family Affordability Tax Credit

Enacted by House Bill 24-1311, the FATC is a refundable income tax credit available to Coloradans with children under age 17 and a federal adjusted gross income (AGI) in 2024 up to $85,000 for single filers and up to $95,000 for joint filers. Credit amounts and AGI are adjusted annually for inflation. The amounts and availability of the credit are dependent on state revenue conditions. For tax year 2024, approximately 320,490 Coloradans claimed the FATC for a total of $865.9 million in income tax credits.

Assumptions

Executive Compensation Addback

State level data on federal corporate deductions are unavailable. However, IRS data provide estimates of line item values on corporate returns, including federal corporate deductions. Though these estimates provide an aggregated total of the corporations that claimed this deduction, they do not provide any information on how much compensation and the number of officers claimed by each corporation. Corporate executive salaries vary widely based on company size, industry, and location, with base salaries typically ranging from $58,000 to over $500,000 annually. Total compensation for top executives often exceeds $1 million.

The fiscal note assumes that corporations filing IRS Form 1125-E will likely claim deductions exceeding $250,000, making them subject to the new state addback deduction. Estimated executive compensation deductions were adjusted according to Colorado's share of U.S. corporate taxable income and applying the statewide apportionment adjustment, resulting in an assumed deduction of $2.08 billion for corporate taxpayers in Colorado. As a result, these deductions are estimated to have reduced Colorado tax liability by $91.4 million in 2022, the most recent year with available data.

The fiscal note uses this estimate as a baseline and projects annual increases throughout the estimation period. By tax year 2027, the first year of the income tax addback, the fiscal note projects that approximately $2.41 billion will be added back to Colorado taxable income, thereby increasing state revenue by approximately $106.5 million per year once the bill is fully implemented.

Due to data constraints, the revenue estimate for this section of the bill carries high, bidirectional risk. A greater or lesser revenue increase than expected would correspondingly increase or decrease the amount of the EFAC.

Colorado Net Operating Loss Deduction

Based on historical data on the amount of NOL deduction claims made between tax years 2020 through 2023, the most recent data available, these deductions were adjusted on the 70 percent of losses as specified in the bill.

Expanded Family Affordability Tax Credit

Assuming the amounts outlined above, the expanded FATC will reduce state revenue by $167.4 million in the bill's first full implantation year, as detailed in the State Revenue section.

State Revenue

The bill requires the amount of revenue generated from the modification of the NOL deduction and the creation of the new corporate income tax addition to be reduced by the expanded child care income tax credit in the bill. As a result, the bill is estimated to have no net impact on state revenue. Table 2 below presents the state revenue impact by General Fund source.

General Fund impacts from the modification to the net operating loss deduction and the employee compensation addback are based on assumptions described in the section above.

Table 2
State Revenue

Source	FY 2026-27	FY 2027-28	FY 2028-29
General Fund from Executive Compensation Addback	$53.0 million	$107.6 million	$110.9 million
General Fund from Net Operating Loss Modification	$9.9 million	$16.5 million	$13.3 million
General Fund from Family Affordability Credit	-$62.9 million	-$124.1 million	-$124.2 million
Total	**$0**	**$0**	**$0**

Executive Compensation Addback

The addition is estimated to increase General Fund revenue by $53.0 million in FY 2026-27 (a half-year impact for tax year 2027), $107.6 million in FY 2027-28, $110.9 million in FY 2028-29 and by similar, increasing amounts in future years. This expected increase is expected will be offset by the EFAC in the bill.

Colorado Net Operating Loss Deduction

The bill is estimated to increase General Fund revenue by $9.9 million in FY 2026-27 (a half-year impact for tax year 2027), $16.5 million in FY 2027-28, $13.3 million in FY 2028-29 and by similar amounts in future years. This expected increase is expected to be offset by the EFAC in the bill.

Extended Family Affordability Credit

Starting for tax year 2027, the bill creates an expanded family affordability credit (EFAC) for Coloradans who are or would be eligible for the Family Affordability Tax (FATC) available in current law. The credit is refundable, meaning any amount by which the credit exceeds a taxpayer’s tax liability is refunded to the taxpayer.

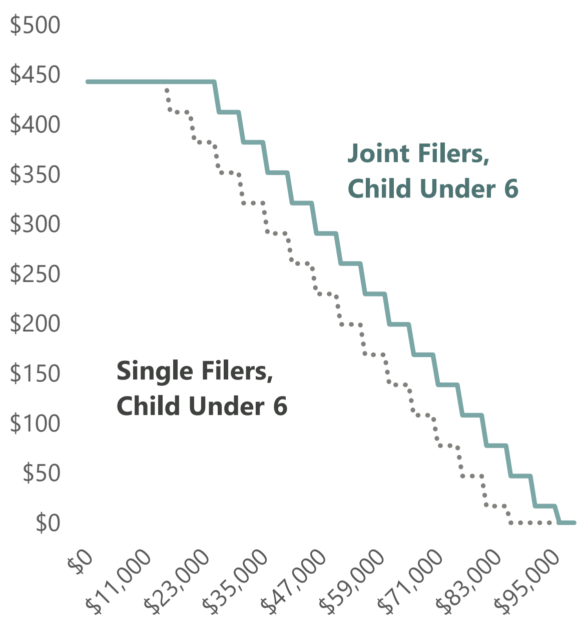
The amount of the EFAC depends on the estimated amount of the state revenue increase that results from the additions and subtractions to taxable income required in the bill. In each December forecast, Legislative Council Staff is required to determine the maximum dollar amounts of the EFAC so that the projected aggregate total of tax credits claimed is equal to the net amount of revenue gain attributable to the additions and subtractions to taxable income required in the bill.

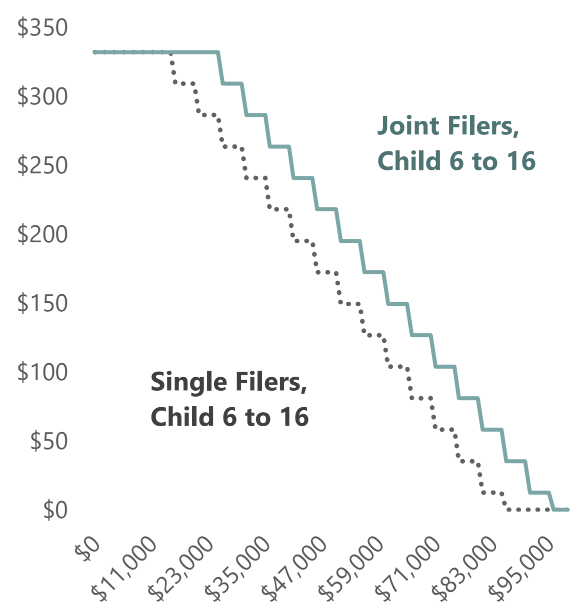
Based on this fiscal note's estimates of the revenue increase from the addition and modification to taxable income required in the bill, the projected amount of the EFAC in tax year 2027 is:

- for each child under age 6, $443 for single filers with AGI of $16,000 or less, reduced by $30 (6.875 percent) for every $5,000 of AGI above $16,000; and
- for each child ages 6 to 16, $443 for single filers with AGI of $16,000 or less (75 percent of the credit for children under age 6), reduced by $30 (6.875 percent) for every $5,000 of AGI above $16,000; or
- for each child under age 6, $332 for joint filers with AGI of $27,000 or less, reduced by $23 (6.875 percent) for every $5,000 of AGI above $26,000; and
- for each child ages 6 to 16, $332 for joint filers with AGI or $27,000 or less (75 percent of the credit for children under age 6), reduced by $23 (6.875 percent) for every $5,000 of AGI above $26,000.

Figure 1 shows the estimated amount of credit allowed in tax year 2027 for taxpayers for each eligible child, depending on their AGI and the child's age. Starting with tax year 2028, credit amounts and AGI amounts are adjusted for inflation.

Figure 1
HB 26-1221 Tax Credit Amounts by Adjusted Gross Income, Filing Status, and Child's Age, Tax Year 2027





State Expenditures

The bill increases General Fund expenditures for the Department of Revenue by about $450,000 in FY 2027-28, $230,000 in FY 2028-29, and by similar amounts in the future. Expenditures are summarized in Table 3 and described below.

Table 3
State Expenditures
Department of Revenue

Cost Component	Budget Year FY 2026-27	Out Year FY 2027-28	Out Year FY 2028-29
Personal Services	$0	$247,123	$155,850
Operating Expenses	$0	$4,992	$3,200
Capital Outlay Costs	$0	$28,000	$0
Software Programing Costs	$0	$23,216	$0
Office of Research and Analysis	$0	$8,778	$8,702
User Acceptance Testing	$0	$6,724	$0
Postage	$0	$9,917	$5,129
DPA Form Change	$0	$41,349	$7,844
Centrally Appropriated Costs	$0	$79,536	$49,755
Total Costs	**$0**	**$449,635**	**$230,480**
Total FTE	**0.0 FTE**	**3.9 FTE**	**2.5 FTE**

Department of Revenue

Staff

In FY 2027-28, the DOR requires 2.8 FTE for tax examiners to review corporate income tax forms to ensure the new executive compensation addback and NOL modification is properly applied. This includes 0.2 FTE for program management. In addition, the DOR will require 1.1 FTE for additional workload in the department’s Tax Conferee Office and Collections Section. Based on the department's historical experience, the Tax Conferee Office sees an increase in protests, taxation disputes, and administrative hearings when changes to the tax code occur. Once an assessment has been made, the Collection Section within the department is responsible for collecting or arranging payments for any unpaid taxes

Beginning in FY 2028-29, DOR staff is reduced to 2.5 FTE as taxpayers become more familiar with the tax changes under the bill and review and tax disputes decline. These costs are expected to be similar for future years.

Software Programming and Testing

In FY 2027-28, the DOR will require $23,216 in software programming costs and $6,724 in user acceptance to program and test the new executive compensation addback. Programming costs represent about 368 hours of contract programming at a rate of $63.09 per hour. Costs for testing at the department are estimated about 164 hours of innovation, strategy, and delivery programming support at a rate of $41 per hour.

Data Analysis and Reporting

Expenditures in the Office of Research and Analysis are required for changes in the related GenTax reports so that the department can access and document tax statistics related to the new tax policy. These costs are estimated at $8,778 in FY 2027-28, representing 231 hours for data management and reporting at $38 per hour, decreasing to $8,702 in FY 2028-29.

Postage and Form Changes

The DOR will have additional costs for postage to administer the tax expenditure, and must make changes to tax forms to include the new income tax addback and process paper returns claiming the credit. New forms are a purchased service from the Department of Personnel and Administration (DPA).

Legislative Department

The bill requires the Legislative Council Staff to make determinations related to the revenue impacts of this bill. This work will be accomplished within existing appropriations.

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 other costs, are shown in the Table 3 above.

TABOR Refunds

While the bill impacts state revenue streams subject to TABOR, the net revenue impact to the state is $0. As a result, the bill has no impact to TABOR refunds.

Effective Date

The bill takes effect 90 days following adjournment of the General Assembly sine die, assuming no referendum petition is filed.

State and Local Government Contacts

Legislative Council Staff
Revenue
Personnel

The revenue and expenditure impacts in this fiscal note represent changes from current law under the bill for each fiscal year. For additional information about fiscal notes, please visit the General Assembly website.