INDIVIDUAL INCOME TAX
by Louis Pino

The individual income tax is the largest source of General Fund revenue, accounting for 60 percent of General Fund collections in FY 2013-14. This issue brief provides a brief history of Colorado income tax rates, discusses the general process for determining Colorado’s individual income tax, the amount of revenue collected, and how the tax compares with surrounding states.

History of Colorado Income Tax Rates

The state’s income tax was first levied in 1937. From that time until 1986, the state had a graduated income tax system. Under a graduated or marginal income tax system, a taxpayer will pay different tax rates on separate brackets of income. Colorado moved to a single tax rate or flat tax in 1987 that was initially set at 5.0 percent. In 1999, the flat tax rate was reduced to 4.75 percent and to 4.63 percent in the following year.

Calculating Colorado Individual Income Tax

Figure 1 illustrates the general process for calculating Colorado’s individual income tax. Colorado utilizes current federal taxable income as the starting point for determining state taxable income. Federal taxable income is then adjusted by state-specific deductions and additions. For example, if there are any items included in the federal taxable income that are not subject to Colorado income tax, such as interest earned on U.S. treasury securities, the taxpayer is eligible to subtract the interest amount from their federal taxable income. After these adjustments, Colorado levies a flat 4.63 percent income tax against state taxable income. Finally, state tax credits are applied to offset any tax liabilities. Examples of state tax credits are the child care contribution credit, the alternative fuel income tax credit, and the historic property preservation tax credit.

Figure 1
General Process for Calculating Individual Income Tax

Federal Taxable Income
(104EZ line 6, 1040A line 27,
or 1040 line 43 from your 2013 federal income tax return)

State Additions

State Subtractions

Colorado Taxable Income

Colorado Taxable Income

4.63% Individual Tax rate

Colorado Tax Credits

Net Tax

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Individual Tax Collections

As the state’s main source for financing operations, the individual income tax is a crucial component for the state budget. Revenue from state income taxes is significantly influenced by the economy. After the 2001 recession, state revenue from individual income taxes increased steadily until FY 2007-08. The Great Recession caused individual income tax revenue to fall in FY 2008-09 and FY 2009-10. As the economy recovered, revenue began increasing again in FY 2010-11. In FY 2013-14, the amount of revenue received from individual income taxes was $5.7 billion, up 11.5 percent from the previous year. Figure 2 shows Colorado individual tax collections between FY 2000-01 and FY 2013-14.

Figure 2
Individual Income Tax Collection
FY 2000-01 - FY 2013-14

Colorado's surrounding states have various income tax systems, with the exceptions of Texas and Wyoming, which do not levy a state income tax. Of the surrounding states with a graduated tax rate system, Nebraska has the largest marginal rate of 6.84 percent for all income above $29,000. Table 1 compares Colorado's individual income taxes with nearby states.

Table 1
Individual Income Taxes in Surrounding States
(Tax Year 2014 - as of January 1, 2014)

<table>
<thead>
<tr>
<th>State</th>
<th>Tax Rate Range</th>
<th>Number of Brackets</th>
<th>Income Brackets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>High</td>
<td></td>
<td>Lowest</td>
</tr>
<tr>
<td>Colorado</td>
<td>4.63%</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Arizona</td>
<td>2.59% - 4.54%</td>
<td>5</td>
<td>$10,000 (A)</td>
</tr>
<tr>
<td>Kansas</td>
<td>2.7% - 4.80%</td>
<td>2</td>
<td>$15,000 (A)</td>
</tr>
<tr>
<td>Nebraska</td>
<td>2.56% - 6.84%</td>
<td>4</td>
<td>$3,000</td>
</tr>
<tr>
<td>New</td>
<td>1.70% - 4.90%</td>
<td>4</td>
<td>$5,500 (B)</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>0.5% - 5.25%</td>
<td>7</td>
<td>$1,000 (C)</td>
</tr>
<tr>
<td>Texas</td>
<td>No State Income Tax</td>
<td></td>
<td>No State Income Tax</td>
</tr>
<tr>
<td>Utah</td>
<td>5.0%</td>
<td>1</td>
<td>Flat Rate</td>
</tr>
</tbody>
</table>

(A) For joint returns, taxes are twice the tax on half the couple's income.
(B) The income brackets reported for New Mexico are for single individuals. For married couples filing jointly, the same tax rates apply to income brackets ranging from $8,000 to $24,000.
(C) The income brackets reported for Oklahoma are for single individuals. For married couples filing jointly, the same rates apply to income brackets ranging from $2,000 to $15,000.

Finally, Colorado is the only state, among the states shown in Table 1, that utilizes federal taxable income as a starting point for determining state taxable income. All of the other states use federal adjusted gross income (FAGI) as their starting point. Federal taxable income is the FAGI less the deduction for personal exemptions and itemized deductions. States that use FAGI as a starting point for determining state taxable income offer their own deductions and exemptions. As a result, standard deductions and exemptions vary for these states and are different than those applicable to federal taxable income.

State Income Tax Rate Comparisons

Tax rates. State income tax rates vary across states. Eight states levy a flat tax, while others impose a graduated tax rate. Seven states do not collect a state income tax at all.

In 2014, among states with a flat tax rate, Pennsylvania had the lowest rate at 3.07 percent, while North Carolina’s was the highest at 5.8 percent.