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Options Beyond Cuts



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Colorado Credits & Exemptions

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What are we talking about?

- State income tax credits
 - Individual
 - Corporate
- State sales (& use) tax exemptions





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Corporate Tax Credits

- 26 total
 - 21 active
- \$38.2 million in FY2008
 - 7.53% of corporate collections (\$507 million)





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Individual Tax Credits

- 31 total
 - 28 active
- \$315 million in FY2008
 - 6.28% of FY08 personal income tax collections (\$5.01 billion)





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Individual Tax Credits- top 3

1. Credit for taxes paid to another state
2. Child care contribution
3. CO minimum tax credit





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Income Credits- Summary

- Generally, rates are so low we don't exempt much





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Sales Tax Exemptions

- 71 total
- \$1.8 billion = 2009 estimated revenue impact
 - 55.5% of FY2008 sales, use, & excise collections (\$3.3 billion)





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Sales Tax Exemptions – top 3

1. Components to manufacturing
2. Food for domestic consumption
3. Gasoline





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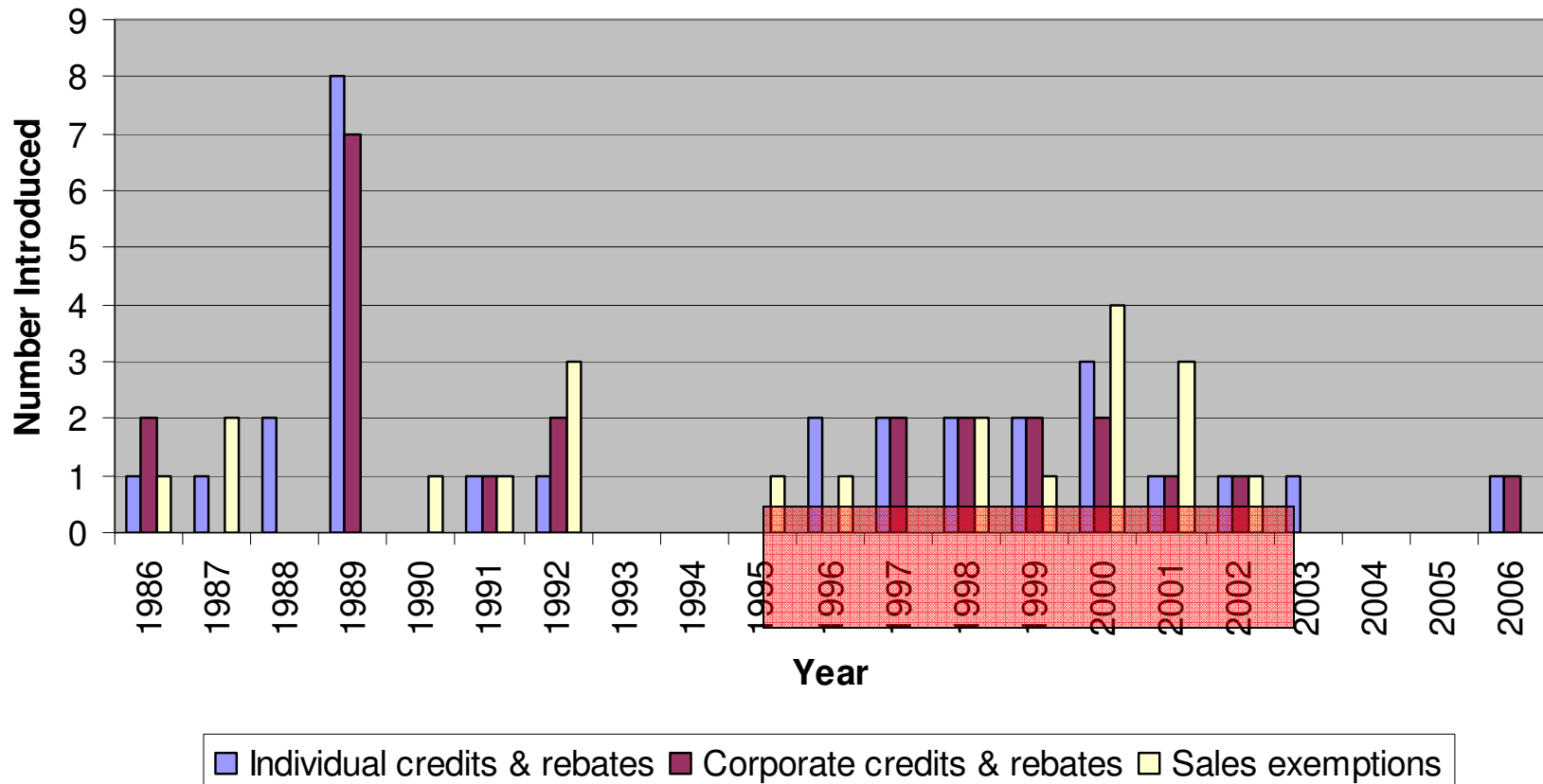
Sales Tax Exemptions

- Most are justified as components of production
 - E.g. locomotive parts ('92)
- Some avoid double taxation
 - E.g. gasoline
- The rest offset the regressivity of a consumptive tax
 - E.g. Utilities, food, Rx





Colorado Tax Credits & Exemptions Introduced (1986-2006)



Source: CO legislative council staff, 2009



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Review

- 8, 6, 55
- Slim pickings; relatively clean



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Concluding Remark #1 – Credits on the whole

- Using tax policy to incentivize behavior is appropriate when...
 - The objective is be clear
 - The process is accountable and reviewable (outcomes!)

Concluding Remark #2 – credits for job creation



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- Tax *differentials* between states are so low that few change their mind as a result.

Concluding Remark #3 – TABOR years



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- We should take a careful look at TABOR year exemptions & credits

Concluding Remark #4 – Services?



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- Sales tax applies only to sales of “*tangible personal property*”



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Governor's Revenue Options

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Governor's Revenue Options

- Included in Governor Ritter's FY 2010-11 budget were 13 revenue raising measures.
- The Governor's staff estimates these measures will raise \$131.8 million for FY 2010-11.

Governor's Revenue Options

Sales Tax Exemptions



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- **Suspend sales tax exemption for industrial and manufacturing energy use - \$48 million**
- **Eliminate the sales tax exemption for candy and soft drinks - \$17.9 million**
- **Redefine types of software included in exemption -- \$15 million (minimum)**
- **Enforce sales tax collections for certain online purchases - \$5 million**



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Governor's Revenue Options

Sales Tax Exemptions

- **Suspend exemption for pesticides - \$2.9 million**
- **Eliminate exemption for non-essential food containers – \$2.1 million**
- **Suspend exemption for agricultural compounds and bull semen - \$1.5 million**
- **Suspend exemption for materials used in direct mail advertising - \$1.45 million**



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Governor's Revenue Options

Income Tax Credits

- **Temporarily limit the net operating loss for a corporation -** *\$33.5 million (\$16.75 million in FY 11)*
- **Temporarily cap gross conservation easement credits –** *\$26 million (\$13 million in FY 11)*
- **Temporarily limit corporate enterprise zone investment tax credits -** *\$8.9 million (\$4.45 million in FY 11)*
- **Eliminate alternative minimum tax and tax credit -** *\$5 million (\$2.5 million in FY 11)*
- **Narrow alternative fuel vehicle credits -** *\$2.5 million (\$1.25 million in FY 11)*



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COFPI Revenue Options

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Review of Taxes in Colorado

- Like most states, Colorado's income tax system is connected - or "coupled"- with the federal income tax system.
 - Colorado taxes begin with federal taxable income
 - Federal taxable income does not include any deductions permitted at the federal level
- Colorado is permitted to insulate portions of its internal tax code by "**decoupling**"
 - Decoupling simply means that state tax provisions do not follow the federal tax code



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Income Tax Apportionment

- In 2008, the Legislature voted to implement a single-sales factor apportionment
 - Corporations allocate their federal taxable income to the states according to a variety of formulas
- Corporations apportion income to Colorado based entirely on **sales** within the state
 - Does not matter how many, if any, facilities and/or employees are located in the Colorado – only based on sales



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Example:

- Corp A has income of \$1 billion
- After federal deductions, federal taxable income is \$400 million
- Corp A makes 5% of their sales in Colorado, therefore it apportions 5% of its federal taxable income to Colorado
- Corp A's taxable income for Colorado is \$20 million



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COFPI Revenue Options

- Different than the options discussed before
- These are decoupling options
- They impact federal taxable income that is then apportioned to Colorado, and therefore indirectly, the amount of revenue collected in Colorado
 - The value of the deduction remains the same for federal tax purposes



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Example with decoupling:

- Corp A has income of \$1 billion
- After federal deductions, federal taxable income is \$400 million
 - Decoupling increase taxable income in Colorado
 - Federal taxable income that is apportioned increases to \$405 million after decoupling add-back
- Corp A makes 5% of their sales in Colorado
- Corp A's taxable income for Colorado is **\$20.25 million**



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Eliminating DPAD

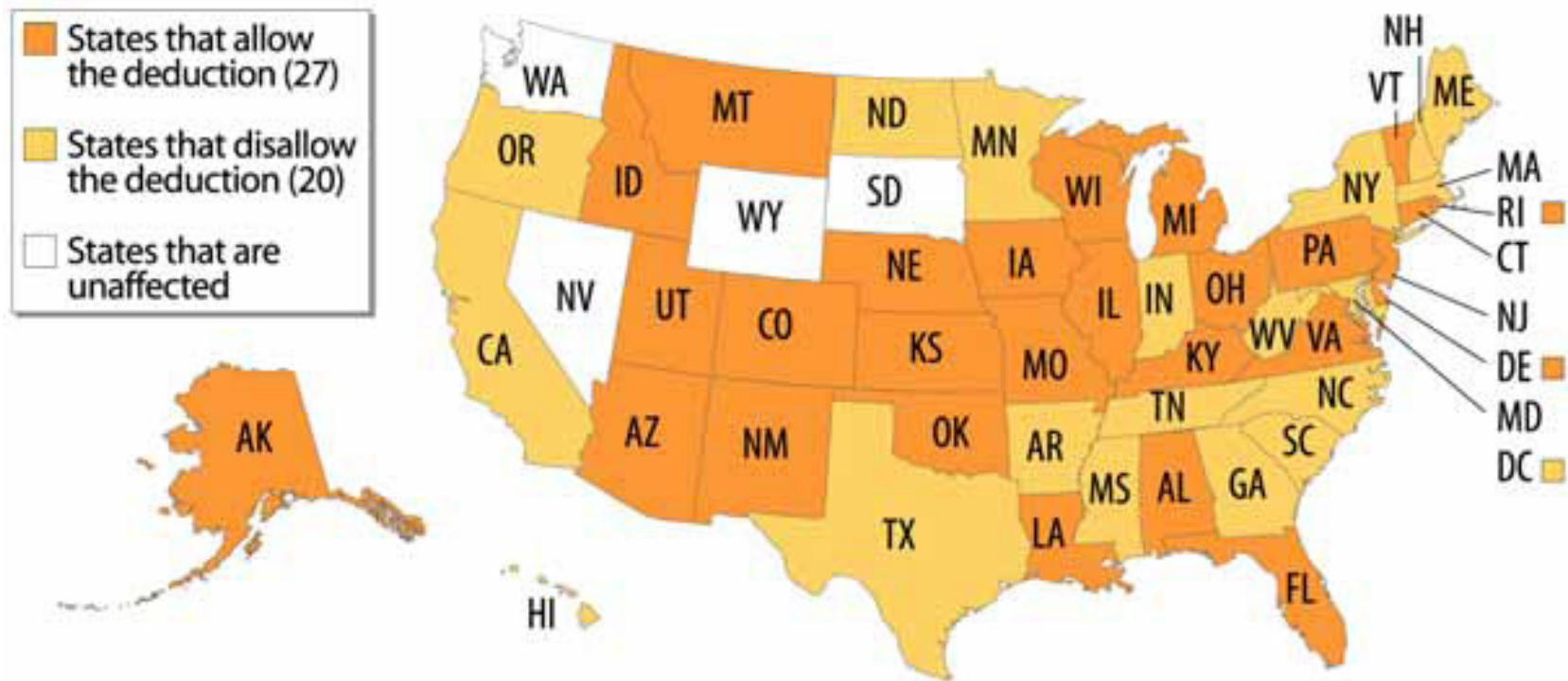
- Domestic Production Activities Deduction (DPAD)
 - Allows entities with domestic “manufacturing” income to take a tax deduction
 - Manufacturing construed very broadly (26%)
 - Includes:
 - food processing, software developing, filmmaking, mining and oil extraction, publishing, electricity and natural gas production, construction, engineering and architecture
 - Deduction amount is increasing in 2010
 - 2004-2006 = 3%
 - 2007-2009 = 6 %
 - **2010 and thereafter = 9%**



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20 States have already decoupled from DPAD

27 States Lose Revenue Due To "Domestic Production Deduction" Corporate Tax Break



Source: Center on Budget and Policy Priorities



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Eliminating DPAD:

- Increase in state revenue
- Easy to enact and inexpensive to administer
 - “Add back” line on Colorado return
 - probably already calculated for 20 other states that have already decoupled
- Does not affect Colorado jobs or local businesses
 - SALES!
- Will not hurt firms that are struggling in the current market
 - Must have profitable taxable income to receive the deduction



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Cap on Deduction for Excessive Compensation

- Corporations deduct ordinary business expenses
 - Currently includes almost all employee compensation and wages
- Federal Cap on Excessive Compensation = \$1 million for top 4 highest paid officers
 - Enacted in response to concerns about out-of-control and non-transparent executive income
- Colorado cap on Excessive Employee Compensation = \$250,000



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Key points on Excessive Compensation Cap

- Affects corporations *not* individuals
 - The limitation is on the *business deduction taken by corporations*
- Does *not* limit compensation that business may pay employees
- Tax is imposed on *excess* compensation – that above \$250,000
 - If an employee makes \$300,000 annually, the corporation will not be permitted to deduct the excessive compensation beyond \$250,000, or \$50,000



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Questions?

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