



COLORADO FISCAL  
POLICY INSTITUTE

**Limitation on Deduction of Business Expenses**

**With revenue deficits at an all time high, Colorado taxpayers should not be required to subsidize excessive salaries for corporate employees.**

Federal law allows corporations to deduct remuneration paid to employees as a business expense. For tax purposes, remuneration includes wages, salaries, or other compensation, such as vacation allowances, bonuses, commissions, and fringe benefits. As a result, salary and bonus expenses reduce the amount of federal taxes paid by corporations.

Colorado starts its calculation of taxes owed to the state with the amount calculated for federal taxable income--an amount that has been reduced by the salary and bonus deduction. As a result, corporate taxes paid in Colorado are reduced because of the federal deduction.

In tough economic times like these, it is hard to justify cutting spending on critical core services so that corporations can reduce their state tax bill. Colorado could limit the deductibility of salaries and bonuses to \$250,000 per employee in order to increase state revenue.

Currently, the federal government recognizes some limitations on the deductibility of salaries and bonuses by capping the deduction at \$1 million for the top four executives in each corporation. Colorado could choose to limit excessive compensation even more. States such as Texas have chosen to create their own, lower excessive compensation cap. The Texas Margin Tax disallows any business expense deduction for any compensation paid to an officer, director or employee in excess of \$300,000.

It is important to note that corporations, *not their employees*, are the beneficiaries of the salary deduction and it is the *corporations* that would be liable for the additional taxes. The adjustment would *not* limit the compensation that corporations may pay their employees; it would merely disallow any excessive compensation (anything over \$250,000) from being deducted as a business expense. The adjustment would apply only to the amount in excess of \$250,000. (For example, if an employee is compensated at \$300,000 per year, the corporation will be allowed to deduct \$250,000 of that employee's compensation and will only pay tax on the remaining \$50,000.)

**COFPI's Preliminary Revenue Estimates:**

Increase in Revenue from Corporate Collections: \$ 14.5 million

Increase in Revenue from Personal Collections: \$ 10.6 million

Combined Increase in Revenue: \$25.1 million

**Example:**

Following is an example to help understand the compensation deduction process. For purposes of the example, assume that the fictional company “X Co.” has \$3.8 million in gross receipts and takes a \$380,000 deduction for salaries and wages. X Co. has federal taxable income of \$228,000 and apportions 5% of sales to Colorado.

The Colorado corporate income tax form begins with federal taxable income as reported in the federal return. With the business expense limitation in place, X Co. will add the compensation deduction taken at the federal level to its federal taxable income on the Colorado return. Once the “add back” has been made, X Co. will then be permitted to “re-deduct” any compensation below the excessive compensation limit (\$250,000), leaving only the excessive compensation, no longer deductible from taxable income. In this example, X Co. makes 5% of its total sales in Colorado. Therefore, according to current Colorado tax law, only 5% of its total federal taxable income is taxed here.

In our representative example, the addition of the business expense limitation results in roughly a \$44 increase in Colorado tax owed. This is an 8% increase in tax liability for X Co.

<b>X CO. EXAMPLE</b>		
Gross Receipts	\$ 3,800,000	
Compensation	\$ 380,000	
Federal Taxable Income	\$ 228,000	
	<b>Without Business Expense Limitation</b>	<b>With Business Expense Limitation</b>
<b>COLORADO RETURN</b>		
Federal Taxable Income	\$ 228,000	\$ 228,000
Plus Compensation Deducted at Federal Level	N/A	\$ 380,000
Less Compensation below Excessive Compensation Cap	N/A	\$ 361,000
Colorado Taxable Income	\$ 228,000	\$ 247,000
Colorado Sales Apportionment (5% CO sales)	\$ 11,400	\$ 12,350
Colorado Tax Owed (at 4.63%)	\$ 528	\$ 572
<b>Additional Revenue per Corporation</b>		<b>\$ 44</b>
<b>Percent Increase in Tax Revenue</b>		<b>8%</b>

For more information please contact:

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**JOIN THE EFFORT TO TAKE A BALANCED APPROACH TO THE BUDGET**  
***LIMIT THE AMOUNT A CORPORATION CAN DEDUCT FOR EXCESSIVE EMPLOYEE***  
***COMPENSATION***

**My organization supports limiting the amount a corporation can deduct for employee compensation to \$250,000 per employee. We believe that Colorado taxpayers should not subsidize excessive compensation to the highest paid employees at a time when critical state priorities like health care, K-12 education, and higher education are all suffering. This corporate deduction is based on compensation for all employees nationwide, not just those in Colorado, so this limitation does not have a direct tie to jobs in the state. Limiting the corporate deduction for excessive employee compensation will help Colorado invest in key priorities instead of excessive pay.**

**Please list my organization as supporting the effort to limit the corporate deduction for excessive compensation.**

Name of Organization \_\_\_\_\_

Contact Person \_\_\_\_\_

Address \_\_\_\_\_

Phone #s \_\_\_\_\_

E-mail \_\_\_\_\_

We are willing to communicate with our members and supports about this issue in our newsletter, web site, blog, letters, and other communications materials.

We are willing to attend coalition and other meetings and hearings to advance this policy.

We are willing to provide people to testify at the Capitol and speak at other events.

We are willing to gather signatures of support for this policy.

Other: \_\_\_\_\_

We know the following organizations to contact about involvement in this campaign. (please list names and contact on reverse side)

**Please return completed form to:**

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