



COLORADO FISCAL
POLICY INSTITUTE

Revenue Options: The Other Side of the Ledger **August 2009**

Colorado cannot cut its way back to prosperity. Instead, lawmakers must explore a balanced revenue solution to the perpetual fiscal crisis we find ourselves in. The Colorado Supreme Court (*Mesa County v State of Colorado, 2009*) opened the door for the Legislature to consider a menu of revenue ideas that were not previously available. As Coloradans are faced with serious cuts to public services, COFPI believes it is imperative for our economic future to consider the options outlined below:

Suspend the Net Operating Loss Deduction, Shorten the Carry Forward Period or Cap the Amount*

A net operating loss or “NOL” is the excess of allowable deductions over gross income, creating negative taxable income. A net operating loss deduction is negative taxable income that was generated in a previous tax year that is carried forward to offset future taxable income. Therefore, if a corporation is profitable in a year after a loss, they can use the amount of the loss from the previous year to offset income in the current year. Colorado has a generous net operating loss provision allowing the loss to be carried forward for 20 years. There are currently 22 states with a net operating loss carryforward period of less than 20 years. Colorado could follow the lead of New Hampshire and cap the total amount of net operating loss at \$1 million dollars annually with a 10 year carryforward period. Pennsylvania also has capped the total annual amount of net operating loss deduction at \$3 million dollars. In order to use this provision to address the immediate budget challenges, Colorado would need to suspend the Net Operating loss deduction for the next two years. California has adopted that approach in four of the past seven years (2002, 2003, 2008, & 2009). **COFPI estimates the state of Colorado could gain \$110 million annually by suspending net operating loss deductions.**

Decouple from the Domestic Production Activities Deduction*

The domestic production activities deduction “DPAD” was a federal tax deduction enacted in 2004 for manufacturers. This deduction is an additional tax break that effectively lowers the Federal corporate tax rate for domestic manufacturers by 3%. There are currently 20 states that disallow this deduction. **The Center on Budget and Policy Priorities estimates that Colorado will lose \$15 million dollars in 2009 and \$23 million dollars in 2011 from the DPAD.**

Require Withholding for All Non-Resident Partners & Shareholders[†]

Colorado currently does not require withholding on non-resident individuals if the person signs an agreement to pay tax or is included in a composite return. Many partnerships and s-corporations never turn in these signed agreements and never withhold tax on non-resident partners. The Colorado Department of Revenue has very limited audit capacity and enforcing tax compliance on non-resident partners and shareholders is difficult. By requiring that partnerships and s-corporations withhold tax on non-resident partners, the state would make non-residents with Colorado tax liability pay their fair share. **COFPI estimates the state of Colorado could gain \$49 million in revenues annually by requiring withholding of income tax due by non-residents.**

Economic Nexus Standard for Internet Businesses[†]

In 2008, New York amended its sales tax statute to include Amazon and other internet retailers. Under this statute an internet business is required to collect sales tax if it enters into an agreement with a New York resident to—directly or indirectly, through a link on an Internet website or otherwise—refer potential customers to the seller for a commission. Ten other states have pursued this course of action and it was adopted in Rhode Island. The New York State Department of Taxation and Income reported \$25 million in new sales tax collections in FY 2009 as a result of the change and expects to collect \$33 million in new revenue in FY 2010. **COFPI estimates the State of Colorado could gain \$7 million in new sales tax revenue annually by amending its tax statute as New York and Rhode Island have.**

Limit the Salary Deduction for Corporations and Pass-through Entities*

Colorado could potentially limit the deduction allowed for salary expense per employee. The Texas Margin Tax disallows any deduction for wages and other compensation that is in excess of \$300,000 per employee. The federal limit is currently \$1 million and if Colorado limited the deduction to \$250,000, **COFPI estimates the state could derive \$184 million in new revenue annually.**

Make the Enterprise Zone Credit More Targeted and Accountable

In 2008, Colorado distributed \$47 million in tax expenditures related to Colorado enterprise zone credits. This credit was created in 1986 by the Colorado General Assembly to help economically blighted areas of the state. However, the economically blighted areas of Colorado, or “enterprise zones,” cover more than 70% of Colorado’s land mass. Both studies and reports by Colorado Legislative Council and the State Auditor were unable to conclude whether or not the enterprise zone program has been effective. Some suggest this is too much revenue to sacrifice during difficult economic times for a program that has been operating for 23 years with, at best, inconclusive results. A study by the University of Colorado concluded that if enterprise zones were shown to have any impact on employment, the results show that they had a negative impact on employers with over fifty employees. Also there was no evidence that the program had any effect on smaller establishments. The Enterprise Zone Credit should be better targeted, and include greater accountability measures.

Additional Revenue Ideas

Tax Enforcement—By some estimates, as much as if not more than \$40 million is owed to Colorado in back taxes. The Department of Revenue does not have the capacity to effectively enforce tax laws, which comes at the cost of law-abiding taxpayers. Strengthening enforcement measures is a fairness issue.

Redirecting Federal Recovery Dollars—While hundreds of millions of dollars in federal stimulus money come into Colorado, the overwhelming majority of it is required to be spent in specific areas—in some cases areas that do not help address the state budget shortfall.

Tax Exemptions/Closing Loopholes—There are a variety of other tax exemptions, credits, and loopholes in statute—as many as thirty different exemptions—that should be assessed, as Colorado tries to tackle the deepening budget crisis. Some of these provisions are decades old and have no place in a 21st Century economy. Some of them were passed hastily in booming economic times, such as the late 1990s. The Legislature should continue examining state tax policy to ensure that these exemptions and loopholes are efficient and effective in achieving what they were intended to do.

Conclusion

Colorado faces a perpetual budget crisis because we do not have a revenue system that sustains the public services Coloradans rely on every day. To close the current budget gap with the above measures, Colorado needs a special session this year. In the longer term, unless **lawmakers address the state’s tax system in a comprehensive way, and work to modernize its broken fiscal system, Colorado will continue to face these continuous budget problems to the detriment of our economic future.**

Tax Change Timing Restrictions

Under Article 10 section 20 (8) of TABOR tax rate increases and redefinitions of taxable income are only applicable starting the calendar (tax) year following enactment. Thus revenue options involving income redefinitions or tax rate changes experience a calendar year lag. For instance, any such change enacted before the end of calendar year (CY) 2009 would then be applicable only in CY 2010—the second half of fiscal year (FY) 2010 and the first half of FY2011.

**Revenue options marked with a “*” fall under the above TABOR timing restriction and suffer from a calendar year lag.*

† Revenue options marked with a “†” do not fall under the TABOR timing restriction and offer immediately realizable revenue gains to the state.

Options so labeled would have immediate effect, either producing an immediate continuous stream of revenue (in the case of an internet nexus redefinition) or immediate eligibility for collection within the calendar (tax) year of passage (in the case of non-resident withholding requirements).

Estimated Revenue Gains: Special Session Implications (millions of dollars)

Measure	No Special Session (all measures passed in 2010 leg. Session)			Special Session (all measures passed before Jan 1, 2010)		
	FY2010	FY2011	FY2012	FY2010	FY2011	FY2012
Non-Res Withholding	\$ 45	\$ 47	\$ 49	\$ 45	\$ 47	\$ 49
Internet Nexus	\$ 3	\$ 6	\$ 7	\$ 4	\$ 6	\$ 7
NOL Suspension	\$ -	\$ 47	\$ 110	\$ 47	\$ 93	\$ 110
DPAD Decoupling	\$ -	\$ 12	\$ 27	\$ 10	\$ 23	\$ 27
Salary Ded. Cap	\$ -	\$ 85	\$ 184	\$ 175	\$ 184	\$ 184
ANNUAL TOTAL	\$ 48	\$ 196	\$ 377	\$ 280	\$ 354	\$ 377
CUMULATIVE TOTAL	\$ 48	\$ 244	\$ 622	\$ 280	\$ 634	\$ 1,011

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