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COLORADO CENTER on LAW & POLICY
Justice and Economic Security for all Coloradans

Colorado Fiscal Institute

Amendment 66: Economic analysis

Amendment 66 will improve Colorado's income tax

Amendment 66 will restore Colorado's ability to raise enough revenue to meet our schools' growing needs and make the income tax more like those of our neighboring states, all without overburdening Coloradans. From the adoption of the income tax in 1937 through 1986, Colorado used a "tiered" income tax, where tax rates rose along with a taxpayer's income. Shifting to a single-rate income tax in 1986 seriously harmed the state's ability to fund education. Amendment 66 will reinstate Colorado's tiered personal income tax, making Colorado more like other states, the vast majority of which employ a tiered income tax.

Amendment 66 will not exhaust the resources of Coloradans, even as it brings in an additional $950 million in revenue dedicated to public education. Colorado will remain well below the national average in state and local tax collection. Furthermore, investing $950 million in education is expected to strengthen and grow the economy, not slow it.[1]

Amendment 66 also will better balance the tax contributions of upper-income and lower-income Coloradans. Currently, lower-income residents pay a higher percentage of their income in taxes than upper-income residents. A tax system in which those with the least ability to pay are contributing *more* of their income to support schools, health care and other public services than wealthier Coloradans is neither fair nor efficient. Amendment 66 will move us toward a more balanced tax system based on ability to pay and make our taxes more productive, by taxing one of the fastest-growing portions of the economy – high-income earners.

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Single-rate income tax is a drag on Colorado's resources

Three important forms of taxation fund public investments in Colorado: income taxes, sales taxes and property taxes. Together, they generate the funding essential to maintaining quality education, accessible health care, well-maintained parks and other public services.

State income taxes can either be structured as "single rate," where everyone pays that same tax rate regardless of income, or "tiered rate," where rates rise with taxable income. Colorado had a tiered income tax for 49 years, from 1937 to 1986. Rates reached as high as 10 percent for those earning more than $11,000 in 1947 ($112,000 in 2013 dollars) and fell as low as 1 percent for those with incomes under $1,000 in 1947 ($10,000 in 2013 dollars).

In 1986, Colorado eliminated the tiered structure, changing to a single rate of 5 percent. That means that regardless of whether a taxpayer has $10,000 or $112,000 of taxable income, they pay 5 percent of their earnings in taxes. The change was reinforced in 1992 with the passage of TABOR, which constitutionally required Colorado to maintain a single-rate income tax. Since then, Colorado has cut the single-rate tax twice, thereby reducing the capacity of the income tax to generate adequate revenue to meet the state's growing needs.

That has had big consequences for Colorado's ability to fund public services, especially education. Today, Colorado ranks 48th in overall state tax collections per $1,000 of income, largely due to the limited capacity of the income tax.[2] The amount it collects is 27.7 percent less than the average for all states. Even when state and local taxes are combined, only five other states have lower tax collections than Colorado, and it ranks the lowest of all of its geographic neighbors (see Table 1).

Table 1

Tax Collections Per $1,000 of Income

State	Rank	Tax
State Total Taxes *FY 2010-11*		
Alaska	1	$175.30
Colorado	**48**	**$44.35**
New Hampshire	50	$40.32
Combined State and Local Taxes Among Colorado's Neighbors *FY 2008-09*		
Wyoming	2	$150.49
New Mexico	17	$103.99
Nebraska	22	$101.33
Kansas	25	$100.98
Utah	31	$96.31
Arizona	38	$91.16
Texas	40	$89.34
Oklahoma	43	$88.49
Colorado	**45**	**$86.82**

Source: U.S. Census Bureau; Colorado Legislative Council Staff

Nationally, state and local tax collections per $1,000 of income have declined 9.1 percent over the past decade, as a result of tax policy changes and two recessions. But Colorado's state and local tax collections per $1,000 of income have declined 24.3 percent, more than *double* the national average.[3] In short, Colorado is falling faster and farther than most other states in revenue collection, even though needs and costs have grown. Colorado's low single-rate income tax is a key reason state resources are so depleted compared to almost every other state in the nation.

A tiered state income tax is typical and reasonable

A majority of states (34) has an income tax structure like the tiered one being proposed in Colorado.[4] Only six states have a single-rate income tax and nine have no personal income taxes. Of the states with tiered personal income tax rates, 25 have a higher top marginal tax rate than Colorado's proposed 5.9 percent.

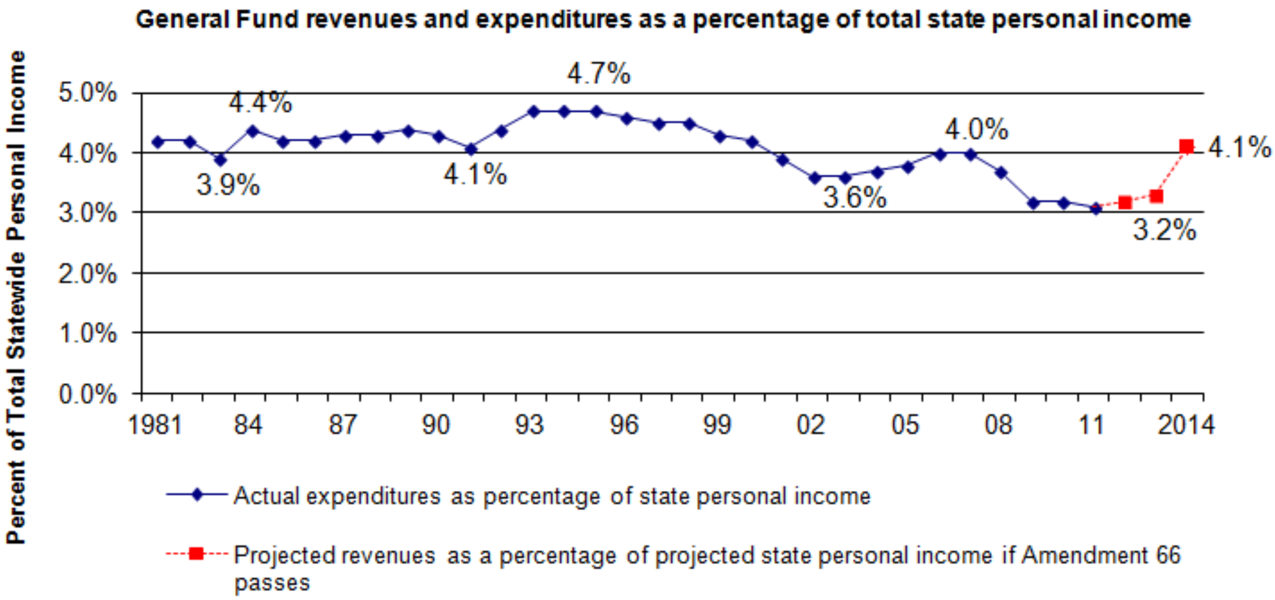

Figure 1

If approved by the voters, Amendment 66 will bring us back to the revenue levels we maintained historically, with projected revenue back up to 4.1 percent of personal income in 2014, as shown by Figure 1. From 1981 through 2006, General Fund revenues averaged 4.2 percent of total personal income. However, during the recession years (2007-2011) Colorado averaged only 3.4 percent. Raising Colorado up from this dip will get us back on track.

Changing back to a tiered income tax structure would not overburden Coloradans. Even after adding $950 million to Colorado's tax collections, Colorado will still be well below the national average in state and local tax collection – 39th from the top in state and local tax collections per thousand dollars of income. Also, part of the $950 million will reduce federal income taxes paid by Coloradans. Because individual income taxes paid by Coloradans are deductible from federal taxes for those who itemize, the amount paid for schools under Amendment 66 may reduce the amount of taxes owed to the federal government. Furthermore, all of the additional revenue will be put toward education, an investment that has been shown to spur economic growth.[5]

Amendment 66 moves us toward a more balanced tax system

Overall, Colorado's poorest families pay a higher percentage of their income in taxes than the wealthiest. Different households are affected more or less heavily by different kinds of taxes. Because lower-income families spend a higher portion of their income, they contribute a larger portion of their earnings to sales taxes than upper-income families. For example, someone making $30,000 a year pays 4.9 percent of his or her income in sales and excise taxes, whereas someone earning $1.5 million pays only 0.8 percent (see Table 2). Lower-income families also pay a larger percentage of their earnings in sales taxes than they do income taxes. For example, someone making $30,000 a year pays 4.9 percent of their earnings in sales and excise taxes, but only 2 percent in income taxes.

The average tax rate on the top 1 percent of Colorado families – those with annual incomes of $1.34 million – is 4.6 percent after accounting for the savings they get from itemized deductions on their federal taxes, as shown in Table 2.[6] The average tax rate on families in the middle of the income distribution – those earning between $39,000 and $59,000 – is 8.3 percent after deductions in their federal taxes. This is nearly double the effective rate that the richest Coloradans pay. The tax rate on the poorest Colorado families – those earning less than $20,000 – is the highest of all. At 8.9 percent, it is twice the effective rate on the very wealthy.

Amendment 66 would narrow those differences between the tax contributions of higher- and lower-income Coloradans. While taxes paid would increase as a share of family income for everyone, the lowest 20 percent of earners would see just a 0.1 percent increase, while the top 1 percent of earners would see an 0.8 percent increase. So someone making $1.5 million would pay approximately 5.4 percent of his or her income in taxes, instead of the current 4.6 percent, while other families at other income levels would see a much smaller increase.

By reinstating the tiered income tax, we will also make Colorado's income tax more productive. The incomes of higher earners are currently growing at a much faster rate than other areas of the economy.[7] It is common sense to tax the fastest-growing areas of the economy at higher rates in order to restore much-needed revenue for education.

How the proposed tax change works and who it affects

The proposed two-tiered income tax structure would establish a 5 percent tax rate for taxable income below $75,000 and 5.9 percent for taxable income above $75,000. A common misconception is that the top tax rate would apply to all taxable income for a person who earns $75,000 or more. In fact, each tax rate is applied only to the taxable income in that category. For example, an individual with $80,000 in taxable income would pay 5 percent on the first $75,000 and 5.9 percent on the last $5,000, not 5.9 percent on all $80,000.

Who Pays in State and Local Taxes? *Table 2*

With Colorado's Current Single-Rate Income Tax of 4.63%

Income Group	Lowest 20%	Second 20%	Middle 20%	Fourth 20%	Next 15%	Next 4%	Top 1%
Average income	$11,500	$28,900	$48,400	$74,900	$128,600	$272,000	$1,345,400
Sales & Excise Taxes	5.6%	4.9%	3.9%	3.2%	2.3%	1.5%	0.8%
Property Taxes	2.6%	2.2%	2.3%	2.1%	2.1%	2.0%	1.8%
Income Taxes	0.7%	2.0%	2.5%	2.9%	3.2%	3.3%	3.3%
Total Taxes	8.9%	9.0%	8.7%	8.2%	7.6%	6.7%	5.9%
Federal Deduction Offset	0%	-0.1%	-0.4%	-0.6%	-1.0%	-0.9%	-1.2%
OVERALL TOTAL	**8.9%**	**9.0%**	**8.3%**	**7.6%**	**6.6%**	**5.8%**	**4.6%**

Source: *Who Pays? A Distributional Analysis of the Tax Systems of all 50 States (4th Edition),* Institute of Taxation and Economic Policy 2013

Importantly, Amendment 66 affects only the *personal* income tax rate and leaves the corporate rate unchanged. Businesses organized as "C-corporations" will continue to pay a 4.63 percent corporate income tax.

Not all businesses are C-corporations.[8] Businesses can be legally set up in a number of ways, regardless of their size or profitability. Those not legally set up as C-corporations do not pay the corporate tax rate, nor do they pay an income tax. Rather, the *owners* of those businesses pay taxes on the income they receive from those businesses. The owner of an "S-corp," for instance, pays income taxes just like an employee of that S-corp.

An owner of an S-corp making $100,000 a year would pay an extra $21 a month if Amendment 66 is approved, which is the same as the wage earner who makes $100,000 a year.

The positive impact of Amendment 66
Colorado had a tiered income tax for 49 years. Since we moved to a single-rate income tax, our ability to fund public services has been dramatically weakened, particularly compared to other states in the region. Under the current tax system, lower-income workers contribute a higher portion of their earnings than upper-income workers. We need to change that, both as a matter of fairness and to meet the growing needs of Colorado families and our economy.

Voting "yes" on Amendment 66 will make our income tax more traditional, typical, balanced and productive.

Amendment 66

This fall, Coloradans will have a rare opportunity to secure better investments for their schools and boost the economy at the same time. From Oct. 15 through Nov. 5, 2013, they will vote on Amendment 66, a ballot measure to fund education reforms that will help schools provide a top-notch education to the children who will eventually become the workforce of Colorado's future and the backbone of its economy.

Amendment 66 proposes to increase the state income tax rate to 5 percent on the first $75,000 of taxable income and to 5.9 percent on all taxable income above $75,000. The current rate is a flat 4.63 percent. The typical Colorado taxpayer would pay about $133 more per year – around $11 each month – and the plan will raise an estimated $950 million annually. That revenue can be used only to fund reforms and improvements to preschool through 12th-grade education enacted by the legislature. These include:

- Expanding early childhood education and full-day kindergarten.
- Improving reading skills by the third grade.
- Decreasing class sizes by reducing the number of students taught by each teacher.
- Ensuring more individual attention for all students, especially low-income, gifted and talented and special-education students, as well as English-language learners.
- Implementing new teacher-support and evaluation procedures.
- Increasing public understanding of education spending and making school officials more accountable for that spending.

Some of these reforms are already law but have never been funded. Others will go into effect only if Amendment 66 passes. The amendment is necessary because the TABOR amendment to the state constitution forbids the state legislature from increasing taxes to fund the reforms it enacts. Only voters can raise taxes.

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This is one of three policy briefs outlining the economic benefits of Amendment 66. The previous briefs showed that investments in education spur economic growth (Investing in education will boost Colorado economy) and that increasing the income tax won't harm the state's economy (Increasing income tax won't harm Colorado economy).

Footnotes

[1] See policy briefs 1 and 2 in this series: *Investing in education will boost Colorado economy* and *Increasing income tax won't harm Colorado Economy*.

[2] The most prevalent rankings measure taxes per $1,000 of income, which shows the relative taxes on state taxpayers. By contrast, measuring revenue on a per-capita basis does not take into account the differing abilities of states to raise revenues and fund programs. The per-$1,000-of-income approach allocates taxes to those who pay them, in proportion to how much is paid. A taxes-per-capita approach spreads total taxes across the entire population (including children, institutionalized populations and others who are not taxed) and assumes equal distribution of taxes for all individuals. This ranking comes from a 2012 report by the Colorado Legislative Council.

[3] See Kirk, Ron, *How Colorado Compares in State and Local Taxes,* Colorado Legislative Council Issue Brief Number 12-07, June 29, 2012.

[4] Federation of Tax Administrators, *State Individual Income Taxes,* Jan. 1, 2013. http://www.taxadmin.org/fta/rate/ind_inc.pdf

[5] See policy briefs 1 and 2 in this series (footnote 1).

[6] The Federal Deduction Offset refers to the savings in federal income taxes received by taxpayers who itemize when computing their federal income taxes. The amount they pay in state income taxes reduces the amount of federal income taxes they owe.

[7] Saez, Emmanuel, *Striking it Richer: The Evolution of Top Incomes in the United States Updated with 2012 preliminary estimates,* Sept. 3, 2013, http://elsa.berkeley.edu/~saez/saez-UStopincomes-2012.pdf.

[8] Businesses that are not legally structured as C-corporations include S-corporations, sole proprietorships, partnerships and non-profits.