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# Colorado's Unique Constraints: TABOR, GALLAGHER, 23 and Low Taxes

# Colorado is Uniquely Constrained Fiscally Unrelated to Economic Conditions



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Constitution has been used to limit  
government

Initiative process has made the constraints  
possible

Interpretations of policy have typically been  
conservative



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# CONSTRAINTS HAVE WORKED TO KEEP GOVERNMENT SMALL

Taxes low

State and Local

Spending low



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# Where We Rank In State Taxes

(Legislative Council Jan 2009)

## Colorado's Rank in Selected State Taxes

per \$1,000 income, FY 2006-07

| Tax               | Colorado |         | National |         |
|-------------------|----------|---------|----------|---------|
|                   | Rank     | Tax     | High     | Low     |
| Total Taxes       | 49       | \$48.91 | \$133.26 | \$41.65 |
| Individual Income | 28       | \$21.68 | \$45.53  | \$0.00  |
| Sales and Use     | 44       | \$11.79 | \$54.03  | \$0.00  |
| Corporate Income  | 43       | \$2.55  | \$31.50  | \$0.00  |
| Motor Fuels       | 31       | \$3.52  | \$7.23   | \$0.61  |



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# WHERE WE RANK IN STATE AND LOCAL TAXES

(Legislative Council Jan 2009)

## Combined State and Local Tax Collections

per \$1,000 Income, FY 2005-06

| State        | Rank | Tax      |
|--------------|------|----------|
| Wyoming*     | 1    | \$165.92 |
| U.S. Average | n/a  | \$116.22 |
| Colorado     | 46   | \$98.01  |
| South Dakota | 50   | \$91.03  |



# Even When the Economy Improves, the Challenges Remain

|                             | State Ranking |
|-----------------------------|---------------|
| ● <b>Total Expenditures</b> |               |
| ● per \$1000 of income      | 47            |
| ● per capita                | 45            |
| ● <b>K-12 education</b>     |               |
| ● per \$1000 of income      | 47            |
| ● per capita                | 32            |
| ● <b>Medicaid</b>           |               |
| ● per \$1000 of income      | 49            |
| ● per capita                | 49            |
| ● <b>Higher Education</b>   |               |
| ● per \$1000 of income      | 48            |
| ● per capita                | 48            |
| ● <b>Highways</b>           |               |
| ● per \$1000 of income      | 48            |
| ● per capita                | 48            |

2007 PRE-RECESSION RANKINGS



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# Current Economic Conditions Confound the Problems

## Reductions in State General Fund Revenue

June estimates identified:

\$249 million reduction in money available for  
FY 08-09<sub>(that ended on June 30 2009)</sub>

\$384 million less than budgeted for FY 09-10

\$873 million shortfall for FY 10-11

\$838 million shortfall for FY 11-12



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# 2009 Developments

## Reform of Statutory Spending Provision

The Legislature eliminated a statutory provision that would have required state spending to remain at recessionary levels. (SB 228) The provision that was amended, Arveschoug Bird, caused a reduction in general fund spending of over \$1 billion because of the recession of 01-02.

## Supreme Court Decision—Mesa Co v State of Colorado

The State Supreme court affirmed the authority of the legislature to make certain “tax policy changes” without a popular vote. This opinion opens the door for new policy options for dealing with reductions in state general fund revenue.



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# Revenue options-Should be considered just as cuts are considered

## **Measures to increase GF revenue-adopted in 2009 session**

Reduction in Capital Gains exemption

Elimination of sales tax credit for cigarettes

Suspension of credit for collections of sales taxes

## **Options for other non voter approved GF increases**

Withholding for out of state partners and shareholders

Elimination deduction for salary expenses in excess of \$250,000

Review of Enterprise Zone Tax Credits

Review of all Sales Tax Credits

Others

## **Other options for voter approval in 2010 or 2011 ballot**



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## Other options for voter approval in 2010 or 2011 ballot

### Modernize our tax system

Progressive Income Tax

Expand Sales Tax to Services

Reform Business Personal Property Tax

Implement a permanent Earned Income Tax  
Credit

Adopt a transportation finance system that  
reflects the cost of maintaining the system



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# Major Constraints

TABOR—Constitutional-Limits Government

Gallagher Amendment—Constitutional—  
Property Taxes

Amendment 23—Constitutional—Compels  
Spending for K-12 Education



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All these ideas for reform and improvement must be considered in light of unique constitutional constraints



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# TABOR



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# TABOR-Taxpayer Bill of Rights

Adopted by voters in 1992 on the third try

Encompasses a philosophy of shrinking the size of government relative to the economy, “preferred interpretation shall reasonably restrain most the growth of government”

Attempts to adopt in other states failed largely based on the Colorado experience



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# TABOR's Major Provisions

Voter Approval of  
Tax Increases

Revenue Limits

Limits on  
Revenue  
Options



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## The first major provision: **VOTER APPROVAL OF TAX INCREASES**

TABOR requires voter approval of any new tax, tax rate increase, debt increase, increase in mill levies, and any tax policy change that will result in a net revenue gain.



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## The second major provision: REVENUE LIMITS

- Imposes a limit on how much revenue that is collected by government can be kept.
- Constitution contains different formulas for growth at different levels of government but all are based on a calculation of inflation and growth.
- Each growth formula is applied to the prior year's "fiscal year spending" which translates to actual revenue collections or the formula-limited collections, whichever is lower.



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# Revenue Limits: TABOR Formulas

Amount of revenue each district is allowed to keep is an increase equal to:

## **State**

% POPULATION CHANGE + RATE OF INFLATION

## **Local Government**

NET NEW CONSTRUCTION + RATE OF INFLATION

## **School Districts**

% CHANGE IN STUDENT ENROLLMENT+ RATE OF INFLATION



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# Revenue Limits: What counts as revenue?

## REVENUE

- General Fund Revenue— income taxes, sales & use taxes, estate taxes, excise taxes
- Cash Funds—Tuition, license fees, gas tax, UI tax

## NOT REVENUE for TABOR purposes

- Federal Funds
- Litigation settlements
- Enterprise revenue – enterprises defined narrowly in TABOR



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## Revenue Limits: What if revenue exceeds the limit?

VOTERS MUST APPROVE KEEPING IT  
Often called a De-Brucing measure.

Or

IT MUST BE REFUNDED

TABOR does not specify the manner or mechanism to refund the surplus. It allows for any “reasonable” method.



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## Revenue Limits: How has revenue been refunded?

- Automatic, temporary reduction in income taxes
- Contingent Tax Credits (TABOR refund mechanisms)
- 6-Tier Sales Tax Refund on individual tax returns
- Local Mill Levy Reductions
- Tax Free Days
- Free Public Service Days



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## Revenue Limits: How much revenue has been refunded?

Between 1997 and 2002--\$3.2 billion was  
refunded

No contingent tax credits or sales tax refund will  
be funded in years without surplus



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## The third major provision: **LIMITS ON REVENUE OPTIONS**

No new or increased real estate transfer taxes

No state real property taxes

No local district income taxes

No new state income tax rate or definition of taxable income shall apply before the next tax year



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## TABOR Constrains Public Services

TABOR limits the relative size of government to its relative size in 1992.

- Growth formula keeps government from occupying a larger share of economy than it did in 1992.
- Envisioned that any new demands beyond population growth or inflation would be funded by eliminating waste or by not funding something else the government did in 1992.



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## TABOR Makes Budgeting Political

- Increases in revenue require elections
- Keeping up with the economy requires elections
- Pits one interest against another—not special interests but basic interests
- Pits locals versus state



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## TABOR Constrains Local as well as State Resources

Override elections and revenue enhancements more successful at local level but rules still hamper ability to provide services—reserve requirements, etc.



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**Gallagher**



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# Gallagher

## Constitutional Residential Property Tax Relief

Caps Non-Residential Assessment Rate at 29%, Residential at 21%

Establishes that 55% of total property tax collections statewide must come from non residential sources and 45% from residential sources

In order to maintain this statewide ratio over time, the residential assessment rate has fallen from 21% in 1982 to 7.96% in 2003



## TABOR And Gallagher

Prior to TABOR, mill levies could float up or down, allowing local governments to maintain funding levels.

TABOR prohibits mill levy increases without a vote. As the residential assessment rate falls to maintain statewide ratio, same mill levy raises less money.

$$\$100,000 \times 30\% \times .020 = \$600$$

VS

$$\$100,000 \times 7.96\% \times .020 = \$159$$



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## TABOR And Gallagher

Amount/value of residential property has increased more rapidly than non-residential.

Per unit burden, in general, has shifted to non residential property.

Statewide averages play out differently in different locations.



# TABOR And Gallagher

Total value of properties is \$500,000--residential \$300,000, non-residential \$200,000—no growth in value

|                   |         |         |        |
|-------------------|---------|---------|--------|
| 1982 -- \$300,000 | X .21   | X .020= | \$1260 |
| --\$200,000       | X .30   | X .020= | \$1200 |
| 2002 -- \$300,000 | X .0796 | X .020= | \$479  |
| --\$200,000       | X .29   | X .020= | \$1160 |

Total value of property in 1982 is \$500,000. Assume Residential grew at 40% and non residential at 30%

|                   |         |         |        |
|-------------------|---------|---------|--------|
| 1982 -- \$300,000 | X .21   | X .020= | \$1260 |
| --\$200,000       | X .30   | X .020= | \$1200 |
| 2002 -- \$420,000 | X .0796 | X .020= | \$669  |
| --\$260,000       | X .29   | X .020= | \$1508 |



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# Amendment 23



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## Amendment 23

Reaction to TABOR's and Gallagher's effect on public education funding.

Statistically, state support for public education had fallen dramatically since passage of TABOR.

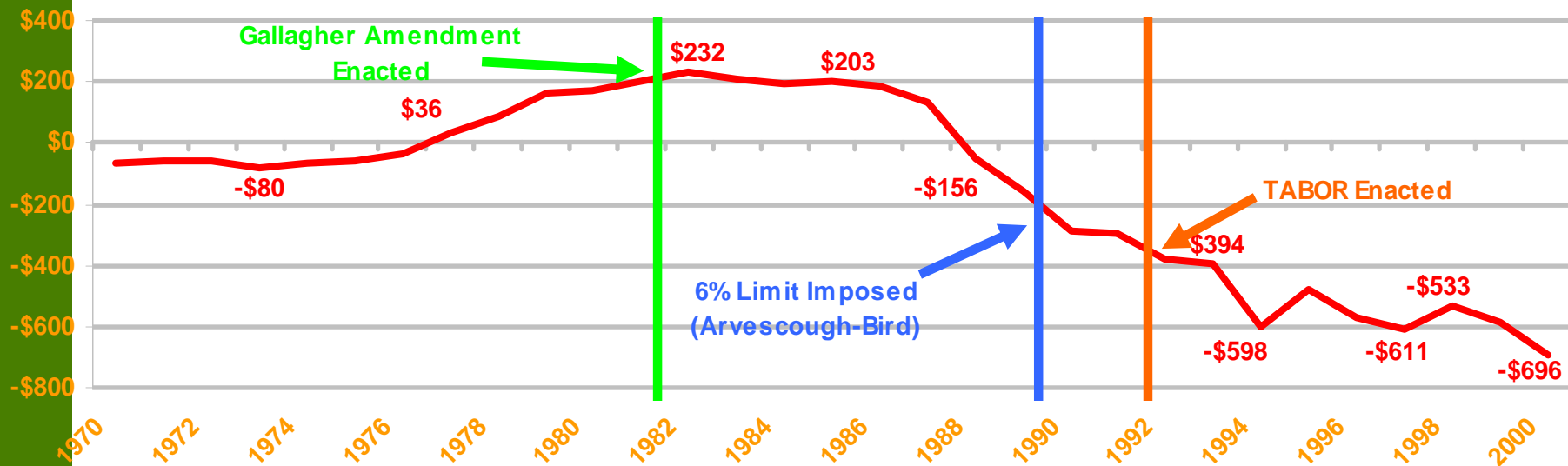
As a percentage of personal income, Colorado's total state spending on education was 49<sup>th</sup> in the country.



# How Colorado Compares

## K-12 Per-Pupil Funding: Colorado vs. National Average

Source: National Center for Education Statistics



### Per pupil spending compared to U.S. Average:

2008: \$1,034 below the national average

2009: \$1,449 below the national average



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## Amendment 23

Amendment 23 mandated increased levels of funding for K-12 public education

- Base K-12 education funding should increase by a rate of inflation plus 1% for ten years.

- After 2010, base K-12 education funding should increase by the rate of inflation.



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## Amendment 23

Mandated increases funded by increased general funds and the new State Education Fund (SEF) established in the law.

The SEF is capitalized by annual deposits of 33% of 1% of income tax revenue.

The SEF was to grow and compound to support expanded funding for the long term.



## The Wreck

The huge drop in revenue in 2002 resulted in the Legislature using balances in the State Education Fund to offset required increased funding from the General Fund.

- Increases in personal income of less than 4.5% triggered a provision in Amendment 23 that allows the Legislature to draw more heavily from the State Education Fund.
- The SEF is no longer capable of supporting the required funding for K-12.



# The Wreck

Amendment 23 hastened the problem by mandating funding increases.

But, even without 23, the structure of education funding is unsustainable.

- The Gallagher/TABOR combo has resulted in a shift from primarily local funding for schools to primarily state funding for schools
- A provision of the School Finance Act exacerbates the problem—requires a reduction in the mill levy when local property tax revenue exceeds the TABOR limit
- There has been no recognition of this phenomenon in the financing structure



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# Referendum C



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## Referendum C

Adopted by voters in November 2005

Authorized the state to keep money collected in excess of the limit for 5 years

Changed the calculation of the base to eliminate the constitutional revenue ratchet effect in the future

Voters told that retained revenue would be used for Higher Education, K-12, Health Care



## Referendum C

Because it didn't suspend Arveschoug Bird, much of the retained revenue could not be spent on priority areas

Increased significantly the general fund revenue for transportation and other capital expenditures

Current revenue projections exceed election projections by \$800 m (down from an estimated \$3B above original projections)



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## Other Constraints

Single subject provision

Prohibition on debt

Balanced budget requirement

SB 97-01

HB 03-1310

Low tax rates