SB 22-124

Legislative Council Staff

Nonpartisan Services for Colorado's Legislature

Revised Fiscal Note

(replaces fiscal note dated March 15, 2022)

Drafting Number:	LLS 22-0769	**Date:**	May 3, 2022
Prime Sponsors:	Sen. Woodward; Kolker Rep. Ortiz; Van Winkle	**Bill Status:**	House Business
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Bill Topic: **SALT PARITY ACT**

Summary of Fiscal Impact:

☐ State Revenue
☒ State Expenditure
☐ State Transfer
☐ TABOR Refund
☐ Local Government
☐ Statutory Public Entity

The bill allows pass-through businesses to elect to retroactively pay their state income tax at the entity level, rather than the individual level, beginning in tax year 2018, and creates a tax credit for owners of electing pass-through businesses. The bill increases state expenditures beginning in FY 2022-23.

Appropriation Summary: For FY 2022-23, the bill requires an appropriation of $2,434,846 to the Department of Revenue, and includes an appropriation of $550,447 to the Department of Revenue.

Fiscal Note Status: The fiscal note reflects the reengrossed bill.

Table 1
State Fiscal Impacts Under SB 22-124

		Budget Year FY 2022-23	Out Year FY 2023-24
Revenue		-	-
Expenditures	General Fund	$2,434,846	$117,445
	Total Expenditures	**$2,434,846**	**$117,445**
	Total FTE	**27.4 FTE**	**1.5 FTE**
Transfers		-	-
Other Budget Impacts	General Fund Reserve	$365,227	$17,617

Summary of Legislation

Beginning in tax year 2018, the bill allows S-corporations and partnerships (pass-through businesses) to retroactively elect to pay their state income tax at the entity level, rather than the individual level. Additionally, the bill repeals the state income tax deduction for electing pass-through owners created by HB 21-1327, and replaces this deduction with a refundable tax credit equal to the electing pass-through business owner's distributive share of the state income tax imposed on the electing pass-through entity.

Background

The federal Tax Cuts and Jobs Act of 2017 placed a temporary $10,000 annual cap on the federal income tax deduction for state and local taxes ("SALT" deduction) for individual income taxpayers. No cap exists for this deduction for C-corporations. The cap expires on December 31, 2025. This bill allows Colorado owners of partnerships and S-corporations to file taxes at the entity level instead of the individual level, which may allow taxpayers a larger SALT deduction.

Assumptions

The number of individuals and entity level tax returns that will be amended and refiled with the Department of Revenue (DOR) as a result of this bill is uncertain. In tax year 2018, a total of 7,020 pass-through businesses in Colorado had more than $250,000 in federal taxable income and at least one owner who exceeded the individual SALT deduction cap by more than $5,000. These pass-through businesses are most likely to elect to amend their tax returns to file at the entity level, as they would have paid state and local taxes on relatively sizable business income and would benefit personally from mitigating the impact of the federal SALT deduction cap. The fiscal note assumes that 80 percent of these pass-through businesses will elect to amend their tax returns to file at the entity level. Assuming the number of pass-through businesses that satisfy the previous criteria grew by 1 percent each year between 2018 and 2021, this results in a total of 22,803 pass-through businesses electing to retroactively file at the entity level. Based on updated data from the DOR, these businesses had on average 9.13 partners per entity. As such, the fiscal note assumes that 208,193 individuals will also file amended returns as members of pass-through businesses electing to file at the entity level.

The fiscal note assumes that 95 percent of pass-through businesses electing to file at the entity level, and their individual owners, will file their amended returns in FY 2022-23, and 5 percent will file in FY 2023-24.

Because the number of taxpayers impacted by the bill may differ significantly from the assumptions in this fiscal note, workload impacts may differ significantly from those estimated. If more (or fewer) businesses and individuals file amended returns than assumed in this fiscal note, expenditures in the DOR could be significantly higher (or lower) than presented in this fiscal note. If this occurs, the DOR may address this difference through the annual budget process.

State Revenue

The bill is not expected to affect state revenue. Under Colorado law, taxpayers are required to add back any state and local taxes deducted at the federal level to their Colorado taxable income. As such, total Colorado taxable income is not expected to change under this bill.

State Expenditures

The bill increases state expenditures in the Department of Revenue by $2,434,846 in FY 2022-23 and $117,445 in FY 2023-24 from the General Fund. Expenditures are shown in Table 2 and detailed below.

Table 2
Expenditures Under SB 22-124

	FY 2022-23	FY 2023-24
Department of Revenue		
Personal Services	$1,420,876	$76,096
Operating Expenses	$40,230	$2,025
Capital Outlay Costs	$186,000	-
GenTax Programming	$90,000	-
Computer and User Acceptance Testing	$186,795	-
Document Management and Form Changes	$89,873	$4,679
Data Reporting	$12,800	$12,800
Employee Insurance / Supplemental PERA / Leased Space	$408,272	$21,945
Total Cost	**$2,434,846**	**$117,445**
Total FTE	**27.4 FTE**	**1.5 FTE**

Department of Revenue. The DOR will require an additional 27.4 FTE tax examiners in FY 2022-23 to process amended returns for both businesses and individuals across four different tax years. The fiscal note assumes that the amended returns will include more errors than usual and require longer review times due to the retroactive nature of these changes.

- **Computer programming and testing.** For FY 2022-23 only, the bill will require changes to the DOR's GenTax software system and additional testing. Changes are programmed by a contractor at a cost of $225 per hour. Approximately 400 hours of computer programming are required to implement this bill, totaling $90,000. Additional computer and user acceptance testing are required to ensure programming changes are tested and functioning properly, resulting in an additional $186,795 in expenditures by the department.

- **Document management and form changes.** The bill requires $89,873 in FY 2022-23 and $4,679 in FY 2023-24 for expenditures related to document management, data entry, and tax form changes. These expenditures take place in the Department of Personnel and Administration using reappropriated funds from the DOR.

- **Data reporting.** Beginning in FY 2022-23, the Office of Research and Analysis within the DOR will expend $12,800 annually to collect and report data related to the changes in this bill.

Centrally appropriated costs. Pursuant to fiscal note and Joint Budget Committee policy, centrally appropriated costs for bills involving more than 20 FTE are appropriated in the bill, rather than through the annual budget process. These costs, which include employee insurance and supplemental employee retirement payments, are shown in Table 2.

Other Budget Impacts

General Fund reserve. Under current law, an amount equal to 15 percent of General Fund appropriations must be set aside in the General Fund statutory reserve beginning in FY 2022-23. Based on this fiscal note, the bill is expected to increase the amount of General Fund held in reserve by the amounts shown in Table 1.

Effective Date

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

State Appropriations

For FY 2022-23, the bill requires a General Fund appropriation of $2,434,846 to the Department of Revenue, and 27.4 FTE. Of this amount, $89,873 is reappropriated to the Department of Personnel and Administration.

For FY 2022-23, the bill includes a General Fund appropriation of $550,447 to the Department of Revenue, and 4.4 FTE. Of this amount, $996 is reappropriated to the Department of Personnel and Administration.

Departmental Difference

The DOR estimates the bill requires General Fund expenditures of $3,268,963, and 38.4 FTE in FY 2022-23, and $168,543 and 2.1 FTE on the assumption that a total of 28,504 business and 291,735 individual tax returns will be amended and filed with the DOR as a result of this bill. This fiscal note uses different assumptions and estimates that a total of 22,803 business returns and 208,193 individual returns will be amended and filed with the DOR as a result of this bill. The DOR assumes that all pass-through businesses with more than $250,000 in federal taxable income, and at least one owner who exceeded the individual SALT deduction cap by more than $5,000 will retroactively amend their returns in response to this bill, while the fiscal note assumes only about 80 percent of these pass-through businesses will do so. As such, the workload impact and associated expenditures in this fiscal note are lower than the estimate provided by the DOR.

State and Local Government Contacts

Information Technology	Law
Personnel	Revenue