

ANALYSIS

Proposition 103 Temporary Tax Increase for Public Education

Proposition 103 proposes amending the Colorado statutes to:

- ◆ increase the state income tax rate from 4.63 to 5.0 percent for five years, starting January 1, 2012;
- ◆ increase the state sales and use tax rate from 2.9 to 3.0 percent for five years, starting January 1, 2012; and
- ◆ require the state legislature to spend the money on public education by increasing funding above the amount in budget year 2011-12.

Summary and Analysis

Proposition 103 temporarily increases the state income and sales and use tax rates and requires the state to spend the money on public education. Public education includes public preschools, kindergarten through 12th grade schools, and colleges and universities.

What is the state income tax? Households and businesses pay taxes on their income to both the state and federal governments. State income taxes are calculated by applying a fixed rate to a taxpayer's Colorado taxable income. The state income tax is the largest source of revenue the state collects to pay for its main programs. The state's current income tax rate is 4.63 percent for both households and businesses, regardless of income level. In 1987, the state moved from a graduated income tax rate to a single tax rate, which was initially set at 5.0 percent. This rate was reduced to 4.75 percent in 1999, and reduced again to 4.63 percent in 2000. The measure returns the rate to 5.0 percent for five years, after which it will be restored to 4.63 percent.

What is the state sales and use tax? The state sales tax is paid on the purchase price of most items. Some items are exempt, such as food bought at grocery stores, prescription drugs, and household electricity and heat. The tax applies to some services, most notably local telephone service, cell phone service, food and drink service at

restaurants and bars, and lodging. The state use tax is paid on taxable items for which the sales tax was not collected, such as items bought from sellers outside the state. In addition to the state sales and use tax, local governments also have sales and use taxes, although local rates may be different and may apply to different items than the state tax. In 2000, the state legislature reduced the sales and use tax rate from 3.0 to 2.9 percent. Proposition 103 returns the rate to 3.0 percent for five years, after which it will be restored to 2.9 percent. The measure does not affect local tax rates.

How much money will the state collect under Proposition 103?

Over the five-year period of the tax rate increase, the state will collect about \$2.9 billion in new tax revenue for public education. Table 1 shows the estimated increase in individual income tax, business income tax, and sales and use tax collections from 2012 through 2016.

Table 1. Estimated Increase in Tax Collections under Proposition 103*
(in millions of dollars)

| Year | Individual Income Tax | Business Income Tax | Sales and Use Tax | Totals |
|------|-----------------------|---------------------|-------------------|---------|
| 2012 | \$398.8 | \$39.8 | \$76.1 | \$514.7 |
| 2013 | \$423.3 | \$44.7 | \$79.5 | \$547.5 |
| 2014 | \$447.0 | \$47.9 | \$83.0 | \$577.9 |
| 2015 | \$472.1 | \$51.3 | \$86.8 | \$610.2 |
| 2016 | \$498.7 | \$55.0 | \$90.7 | \$644.4 |

**Amounts are shown for calendar years. The ballot title reflects budget year amounts.*

How much will state income taxes increase under Proposition 103? Currently, Colorado taxpayers pay \$46.30 in state income taxes for each \$1,000 of taxable income. Under Proposition 103, taxpayers will pay \$50.00 in state income taxes for each \$1,000 of taxable income, or about 8 percent more than under current law. Taxpayers will pay the higher rate for five years, beginning with the tax payment due in April 2013 for the 2012 tax year. An individual's taxable income is equal to the person's gross income minus deductions, exemptions, or other adjustments. It varies based on marital status, the number of dependents, business

exemptions, and other factors such as deductions for mortgage interest, charitable contributions, or interest paid on student loans.

Table 2 shows the estimated change in the yearly state income tax bill for three sample households as a result of Proposition 103.

Table 2. Estimated Annual Income Tax Increases for Selected Households under Proposition 103

| Household description | Tax Paid under Current Law | Tax Paid under Proposition 103 | Amount of Increase |
|---|----------------------------|--------------------------------|--------------------|
| Single person Annual income of \$35,000 Colorado taxable income of \$27,379 | \$1,268 | \$1,369 | \$101 |
| Single person with children Annual income of \$70,000 Colorado taxable income of \$48,571 | \$2,248 | \$2,428 | \$180 |
| Married couple filing jointly Annual combined income of \$125,000 Colorado taxable income of \$85,283 | \$3,949 | \$4,264 | \$315 |

How much will state sales taxes increase under Proposition 103? Table 3 shows the estimated change in the amount of state sales tax paid for four different purchases as a result of Proposition 103. Consumers will pay about 3.4 percent more in state sales tax on purchases than under current law. Local sales taxes are not affected.

**Table 3. Comparison of State Sales Taxes Paid
under Current Law and Proposition 103**

| Purchase Price | Current State Sales Tax (2.9%) | Proposed State Sales Tax (3.0%) | Total Tax Increase |
|-----------------------|---------------------------------------|--|---------------------------|
| \$50 | \$1.45 | \$1.50 | \$0.05 |
| \$100 | \$2.90 | \$3.00 | \$0.10 |
| \$500 | \$14.50 | \$15.00 | \$0.50 |
| \$5,000 | \$145.00 | \$150.00 | \$5.00 |

What does the state spend on public education? For budget year 2011-12, the state's portion of public school funding is currently set at \$3.7 billion for preschool through high school education and \$624 million for higher education. This amount may change, for example, when mid-year adjustments are made to balance the budget. Combined, spending on public education represents about 50 percent of the General Fund, which pays for the state's general operating expenses. Direct state funding for public education has declined in the past few years, although some of these reductions have been offset with other sources of money. Local communities contribute taxes and fees, and universities and colleges charge tuition and fees and seek private donations. In addition, the federal government provides funding for a variety of education programs. The combination of these funds pays for programs and services such as classroom instruction, preschool programs, administrative services provided by the state, and financial aid to students attending public universities and colleges.

How does Proposition 103 impact state spending on education? The measure sets budget year 2011-12 state funding for public education — currently about \$4.3 billion — as a minimum funding level for five years. It requires that the money raised through the tax increase be allocated in addition to, not as a substitute for, this amount. Although Proposition 103 requires that the money raised be spent on public education, it does not specify how the money is to be split between the various preschool through high school and higher education programs.

For information on those issue committees that support or oppose the measures on the ballot at the November 1, 2011, election, go to the Colorado Secretary of State's elections center web site hyperlink for ballot and initiative information:

www.sos.state.co.us/pubs/elections/Initiatives/InitiativesHome.html

Arguments For

1) Public education is important to Colorado's economic future. This investment may lead to a speedier economic recovery and help maintain a competitive business climate. Businesses value a robust public education system that provides an educated workforce, and employees want to live in communities with good schools for their children. In addition, Coloradans need access to affordable education and retraining offered by public community colleges and universities to be prepared to meet the demands of a 21st century economy. Proposition 103 provides the state with the opportunity to invest in job-training programs for Colorado citizens who are struggling to find employment.

2) The additional education funding provided by Proposition 103 will help reverse the recent trend of education budget cuts, which is hindering the state's ability to provide a quality education to all of its citizens. School districts have been forced to close schools, lay off educators, increase class sizes, and cut programs that are important to students and families. State funding for higher education is often the first item to be cut during tough economic times, even as enrollment and costs continue to increase. Since 2006, tuition costs for in-state students have increased 43 percent, on average, making higher education unaffordable for some students. In the absence of additional funding, these trends will continue.

3) Proposition 103 raises tax rates only a fraction of a percentage point, restoring them to 1999 levels. This temporary increase provides relief from further education funding cuts, allowing policymakers time to implement a long-term solution. Colorado spends \$1,781 less per K-12 student than the national average. Colorado's higher education institutions receive, on average, about 63 percent of the state funding received by similar institutions in other states. The measure's small contributions from a large pool of Colorado citizens will amount to

approximately \$2.9 billion in funding over five years that can be used to bolster the state's public education system.

Arguments Against

1) Raising taxes may slow Colorado's economic recovery. Coloradans are struggling with stagnant incomes, a weak housing market, and high gas and food prices. Charging more in taxes may result in less consumer spending and business investment, which may further weaken the economy. In addition, raising sales taxes burdens lower- and middle-income consumers the most because they spend a higher percentage of their overall budget on everyday necessities that are subject to sales tax.

2) Proposition 103 lacks accountability to taxpayers. It does not provide a plan for how more than \$575 million in additional taxpayer money each year will improve public education. The state government already spends about \$4.3 billion of its General Fund operating budget on education each year, and increasing the tax burden on Colorado's citizens does not guarantee a higher quality public education for students. Education is a local issue, and schools are accountable to their communities. Communities can seek local options and private resources if they feel that their schools need more funding. Similarly, pursuing higher education is an individual choice and should not be further subsidized by the state.

3) Proposition 103 is a fiscally irresponsible approach to increase education funding. If the economy fails to recover during the five-year period of the tax increase, larger cuts to other programs may be necessary to meet the minimum education funding levels set in the measure. On the other hand, if the economy improves during the five-year period, money that could have been used to increase education funding may now be used to increase the size of other state government programs, as education will be funded from the tax increase. Finally, regardless of how the economy fares during the five-year period, Proposition 103 is a temporary tax increase and substantial spending cuts will be required in 2016 when the tax rate returns to the previous level.

Estimate of Fiscal Impact

This is a summary of the measure's estimated fiscal impact. For more detailed information, please refer to the fiscal impact statement located here:

www.colorado.gov/cs/bluebookfiscalimpact

State revenue and spending. Proposition 103 is expected to increase state tax revenue by \$2.9 billion over the next five years, as indicated in Table 1. The proposition requires that all new revenue from the tax rate increases be spent on public education.

Impact on taxpayers. Individuals and businesses pay sales taxes, use taxes, and income taxes. Visitors to the state also pay sales taxes. The additional amount of taxes paid by each Colorado household or business will depend on its spending habits, consumption, and the amount of taxable income it receives. For examples, please refer to Table 2 and Table 3. For instructions on estimating your household's or business's tax changes under Proposition 103, please refer to the measure's more detailed fiscal impact statement online.

State Spending and Tax Increases

The state constitution requires that the following fiscal information be provided when a tax increase question is on the ballot:

- 1) the estimated or actual state spending under the constitutional spending limit for the current year and each of the past four years with the overall percentage and dollar change; and
- 2) for the first full year of the proposed tax increase, an estimate of the maximum dollar amount of the tax increase and of state fiscal year spending without the increase.

Table 4 shows the dollar amount of state spending under the constitutional spending limit.

Table 4. State Spending

| | Actual FY 2007-08* | Actual FY 2008-09 | Actual FY 2009-10 | Estimated FY 2010-11 | Estimated FY 2011-12 |
|---|-----------------------------------|----------------------------------|----------------------------------|-------------------------------------|-------------------------------------|
| State Spending | \$9,999 million | \$9,102 million | \$8,567 million | \$9,482 million | \$9,962 million |
| Four-Year Dollar Change in State Spending: -\$37 million | | | | | |
| Four-Year Percent Change in State Spending: -0.4% | | | | | |

*FY = fiscal year. The state's fiscal (or budget) year runs from July through June.

The numbers in Table 4 show state spending from 2008 through 2012 for programs that were subject to the constitutional spending limit during those years. However, the constitution allows a program that operates similar to a private business to be exempt from the limit if it meets certain conditions. Because the exempt status of some programs has changed during the last five years, the numbers in Table 4 are not directly comparable to each other.

Table 5 shows the revenue expected from the increased tax rates; state fiscal year spending without these taxes for FY 2012-13, the first full fiscal year for which the increase would be in place; and the sum of the two.

Table 5. Estimated State Fiscal Year Spending and the Proposed Tax Rate Increases

| | FY 2012-13 Estimate |
|-----------------------------------|--------------------------------|
| State Spending Without New Taxes | \$10,576 million |
| New Sales Tax Increase | \$78 million |
| New Income Tax Increase | \$455 million |
| State Spending Plus the New Taxes | \$11,109 million |