Colorado
Legislative
Council
Staff

Room 029 State Capitol, Denver, CO 80203-1784
(303) 866-3521 FAX: 866-3855 TDD: 866-3472

MEMORANDUM

Pursuant to section 24-72-202(6.5)(b), research memoranda and other final products of Legislative Council Staff research that are not related to proposed or pending legislation are considered public records and are subject to public inspection. If you think additional research is required and this memorandum is not a final product, please call the Legislative Council Librarian at (303) 866-4011 by July 13, 2009.

July 6, 2009

TO: Long-Term Fiscal Stability Commission

FROM: Kate Watkins, Economist, 303-866-6289

SUBJECT: State Spending Limitations: TABOR and Referendum C

This memorandum provides an overview of the Taxpayer's Bill of Rights (TABOR) spending limit[1] and the Referendum C cap.[2]

Summary

Since 1992, state fiscal year spending has been subject to TABOR, which limits spending of TABOR revenue to the prior fiscal year's expenditures and reserve increases grown by inflation and population growth. Referendum C, approved by voters in 2005, allows the state to retain and spend money from existing revenue sources above the TABOR limit each year beginning in FY 2005-06. The state may spend all revenue subject to TABOR for five years through FY 2009-10. Beginning in FY 2010-11, the state may spend revenue above the TABOR limit up to a capped amount known as the "Referendum C cap." The Referendum C cap grows from the prior year's cap instead of the prior year's spending by inflation plus population growth. In effect, Referendum C eliminated the "ratchet-down"[3] effect, where spending decreases when revenue falls below the TABOR limit.

---

[1]Article X, Section 20, Colorado Constitution.

[2]24-77-103.6, C.R.S.

[3]The ratchet-down effect is a term commonly used to describe when revenue subject to TABOR falls below the TABOR limit resulting in the following year's limit falling below where it would have been had revenues met or exceeded the limit in the prior fiscal year.

The TABOR Amendment

Voted into the state constitution by the people in 1992, TABOR contains a number of substantive provisions that apply to districts,[4] including: limitations on government spending of certain revenue, voter approval for certain types of tax increases, and voter approval for revenue changes. Each of these provisions are discussed below in the context of *state* spending.

TABOR spending limit. TABOR limits the amount of revenue that the state may spend each fiscal year. Revenue in excess of the TABOR limit, commonly referred to as the "TABOR surplus," must be refunded to taxpayers, unless voters approve a revenue change as an offset. The formula for determining the state TABOR limit can be summarized as follows:

$$\text{State TABOR Limit} = (\text{Previous Fiscal Year Spending}) \times (1 + \text{Inflation} + \text{Population Growth})^{5} + (\text{Voter-Approved Revenue Changes})$$

Voter approval for revenue changes. TABOR requires voter approval to retain revenue above the TABOR limit. An example of a statewide voter-approved revenue change is Referendum C, which is discussed below.

Voter approval for tax increases. TABOR also requires voter approval for any new tax, tax rate increase, mill levy increase, an increase in a property assessment valuation ratio, extension of an expiring tax, or a tax policy change causing a net tax revenue gain.[6] An example of a voter-approved tax increase is Amendment 35, which passed in November of 2004. Amendment 35 amended the constitution to increase taxes on cigarettes and other tobacco products and targeted the new revenue to fund health care and tobacco education and cessation programs. No voter approval is needed to decrease a tax imposed by statute.

Referendum C

Referendum C, passed by voters in 2005, is a voter-approved revenue change that allows the state to retain and spend all excess TABOR revenue collected above the TABOR limit for five years, from FY 2005-06 through FY 2009-10. This period of time is commonly referred to as the "five-year timeout period." After the timeout period, Referendum C allows the state to retain and spend all excess revenue up to a "cap", which is equal to the highest total state revenue for a fiscal year during the timeout period adjusted by inflation plus population growth for each subsequent year. Revenue collected above the cap will be refunded to taxpayers via the TABOR refund mechanisms. Based on the June 2009 Legislative Council forecast, FY 2007-08 will be the year with the highest

---

[4]Districts include state and local governments, excluding enterprises.

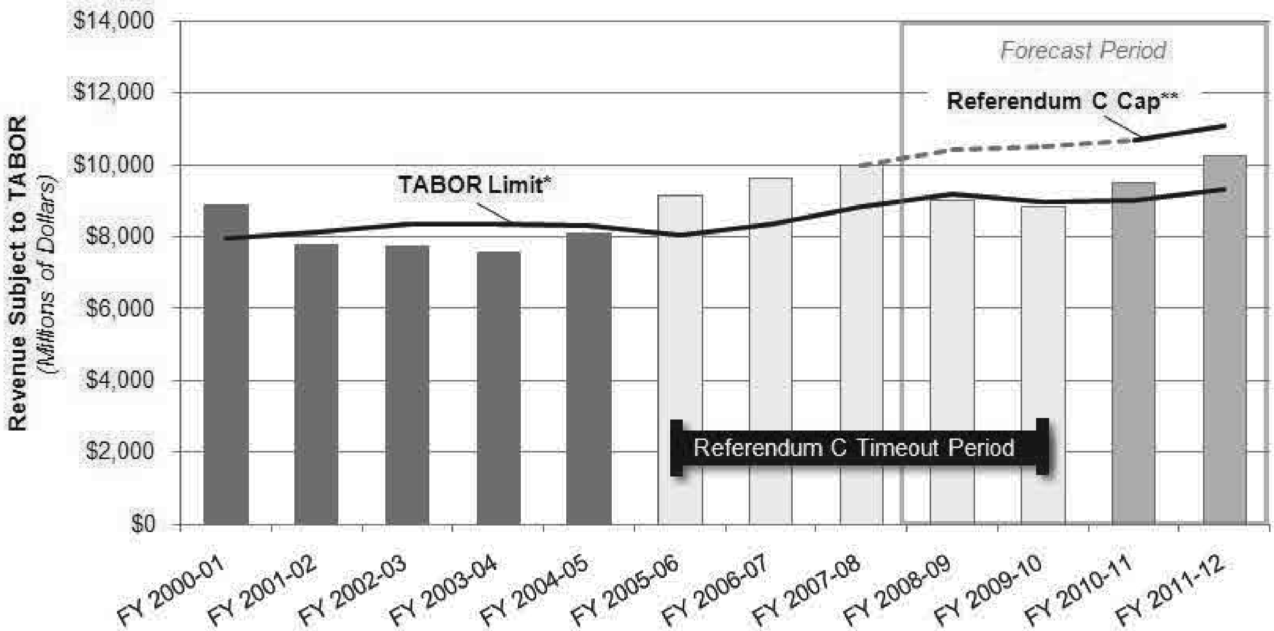
[5]Inflation is measured by the Denver-Boulder-Greeley Consumer Price Index inflation rate published by the U.S. Bureau of Labor Statistics. Population growth is based upon estimates provided by the U.S. Census Bureau, which are subject to updates requiring periodic adjustments.

[6]Income tax rate increases or a new state definition of taxable income may not take effect until the next tax year. TABOR also prohibits certain types of taxes and provides that income tax law changes shall require all taxable net income to be taxed at one rate.

revenue during the timeout period from which the cap will grow by inflation plus population growth.

Figure 1 shows revenue subject to TABOR and the TABOR limit from FY 2000-01 through FY 2007-08. The forecast for TABOR revenue and the TABOR limit are also shown from FY 2008-09 through FY 2011-12. Additionally, the dotted line shows the projected Referendum C cap, growing from FY 2007-08 revenue.

Figure 1
Revenue Subject to TABOR



Source: Department of Revenue and Legislative Council Staff.
*The TABOR Limit was adjusted for changes in TABOR enterprise status in FY 2007-08 through FY 2009-10. FY 2008-09 through 2011-12 are Legislative Council Staff projections based on the June 2009 forecast.
**Legislative Council Staff projections based on the June 2009 forecast.

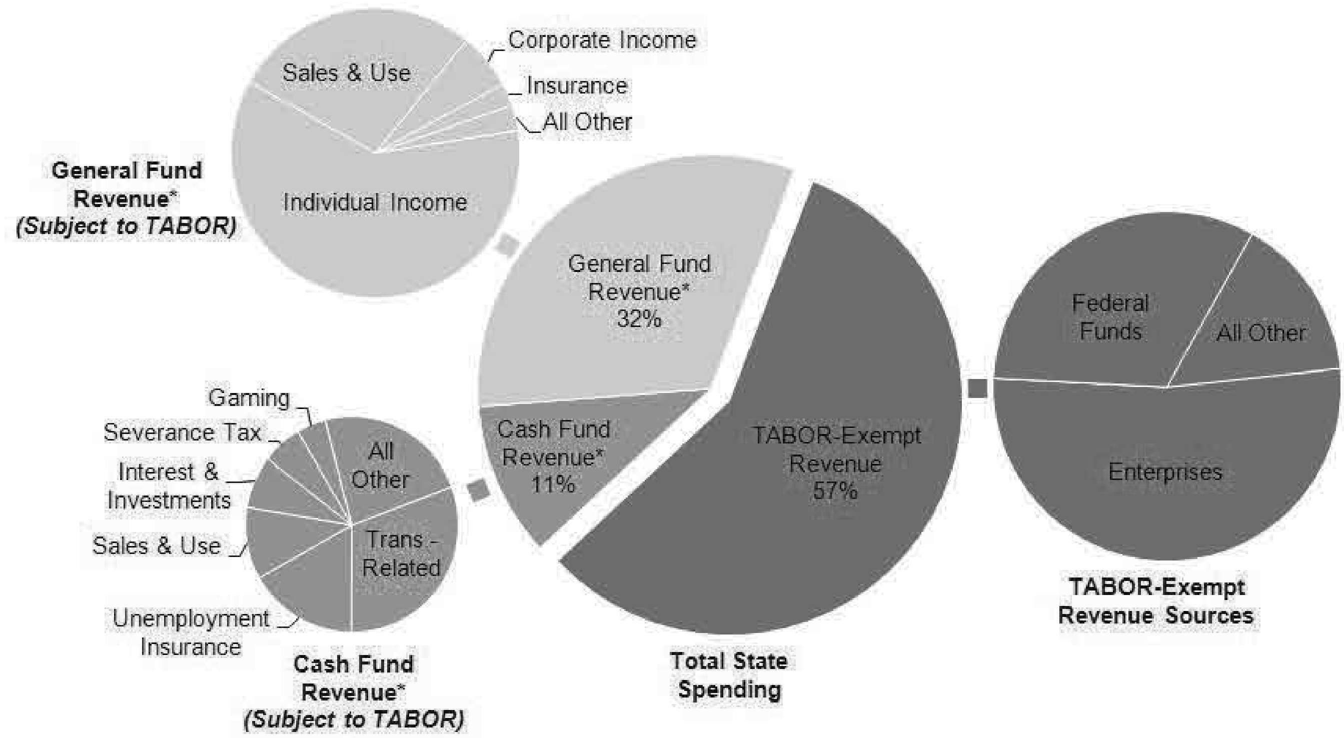
What is the TABOR Ratchet-Down Effect?

Prior to Referendum C, if TABOR revenue was less than the TABOR limit, the following year's limit was reduced to the level of reduced revenue plus inflation and population growth. The term "ratchet-down" has been used to describe the lowering of the limit. The ratchet-down effect occurred in FY 2001-02 and FY 2002-03 as a result of depressed revenues during the economic recession. In effect, Referendum C kept the state from ratcheting-down during the recession which began December 2007 because the Referendum C cap will likely grow from FY 2007-08 revenue levels which were relatively high instead of growing from prior year spending levels. Referendum C effectively eliminated the possibility of ratcheting-down because the cap on revenue the state is allowed to retain and spend grows from the prior year's *cap* instead of the prior year's *spending*.

What Revenue is Subject to TABOR and Referendum C?

The "TABOR base" is a term commonly used to describe revenue subject to TABOR spending limits. The TABOR base, which is used to calculate the following year's TABOR limit, is equal to the lower of the TABOR limit or the amount of TABOR revenue collected during the past fiscal year. Not all revenue is subject to TABOR spending limits. The TABOR limit e*xcludes* federal funds, gifts, employee pension contributions and fund earnings, damage awards, and property sales. Therefore, revenue from these sources are not included in the TABOR base. Additionally, enterprises are not subject to TABOR and are therefore not included in the TABOR base. In FY 2007-08, the spending of revenue subject to TABOR represented 43 percent of the total state budget. Figure 2 below shows state expenditures by revenue source for FY 2007-08, including the distribution of TABOR versus TABOR-exempt revenue.

Figure 2
State Expenditures by Revenue Source, FY 2007-08



Data Source: State Controller's Office.

*General Fund and cash fund revenue includes retained surplus revenue pursuant to Referendum C.

What is an Enterprise?

Enterprises, which represented the largest share of TABOR-exempt revenue in FY 2007-08, are self-supporting, government-owned businesses that receive revenue (usually primarily from fees) in return for the provision of goods or services, and have the authority to issue revenue bonds. An enterprise must be designated so by the General Assembly and may only receive up to ten percent of its annual revenue from government sources, and must otherwise be financially independent. Current enterprises include higher education auxiliary facilities, the State Lottery, College Assist and CollegeInvest, correctional industries, and the state nursing home system. More recently, the State Fair Authority, the Student Obligation Bond Authority, the Division of Wildlife, and the Colorado Tolling Enterprise were granted enterprise status. Starting in FY 2009-10, the Unemployment Insurance Program will be an enterprise.

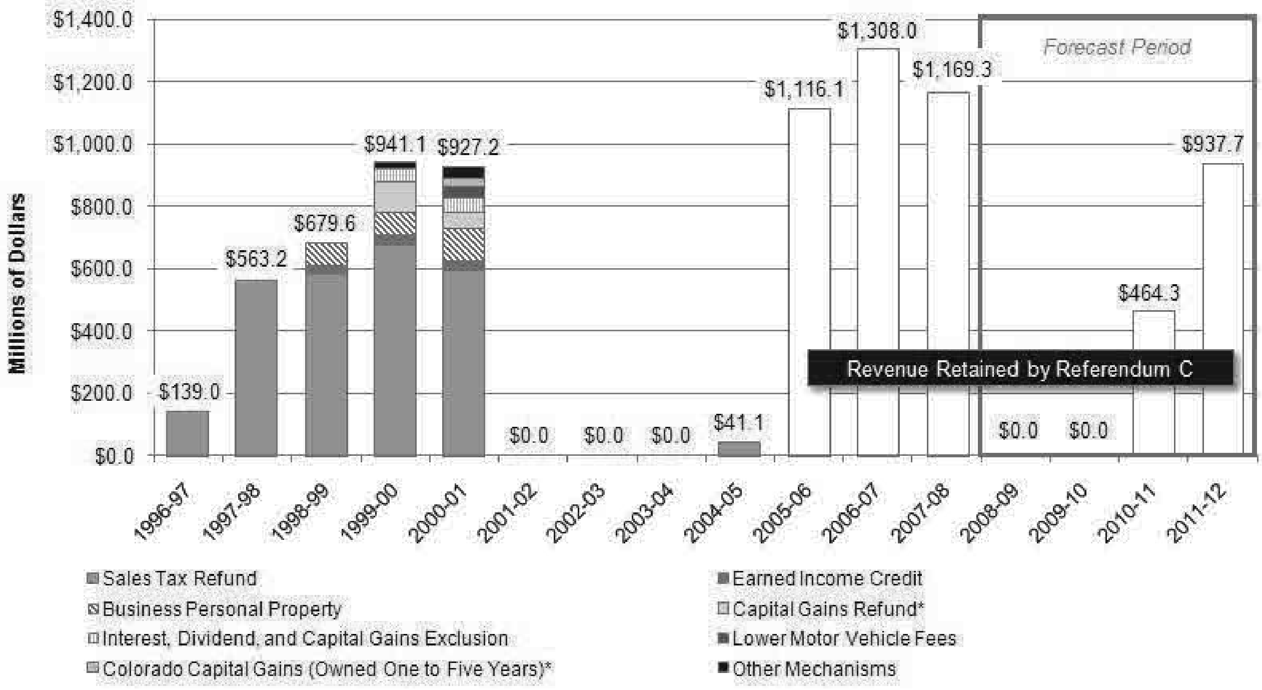
Changes in Enterprise Status. The TABOR base must be adjusted when a program's enterprise status changes. When a program becomes an enterprise, its revenue is no longer counted as TABOR revenue and the TABOR limit is reduced by that amount. Similarly, when a program loses enterprise status, revenue is subject to the TABOR limit and the TABOR limit is adjusted upward accordingly.

How is the TABOR Surplus Refunded?

TABOR requires that the state refund any excess revenue collected over the limit to taxpayers within one year unless voters approve a revenue change that allows the state to keep all or part of the TABOR surplus. For the first two years of surplus (FY 1996-97 and FY 1997-98), refunds were made through a sales tax refund based on taxpayers' federal adjusted gross income. During the legislative sessions between 1998 and 2001, a number of bills established additional TABOR refund mechanisms. Figure 3 shows TABOR surplus refunds by mechanism from the first surplus year through a forecast period of FY 2008-09 through FY 2011-12. During the Referendum C five-year timeout period, the state was allowed to retain all surplus revenue, as is indicated in Figure 3 by the white bars. After the five-year timeout period, which ends in FY 2009-10, revenue collected above the Referendum C cap will be refunded to taxpayers via the TABOR refund mechanisms.

Beginning tax year 2010, House Bill 05-1317, which became effective when Referendum C passed, adds a reduction in the state income tax rate from 4.63 percent to 4.50 percent as a new TABOR refund mechanism. This mechanisms will only take effect only if the amount of money the state collects over its spending limit exceeds the estimated revenue reduction resulting from the decrease in the income tax rate. In years when the mechanism is in effect, the income tax rate reduction will be prioritized ahead of all other refund methods.

Figure 3
TABOR Surplus Refunds by Mechanism



Source: Department of Revenue and Legislative Council Staff.
*Repealed by HB09-1366.
Note: Surplus is shown in the year revenue was collected; Refunds occurred in the following year. FY 2008-09 through 2011-12 are Legislative Council Staff projections based on the June 2009 forecast.

How Is Revenue Retained by Referendum C Spent?

Retained Referendum C revenue (revenue above the allowable TABOR limit but below the Referendum C cap) is statutorily[7] required to be spent on the following:

- health care;
- education, including public elementary and high schools, higher education, and capital construction projects;
- firefighter and police retirement plans; and
- strategic transportation projects.

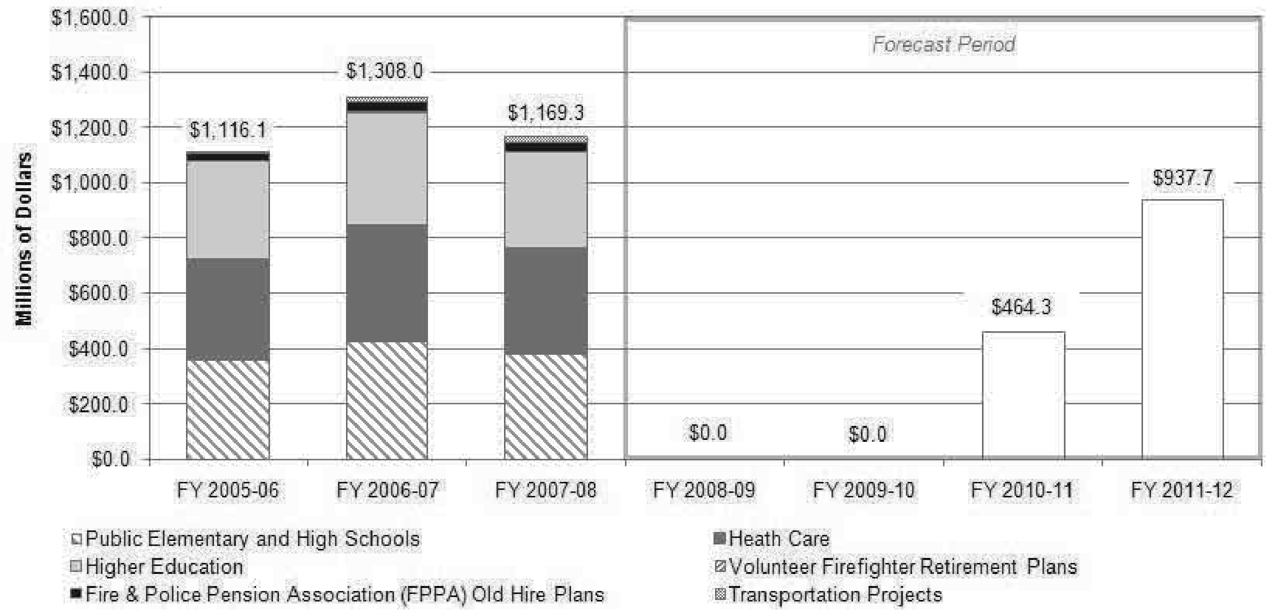
State statute[8] allows that the first $55 million in FY 2005-06, $95 million in FY 2006-07, and $125 million each year thereafter be spent on any of the areas listed above. Any remaining revenue is required to be distributed evenly in thirds to public elementary and high school education, higher education, and health care. Figure 4 shows the distribution of Referendum C retained revenue from the start of the Referendum C timeout period through the end of the forecast period. Based on the Legislative Council Staff June 2009 economic forecast no revenue will be retained from FY 2008-09

[7] 24-77-103.6, C.R.S.

[8] 24-77-104.5, C.R.S.

through FY 2009-10, the last two years of the Referendum C timeout period due to depressed revenue resulting from the economic recession. Based on the forecast, $464.3 million and $937.7 million will be retained in FY 2010-11 and FY 2011-12, respectively.

Figure 4
Spending of Revenue Retained by Referendum C



Source: Joint Budget Committee and Legislative Council Staff.
Note: FY 2008-09 through 2011-12 are Legislative Council Staff projections based on the June 2009 forecast.