

An overview of Colorado's state and local tax structures

Daphne Greenwood and Tom Brown

Colorado has a highly decentralized revenue-raising structure compared to many other states. Although combined state and local taxes are somewhat below the national average, local taxes are among the highest and state taxes one of the lowest. This reflects the strong philosophy of "local control" in Colorado. It has also given rise to so many governmental or quasi-governmental structures that one exists for every 1900 of Colorado's 4.3 million citizens!

First, let's take a brief look at how we raise revenues in Colorado. State government relies primarily on income tax and the state portion of sales tax. (See Figure 1). School districts rely directly on property taxes, although most receive operating budget equalization dollars from income and sales tax dollars the state receives. Cities, counties, and special districts rely on a mix of sales and property taxes. Over time, state government has become more reliant on the income tax relative to the sales tax, while local governments have become more reliant on the sales tax relative to the property tax (Figs 2 and 3).

The Colorado income tax was made quite simple and understandable when it was based on a single flat rate, now 4.63% (down from 5% a few years ago) applied to federal taxable income of Colorado residents. It is mildly progressive – taking a higher portion of income as income rises -- despite being a single rate because it is based on federal taxable income. The state income tax now raises xx% of state revenues, up from xxx% ten years ago and xx % twenty years ago. Corporations also pay a corporate income tax of xx%, although this is not a significant part of the tax base.

The sales tax appears simple to the consumer who pays it. But it is a complex patchwork of rates levied in over 1500 individual jurisdictions, each added to the 2.9% state sales tax depending on the location of sale. This increases complexity for businesses operating in multiple jurisdictions and influences local growth decisions. Determining all the different possible sales tax rates in Colorado is quite complicated. Portions of the tax paid may go to the city, the county, and various special districts as well as to state government. Total sales tax ranges from xxx in xxx to xxx in xxx.

The property tax is probably the most difficult tax to understand and one of the most unpopular taxes. It pays a substantial part of the operation of public schools, is the only source for building new schools, and funds a significant part of the activities of most counties and many special districts. City governments receive some property tax revenue also. The range of mill levies in Colorado's over 1700 (?) districts across the state is from xx to xx as indicated in Appendix B.

Property tax paid is a product of the assessed value, the assessment ratio for the particular class of property and the local mill levy. Assessment ratios are determined at

the state level, while local assessors determine assessed value and local votes determine the mill levy. The interaction of the 1982 Gallagher and 1992 TABOR amendments to the Colorado constitution adds to the inherent confusion of mill levies, assessments, and assessment ratios for different classes of property. Local governments find that the mix of residential, business, and other assessment categories may mean that they must use a much higher mill levy to raise \$1000 than a neighboring government with a different mix of property types. This makes it much harder to fund schools or other locally based activities in some districts than in others, as a recent analysis done at the Center shows (see Tom Brown's *The Great Divide* on this website).

Traditionally, Colorado, like most states in the U.S., has relied on the “three-legged stool” of raising revenues through a combination of income, sales, and property taxes. The inequities in treatment of individual taxpayers and the economic inefficiencies caused by each of the three taxes are largely offset by the other two. Some people may be able to avoid one kind of taxation but they are unlikely to be able to avoid paying another. Thus, everyone pays at least a fair approximation of their “fair share”. Each tax has certain economic disincentives which would become more serious if we relied solely on that tax to raise all the revenue needed. Using a relatively balanced combination of all three keeps any one tax from being as high as it would be if it were the sole source of revenue and minimizes the problems caused by that tax.

Income taxes reflect “ability to pay” more clearly than other taxes, but rise and fall with the economy. Sales taxes are the most regressive tax taking a larger share of income for low and middle-income families than for high income. This happens because as income increases a greater share goes into mortgage payments, personal services, and investments – all areas exempt from the sales tax.

Property taxes are the most stable source of revenue, in part because changes in assessed value occur a year or two later than changes in the economy. A myth has arisen that property taxes are more regressive than sales taxes. In fact, they are roughly proportional to income, because high-income families tend to own higher value homes. And due to reverse mortgages or legislation which allows senior citizens to postpone property taxes until death, elderly people are no longer forced to leave their homes because of higher property tax valuations.

Local governments collect a declining portion of their revenues from property tax. Sales tax revenues make up an increasing share of city and county revenues, while state aid is an increasing share for school districts. Two amendments to the Constitution have resulted in declines despite sharply rising property values. The “Gallagher” amendment requires that residential owners pay no more than 45% of the statewide total property tax. As the number of homes has increased much more rapidly than the value of commercial and agricultural property, the assessment rate on residences has fallen to 9.74% from 21%, which results in less dollars of property tax.

The 1992 “TABOR” amendment reduces property tax collections even further. It requires mill levies to fall when collections increase by more than inflation plus new growth, but does not allow them to rise when the reverse is true. The limit TABOR sets

on local government revenues is a complex measure of local area growth that is based on property values, but does not include more population or higher incomes.

Since the benefits of growth are not shared without special voter approval growth cannot automatically pay for itself. The TABOR revenue limit also favors annexations and new construction. If individuals or businesses rehab older, existing properties this does not increase the local revenue limit in the same way that a new subdivision or office park does.

The increased reliance of local governments on sales vs. property taxes has two important effects. The first of these is the instability of sales tax revenues over the business cycle relative to property tax. Many services of local governments, such as fire and police protection, require a stable funding source since their need is unabated when the economy turns down. Capital spending on infrastructure could be reserved for “good years”. But once again, the constitutionally based TABOR limit on “spendable revenues” makes this difficult to do.¹ If the limit would have allowed 4% growth in spending but slower sales tax growth allows for only 2%, the ceiling on the local budget will be adjusted down permanently. Future revenue growth will be allowed only to the degree that inflation and the addition of new real properties through construction or annexation occurs, even if sales tax revenues rebound.

The second important effect of increased reliance on sales vs. property taxes is the highly regressive nature of sales vs. property taxes. Economic growth is already benefiting the top 20% of earners and bypassing the bottom 60%. Affordable housing is an issue of increased concern to local governments around the state. It doesn’t make sense to rely more on taxes that fall disproportionately on low-income families. This problem is most serious in rural areas which often have a local sales tax on food, along with higher than average poverty rates.

The relative popularity of the sales tax in polls and tax elections is often attributed to the fact that “tourists help pay it”. While there is truth in this, many of the “tourists” in one locality often turn out to be residents of the adjoining county. Coloradans are driving back and forth to do their shopping, taking turns at being tourists as they cross jurisdictional lines. On a statewide level, nonresidents also pay property taxes when they own second homes or stay in hotels and resorts. They pay gasoline excise taxes when they drive in Colorado and business personal property taxes when they own shares in companies operating in Colorado.

Daphne Greenwood is Professor of Economics and Director of the Center for Colorado Policy Studies at CU-Colorado Springs. Policy papers exploring effects of the Gallagher and TABOR amendments, as well as other aspects of state and local tax policy may be found at <http://web.uccs.edu/ccps>.

Tom Brown

¹ Broadwell, David. XXXXXXXXXXXXXXXX. Colorado Municipal League.