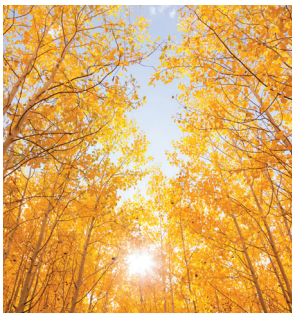
Report on Federal Tax Law Provisions and Changes that Impact the Colorado Tax Base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OFFICE OF THE STATE AUDITOR

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Office of the State Auditor

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Contents

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Report on Federal Tax Law Provisions and Changes that Impact the Colorado Tax Base

Overview

Colorado uses federal taxable income as the starting point for calculating Colorado taxable income and conforms to the current version of the federal Internal Revenue Code [Title 26 of the United States Code (26 USC)] for both corporate and individual taxpayers. This means that Colorado generally conforms with federal policies for determining what is considered income for the purposes of calculating income tax and the amount taxpayers may deduct when calculating taxable income. Additionally, if the federal government amends the Internal Revenue Code (IRC), in most cases the amendments are automatically incorporated into Colorado's income tax base and could potentially impact the amount of income tax revenue that Colorado receives.

House Bill 24-1053 (codified at Section 39-21-306, C.R.S.) requires the State Auditor to annually "study and evaluate impacts to the state's policy of using federal taxable income as the basis for Colorado taxable income. The evaluation must include a review of federal tax law, including changes, that may have a significant impact on the state's tax base or otherwise impact taxable income within the state." This report, the first issued under this requirement, includes:

- A background section, which provides an overview of how federal taxable income is calculated for individual and corporate taxpayers, a brief legislative history of Colorado's income tax base, a comparison of how other states calculate their state income taxes and their conformity to the IRC, and the implications of federal conformity.

- A section outlining the current impact of Colorado using federal taxable income as its tax base.

- A recent and pending changes section, which summarizes changes to federal tax law that occurred between the beginning of 2024 through May 2025 and pending changes that may impact Colorado.

- Several appendices, which are referred to throughout the report to provide more specific information on topics such as what items of income are included in gross income, what items are excluded from income, descriptions of deductions allowed to be taken at the federal level (including data on how frequently they are claimed and the amount, when available) and their impact on the State, Colorado income tax credits that are calculated based on federal credits, and a list of the types of organizations exempt from federal income tax.

Background

How Does the Calculation of Federal Taxable Income Impact Colorado Taxable Income?

To understand the relationship between federal tax policies and the tax revenue Colorado collects, a basic understanding of how federal and Colorado taxable income are calculated is helpful. As outlined below, taxpayers generally must calculate their federal taxable income, which is the starting point for calculating Colorado taxable income, before they can determine their Colorado tax liability. Additionally, corporate taxpayers are subject to separate laws regarding the calculation of taxable income and tax liability.

Calculating Federal Taxable Income for Individuals

As shown in Exhibit 1, individuals calculate their federal taxable income by first determining what is included in gross income, then subtracting certain deductions known as "above-the-line" deductions to determine federal adjusted gross income. From adjusted gross income, individual taxpayers can claim either the standard deduction, which provides a standard deduction amount based on taxpayers' filing status (e.g., single, married filing jointly), or itemize deductions, which allows taxpayers to take deductions based on certain actual expenses they incurred during the year. A few additional deductions are available for individuals after taking either the standard deduction or itemizing deductions to arrive at federal taxable income.

Exhibit 1
How Federal Taxable Income is Calculated for Individuals

	Federal Gross Income (exclusive of exclusions)
–	"Above-the-Line" Deductions
=	**Federal Adjusted Gross Income**
–	Standard Deduction or Itemized Deductions
–	Qualified Business Deduction
–	Charitable Contribution Deduction for Non-itemizing Taxpayers
–	Personal Exemptions
=	**Federal Taxable Income**

Source: Office of the State Auditor analysis of federal laws.

As will be discussed in more detail in the sections that follow, federal tax laws, regulations, administrative rulings, and court decisions govern how taxpayers may calculate each step of the process shown in Exhibit 1, and ultimately determine how much tax they must pay. For example, the determination of federal gross income is subject to a body of law defining what income is and excluding certain types of income for tax purposes; when taxpayers are allowed to exclude more income from their gross income for tax purposes, they will generally have less taxable income and pay less in taxes. Similarly, the extent to which taxpayers are allowed to subtract deductions from their gross income and adjusted gross income will determine their taxable income and tax liability.

Calculating Federal Taxable Income for Corporations

In many ways, the calculation of corporations' federal taxable income is similar to individuals. For example, corporations share the same definition of gross income for federal tax purposes as individuals: "all income from whatever source derived" [26 USC 61(a)] and may exclude income only as explicitly provided by the IRC. Corporations are also allowed to claim deductions from gross income when calculating their federal taxable income [26 USC 63(a)]. However, computation of federal taxable income for corporations differs from individuals in important ways that impact the types of deductions they typically claim and the calculation of taxable income. Generally, U.S. tax laws for corporations are designed to tax businesses on their net income (i.e., revenues in excess of expenses) and establish when they must recognize revenue, expenses, and income for tax purposes, since the timing of revenues may not match the timing of expenses related to those revenues. This section describes how corporations calculate their federal taxable income, with an emphasis on concepts that are applicable to businesses, such as cost of goods sold, capitalizing versus expensing expenditures, and business-oriented deductions.

Similar to federal income taxes for individuals, federal laws establishing when businesses must recognize sales revenue, costs, and income all impact the calculation of federal taxable income as shown in each step of Exhibit 2. For example, if a business is allowed to exclude certain income in any given tax period, it will generally recognize less federal gross income and pay less in taxes. Similarly, the more losses and other deductions a business can subtract from its gross income, the less it will generally owe in taxes.

Exhibit 2
How Federal Taxable Income is Calculated for Corporations

	Gross Sales
–	Cost of Goods Sold
=	**Federal Gross Income**
–	Deductions
=	**Federal Taxable Income**
–	Federal Net Operating Loss Deduction
–	Special Deductions
=	**Net Federal Taxable Income**

Source: Office of the State Auditor analysis of federal laws.

Cost of goods sold. Cost of goods sold is a concept that is important for businesses that make or sell goods (i.e., producers/manufacturers or resellers/retailers). According to case law [Patients Mutual Assistance Collective Corp. v. Commissioner (2018)], "COGS [cost of goods sold] is the costs of acquiring inventory, through either purchase or production." Cost of goods sold is technically an exclusion from gross income rather than a deduction because it is subtracted from gross sales to calculate gross income. Federal law provides that businesses must recover costs related to the inventories that they produce or acquire for resale in the same tax period that they sell the inventory rather than take deductions for those expenses in the year in which the expense was incurred. For example, if a company spends $100 on 10 items to resell, it cannot necessarily deduct that $100 in costs related to the acquisition of the goods in the year of the purchase. Rather, the company subtracts those costs from gross sales at the time it sells the inventory. In this example, if the company sells 5 of the items in a year, it may subtract $50 from gross sales to arrive at gross income in that year. Costs directly, and in many cases indirectly, related to the inventory must also be recovered over time (as cost of goods sold). Examples of direct costs include the cost of the items themselves (if a reseller) or raw materials/components of an item as well as labor directly used to manufacture the items (if a producer/manufacturer). Examples of indirect costs include management expenses and materials that are not a part of the final product but are used to produce it. Additionally, the types of costs that must be included in cost of goods sold may vary depending on the type of business.

Depreciation of capital assets. Subject to some exceptions provided in the IRC, expenditures made to acquire or create an asset with a useful life of more than a year, improve property, restore property, or adapt property for a new use cannot be deducted entirely in the current tax year. Instead, these expenditures must be capitalized and recovered through depreciation or amortization over time. According to Bloomberg Law, "The policy underlying the disallowance of current

deductions for capital expenditures is that the cost of an asset that remains productive in the taxpayer's business for a period of years should be recovered over the period that the asset provides benefits to the business; therefore, the expenditure does not represent a current operating expense." The IRC provides the recovery periods for broad classes of assets, and in some cases allows for accelerated recovery periods (i.e., shortened depreciation or amortization periods). Generally, depreciation is deducted from federal gross income as part of calculating federal taxable income.

Net operating losses. A net operating loss occurs when a taxpayer's allowable deductions exceed their income for the tax year. In general, a net operating loss means that a taxpayer has "negative income" in a particular tax year and does not have income tax liability in that year. A net operating loss carryback or carryforward allows a taxpayer to subtract their net operating loss from federal taxable income in past or future tax years, respectively. This policy is generally meant to factor in businesses' long-term profits or losses in determining their tax liability, and can ultimately reduce the taxpayer's tax liability across multiple years. A net operating loss carryback, which allows the taxpayer to reduce net taxable income in a prior tax year can result in an immediate refund to the taxpayer, assuming they had filed and paid taxes during the tax year the net operating loss is applied to; whereas, a net operating loss carryforward can be subtracted from income in future tax years resulting in a lower tax liability in those years. A taxpayer may claim a net operating loss deduction for up to 80 percent of their federal taxable income (computed without regard to the net operating loss deduction). Most taxpayers can carry forward net operating losses indefinitely but not carry them back to prior years.

Calculation of tax liability. After corporations have calculated their federal taxable income, they apply the federal tax rate to it to determine their tax liability. The federal corporate income tax is imposed at a flat rate of 21 percent. It is important to note that corporations that have income from business activities both within and outside of Colorado do not typically pay Colorado income tax on their entire federal taxable income. Rather, these corporations apportion and allocate their income among the jurisdictions in which they earn income.

Calculating Colorado Taxable Income

In general, since Colorado uses federal taxable income as the starting point for calculating Colorado taxable income and generally conforms to the current IRC (known as "rolling conformity"), most aspects of federal law that impact the calculation of federal taxable income at the federal level also flow through to Colorado and impact Colorado taxable income, and ultimately state tax revenue, unless the General Assembly enacts legislation to deviate from federal tax treatment. Specifically:

- Any income item that is excluded from federal gross income is also excluded from Colorado taxable income unless the General Assembly enacts legislation to include it, typically through an adjustment to taxable income known as an "addback." Similarly, any deduction that is allowed for federal tax purposes is also incorporated into Colorado taxable income unless the General Assembly enacts legislation to disallow it, typically through an addback.

- Any income that is included in federal gross income is also included in Colorado taxable income unless the General Assembly enacts legislation to exclude it, typically through an adjustment to taxable income known as a "subtraction." Similarly, any deduction that is not allowed for federal tax purposes is not incorporated into Colorado taxable income unless the General Assembly enacts legislation to allow a deduction at the state level, typically through a "subtraction."

Exhibit 3 shows the calculation of Colorado tax liability, using federal taxable income as the starting point.

Exhibit 3
How Colorado Income Tax is Calculated

	Federal Taxable Income
+	State Addbacks
–	State Subtractions
=	**Colorado Taxable Income x Colorado Income Tax Rate (4.4 %)**
=	**Colorado Tax Liability**
–	Colorado Credits
=	**Colorado Income Tax Due**

Source: Office of the State Auditor analysis of State tax laws.

Legislative History of Colorado's Income Tax Base

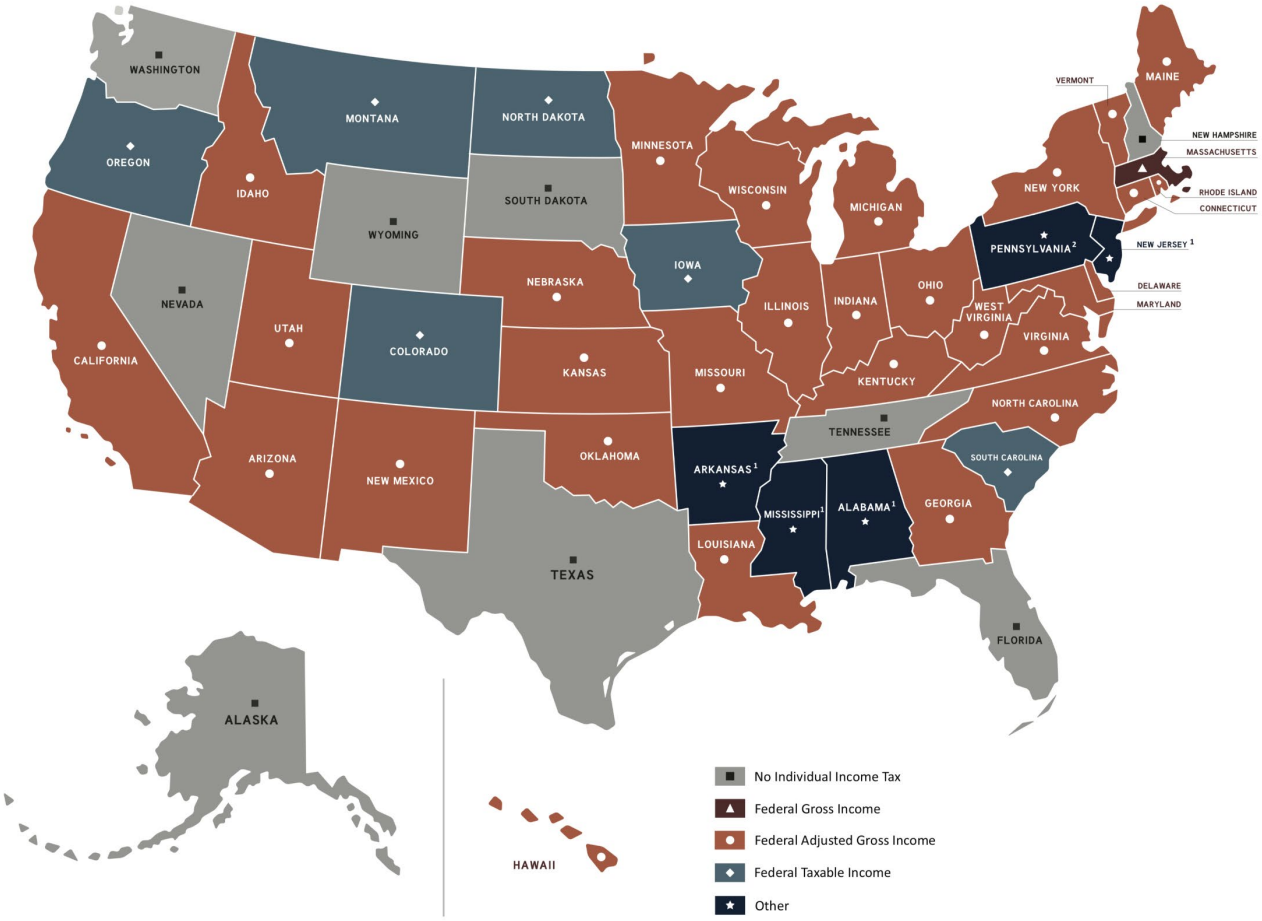
Colorado first began imposing an income tax in 1937. From 1937 to 1964, the State generally required taxpayers to calculate their state taxable income independently from federal tax law. In 1964, the General Assembly enacted the Colorado Income Tax Act of 1964 [House Bill 64-1003], which provided that Colorado taxable income would be calculated based on federal tax laws in tax years beginning after December 31, 1964. The General Assembly stated that its intent for using federal law as the basis for calculating Colorado taxable income was "to (1) simplify preparation of state income tax returns, (2) aid interpretation of the state income tax law through increased use of federal judicial and administrative determinations and precedents, and (3) improve enforcement of the state income tax laws through better use of information obtained from federal income tax audits." Starting with the 1965 tax year, individuals used federal adjusted gross income as the starting point for calculating Colorado taxable income, and corporations, estates, and trusts used federal

taxable income as the starting point, after which the taxpayers would make adjustments to their federal adjusted gross or taxable income as required by state law, to arrive at Colorado taxable income. In 1987, the General Assembly enacted the Colorado Income Tax Act of 1987 [House Bill 87-1331], which transitioned individuals from using federal adjusted gross income as the starting point to using federal taxable income as the starting point.

Other States Comparison

Many states with an individual income tax use a version of federal income as the starting point for calculating their state taxable income, such as federal gross income, federal adjusted gross income, or federal taxable income. As of March 2025, there are five other states (excluding Colorado) that use federal taxable income as the starting point for calculating state taxable income for individuals. The majority of states (29) with an individual income tax use federal adjusted gross income as the starting point for calculating state taxable income for individuals. One state (Massachusetts) uses federal gross income and five states use other approaches that do not use a federal starting point for individual taxpayers. Exhibit 4 shows the starting points for determining state taxable income for states with an individual income tax.

Exhibit 4
State Starting Points for Calculating State Taxable Income for Individuals, 2025

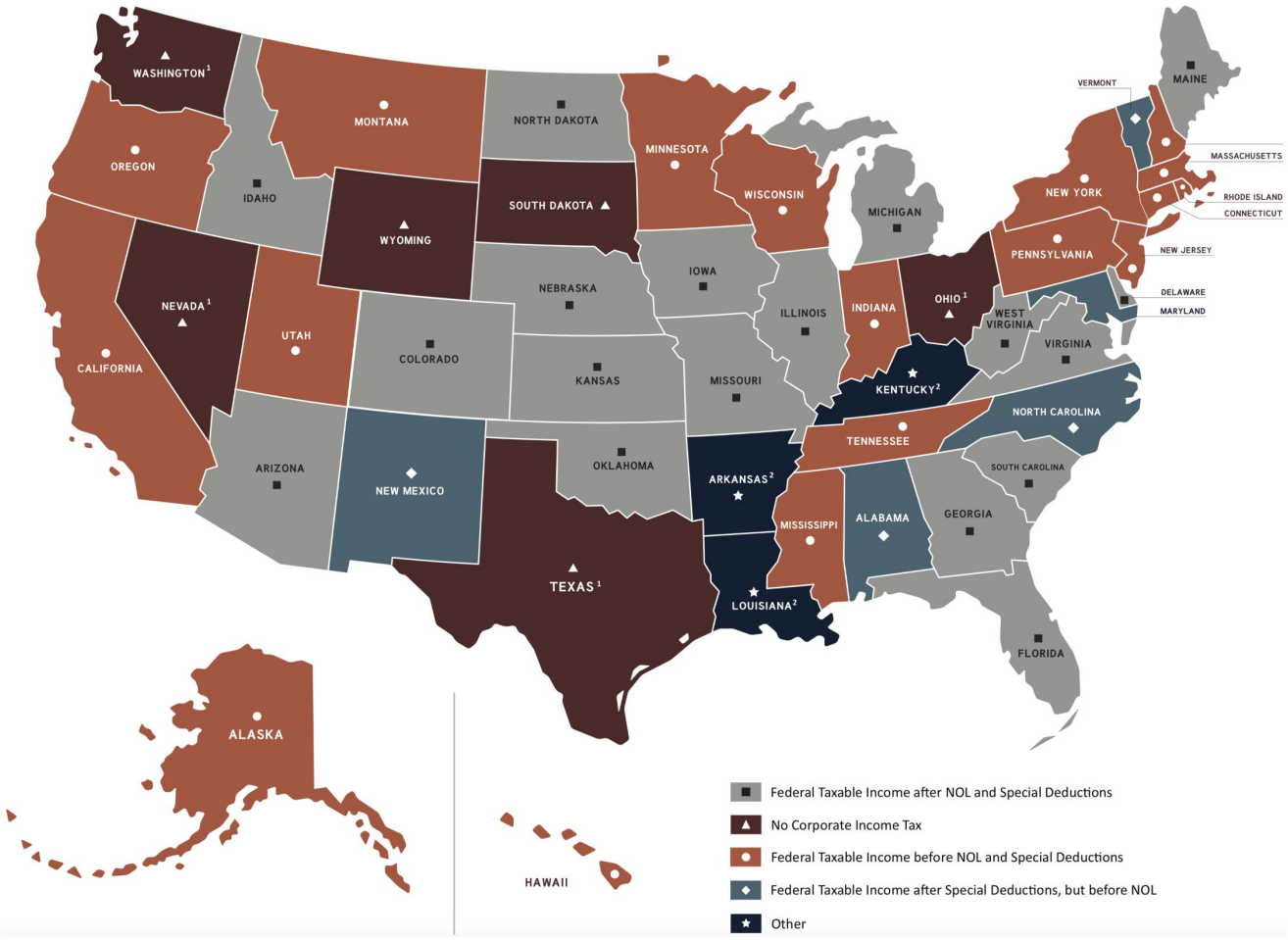


Source: Office of the State Auditor analysis of Bloomberg Law and other states' statutes.
[1] Alabama, Arkansas, Mississippi, and New Jersey do not use a federal starting point; instead, they use state gross income. In computing state taxable income, they incorporate some definitions from the IRC.
[2] Pennsylvania does not use a federal starting point; instead, Pennsylvania's state income tax is imposed at a flat rate on different types of income, such as compensation, gains, dividends, and interest.

Similar to individual income tax, many states with a corporate income tax use a version of federal income as the starting point for calculating state taxable income. However, for corporations, the starting points are typically different from individuals and include federal gross receipts; federal gross income; federal taxable income before the net operating loss (NOL) deduction and special deductions (such as the dividends received deduction); federal taxable income after the net operating loss deduction and special deductions; and federal taxable income after special deductions but before the net operating loss deduction. Net operating losses and special deductions for corporations are discussed later in the report. Colorado's starting point for calculating state taxable income for corporations is federal taxable income after the net operating loss deduction and special deductions; however, as discussed later in this report, Colorado has decoupled from the federal net operating loss provision in state law. As of March 2025, there are 17 other states (excluding Colorado) with a corporate income tax that also use federal taxable income after the net operating

loss deduction and special deductions as the starting point for calculating state taxable income for corporations. There are 18 states with a corporate income tax that use federal taxable income before the net operating loss deduction and special deductions as the starting point and five states that use federal taxable income after special deductions but before the net operating loss deduction. Three states use other starting points. Specifically, one other state (Louisiana) uses federal gross receipts, another (Kentucky) uses federal gross income, and one (Arkansas) uses another starting point depending on whether the corporation operates only in Arkansas or in multiple states. Exhibit 5 shows the starting points for determining state taxable income for states with a corporate income tax.

Exhibit 5
State Starting Points for Calculating State Taxable Income for Corporations, 2025



Source: Office of the State Auditor analysis of Bloomberg Law and other states' statutes.
[1] Nevada, Ohio, Texas, and Washington do not impose corporate income taxes, but instead impose other taxes on businesses, including the Nevada Modified Business Tax, Ohio Commercial Activity Tax, Texas Franchise Tax, and Washington Business and Occupation Tax.
[2] In Arkansas, corporations that only operate in Arkansas use federal gross sales as the starting point for calculating state taxable income. For multistate corporations, the starting point is federal taxable income before net operating losses and special deductions. Louisiana uses federal gross receipts as its starting point. Kentucky uses federal gross income as its starting point.

Incorporation of the IRC into the State's tax code (referred to as "conformity") is also an important factor when considering Colorado's tax base. Conformity concerns whether states automatically incorporate amendments to federal law into their own income tax laws by reference to the IRC. According to The Tax Adviser, which is the magazine for the American Institute of Certified Professional Accountants (AICPA), "States generally conform to the [Internal Revenue] Code to simplify the calculation of taxpayers' income taxes and to make the administration of the state tax system simpler and more efficient. These efficiencies of conformity, however, often butt up against other state policy concerns such as state budgets and state-specific incentives that do not necessarily align with those of the federal government. Further, as Congress inevitably continues to amend the [Internal Revenue] Code, the federal policy goals animating those amendments may change over time, causing states to adjust their conformity to the [Internal Revenue] Code or limit their adoption of future changes."

Colorado conforms to the current version of the IRC for both corporate and individual taxpayers. As discussed, this is referred to as "rolling conformity." The Colorado General Assembly must pass legislation if it wants to decouple from new amendments to the IRC, and it has done so for many provisions, which are discussed throughout this report. Rolling conformity is common among states with broad-based income taxes, with 20 other states (50 percent) having rolling conformity for their individual income tax and 24 other states (56 percent) having rolling conformity for their corporate income tax. Two of these states (Virginia and Maryland) have rolling conformity, but have provisions in their state statutes that prevent automatic conformance to provisions that are expected to exceed a certain revenue impact to the state; in Maryland the threshold is $5 million and in Virginia it is either $15 million or $75 million, depending on whether its General Assembly is in session when the federal amendment takes effect.

Many states instead conform to the IRC as of a certain date. This is typically referred to as "static conformity." Sixteen (40 percent) other states with a broad-based income tax have static conformity for their individual income tax, and 16 (37 percent) have static conformity for their corporate income tax. There are a few other states that either do not conform to the IRC or selectively conform to it. For example, Mississippi does not conform to the IRC generally, but the IRC is incorporated by reference throughout the Mississippi tax statutes. Exhibit 6 shows how states conform to the IRC.

Exhibit 6
State Conformity to the Internal Revenue Service

Conformity Type	States
Rolling Conformity	Alabama, Alaska[1], Colorado, Connecticut, Delaware, Illinois, Iowa, Kansas, Louisiana, Maryland[2], Massachusetts, Michigan, Missouri, Montana, Nebraska, New Mexico, New York, North Dakota, Oklahoma, Oregon[3], Pennsylvania[4], Rhode Island, Tennessee[5], Utah, Virginia[6]
Static Conformity	Arizona, California, Florida[7], Georgia, Hawaii, Idaho, Indiana, Kentucky[8], Maine, Minnesota, North Carolina, New Hampshire[9], Ohio[10], South Carolina, Vermont, West Virginia, Wisconsin
Selective Conformity	Arkansas, Mississippi
No Conformity	New Jersey, Pennsylvania[4]

Source: Office of the State Auditor analysis of Bloomberg Law and other state statutes.
[1] Alaska has rolling conformity for its corporate income tax. It does not have an individual income tax.
[2] Maryland conforms to the IRC on a rolling basis; however, if the Maryland Comptroller determines that amendments to the IRC will impact state income tax revenue by at least $5 million, the amendments are not automatically adopted by Maryland.
[3] Oregon has "rolling reconnection" to the IRC, which is effectively rolling conformity. According to Oregon's Legislative Revenue Office, "Since 1997 Oregon has frequently maintained an automatic connection to changes in taxable income as defined by the IRC. This policy of a continuous connection is known as "rolling reconnect." Under a rolling reconnect policy, the revenue impacts resulting from changes in federal taxable income are estimated as needed and then incorporated into the Oregon current law revenue forecast. While the Legislature continues to review and monitor federal tax changes each year, specific legislation disconnecting Oregon from federal law is required to avoid inherently adopting federal changes to the Oregon tax base."
[4] Pennsylvania has rolling conformity for its corporate income tax and no conformity for its individual income tax. Its individual income tax is imposed at a flat rate on different types of income (e.g., compensation, gains, interest, dividends).
[5] Tennessee has rolling conformity for its corporate income tax. It does not have an individual income tax.
[6] Virginia has certain exceptions to rolling conformity: (1) it does not automatically conform to federal provisions that result in a revenue impact of at least $15 million in the fiscal year of the amendment or any of the following 4 fiscal years, (2) it will not automatically conform to federal amendments that occur between the General Assembly's sine die adjournment of one regular session and the first day of the next regular session if the projected impact of such amendments would increase or decrease general fund revenues by $75 million or more in the fiscal year of the amendment or any of the 4 succeeding fiscal years, unless the provision was adopted by the legislature before the cumulative projected impact was met. The $15 million and $75 million figures are adjusted for inflation.
[7] Florida has static conformity for its corporate income tax but regularly considers whether to adopt a more recent version of the IRC. It does not have an individual income tax.
[8] Kentucky conforms to the IRC in effect on December 31, 2023. It does not automatically adopt amendments to the IRC after that date unless they extend provisions already in effect.
[9] New Hampshire has static conformity for its corporate income tax. It does not have an individual income tax.
[10] Ohio has rolling conformity for its individual income tax. It does not have a corporate income tax; it instead imposes a Commercial Activity Tax, which does not involve conformity to the IRC.

Impact of Colorado using Federal Taxable Income as its Tax Base

The impact of Colorado's policy of using federal taxable income as its tax base includes several components. First, and most directly, this policy has an impact on Colorado's tax revenue. For example, according to Department of Revenue (Department) data, in Tax Year 2020, which was the most recent year of data available, there were 2,636,017 individual Colorado income tax returns filed in Colorado by full-year Colorado residents. These returns included a total of about $2.9 billion in deductions from gross income, which resulted in $225.7 billion in federal adjusted gross income and $179.8 billion in federal taxable income. Based on these figures we estimate that Colorado taxpayers claimed about $48.8 billion in federal deductions (calculated by adding the $2.9 billion in above-the-line deductions and $45.9 billion in below-the-line deductions, which we estimated by subtracting federal taxable income from adjusted gross income). Colorado partially offset this amount claimed through federal deductions by requiring addbacks (i.e., state-level additions to federal taxable income) totaling $5.6 billion, resulting in about a $43.2 billion difference in taxable income due to federal deductions being incorporated into Colorado taxable income. Based on Colorado's 4.55 percent income tax rate in 2020, this reduction in taxable income could have resulted in a reduction to state tax revenue of roughly $2.0 billion. However, the true revenue impact to the State's tax revenue is unknown because it is dependent on the policy choices Colorado would make in the absence of using federal taxable income as its tax base. For example, of the $43.2 billion in federal deductions in the previous example, $36.3 billion (about 74 percent) is due to the federal standard deduction and many states that do not use federal taxable income as their tax base allow some form of a standard deduction. Additionally, if Colorado used a different method for establishing Colorado taxable income, taxpayers would likely make different choices in order to minimize their tax liability, which would also have an impact on the revenue the State collects.

Second, Colorado's decision to use federal taxable income as its tax base means that the economic impacts of federal tax policies for determining federal taxable income are amplified in Colorado since they are automatically incorporated into Colorado's tax policies and increase the economic incentives created by federal policies. For example, to the extent that the federal deduction for home mortgage interest expenses encourages home ownership and offsets the cost of housing, these impacts are amplified in Colorado since the State's policy effectively applies the same deduction for the purposes of determining Colorado taxable income, thereby increasing the total tax benefit available to qualifying taxpayers. Similarly, since the federal government uses deductions (e.g., the standard deduction) in addition to tax rates to adjust how much individuals must pay as a percentage of their income (to make the tax code more or less progressive), these decisions will flow through to Colorado's tax policies. For example, if the federal government reduced the standard deduction amount without other changes, this would cause lower income earners to pay a higher effective tax rate, making the tax system less progressive and this policy would automatically be applied in Colorado.

Third, Colorado's tax policy eases the administrative burden on taxpayers and the Department. Specifically, taxpayers can use their federal tax returns to complete their state tax returns instead of having to start over for Colorado tax purposes. Additionally, the Department is able to leverage federal oversight and enforcement instead of having to administer and enforce an entirely separate tax system. Further, although the State could likely achieve similar efficiencies by using a different tax base, such as federal adjusted gross income, that is already calculated for federal tax purposes, the process of changing this system would likely cause disruptions for taxpayers who would need to adjust to a new system and require the Department to make large-scale administrative changes that would likely be costly.

In the sections that follow, and in related appendices, we provide information on the major federal tax provisions and their potential impact on Colorado. Overall, because the IRC and its related body of law is large and highly complicated, we have limited our review to the more significant provisions in federal tax code.

Calculation of Federal Gross Income

Federal gross income is broadly defined as "all income from whatever source derived" [26 USC 61(a)]. Federal law provides a non-exhaustive list of items that are considered to be income, including, for example, compensation for services (including fees, commissions, and fringe benefits), income derived from business, gains from dealings in property (e.g., capital gains), interest, dividends, pension benefits, and some social security benefits. Additionally, in Commissioner of Internal Revenue v. Glenshaw Glass Co. (1955), the U.S. Supreme Court gave a liberal construction to federal statute to tax all income and gains except those specifically exempted in law, referring to the statutory language as a "catchall" provision. Some notable items of income that have been determined by case law to be considered part of gross income include punitive damages (except in the case of wrongful death claims) and income derived from illegal activities, such as the sale of illegal drugs. **A list of the types of income that are specifically stated in federal law to be included in gross income can be found in Appendix A.** Colorado generally conforms to the federal definition of gross income; however, when Colorado law has decoupled from federal tax treatment of certain types of income, we note that in Appendix A.

Federal law explicitly provides that some types of income are excluded from federal gross income. According to estimates from the U.S. Treasury Department, at the federal level, the exclusions with the highest revenue impacts to the U.S. government are the exclusion for employer contributions for medical insurance premiums and medical care [26 USC 106(a) and (d)], which had an estimated revenue impact of about $247.3 billion, and exclusion of gain from sale of principal residence [26 USC 121], which reduced federal revenues by about $59.1 billion in federal Fiscal Year 2024. Other income exclusions that many taxpayers may be aware of are gifts and inheritance [26 USC 102], interest on state and local bonds [26 USC 103], qualified scholarships [26 USC 117], and qualified tuition program distributions (often referred to as 529 plans) [26 USC 529(c)(1)]. Because Colorado generally conforms with federal exclusions from gross income, federal exclusions also reduce Colorado taxable income and state tax collections. Although we did not identify state-specific data

on the revenue impact of these exclusions, given their impact on federal revenues, they likely also have a significant impact on state revenues. **A list of the types of income that are specifically excluded from gross income can be found in Appendix B.** When Colorado law has decoupled from federal exclusions, we note that in Appendix B.

Deductions from Federal Gross Income—"Above-the-Line" Deductions

After federal gross income is determined, individuals are allowed to take certain deductions to determine federal adjusted gross income (AGI). As discussed, these are often referred to as "above-the-line" deductions, with "the line" being federal AGI. Examples of above-the-line deductions include trade or business deductions, certain expenses of elementary and secondary school teachers, interest on education loans, and amounts contributed to health savings accounts. According to Department reports, Colorado taxpayers claimed about $2.9 billion in above-the-line deductions on their federal returns in Tax Year 2020. Based on the State's tax rate of 4.55 percent, we estimate that these deductions could have reduced state revenue by as much as $134 million, although some taxpayers likely did not earn enough income to incur tax liability regardless of the deductions, so the actual amount is likely somewhat less. **A list of the above-the-line deductions with descriptions and data on claims (when available) can be found in Appendix C.** By setting its tax base as federal taxable income, Colorado has generally incorporated these deductions into its tax base; however, when Colorado law has decoupled from federal above-the-line deductions, we note that in Appendix C.

Additionally, Colorado has several tax expenditures that are means-tested based on federal AGI, meaning if a taxpayer has over a certain amount of federal AGI, they are not eligible for the state tax expenditures. For example, the Colorado Qualified Care Worker Credit [Section 39-22-566, C.R.S.] is only available to eligible taxpayers with $75,000 or less in federal AGI ($100,000 or less if filing a joint return). To the extent that changes to federal law impact the calculation of Colorado taxpayers' federal AGI, it may impact their eligibility for these State tax expenditures, which can, in turn, impact Colorado income tax revenue.

Deductions from Adjusted Gross Income—"Below-the-Line" Deductions

From AGI, individual taxpayers can deduct either the standard deduction amount or itemize additional deductions. Deductions taken from AGI are sometimes referred to as "below-the-line" deductions. For Tax Year 2025, the standard deduction amount is $15,000 for single taxpayers and married individuals filing separate returns; $30,000 for married couples filing jointly; and $22,500 for individuals filing as heads of households. If an individual is at least 65 years of age or blind, they can claim an additional standard deduction amount; this amount is $1,600 for Tax Year 2025 per eligible person for taxpayers filing joint returns and $2,000 for single filers. According to Internal Revenue Service (IRS) Statistics of Income data, in Tax Year 2022, which was the most recent year of data available, about 5.3 million people in Colorado filed approximately 3 million federal tax returns using

Colorado addresses. The standard deduction was claimed on about 2.6 million (87 percent) of those returns, with standard deductions totaling about $46.6 billion. The additional standard deduction was claimed on about 459,000 returns, totaling about $973.2 million. Exhibit 7 shows the number of returns that claimed the standard deduction, the total amount of standard deductions for various AGI groups, and our estimated reduction in state tax revenue associated with the standard deduction.

Exhibit 7
Number of Federal Returns Filed Using a Colorado Address that Claimed the Standard Deduction and Total Amount of Standard Deductions, by Adjusted Gross Income, Tax Year 2022

	Size of Adjusted Gross Income					
	Total	$1 to $25,000	$25,000 to $100,000	$100,000 to $200,000	$200,000 to $1,000,000	$1,000,000 or more
Number of Returns Claiming the Standard Deduction	2,582,250	681,840	1,308,400	429,640	157,680	4,690
Percent of Total Returns[1]	87%	23%	44%	14%	5%	<0.5%
Percent of Total Returns in AGI Group	N/A	98%	93%	79%	59%	29%
Total Dollar Amount of Standard Deductions	$46.60 billion	$9.64 billion	$22.77 billion	$10.12 billion	$3.95 billion	$116.75 million
Estimated State Revenue Impact[2]	$2.05 billion	$424.25 million	$1 billion	$445.43 million	$173.70 million	$5.14 million

Source: Office of the State Auditor analysis of Internal Revenue Service Statistics of Income data.
[1] Based on a total of 2,972,380 federal returns filed with Colorado addresses.
[2] We estimated the state revenue impact of this provision by multiplying the total dollar amount of standard deductions by the State's 2022 income tax rate (4.4 percent). Beginning in Tax Year 2023, Colorado statute [Section 39-22-104(3)(p.5), C.R.S.] requires that taxpayers with $300,000 or more in federal adjusted gross income add back to their federal taxable income when calculating Colorado taxable income any amount of itemized deductions or the standard deduction claimed that is over $12,000 for single filers and $16,000 for joint filers. This estimate does not account for this state addback since the state addback did not go into effect until Tax Year 2023.

If taxpayers qualify for itemized deductions in excess of the standard deduction amount, they will typically claim itemized deductions rather than the standard deduction. Itemized deductions include medical and dental expenses (if they exceed 7.5 percent of AGI), state and local taxes (limited to $10,000 for individuals for Tax Years 2018 to 2025), home mortgage interest, investment interest, charitable contributions, casualty and theft losses, and wagering losses. There are also other miscellaneous itemized deductions, some of which are subject to a limit. **Appendix D provides a list with descriptions of the itemized deductions as well as data from the IRS on claims of itemized deductions on federal returns for taxpayers who used a Colorado address.** By using federal taxable income as its tax base, Colorado conforms with most of these deductions; however, when Colorado law has decoupled from federal itemized deductions, we note that in Appendix D.

According to IRS Statistics of Income data, in Tax Year 2022, which was the most recent year of data available, about 342,000 (12 percent) of the 3 million federal returns filed by taxpayers using a Colorado address claimed itemized deductions rather than the standard deduction. Exhibit 8 shows the number of federal returns filed using a Colorado address that claimed itemized deductions, the total amount of itemized deductions for various adjusted gross income groups, and our estimate of the impact of itemized deductions on state tax revenue.

Exhibit 8
Number of Federal Returns Filed Using a Colorado Address that Claimed Itemized Deductions and Total Amount of Itemized Deductions, by Adjusted Gross Income, Tax Year 2022

	Size of Adjusted Gross Income					
	Total	$1 to $25,000	$25,000 to $100,000	$100,000 to $200,000	$200,000 to $1,000,000	$1,000,000 or more
Number of Returns Claiming Itemized Deductions	342,050	11,070	97,530	113,840	108,250	11,360
Percent of Total Returns[1]	12%[2]	<0.5%	3%	4%	4%	<0.5%
Percent of Total Returns in AGI Group	N/A	2%	7%	21%	41%	71%
Total Dollar Amount of Itemized Deductions	$13.0 billion	$276.17 million	$2.41 billion	$3.41 billion	$4.52 billion	$2.39 billion
Estimated State Revenue Impact[3]	$571.86 million	$12.15 million	$105.87 million	$150.12 million	$198.70 million	$105.03 million

Source: Office of the State Auditor analysis of Internal Revenue Service Statistics of Income data.
[1] Based on a total of 2,972,380 federal returns filed with Colorado addresses.
[2] The percentages of total returns claiming the standard and itemized deductions do not equal 100 percent because there were about 48,000 returns that had under $1 in adjusted gross income and did not claim either the standard deduction or itemized deductions.
[3] We estimated the state revenue impact of this provision by multiplying the total dollar amount of itemized deductions by the State's 2022 income tax rate (4.4 percent). This estimate does not account for state income tax addbacks required for itemized deductions. The State requires several addbacks of itemized deductions claimed at the federal level, including state income taxes deducted at the federal level and a charitable contribution deduction for a conservation easement for which the taxpayer is also claiming the Colorado Conservation Easement Credit. In Tax Year 2020, which was the most recent year of data available, Department of Revenue data showed that state income taxes were added back to 290,279 Colorado returns for a total amount of about $981.3 million added back, which would generate an estimated $44.7 million in state revenue (when applying the amount added back by the State 2020 income tax rate of 4.55 percent). The Department did not have any data available on the amount added back due to conservation easements that were claimed as charitable contributions on Colorado taxpayers' federal returns. Additionally, beginning in Tax Year 2023, Colorado statute [Section 39-22-104(3)(p.5), C.R.S.] requires that taxpayers with $300,000 or more in federal adjusted gross income add back to their federal taxable income when calculating Colorado taxable income any amount of itemized deductions or the standard deduction claimed that is over $12,000 for single filers and $16,000 for joint filers. This estimate does not account for this state addback since the state addback did not go into effect until Tax Year 2023.

Although Colorado generally conforms with federal deductions, state statute limits the ability of taxpayers with higher income to claim below-the-line deductions for state tax purposes. Regardless of whether a taxpayer claims the federal standard deduction or itemized deductions, beginning in Tax Year 2023, Colorado statute [Section 39-22-104(3)(p.5), C.R.S.] requires that taxpayers with $300,000 or more in federal AGI add back to their federal taxable income when calculating Colorado taxable income any amount of itemized deductions or the standard deduction claimed that is over $12,000 for single filers and $16,000 for joint filers. House Bill 22-1414, which was referred to voters in the November 2022 election as Proposition FF and passed, provided that revenue generated from this addback is to be used to fund the Healthy School Meals for All Program, which "allows public School Food Authorities…participating in the National School Lunch and School Breakfast Programs to provide free meals to all students." According to the Office of State Planning and Budgeting's Healthy School Meals for All (HSMA) Program Revenue Report 2024, "Based on

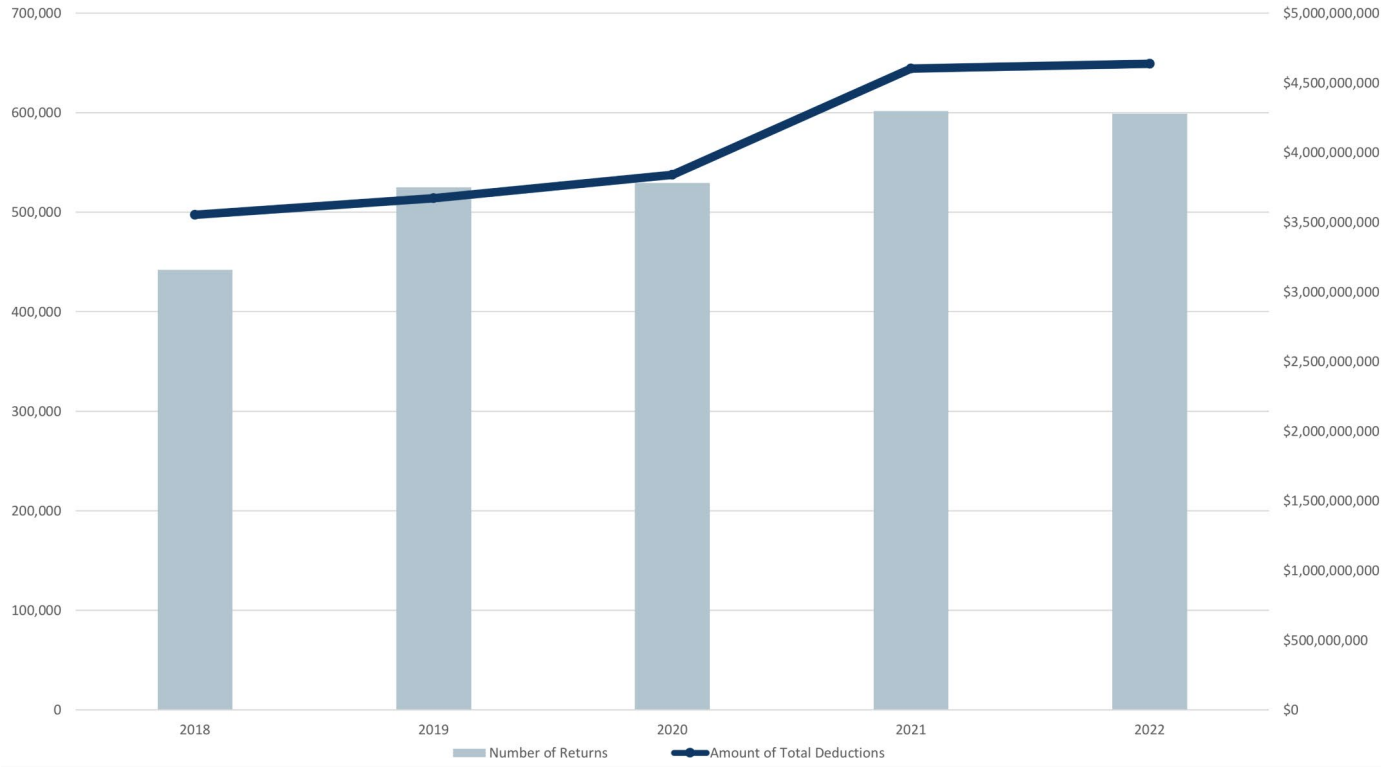
the most recent income tax data from [the Department], there were 187,231 state tax returns impacted by Proposition FF tax provisions in Tax Year 2023. The total HSMA revenue recorded in Tax Year 2023 was $109,189,061. The average revenue per qualifying return allocated to HSMA was $583.18 during this period."

Qualified Business Income Deduction

After claiming either the standard deduction or itemized deductions, eligible taxpayers are also allowed to claim a deduction for qualified business income pursuant to 26 USC 199A. This deduction allows certain self-employed and small-business owners to claim a deduction for 20 percent of the qualified income from an eligible pass-through trade or business, such as a partnership. Certain types of businesses are not eligible for this deduction, including health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, services consisting of investment and investment management, and trading of securities, partnership interests, or commodities. This deduction was available starting in tax years beginning after December 31, 2017 and is scheduled to expire at the end of 2025. However, Colorado does not fully conform to this provision of the IRC. Specifically, there are two instances in which Colorado taxpayers must add back the amount of the Qualified Business Income Deduction claimed on their federal return when calculating Colorado taxable income. First, beginning in Tax Year 2018, if an individual is a partner or shareholder in a partnership or S corporation that makes a SALT Parity Act Election (to be taxed as an entity at the state level under Section 39-22-343, C.R.S.), the individual must add back the full amount of their qualified business income deduction [Section 39-22-104(3)(r), C.R.S.]. Second, beginning in Tax Year 2021, if a single filer has more than $500,000 in federal adjusted gross income or joint filers have over $1 million in federal adjusted gross income, they must add back the full amount of their qualified business income deduction. The addback is not required if the taxpayer files a Schedule F, which is generally required for farmers, with their federal returns [Section 39-22-104(3)(o), C.R.S.]. Colorado's addback of the Qualified Business Income Deduction based on taxpayers' federal adjusted gross income is scheduled to expire at the end of 2025, which coincides with the scheduled expiration date of the federal Qualified Business Income Deduction in 26 USC 199A.

Exhibit 9 shows the number of federal returns filed using a Colorado address that claimed the qualified business income deduction and the total amount of qualified business income deductions from Tax Years 2018 to 2022, based on IRS data.

Exhibit 9
Number of Federal Returns Filed Using a Colorado Address that Claimed the Qualified Business Income Deduction and Total Amount of Qualified Business Income Deductions, Tax Years 2018 to 2022



Source: Office of the State Auditor analysis of Internal Revenue Service Statistics of Income for Tax Years 2018 through 2022.

Exhibit 10 shows the number of federal returns that were filed using a Colorado address that claimed the qualified business income deduction, the total amount of qualified business income deductions, and our estimate of the deductions' revenue impact to the State, for various AGI groups for Tax Year 2022, which was the most recent year of data available.

Exhibit 10
Number of Federal Returns Filed Using a Colorado Address that Claimed the Qualified Business Income Deduction and Total Amount of Qualified Business Income Deductions, by Adjusted Gross Income, Tax Year 2022

	Size of Adjusted Gross Income					
	Total	$1 to $25,000	$25,000 to $100,000	$100,000 to 500,000	$500,000 to $1,000,000	$1,000,000 or more
Total Returns	2,972,380	692,960	1,405,950	773,950	35,450	16,050
Number of Returns Claiming Qualified Business Income Deduction	599,030	39,020	238,220	287,150	22,740	11,900
Percent of Total Returns[1]	20%	1%	8%	10%	1%	<0.5%
Percent of Returns in AGI Group	N/A	6%	17%	37%	64%	74%
Total Dollar Amount of Qualified Business Income Deductions	$4.64 billion	$26.86 million	$579.62 million	$1.95 billion	$537.67 million	$1.54 billion
Estimated State Revenue Impact[2]	Up to $136.23 million	$1.18 million	$25.50 million	$85.90 million	Up to $23.66 million	Likely little to no revenue impact

Source: Office of the State Auditor analysis of Internal Revenue Service Statistics of Income for Tax Year 2022.
[1] Percentages are based on a total of 2,972,380 federal returns filed with a Colorado address. Note that this table does not include about 48,000 returns that filed a return with under $1 of adjusted gross income. The Qualified Business Income Deduction was not claimed on any of those returns.
[2] To calculate the estimated state revenue impact, we multiplied the total dollar amount of Qualified Business Income Deductions in each AGI group by the 2022 Colorado income tax rate of 4.4 percent. These estimates have several limitations. First, for the total and all AGI groups, we were unable to determine which taxpayers had to add back their Qualified Business Income Deduction because of the pass-through entity from which they are getting the deduction made a SALT Parity Act election, which has the potential to decrease the state revenue impact in any of the AGI groups and the overall total. Second, we were unable to determine the revenue impact of the $500,000 to $1 million income group because we do not know the federal filing status of the claimants, and single filers with $500,000 in AGI are required to add back their Qualified Business Income Deduction but joint filers with over $500,000 but under $1 million in AGI are not. We estimated the maximum by multiplying the total dollar amount of Qualified Business Income Deductions in that AGI group by the Colorado 2022 income tax rate of 4.4 percent. Finally, deductions claimed by taxpayers with $1 million or more in AGI should generally not have a revenue impact on the State since taxpayers with over $1 million in AGI who claimed the deduction on their federal return are required to add it back when calculating Colorado taxable income; the exception to this is taxpayers in this AGI group who filed a federal Schedule F (for farming income), so federal deductions claimed by taxpayers in this AGI group who filed a Schedule F could have a revenue impact on the State.

Deduction for Charitable Contributions

Individual taxpayers who do not itemize their deductions but make charitable contributions are allowed to claim a deduction for the amount contributed, not in excess of $300 (or $600 for joint filers), if the contribution was made to a qualifying organization [26 USC 170(p)]. Department data shows that in Tax Year 2020, this deduction was claimed on 680,476 federal returns of taxpayers who also filed Colorado full-year resident returns for a total of $167.3 million in deductions. Colorado conforms with the federal charitable contribution deduction for taxpayers who do not itemize deductions. We estimate that the revenue impact to the State associated with taxpayers claiming the federal deduction is about $7.6 million. Statute [Section 39-22-104(4)(m), C.R.S.] provides an additional state-level charitable contribution deduction for taxpayers who did not itemize their deductions on their federal returns that allows for a potentially larger deduction than at the federal level. The Colorado deduction is only allowed for the aggregate amount of charitable contributions over $500. According to Department data, in Tax Year 2022, the Colorado Charitable Contribution Deduction was claimed on 397,734 returns for a total revenue impact of about $40.9 million to the State.

Personal Exemptions

In tax years prior to 2018, taxpayers could also claim deductions for personal exemptions for themselves and eligible dependents. The Tax Cuts and Jobs Act (TCJA) reduced the personal exemption amount to $0 for Tax Years 2018 through 2025, effectively making personal exemptions unavailable during those years; however, without new federal legislation personal exemptions will again be available beginning in Tax Year 2026. Eligible dependents are qualifying children and qualifying relatives, and IRS guidance provides tests that must be met in order for dependents to be considered qualifying children or relatives. For example, a married couple that files a joint return and has two minor children that live with them during the year and do not provide at least half of their own support could claim four personal exemption deductions. Personal exemptions are phased out when taxpayers have over a certain amount of AGI. For Tax Year 2017, the personal exemption amount was $4,050 per eligible person and began phasing out for taxpayers filing a single return when they had $261,500 in AGI and for taxpayers filing a joint return when they had $313,800 in AGI.

Corporate Tax Deductions

According to Department data, in Tax Year 2021, there were 61,288 corporate returns filed in Colorado. These returns included a total of about $1.4 trillion in federal taxable income. After state adjustments were made, these returns collectively had about $10.7 billion in Colorado taxable income and corporations paid about $985.2 million in Colorado income tax.

A significant amount of the federal deductions allowed for businesses fall under 26 USC 162, which broadly states, "There shall be allowed as a deduction all the ordinary and necessary expenses paid or

incurred during the taxable year in carrying on any trade or business…" This phrase has been the subject of judicial and regulatory interpretation. Whether an expense is "ordinary and necessary" often depends on the facts and circumstances of a particular business. "Carrying on" is also an important phrase, as it requires that business activities have actually begun in order to deduct expenses; therefore, expenses related to starting up a business are generally not deductible and must be capitalized and recovered over time.

26 USC 162(a) explicitly provides that deductions are allowed for the following: "(1) a reasonable allowance for salaries or other compensation for personal services actually rendered; (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity." Many other types of expenses not explicitly listed in 26 USC 162 are allowed to be claimed as ordinary and necessary business expenses under 26 USC 162; many of these have been established as deductible through regulatory action or case law. **A list of these other ordinary and necessary business expenses, with descriptions, is included in Appendix E**. By using federal taxable income as its tax base, Colorado conforms with most of these deductions; however, when Colorado law has decoupled from federal business deductions, we note that in Appendix E.

Additionally, several other sections of the IRC provide deductions that can be claimed by businesses in a variety of industries, including, for example, amortization [26 USC 197], asset expensing [26 USC 179], charitable contributions [26 USC 170], and depreciation [26 USC 167 and 168]. **A list of these business deductions, which are available for many types of industries, is included in Appendix F.** By using federal taxable income as its tax base, Colorado conforms with most of these deductions; however, when Colorado law has decoupled from federal business deductions, we note that in Appendix F.

Federal law [26 USC 172] also allows corporations to claim a deduction for net operating losses. Colorado does not conform to the federal net operating loss deduction for corporations. Colorado statute [Section 39-22-304(2)(c), C.R.S.] requires that corporations add back their federal net operating loss deduction to federal taxable income when calculating Colorado taxable income. Statute then allows a deduction for the portion of the federal net operating loss that is allocated to Colorado. The Colorado Net Operating Loss Deduction is also limited to 80 percent of Colorado taxable income before the Colorado Net Operating Loss Deduction. If the deduction exceeds the taxpayer's taxable income, the deduction can be carried forward for up to 20 years. According to Department data, in Tax Year 2021, the federal net operating loss deduction was added back on 6,959 corporate returns for a total amount of about $159.5 billion added back. In that same year, the Colorado Net Operating Loss Deduction was claimed on 4,894 returns with a total of about $3.6 billion deducted, which resulted in a revenue impact of about $161.8 million to the State.

Corporations are allowed to claim additional "special deductions" when calculating federal taxable income, including dividends received deductions [26 USC 243, 245, and 245A], organizational expenditures [26 USC 248], and certain types of foreign source income [26 USC 250]. **These special deductions are described in Appendix G.** By using federal taxable income as its tax base, Colorado conforms with most of these deductions; however, when Colorado law has decoupled from federal special deductions, we note that in Appendix G.

The deductions discussed above apply to businesses across various industries. There are many types of businesses that operate in Colorado, such as farming, growing timber, producing oil and gas, extracting minerals, print publishing, and film and television production, that have special tax rules and deductions that apply to them, such as the ability to deduct expenses that are specific to their type of business, such as film and television production costs (normally capitalized), circulation expenditures (normally capitalized), and depletion. Since these are typically industry-specific deductions, we did not include a comprehensive list or discussion of them in this report.

Tax Liability

After individual taxpayers have calculated their federal taxable income, they apply the marginal federal tax rates to it to determine their tax liability. In Tax Year 2024, the rates range from 10 percent to 37 percent. Lower amounts (referred to as "tax brackets") of income are taxed at a lower rate, with the rate increasing on higher amounts of income. Anything that happens "after" federal taxable income for federal tax purposes (i.e., applying federal tax rates or claiming federal credits) does not directly impact the calculation of Colorado taxable income since federal taxable income is the starting point. However, federal tax rates can impact Colorado's economy and total tax revenue by increasing or decreasing taxpayers' after-tax income.

After corporations have calculated their federal taxable income, they apply the federal tax rate to it to determine their tax liability. The federal corporate income tax is imposed at a flat rate of 21 percent. It is important to note that corporations that have income from business activities both within and outside of Colorado do not typically pay Colorado income tax on their entire federal taxable income. Rather, these corporations apportion and allocate their income among the jurisdictions in which they earn income.

Credits

After determining their tax liability, taxpayers subtract the value of any credits they are eligible to claim from their tax liability. Like the calculation of tax liability, federal credits do not directly impact the calculation of federal taxable income or taxable income for state tax purposes. However, changes to certain federal credits may impact Colorado income tax revenue since there are a few Colorado income tax credits that are calculated based on a percentage of a similar federal credit. These are the Child and Dependent Care Expenses Income Tax Credit [Section 39-22-119, C.R.S.], Colorado Earned Income Tax Credit [Section 39-22-123.5, C.R.S.], and Colorado Minimum Tax Credit [Section 39-22-105(3)(b), C.R.S.]. **Additional details about how these credits work, how they are**

calculated based on federal credits, the state revenue impacts of the credits, and links to our office's evaluations of the credits are provided in Appendix H.

Federally Tax-Exempt Organizations

Colorado statute [Section 39-22-112(1), C.R.S.] provides that a "person or organization exempt from federal income taxation under the provisions of the internal revenue code shall also be exempt from the tax imposed by this article 22 [income tax] in each year in which such person or organization satisfies the requirements of the internal revenue code for exemption from federal income taxation…" Statute [Section 39-22-112(1), C.R.S.] further provides, "If the exemption applicable to any person or organization under the provisions of the internal revenue code is limited or qualified in any manner, the exemption from taxes imposed by this article 22 [income tax] shall be limited or qualified in a similar manner." Therefore, if organizations that operate in Colorado receive federal tax-exempt status, they also receive that status for Colorado income tax purposes and if they lose their federal tax-exempt status, they become subject to income taxes in Colorado.

Tax-exempt status under the IRC is largely determined under 26 USC 501. Common types of organizations that are exempt from federal income taxes include trusts created or organized in the United States that form a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of its employees or their beneficiaries that is described in 26 USC 401(a); charitable, religious, educational, scientific, etc., organizations; business leagues; and certain political organizations. Most organizations that are exempt under 26 USC 501(c)(3) (charitable, religious, etc. organizations), 501(c)(4), and 501(c)(9) are required to apply to the IRS for recognition of their tax-exempt status. **A list of the types of organizations that are exempt from federal income tax is included in Appendix I.**

Recent and Pending Changes to Federal Law that Could Have an Impact on Colorado Taxable Income

Tax Cuts and Jobs Act of 2017

The TCJA was the largest federal tax overhaul since 1986 and made substantial changes to how federal taxable income is determined for both individual and corporate taxpayers and the federal tax rates. The stated policy goals of its advocates in the House Ways and Means Committee Report were to improve simplicity of the tax code by broadening the tax base and lowering tax rates, as well as stimulate economic growth by reducing taxes. While these changes resulted in a reduction in federal tax revenue, they increased Colorado tax collections. This is because state taxes are based on federal taxable income, which was broadened by the TCJA through the elimination of or limitations on certain exemptions and itemized deductions, while state tax rates remained unchanged. In particular, the elimination of personal exemptions, increase in the standard deduction (which almost doubled for most taxpayers), and limitations on itemized deductions led to significant changes in taxable

income for individual filers. Exhibit 11 provides the total amount Colorado taxpayers claimed in personal exemptions, standard deductions, and itemized deductions in Tax Year 2017, the year before the TCJA became effective, and Tax Year 2018, the first year it applied. As shown, these changes lead to a significant increase in the amount Colorado taxpayers claimed in standard deductions, while reducing the amount of itemized deductions claimed, and eliminating personal exemptions. Based on these changes, in total, Colorado taxpayers deducted about $7.8 billion less from their federal taxable income (FTI) when the TCJA became effective.

Exhibit 11
Changes in Colorado Personal Exemption and Deduction Amounts and Estimated State Revenue Impact, Tax Year 2017 to 2018

	Tax Year 2017	Tax Year 2018	Change
Personal Exemption	$17.66 billion	$0	-$17.66 billion
Standard Deduction	$12.93 billion	$33.50 billion	$20.57 billion
Itemized Deductions	$22.75 billion	$12.01 billion	-$10.74 billion
Total	$53.34 billion	$45.51 billion	-$7.83 billion
Estimated State Revenue Impact[1]	-$2.47 billion	-$2.11 billion	+$362.53 million

Source: Office of the State Auditor analysis of Colorado Department of Revenue Individual Statistics of Income data.
[1]State revenue impact estimates were calculated by multiplying the total amounts deducted by 4.63 percent, the State's income tax rate in Tax Years 2017 and 2018. This method provides an approximation of the revenue impact to the State, but does not account for some factors that likely had an impact on state tax revenues, such as taxpayers whose deductions exceeded their federal gross income and changes due to inflation and population growth.

Many of the tax changes for individuals included in the TCJA were temporary and are set to expire at or before the end of 2025. Summaries of these provisions and the potential impact of their expiration on Colorado follow, with the most significant provisions highlighted in dark blue. This section discusses expiring TCJA provisions in the order in which they are claimed/applied on federal income tax forms (e.g., above-the-line, below-the-line), then discusses other expiring/changing federal tax provisions separately. Although this list of provisions is not exhaustive, we have included provisions identified by our review as having more significant potential impacts.

Congress has introduced, and the House has passed legislation (House Resolution 1), tentatively titled the "The One, Big, Beautiful Bill," to extend the TCJA and potentially make other significant federal tax changes. The information below does not reflect proposed changes in HR 1. Changes to federal law enacted after June 1, 2025 will be included in subsequent reports issued by our office.

Expiring Tax Cuts and Jobs Act Individual Income Tax Provisions

Moving Reimbursement Exclusion Limited

Description of Provision:

Prior to the TCJA, qualified moving expense reimbursements from an employer to the employee/taxpayer were excludible from an employee's wage income, and therefore not subject to income or payroll tax; however, the TCJA suspended this exclusion for most taxpayers. Until the TCJA provisions expire, employer reimbursements for moving expenses are only excludible from income and wages for members of the Armed Forces who relocated pursuant to a military order for a permanent change in station [26 USC 132(f) and (g)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of moving expense reimbursements under 26 USC 132(g). If this TCJA provision expires, taxpayers will once again be eligible for the exclusion and FTI will decrease, likely causing a decrease in Colorado's tax revenue. While we could not identify a state revenue impact estimate for this provision, the Congressional Budget Office estimated that this provision would increase federal revenue $569 million in FY 2026 if it were extended; therefore, if it were to expire the state revenue impact is likely to be relatively small.

Combat Zone Tax Benefits for Members of Armed Forces in the Sinai Peninsula

Description of Provision:

Typically, combat zones are designated by the President in an Executive Order. Under the TCJA, the Sinai Peninsula is statutorily presumed to be a combat zone, which entitles members of the armed forces serving there to several tax benefits, including income and payroll tax exemptions and special estate tax rules. This designation followed an escalation of violence in the area by ISIS-affiliated militant groups in 2015 [Pub. L. No. 115-97, § 11026].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

If this provision expires, FTI would increase to the extent that there are Colorado taxpayers who are armed forces members serving in the Sinai Peninsula. There are currently 465 US contingent personnel serving with The Multinational Force and Observers, whose operations are entirely centered in the Sinai Peninsula between Egypt and Israel to monitor the terms of the Egypt-Israel Peace Treaty of 1979. While we are not able to ascertain the number who are Colorado taxpayers, it is likely that the expiration or extension of this benefit will not have a significant revenue impact in Colorado. The Congressional Budget Office estimates that this provision will reduce federal revenues by $1 million in FY 2026 if it is extended.

Bicycle Commuter Reimbursement Eliminated

Description of Provision:

Prior to the TCJA, up to $20 per month of qualified employer reimbursements for bicycle commuting expenses were excludible from wage income, and therefore, not subject to income or payroll tax. Employer reimbursements for bike commuting expense are considered wage income until TCJA provisions expire [26 USC 132(f)(1) and (8)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of fringe benefits under 26 USC 132. If the exclusion for bicycle commuter reimbursement is reinstated, it will reduce taxpayer FTI and state tax collections. The federal Joint Committee on Taxation has estimated that if this reimbursement is permanently eliminated, it would increase federal revenues by $14 million in FY 2026 ($218 million over 10 years).

Moving Expense Deduction Limited

Description of Provision:

The TCJA limited deductions for employment-related moving expenses. This deduction was previously available to all taxpayers, who would be eligible for the moving expense deduction if:

- Moving costs were not reimbursed by an employer,
- The new work location was a certain distance from the taxpayer's former home, and
- The taxpayer worked a minimum number of weeks in the first 1 or 2 years after the move.

However, under the TCJA, this deduction is suspended for most taxpayers and only members of the Armed Forces can claim a deduction for moving expenses incurred as a result of work at a new location [26 USC 62(a)(15) and 217].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of moving expenses under 26 USC 217. Limiting the moving expense deduction increased FTI for taxpayers who could no longer claim the deduction. If this limitation expires, FTI should decrease because more taxpayers would be able to claim the deduction, which would reduce Colorado tax collections. While we could not identify a state estimate for this limitation, the federal Joint Committee on Taxation estimates that the expanded eligibility to claim the deduction will increase federal income tax revenues by $1.1 billion in FY 2026 if it expires, therefore this change would likely have a relatively small state revenue impact.

Standard Deduction Increase (Potential for Significant Impact)

Description of Provision:

The standard deduction reduces taxable income and ensures that only households with income above certain thresholds will owe income tax. The TCJA almost doubled the standard deduction, from $13,000 to $24,000 for joint filers and from $6,500 to $12,000 for single filers in Tax Year 2018. The amounts are indexed to inflation. In Tax Year 2025, the federal standard deduction is $15,000 for single filers, $30,000 for joint filers, and $22,500 for individuals filing as heads of households. If this provision expires, standard deduction amounts will revert to their pre-TCJA levels and then be adjusted for inflation [26 USC 63(c)(7)]. The Congressional Budget Office estimates that this provision would have a $73.2 billion federal revenue impact in FY 2026 if permanently extended.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado generally conforms to the federal definition of taxable income, including the federal standard deduction. However, taxpayers who have a federal AGI equal to or exceeding $300,000 must add back the amount of federal deductions (standard or itemized) that exceed $12,000 if filing a single return or $16,000 if married and filing jointly. If this provision expires as scheduled, without other corresponding changes to the IRC, taxpayers' standard deductions would decrease and FTI would increase substantially, which would increase the starting point for calculating Colorado taxable income and Colorado tax collections. In 2018 (the most recent year for which a specific estimate is available), Legislative Council staff economists estimated that for taxpayers who would have claimed the standard deduction with or without the TCJA, the larger standard deduction would reduce Colorado income tax liability by $255 for individuals and by $509 for joint filers.

In addition to their impact on taxable income, the higher standard deduction amounts from the TCJA also caused an increase in the number of taxpayers in Colorado that claimed the standard deduction instead of itemizing deductions. According to Department of Revenue data, the percentage of Colorado single filers who took the standard deduction increased from 77 percent in Tax Year 2017 to 88 percent by Tax Year 2020 and the number of joint filers who took the standard deduction increased from 46 percent to 81 percent over the same time period. The average standard deduction taken per return for single, joint, and head of household taxpayers combined increased from $8,256 in Tax Year 2017 to $16,112 in 2020, while the total amount of standard deductions taken by Coloradans increased from $12.9 billion to $36.3 billion over the same time period. Additionally, as provided in Exhibit 11 above, in 2018, the first year the TCJA was in place, the total amount of standard deductions claimed by Colorado taxpayers increased by about $20.57 billion with itemized deductions decreasing by about $10.75 billion. If the TCJA provisions related to the standard deduction expire it would likely cause a corresponding shift back to taxpayers claiming more in itemized deductions and less in standard deductions. Overall, this would lead to a significant increase in taxable income for Colorado taxpayers.

Note: Colorado allows residents who do not itemize deductions for federal tax purposes to subtract the amount of their charitable contributions in excess of $500. It appears that because of the increased number of taxpayers taking the standard deduction following the implementation of the TCJA, the amount of qualifying charitable contribution deductions increased significantly, jumping from $12.3 million in 2016 to $41.0 million in 2018. If the expanded standard deduction expires, more people may itemize and claim the federal charitable contribution deduction as opposed to the state-level subtraction, which would enable them to deduct the full value of their charitable contributions. (Unless, however, the taxpayer were to make a contribution exceeding 50 percent of AGI. According to a Tax Policy Center analysis of IRS data, the vast majority of itemizing taxpayers contribute a much smaller percentage of their income, often between 2 and 5 percent.)

State and Local Tax (SALT) Deduction Capped (Potential for Significant Impact)

Description of Provision:

Under prior law, taxpayers could claim deductions for all of their state and local property taxes and the larger of either income or sales taxes. The TCJA established a $10,000 cap on the itemized deduction for state and local income, sales, and property taxes for individual taxpayers (referred to as the "SALT cap"). The $10,000 cap is set to expire at the end of 2025 and all eligible state and local taxes will be deductible at the federal level [26 USC 164(b)(6)]. The federal Joint Committee on Taxation estimates that the current SALT deduction will decrease federal revenues by $22.6 billion in FY 2025 and the elimination of the SALT cap would decrease federal revenue by $144.7 billion in FY 2026.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado requires taxpayers to add back any state and local income taxes claimed at the federal level. The elimination of the SALT cap at the federal level would decrease FTI by allowing itemizers to deduct the full value of state and local income, sales, and property taxes. The impact on the State is uncertain; to the extent that taxpayers (likely high-income earners) are able to deduct the full amount of their property taxes, which are not subject to the state addback, tax collections could be reduced. According to IRS data, in Tax Year 2022, 313,550 Colorado filers claimed a total of $4.9 billion in state and local income tax deductions, while 23,980 filers deducted a total of $43.8 million in state and local general sales taxes.

In response to the TCJA's cap on state and local tax deductions, Colorado created a new pass-through entity (PTE) tax, known as the SALT Parity Act. S corporations or partnerships may annually elect to be subject to tax at the entity level, rather than through its owners through the individual income tax code. Since the federal cap on state and local deductions only applies to the individual income tax and not entity-level taxes, taxpayers who elect to be taxed at the entity level can deduct the full amount of their state and local taxes. This "workaround" reduces taxpayers' federal tax liability but does not reduce state tax revenue. If the SALT cap expires, the PTE tax does as well because, according to statute, this election "is only allowed in an income tax year where there is a limitation on the deductions allowed to individuals under section 164 of the internal revenue code" [Section 39-22-343(2), C.R.S.].

According to the Department of Revenue, as of December 3, 2024, there were 20,185 Partnerships and S Corporations that made the SALT Parity Act election in Tax Year 2023 and 17,958 of those returns had a net tax liability. (Note: Data may be incomplete due to fiscal year filers that had not yet filed at the time this data was extracted.) If the SALT cap expires and the SALT Parity Act election is no longer allowed, the Department of Revenue does not anticipate any administrative issues from the shift of pass-through entities back to the individual income tax code since the election is made on an annual basis.

Mortgage Interest Deduction Limited (Potential for Significant Impact)

Description of Provision:

Prior to the TCJA, taxpayers could deduct interest paid on the first $1 million of mortgage debt for a primary and/or secondary residence plus the interest on up to first $100,000 in home equity debt. TCJA limited the deductibility to the interest paid on the first $750,000 of mortgage debt on primary residences only for new loans made after December 15, 2017 and eliminated the deductibility of interest for home equity debt [26 USC 163(h)(3)(F)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of personal interest, including the limitation of the deductions for mortgage interest under 26 USC 163 (h)(3)(F). A lower cap on the mortgage interest deduction broadened the tax base. If this provision expires, FTI should decrease, along with state tax collections. We do not have a state-level estimate for the revenue impact of this provision; however, it could be significant. According to IRS data, in Tax Year 2022, 287,450 Colorado filers claimed $3.98 billion in home mortgage interest deductions, which based on the State's 4.4 percent income tax rate, could have reduced tax revenue by about $175 million. If the current limitations on this deduction expire, the U.S. Treasury Department estimated that the federal revenue impact of the deduction would increase from $30.9 billion in FY 2025 to $67.3 billion in FY 2026, a 118 percent increase. Although the potential reduction in state tax revenue may not be proportionate to the federal revenue impact, the federal estimates indicate that the impact to the State could be large as well.

Charitable Contributions Deduction Limit Increased

Description of Provision:

The TCJA increased the limit for cash donations ("cash" includes payments made by check, electronic funds transfer, debit/credit card, among others) to public charities from 50 percent to 60 percent of a taxpayer's AGI. Prior to the TCJA, cash contributions to public charities were generally limited to 50 percent of the taxpayer's AGI [26 USC 170(b)(1)(G)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of charitable contributions. If the increased deduction cap expires, FTI will increase, which should increase Colorado tax collections. According to IRS data, in Tax Year 2022, 256,140 Colorado filers took $3.8 billion in charitable contribution deductions, which based on the state tax rate of 4.4 percent, could have reduced state revenues by about $168.1 million. We were not able to identify a state-level revenue estimate if the deduction limit is reduced, but it would likely not have a significant impact. The Congressional Research Service has noted that the increased deduction limit was favorable to charitable contributions but affects few taxpayers; the charitable deduction as a share of income was 6 percent in 2021.

Note: Colorado statute [Section 39-22-104 (3) (p.5) C.R.S.] requires taxpayers who have a federal AGI equal to or exceeding $300,000 to add back the amount of federal deductions (standard or itemized) that exceed $12,000 if filing a single return or $16,000 if married and filing jointly. To the extent that a taxpayer's charitable contributions exceed this limit, they would be required to add back deducted charitable contributions when calculating Colorado taxable income.

Personal Casualty Loss Deduction Limited

Description of Provision:

Federal code provides a deduction for uninsured casualty and theft loses of more than $100 each, to the extent that total losses during the year exceed 10 percent of the taxpayer's adjusted gross income. The TCJA created a new limitation that taxpayers can only claim a deduction for uninsured personal casualty losses associated with a disaster declared by the President. Prior to the TCJA, taxpayers could claim an itemized deduction for casualty losses regardless of whether the losses resulted from a federally declared disaster [26 USC 165(h)(5)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal deduction for losses. If this limitation expires, FTI should decrease, along with state tax collections. While we could not identify a state-level estimate for the revenue impact of this expiring provision, the federal Joint Committee on Taxation estimated this deduction would cost the federal government $100 million in FYs 2024 and 2025, and grow to $500 million in FY 2026 after the limitation expires, which indicates that the deduction is claimed only to a limited extent and that this change would have a relatively small impact on state tax revenue.

Wagering Losses Deduction Limited

Description of Provision:

Gambling winnings are often paid in cash. According to Bloomberg Law, Congress created a limitation on the losses that a gambler may deduct in order to encourage reporting of this income; taxpayers who itemize their deductions can deduct gambling losses, provided they do not exceed winnings included in gross income. However, federal tax courts had determined that professional gamblers could deduct non-wagering expenses (such as transportation to and from the casino) in excess of net gambling winnings.

The TCJA disallowed this practice and clarified that the limitation on losses applies to any deductible expenses incurred in carrying on the gambling activity. This provision was described by a House of Representatives Committee report as intended "to clarify that the limitation on losses from wagering transactions applies not only to the actual costs of wagers incurred by an individual, but to other expenses incurred by the individual in connection with the conduct of that individual's gambling activity" [26 USC 165(d)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal deduction for losses. If this provision expires, FTI will decrease but the impact on Colorado will likely be small; the Congressional Budget Office estimated the limitation would generate just $1 million in FY 2026 and $5 million in FY 2027 if extended.

Miscellaneous Expenses Deduction Elimination

Description of Provision:

Prior to the TCJA, taxpayers who itemize deductions could deduct miscellaneous expenses to the extent that such expenses collectively exceed 2 percent of their AGI. Eligible expenses included unreimbursed employee expenses, tax preparation fees, credit and debit card convenience fees, fees to collect interest and dividends, and certain other expenses. The TCJA eliminated this deduction. However, certain unreimbursed employee business expenses may be deductible [26 USC 67(g)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of miscellaneous itemized deductions. If this provision expires, miscellaneous expenses will again be deductible (to the extent that such expenses collectively exceed 2 percent of their AGI) and FTI will decrease, along with state tax collections. Based on federal tax data, in Tax Year 2017, prior to the elimination of the deduction, Colorado taxpayers deducted about $1.76 billion in miscellaneous deductions, which based on the state income tax rate of 4.63 at that time, could have reduced state tax revenue by about $81.4 million. If this provision is reinstated, there could be a similar revenue impact to the State; however, the impact would also be dependent on whether other provisions in the TCJA, such as the increased standard deduction expire as well.

No Limit on Total Itemized Deductions

Description of Provision:

Prior to the TCJA, for taxpayers with AGI above certain thresholds who itemized deductions, the total amount of itemized deductions was reduced by 3 percent of the amount by which their AGI exceeded the threshold. In Tax Year 2017, the AGI thresholds were $261,500 for single taxpayers and $313,800 for taxpayers filing a joint return. This limit was not applied to certain itemized deductions, including the deduction for medical and dental expenses, the deduction for investment interest, the deduction for casualty or theft losses, or the deduction for wagering losses. This limitation of itemized deductions is often referred to as "the Pease Limitation" (named after the former U.S. House Representative Donald Pease). The TCJA removed this limit for Tax Years 2018 through 2025 [26 USC 68(f)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal provision imposing a limit on itemized deductions; therefore, if this provision is reinstated in Tax Year 2026 as currently schedule, it would generally cause an increase in state tax collections. The U.S. Department of Treasury estimated that if the deduction limit was restored it would increase federal revenues by about $12 billion in Fiscal Year 2026 and $17 billion in Fiscal Year 2027.

We did not identify a state-level revenue impact estimate for this provision. However, because Colorado already limits the amount taxpayers with higher incomes can deduct, the revenue impact to the State would likely be less significant than at the federal level. However, this change could impact Colorado's Healthy School Meals for All Program. Specifically, beginning in Tax Year 2023, Colorado statute [Section 39-22-104(3)(p.5), C.R.S.] requires that taxpayers with $300,000 or more in federal AGI addback to their federal taxable income when calculating Colorado taxable income any amount of itemized deductions or the standard deduction claimed that is over $12,000 for single filers and $16,000 for joint filers. Revenue generated from this addback is used to fund the Healthy School Meals for All Program and generated $109.2 million in Tax Year 2023, according Legislative Council economic staff. To the extent that federal itemized deductions are reduced by the limit being reinstated, the revenue generated from the Colorado addback for itemized deductions may decrease, which could impact funding for the Healthy School Meals for All Program. Following the expiration of the TCJA, Proposition FF revenue is forecast to decline to $94.7 million in FY 2026 and $82.4 million in FY 2027. Part of this decrease could potentially be offset by the reinstatement of miscellaneous itemized deductions that were disallowed for Tax Years 2018 through 2025 and are currently scheduled to be allowed beginning in Tax Year 2026. Those miscellaneous deductions were discussed immediately above and are further described in Appendix D.

Deduction for Pass-Through Business Income (199A Deduction)

Description of Provision:

To equalize reductions in the corporate tax burdens for businesses that file through the individual income tax code (e.g., partnerships, S corporations), the TCJA created a deduction equal to 20 percent of qualified business income (QBI). The deduction is limited to the greater of 50 percent of the W-2 wages paid by the business, or 25 percent of W-2 wages plus 2.5 percent multiplied by the value of depreciable property. QBI is the net amount of qualified items of income, gain, deduction, and loss from qualified trade or business [26 USC 199A]. The deduction is not available to businesses in certain trades, including health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, investment services or investment management services, and trading of securities, partnership interests, or commodities.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado largely conforms with the federal deduction for QBI. However, a state-level modification is required for certain single filers with AGI over $500,000 and joint filers with AGI over $1 million, who must add back the full amount of the federal deduction. This addback does not apply if the taxpayer is required to file a schedule F (for farming and ranching) with their federal return. **This addback is set to expire on January 1, 2026 [Section 39-22-104(3)(o), C.R.S.], which coincides with the expiration date of the federal deduction**.

Additionally, if a partnership or S corporation elects to be taxed at the entity level for Colorado income tax purposes, all of its partners or shareholders must add back to their Colorado return all qualified business deductions claimed under 26 USC 199A on their federal return.

If this federal provision expires, FTI would increase along with state tax revenue. According to the federal Joint Committee on Taxation, this provision has an estimated federal revenue impact of $66.1 billion in Fiscal Year 2025 and $26.9 billion in Fiscal Year 2026 if it expires. We did not identify a state-level revenue impact estimate if this provision were to expire, but since Colorado already requires taxpayers to add back some of the federal deduction the state impact may be less significant than at the federal level.

Personal Exemptions Eliminated (Potential for Significant Impact)

Description of Provision:

Personal exemptions reduce taxable income and ensure that only income above a basic level is subject to tax. They also link income tax liability to family size, reducing taxes for families with more dependents. Under the TCJA, the personal and dependent exemption amounts were reduced to zero with the revenue gain and impact on lower income taxpayers offset by the expanded standard deduction and expanded child tax credit. At the end of 2025, personal exemptions are scheduled to revert to pre-TCJA levels and then be adjusted for inflation. The personal exemption would have been $4,150 in 2018 for each taxpayer, spouse, and eligible dependent [26 USC 151 (d)(5)]. According to the Congressional Budget Office, permanently repealing personal exemptions would increase federal revenues by an estimated $133.7 billion in FY 2026.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado generally conforms to the federal definition of taxable income and conforms to the federal definition of dependent by reference to the personal exemptions for dependents. The effective repeal of federal personal exemptions increased taxable income and state tax collections. If the federal provision that effectively eliminated personal exemptions expires, FTI should decrease, which if not coupled with other changes to TCJA provisions, such as the adjustment to the standard deduction, would cause a significant decrease in Colorado tax collections. Although we do not have a current estimate of the impact to state revenue if this provision expires, according to Department of Revenue data, prior to the elimination of personal exemptions in 2017, 2.2 million Colorado returns claimed $17.7 billion in personal exemptions, for an average of $7,974 per return. When the 2017 Colorado income tax rate of 4.63 percent is applied, this comes to an estimated $817.8 million decrease in state tax revenue and a $369 Colorado tax benefit per return (although there are other factors that would influence the actual amount).

Child Tax Credit (CTC) Increased and Expanded

Description of Provision:

The TCJA temporarily increased the maximum child tax credit (CTC) amount to $2,000. Lower income taxpayers may be eligible to receive some or all of the credit as a refundable credit ("the additional child tax credit"). The credit's phase-out threshold was increased to $200,000/$400,000 for single/joint filers and an additional, nonrefundable $500 credit was established for any other dependent the taxpayer can claim (e.g., children over 16, which are not eligible to be claimed under the CTC or full-time students). If this provision expires, the CTC will revert to its pre-TCJA structure with a maximum credit amount of $1,000 that begins to phase out at $75,000/$110,000 for single/joint filers. The credit for other dependents will also expire. The phase-out rate for both versions of the credit is the same: It is reduced by $50 for every $1,000 above the applicable phase-out threshold [26 USC 24(h)]. The U.S. Department of Treasury estimated that the child tax credit would reduce federal revenues by $63.7 billion in FY 2024 and $65.4 billion in FY 2025.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado offers a refundable CTC to individuals with at least one child under the age of six who claim, or could have claimed the federal credit. Colorado taxpayers claimed $89.0 million of state child tax credits in 2022. The amount of the state credit was a percentage of the federal credit through 2023. Starting on January 1, 2024, the state CTC is a set amount that is based on the taxpayer's federal adjusted gross income. Therefore, a change to the federal credit should not directly affect the value of the state credit, although changes that affect taxpayer federal AGI calculations could have an indirect impact on the amounts claimed for Colorado's CTC.

Alternative Minimum Tax Exemption and Phase-out (Potential for Significant Impact)

Description of Provision:

The individual Alternative Minimum Tax (AMT) was originally implemented in 1969 to ensure that high income earners who significantly benefit from certain federal tax provisions pay a minimum amount of tax relative to their income. Specifically, the federal AMT is calculated separately from, and paid in addition to, taxpayers' regular income tax to the extent that it exceeds their regular federal tax liability. To calculate the AMT, an individual first adds back various tax items, including personal exemptions and certain itemized deductions to regular income, which becomes the income base for the AMT.

The current AMT is imposed at 26 percent of an individual's alternative minimum taxable income, with a higher rate of 28 percent applied to taxpayers with alternative minimum taxable incomes over $232,600 in 2024. The TCJA retained the individual alternative minimum tax (AMT) but raised the alternative minimum taxable income exemption amounts to $109,400 for joint filers and $70,300 for single filers, up from $86,200 and $55,400, respectively. The phase-out threshold was increased to $1,000,000/$500,000 for joint/single filers, up from $164,100/$123,100. The exemption/phase-out thresholds were indexed for inflation; for 2024, the AMT exemption amounts are $85,700/$133,300 for single/joint filers. The 2024 phase-out thresholds are $578,150/$1,156,300 for single/joint filers.

If this provision expires, the AMT exemption and exemption phase-out will revert to pre-TCJA levels and then be adjusted for inflation [26 USC 55]. If extended, the Congressional Budget Office estimates that this provision will have a $77.6 billion federal revenue impact in FY 2026 and a $138.8 billion impact in FY 2027.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

For individuals who are subject to the federal AMT, Colorado requires an addition to income for the amount by which AMT income exceeds regular FTI. Colorado AMT income is largely based on federal AMT income with the exception of an additional subtraction for any state and local bond interest.

According to the Congressional Research Service, the increased exemption amounts for the federal AMT reduced the number of people subject to the tax from 3.3 percent of taxpayers in 2017 to 0.2 percent in 2021, which reduced the number of Colorado filers required to make the AMT addition. If the increased federal AMT exemption expires, more taxpayers will owe federal AMT and make the addition to Colorado income, which would likely cause a significant increase in state tax collections. In 2017, the alternative minimum tax was applied to 84,960 Colorado filers and generated $489 million in revenue. In 2018, after the implementation of the TCJA, 5,310 Colorado filers paid $83 million in alternative minimum tax.

Achieving a Better Life Experience (ABLE) Account Changes

Description of Provision:

ABLE Account Contributions—ABLE accounts are tax-favored savings accounts to encourage qualifying disabled individuals to save money for certain disability-related expenses without losing eligibility for federal means-tested programs like Medicaid. Generally, in a given year, an ABLE account cannot receive aggregate contributions in excess of the annual gift tax exclusion amount ($18,000 in 2024). The TCJA allows individuals who are employed to contribute an additional amount, above the gift tax exclusion amount [26 USC 529A(b)(2)(B)].

ABLE Account Saver's Credit—Designated beneficiaries who make qualified contributions to their ABLE account can qualify for a nonrefundable saver's credit of up to $1000 [26 USC 25B(d)(1)(D)].

529 to ABLE Account Rollover—Prior to the TCJA, all rollovers from 529 accounts to ABLE accounts were subject to taxation. The TCJA provided that rollovers from a 529 account to an ABLE account that are less than or equal to the annual ABLE contribution limit are not subject to income taxation, provided that the accounts have the same designated beneficiary. The portion of the rollover in excess of the annual contribution limit is taxable [26 USC 529(c)(3)(C)(i)(iii)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to federal rules related to ABLE accounts, except with regard to rollovers from 529 accounts, which are subject to recapture at the state level. Starting in Tax Year 2023, the State allows taxpayers to deduct the amount they contribute to ABLE accounts up to $20,000/$30,000 per beneficiary for single/joint filers, adjusted annually for inflation. (See Section 39-22-104(4)(i)(II)(B), C.R.S.) Contributions to ABLE Accounts are not deductible for federal tax purposes, but funds distributed from ABLE accounts are excluded from FTI as long as all funds distributed from the account are used for qualified expenses. The state deduction was schedule to expire at the end of Tax Year 2025, but was recently extended until January 1, 2031 by Senate Bill 25-302.

If these federal provisions expire, FTI and state tax collections will be unaffected but, to the extent taxpayers claimed the Saver’s credit or increased their state-deductible contributions to ABLE accounts due to the increased contribution limit, taxpayer liability will increase. The Department of Revenue cannot provide taxpayer data on the ABLE Contribution Deduction for Tax Year 2023 (the first year it was available) until January 2026.

Expiring Tax Cuts and Jobs Act Individual Income Tax Provisions for Businesses

Full Expensing of Capital Expenses and Bonus Depreciation (Potential for Significant Impact)

Description of Provision:

The deduction for depreciation allows taxpayers to recover the cost of certain property over the life of the property. It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property and is deducted from the income of the business. A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization. The TCJA temporarily allowed full expensing (i.e., 100 percent bonus depreciation) for 5 years, until 2022. In other words, firms were able to deduct the full value of capital expenses from taxable income in the year the expense occurred. After 2022, bonus depreciation is scheduled to phase down ratably through the end of 2026 (i.e., 80 percent bonus depreciation for 2023, 60 percent for 2024, 40 percent for 2025, 20 percent for 2026 and no bonus depreciation for 2027 and all years following) [26 USC 168(k)]. According to the Congressional Budget Office, if this provision is extended, it would have a $98.5 billion in Federal Fiscal Year 2026, and $56.2 billion in Federal Fiscal Year 2027.

Effective Date of Change: Changed 1/1/2025, Changes 1/1/2026, Expires 12/31/2026

Potential State Impact:

Colorado conforms to the federal treatment of bonus depreciation for individual and corporate filers. If this provision expires, state FTI and tax collections will increase, as businesses will go from 20 percent bonus depreciation to returning to a standard depreciation schedule. In 2018, Legislative Council staff estimated that this would decrease state revenues initially before increasing revenues in later years. (Total corporate income tax changes were estimated to reduce state revenues by $26.7 million in FY 2018 and $22.2 million in FY 2019 and increase revenues by $17.6 million in FY 2020.) However, this revenue increase in later years from a reduced bonus depreciation percentage is relative to full expensing, not the standard depreciation schedule.

Meals and Entertainment Expenses

Description of Provision:

Prior to the TCJA, a business could deduct up to 50 percent of entertainment expenses directly related to the active conduct of a trade or business incurred immediately before or after a substantial and bona fide business discussion.

The TCJA generally eliminated the deduction for any expenses related to activities considered entertainment, amusement, or recreation. However, under the new law, taxpayers can continue to deduct 50 percent of the cost of business meals if the taxpayer (or an employee of the taxpayer) is present and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer, client, consultant, or similar business contact. If provided during or at an entertainment activity, the food and beverages must be purchased separately from the entertainment, or the cost of the food or beverages must be stated separately from the cost of the entertainment on one or more bills, invoices, or receipts [26 USC 274(k)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of entertainment expenses, except that for Tax Years 2024 through 2030, Colorado statute [Sections 39-22-104(3)(s)(I) and 304(2)(k)(I), C.R.S.] requires that taxpayers who claimed a deduction on their federal return for business meals add those back when calculating Colorado taxable income. We did not identify a state-level estimate on the potential impact of this provision. However, if this provision expires, FTI will likely decrease and Colorado tax collections will decrease due to taxpayers again being able to deduct entertainment expenses, except that Colorado taxpayers who deduct business meals at the federal level will still be required to add those deductions back to their taxable income when calculating Colorado taxable income through Tax Year 2030.

Qualified Opportunity Zones

Description of Provision:

The TCJA established the Opportunity Zone (OZ) tax incentives to spur private investment and economic activity in designated low-income communities. OZ investments provide several tax benefits to taxpayers, including (1) a temporary deferral of capital gains taxation if gains are reinvested in a qualified opportunity fund; (2) an increase in the investment basis (i.e., the initial amount of capital invested) if specific holding periods (5 or 7 years) are met; and (3) a permanent exclusion of the capital gains from income if investments in a Qualified Opportunity Fund (QOF) are held for at least 10 years (hence, these capital gains are not subject to taxation) After 2021, new investments no longer qualified for the 5-year and 7-year basis step-ups, but they are still eligible for the 10-year permanent exclusion.

The federal Joint Committee on Taxation has estimated that qualified OZ tax incentives will reduce federal income tax revenues by $13.2 billion from FY 2024-2026 [26 USC 1400Z-1 and 1400Z-2].

Effective Date of Change: Expires 12/31/2026

Potential State Impact:

Colorado conforms to the federal treatment of capital gains, which includes this provision's increase in investment basis (which reduces the capital gain) and permanent exclusion of capital gain. The ability to defer capital gains through OZ investments temporarily reduces taxable income; if this provision is not extended, any reinvested capital gains in a QOF will be realized on December 31, 2026. However, taxpayers will still be eligible for the permanent exclusion of capital gains from investments held for at least 10 years in QOF. Therefore, the expiration of this provision is likely to increase FTI and Colorado tax collections, although we did not identify a state-level revenue impact estimate.

According a 2023 report by the Treasury Department's Office of Tax Analysis, Colorado appears to have relatively more in-state investments attributable to the OZ program than other states. Through 2020, it was one of the top five states in terms of share of OZs receiving qualified investments as well as average qualified OZ property investment per Zone. The total amount of qualified OZ property in the state was $1.45 billion, or 3.8 percent of the $38.15 billion in qualified OZ property nationwide.

The federal Joint Committee on Taxation estimates that the expiration of the program would generate $29.7 billion in Federal FY 2027 as deferred gains become taxable. If we assume Colorado's share of the revenue gain is proportional to its share of OZ investments, the expiration of this provision could increase revenue by tens of millions of dollars.

The Office of Economic Development and International has active programming to support this incentive but states on its webpage that it is reducing it in anticipation of the December 2026 sunset date.

2025 Changing TCJA Provisions

A significant component of the TCJA involved changes to the taxation of international commerce and income earned abroad by multinational enterprises, including the elimination of tax on foreign dividends. On the whole, Legislative Council staff estimated in 2018 that this shift from a "worldwide" to "territorial" system of taxation would reduce taxable income for some corporations and, therefore, reduce state corporate income tax revenue. Several new provisions were crafted to encourage domestic activity while discouraging profit shifting to foreign subsidiaries and some are scheduled to change at the end of 2025.

Foreign-Derived Intangible Income Deduction

Description of Provision:

The TCJA allowed a deduction for certain foreign source income, known as foreign-derived intangible income (FDII) arising from a trade or business within the United States. This was meant to encourage multinational corporations to situate intellectual property in the U.S. and on-shore profits. The amount of deduction allowed is set to decrease by about 42 percent, from 37.5 percent to 21.875 percent, beginning in Tax Year 2026 [26 USC 250(a)(3)(A)].

Effective Date of Change: Adjusts after 12/31/2025

Potential State Impact:

Colorado conforms to the federal FDII deduction and the expected decrease in the FDII deduction will increase FTI and state tax collections. The Office of Tax Analysis within the U.S. Treasury Department estimated that the change in the FDII deduction percentage would reduce the amount of federal revenue foregone from $16.4 billion in FY 2025 to $11.2 billion in FY 2026, or a $5.2 billion increase.

However, the increase in state tax collections may be partially offset by Colorado's foreign source income exclusion [Section 39-22-303(10) C.R.S.] to the extent that the FDII deduction is allocated or apportioned to foreign source income. Although FDII is neither a class nor a category of foreign source income, the FDII deduction is allowed with respect to foreign source income. When allocating and apportioning a C corporation's income to Colorado, the foreign source income exclusion allows the corporation to exclude some of its foreign source income from Colorado income tax; the calculation of the excluded amount depends on whether the corporation claimed a federal deduction or tax credit for foreign taxes paid or accrued. The greater the amount of the foreign tax credit, relative to foreign source income, the more foreign source income will be excluded for Colorado income tax purposes. Therefore, to the extent that the FDII deduction is allocated to foreign source income that is eligible for Colorado's foreign source income exclusion, the decrease in the FDII deduction percentage could result in more foreign source income being eligible for the foreign source income exclusion, which could decrease state tax collections/have an offsetting effect to Colorado's conformity to the FDII deduction.

Given the small federal revenue impact, this change will likely have a relatively small impact on the State. Additionally, this deduction is a federal incentive for multinational businesses to situate more intangible property in the United States; however, we did not identify any information to determine whether the State's conformity with this provision has resulted in a direct economic benefit to the state or the potential impact to the State's economy if the provision expires.

Global Intangible Low-Taxed Income

Description of Provision:

The TCJA imposed a minimum tax on the income of U.S.-controlled foreign corporations. Corporations include in gross income certain foreign source income known as Global Intangible Low-Taxed Income (GILTI). A deduction is allowed for 50 percent of this income for tax years beginning after December 31, 2017 and before January 1, 2026, at which point the deduction percentage is scheduled to be reduced from 50 percent to 37.5 percent.

According to the Congressional Research Service, GILTI and FDII are related provisions and their economic effects depend on each other [26 USC 250(a)(3)(B)].

Effective Date of Change: Adjusts after 12/31/2025

Potential State Impact:

For tax years beginning on or after Jan. 1, 2022, Colorado conforms to the federal GILTI deduction under 26 USC 250(a)(1)(B).

Like with FDII, conformity to this provision is, to some extent, negated by Colorado's state-level exclusion for foreign source income in Section 39-22-303(10) C.R.S. GILTI is considered foreign source income for the purpose of this exclusion, but the extent to which the two interact depends on other variables, such as the amount of the foreign tax credit allowed to a taxpayer.

If this provision adjusts as scheduled, the reduced federal GILTI deduction will increase the amount of GILTI included in state taxable income and, therefore, increase state tax collections. We were not able to ascertain a state-level revenue estimate for this change. The Office of Tax Analysis within the U.S. Treasury Department estimated that the reduced tax rate on active income of controlled foreign corporations (which is constituted by the GILTI deduction and certain active CFC income) would fall from $37.1 billion in Federal FY 2025 to $34.1 billion in Federal FY 2026, or a $3 billion decrease. Therefore, a reduction in the amount of this income that taxpayers can deduct would potentially result in a modest increase in tax collections for states, although we did not identify an estimate specific to Colorado.

Other Federal Tax Provisions that Impact Federal Taxable Income and Expire in 2025 or 2026

We also identified the following federal tax provisions that impact the calculation of federal taxable income and expire in 2025 or 2026. These changes were not part of the TCJA.

Exclusion From Gross Income of Discharge of Indebtedness on Principal Residence

Description of Provision:

Typically, if a taxpayer has had a debt forgiven, the amount of forgiveness is considered ordinary income. This provision excludes from gross income the discharge of debt due to a federal bankruptcy case or when the taxpayer is insolvent. The Mortgage Forgiveness and Debt Relief Act of 2007 provided that debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure qualify for this relief, according to the Internal Revenue Service. The provision was subsequently extended several times, most recently in the Consolidated Appropriations Act of 2021. It applies to debt discharged after December 31, 2020 and before January 1, 2026 [26 USC 108 (a)(1)(E)].

The US Department of Treasury estimated that this provision reduced federal revenues by $220 million in Federal Fiscal Year 2023 and $140 million in FYs 2024 and 2025.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of income from the discharge of indebtedness [See Section 39-22-103 (5.3), C.R.S.]. If the federal provision excluding from federal gross income discharge of indebtedness due to mortgage restructuring or foreclosure expires, FTI will increase, along with state tax collections. Although we cannot estimate the impact of this provision's expiration to state tax revenue, given the relatively small estimated impact at the federal level, the impact to Colorado would like be relatively small as well.

Special Rule for Certain Discharges of Student Loans

Description of Provision:

The American Rescue Plan Act of 2021 established a broad but temporary student loan exclusion as a means to provide financial relief during the COVID-19 pandemic and ensuing recession [26 USC 108 (f)(5)]. According to IRS guidance, "Under this special rule, gross income does not include any amount which would otherwise be includible in gross income by reason of the discharge (in whole or in part) after December 31, 2020, and before January 1, 2026, of loans provided for postsecondary educational expenses, whether the loan was provided through the educational institution or directly to the borrower." The U.S. Treasury Department estimates that this expenditure reduced federal revenues by $110 million in FY 2024 and $130 million in FY 2025.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of income from the discharge of indebtedness. If the provision excluding discharge of indebtedness from student loans from gross income expires, FTI will increase, along with state tax collections; however, based on the limited estimated impact on federal revenues, the impact to the state will likely be small.

Exclusion for Certain Employer Payments of Student Loans

Description of Provision:

Under current law, employer-provided educational assistance is excluded from an employee's gross income, even though the employer's costs for this assistance are a deductible business expense. The maximum exclusion is $5,250 per taxpayer. From March 27, 2020 through December 31, 2025, employer-provided student loan payments are considered eligible educational assistance [26 USC 127(c)(1)(B)]. The U.S. Department of Treasury estimated that this tax expenditure reduced federal revenues by $1.8 billion in Federal FY 2024 and $1.9 billion in FY 2025.

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal exclusion of employer-provided education assistance from an employees' gross income [See Section 39-22-104(1.7)(c), C.R.S.]. If this provision expires, FTI would increase along with state tax collections. The additional revenue would likely be small.

Seven-Year Recovery Period for Motorsports Entertainment Complexes

Description of Provision:

Certain motorsports entertainment complex properties are allowed an accelerated, 7-year depreciation recovery period, instead of the typical 39 years for this type of property. A Motorsports entertainment complex is defined as a racing track facility permanently situated on land that hosts one or more racing events for automobiles, trucks, or motorcycles during the 36-month period after the first day of the month in which the facility is placed in service. The events must be open to the public for the price of admission. These special depreciation rules apply to the construction of new facilities or improvements to qualified property at existing facilities [26 USC 168(e)(3)(C)(ii) and (i)(15)]. According to the Congressional Research Service, supporters "argued that the benefit helps make motor sports facilities more competitive with sports facilities that are often subsidized by state and local governments."

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to the federal treatment of depreciation. If this provision expires FTI would increase for the select taxpayers who have benefited from it. Several motorsports entertainment complexes in Colorado have announced relocation plans or undergone development in recent years and could potentially benefit from this accelerated depreciation schedule.

However, the revenue gain for the State would likely be small; the federal Joint Committee on Taxation left this provision off their most recent tax expenditure report because its federal revenue impact fell below the de minimus amount of $250 million.

Look-Through Treatment of Payments Between Related Controlled Foreign Corporations Under the Foreign Personal Holding Company Rules

Description of Provision:

According to the Congressional Research Service, generally, "Income earned abroad by foreign-incorporated subsidiaries is taxed in full, not taxed at full rates, or not taxed at all. For passive income (such as interest income) and certain types of payments that can be easily manipulated to reduce foreign taxes, tax rules require this income earned by controlled foreign corporations (CFCs) to be taxed currently [i.e., in the same year it is earned]. This income is referred to as Subpart F income, reflecting the part of the tax code where treatment is specified. Credits against the U.S. tax imposed are allowed for any foreign taxes paid on this income, and are applied on an overall basis... Other income earned abroad by CFCs is subject to the global intangible low-taxed income (GILTI) provision, which taxes this foreign-source income at half the corporate tax rate (10.5%), after allowing a deduction for a deemed return of 10% on tangible assets. Credits are allowed for 80% of foreign taxes paid."

Under the "look-through rule" (adopted in 2005 and subsequently extended several times, most recently by the 2020 Further Consolidated Appropriations Act), certain payments between related corporations can be excluded from income [26 USC 954(c)(6)]. According to the federal Joint Committee on Taxation, "dividends, interest…, rents, and royalties received or accrued by one CFC from a related CFC are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the payor that is neither subpart F income nor treated as ECI [Effectively Connected Income]." When a foreign person engages in a trade or business in the United States, all income from sources within the U.S. connected with the conduct of that business is considered "effectively connected income."

According to the Congressional Research Service, "the main argument against the look-through rules… is that they undermine Subpart F's purpose, which is to prevent firms from using passive and easily shifted income to avoid taxation. The main argument for the provision is to allow firms the flexibility to redeploy earnings from one location to another without having U.S. tax consequences... An argument can also be made that in some cases…, the profit shifting is not harming the U.S. Treasury, but rather reducing taxes collected by foreign governments…"

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado generally conforms to the treatment of subpart F income. We could not identify an estimate of the impact to the state if this provision expires, though it could increase federal taxable income and state tax collections; the federal Joint Committee on Taxation estimates that permanently extending the look-thru rule would cost $230 million in Federal FY 2026 and $612 million in Federal FY 2027. The Department of Revenue staff reported to us that they cannot predict how significantly the expiration of this provision would impact Colorado's income tax base.

Special Expensing Rules for Certain Film, Television and Live Theatrical Productions

Description of Provision:

Initially implemented by the American Jobs Creation Act of 2004 and subsequently extended on multiple occasions, taxpayers may elect to treat the cost of any qualified film, t, or live theatrical production, subject to specified dollar limitations (typically $15 million, but $20 million in certain distressed areas), as an expense that is not chargeable to a capital account. According to the federal Joint Committee on Taxation, the reason for this provision was to entice more film production in America, as U.S. motion pictures and television programs had been increasingly filming abroad due to incentives offered by foreign governments [26 USC 181 (g)].

Effective Date of Change: Expires 12/31/2025

Potential State Impact:

Colorado conforms to federal depreciation provisions. While we could not identify a state-level estimate for this provision, it would likely marginally increase taxpayer FTI and state revenue if it were to expire; the Department of the Treasury's Office of Tax Analysis estimated that this tax expenditure would reduce federal revenues by $180 million in FY 2024 and $240 million in FY 2025.

Additional First-Year Depreciation with Respect to Qualified Property

Description of Provision:

26 USC 168(k) allows an additional first year depreciation deduction in the placed-in-service year of qualified property. “Qualified property” means property that has a recovery period of 20 years or less and includes computer software and water utility property. The TCJA increased the percentage of the additional first year depreciation deduction from 50 to 100 percent and expanded the property eligible for it to include certain film, television, or live theatrical productions [26 USC 168(k)(2)(A) and 460(c)(6)(B)].

Effective Date of Change: Expires 12/31/2026

Potential State Impact:

Colorado conforms to the federal treatment of depreciation. If this provision expires, the qualified property will no longer be eligible for an additional first year depreciation deduction, which will increase FTI and state tax collections. Although we could not identify an estimate (federal or state) for the revenue impact of this provision expiring, the impact on the state would likely be small given its narrowness and relative to other components of bonus depreciation.

Election of Additional Depreciation for Certain Plants Bearing Fruits and Nuts

Description of Provision:

Taxpayers can elect to claim a 60 percent special depreciation allowance for the adjusted basis of certain specified plants bearing fruits and nuts planted or grafted after December 31, 2023 and before January 1, 2025. For certain specified plants bearing fruits and nuts planted or grafted after December 31, 2024, and before January 1, 2026, the special depreciation allowance is limited to 40 percent of the adjusted basis (Note: "Adjusted basis" is the original cost of the plant minus depreciation or certain other qualified adjustments) [26 USC 168(k)(5)(A)].

Effective Date of Change: Expires 12/31/2026

Potential State Impact:

Colorado apple, cherry, and peach orchards are among the potential beneficiaries of this special depreciation allowance. If this provision expires, federal taxable incomes will increase and state tax collections will likely increase, as some farmers will lose access to a special depreciation schedule for certain agricultural products. We could not identify an estimate (federal or state) for the revenue impact of this provision expiring, but the impact on the State would likely be small relative to other components of bonus depreciation.

Reduction in IRS Funding/Administrative Capacity

According to a May 2025 report from the Treasury Inspector General for Tax Administration, as of March 2025, more than 11,000 IRS employees, which represented about 11 percent of the IRS's total workforce, were either terminated or accepted deferred resignation packages through the deferred resignation program. The deferred resignation program allowed federal employees to voluntarily resign and receive pay through September 30, 2025. Some positions within the IRS experienced larger cuts than others. For example, the number of revenue agents, who are the IRS workers who examine tax returns, perform audits, and advise on tax liability, declined by 31 percent (about 3,600 positions eliminated). Revenue officer positions declined by 18 percent (about 600 positions eliminated); revenue officers perform work related to collecting delinquent taxes and surveying for unreported taxes. Tax examiner positions declined by 10 percent (about 1,600 positions eliminated); tax examiners perform work related to processing tax returns, managing accounts, collecting taxes and/or obtaining tax returns, computing or verifying tax, and determining proper tax liabilities. The report noted that Colorado has been among the states with the highest percentage of employee separations (i.e., terminations or deferred resignations) from the IRS. Since March 2025, there have been additional reductions in staffing at the IRS. The same report noted that in April 2025, the IRS extended deferred resignation packages to its employees to which over 23,000 applied and about 13,000 were approved, as of April 22, 2025.

The Federation of Tax Administrators has noted that states rely extensively on the IRS and its activities as part of and a complement to their enforcement and compliance programs. On the corporate income tax side, states are extremely reliant on federal determinations of taxable income: "While states devote substantial resources to the audit of corporation tax returns, their audit

activities are focused primarily on verifying the apportionment of income across states, examining the taxpayer's treatment of certain types of transactions, and determining the membership of the unitary group if the state employs combined reporting. On the individual side, states also rely heavily on federal examinations and adjustments (particularly those involving the matching of information returns) as primary enforcement tools. In addition, states use federal income tax return data for a wide range of individual, independent enforcement programs…. States are also reliant on the federal information reporting mechanisms for state income tax administration. To a very considerable degree, states simply mirror federal requirements [and forms, formats, etc.] for third-party information reporting."

Many state tax officials have expressed concern about the impacts of a reduction in the IRS's capacity. In an interview with Bloomberg Law, Utah's Commissioner of Revenue stated that: "Most states simply adopt the fundamental figure of federal taxable income to begin their analysis of taxpayers' state income tax obligations... They deploy more than 90% of their audit and collection resources to factors below that line. Any disruption at the IRS in calculations and compliance processes could filter down to the states… 'It is conceivable that reductions in force at the federal level could affect the revenues flowing to the states. It could affect it in enforcement. It could affect it in compliance'."

Colorado Department of Revenue staff reported to us that it relies heavily on federal tax information in evaluating the accuracy of Colorado returns. Therefore, to the extent that changes in IRS examination levels reduce the examination of taxpayers subject to Colorado income tax, those changes will directly affect Colorado income tax collections. Department staff also noted that reductions in IRS examination levels could impact Colorado income tax collections if they change taxpayers' perceptions of enforcement risk. Taxpayers may be more aggressive in their tax avoidance efforts if they believe the risk of IRS examination is lower, and this could indirectly impact Colorado.

Appendix A

Income Items Explicitly Included in Federal Gross Income

This appendix provides a list of the types of items that are explicitly included in gross income per federal law. Additionally, in the list, we indicate when Colorado has enacted legislation to deviate from the federal tax treatment of certain types of income and the revenue impact of doing so, when data was available.

- **Compensation for services including fees, commissions, and fringe benefits;** Colorado law deviates from federal treatment of compensation in a few instances. Specifically:
    - **Certain employer-provided benefits**—Colorado statute [Sections 39-22-104(4)(o) and (bb), C.R.S.] allows individual taxpayers to deduct contributions made to certain accounts on their behalf by their employer from federal taxable income when calculating Colorado taxable income. Specifically, individual taxpayers may deduct amounts received by their employer as matching contributions to their adult learners trust or savings account with CollegeInvest. For Tax Years 2024 through 2026, individuals may also deduct any employer contribution made to their qualifying home savings account that is included in federal taxable income. These contributions are likely considered taxable fringe benefits for federal tax purposes.
    - **Military service members who reacquire Colorado residency**—Colorado statute [Section 39-22-104(4)(u), C.R.S.] allows a military service member who is a Colorado resident to claim a deduction for any compensation they receive for active duty military service that is included in their federal taxable income if (1) the service member's home of record is Colorado, (2) while in the military, the service member acquired legal residence in a state other than Colorado, and (3) and the service member subsequently reacquired Colorado residency. According to Department of Revenue data, in Tax Year 2022, this deduction was claimed on 43 returns for a total revenue impact of about $157,100 to the State.
    - **Military Family Relief Fund grants**—Colorado statute [Section 39-22-104(4)(p), C.R.S.] allows Colorado taxpayers to deduct any amount received as a grant from the Military Family Relief Fund from their federal taxable income when calculating Colorado taxable income, to the extent it is included in federal taxable income. Based on our review of this deduction in 2022, it appears that its revenue impact is small, although it is unclear how many taxpayers may have used it.
- **Property transferred in connection with performance of services (e.g., restricted stock plans).**
- **Gross income derived from business.**

- **Gains from dealings in property (e.g., capital gains)**. Capital gains are typically taxed at lower rates than sources of ordinary income, such as compensation. According to Internal Revenue Service guidance, "Almost everything [a taxpayer] own[s] and use[s] for personal or investment purposes is a capital asset. Examples of capital assets include a home, personal-use items like household furnishings, and stocks or bonds held as investments. When [a taxpayer] sell[s] a capital asset, the difference between the adjusted basis in the asset and the amount…realized from the sale is a capital gain or a capital loss. Generally, an asset's basis is its cost to the owner, but if [the taxpayer] received the asset as a gift or inheritance [different rules apply]." If the taxpayer sells the asset for more than its adjusted basis, it is a capital gain. The federal capital gain tax rates generally range from 0 to 20 percent, depending on the taxpayer's taxable income. It is important to note that even though capital gains are taxed at a lower rate than ordinary income, the amount of the capital gain is generally included in federal taxable income; the tax benefit comes from a lower tax rate applied to the capital gain at the federal level. Colorado does not tax capital gains at a separate rate, so for state tax purposes, capital gains are treated the same as other forms of income. Colorado statute [Section 39-22-518, C.R.S.] allows certain taxpayers to deduct certain capital gains included in federal taxable income when calculating their Colorado taxable income. Beginning in Tax Year 2022, the deduction is only allowed for capital gains recognized by qualifying farmers from the sale of agricultural real property that the taxpayer acquired on or after May 9, 1994, but before June 4, 2009. According to Department of Revenue data, in Tax Year 2022, this deduction was claimed on 525 returns for a total revenue impact of about $1.4 million to the State.

- **Interest earnings.** Colorado statute [Sections 39-22-104(4)(a) and 304(3)(a), C.R.S.] allows both individual and corporate taxpayers to deduct from their federal taxable income when calculating Colorado taxable income any interest income on obligations of the United States and its possessions (to the extent included in federal taxable income). Additionally, corporations may deduct any interest or dividend income on obligations or securities of any authority, commission, or instrumentality of the United States to the extent it is included in federal taxable income but exempt from state income taxes under laws of the United States [Section 39-22-304(3)(b), C.R.S.]. According to Department of Revenue data, in Tax Year 2022, this deduction was claimed on 91,424 individual returns for a total revenue impact of about $14.5 million to the State. In that same year, the deduction was claimed on 1,193 corporate returns for a total revenue impact of about $22.3 million to the State.

- **Rents.**

- **Royalties.**

- **Dividends.**

- **Annuities.**

- **Income from life insurance and endowment contracts.**

- **Pensions and some Social Security benefits.** Colorado allows two deductions from federal taxable income related to pension and Social Security benefits. Specifically,
    - **Social Security and pension income.** Colorado statute [Section 39-22-104(4)(f), C.R.S.] allows some individuals who have Social Security and some pension income that is included in federal taxable income to deduct this income from federal taxable income when calculating Colorado taxable income. According to Department of Revenue data, in Tax Year 2022, this deduction was claimed on 560,876 returns for a total revenue impact of about $589.4 million to the State.
    - **Military retirement benefits.** Statute [Section 39-22-104(4)(y), C.R.S.] also allows members of the United States uniformed services, including members of the armed forces (i.e., Amy, Navy, Air Force, Marine Corps, Space Force, Coast Guard) and members of the Commissioned Corps of the National Oceanic and Atmospheric Administration and Public Health Service, who are under 55 years of age to deduct up to $15,000 of the military retirement benefits that are included in their federal taxable income. If they are 55 years of age or older, they can claim the regular pension deduction mentioned above. According to Department of Revenue data, in Tax Year 2022, the military retirement deduction was claimed on 6,420 returns for a total revenue impact of about $4.1 million to the State.
- **Income from discharge of indebtedness.**
- **Distributive share of partnership gross income.**
- **Income in respect of a decedent.**
- **Income from interest in an estate or trust.**
- **Prizes and awards.** Federal law provides an exception to this in 26 USC 74(d) for taxpayers with $1 million or less in federal adjusted gross income who win medals at the Olympic or Paralympic Games. Those taxpayers are allowed to exclude from gross income the value of the medal as well as any prize money received from the United States Olympic Committee. Colorado generally conforms to this provision of the IRC but also allows taxpayers to deduct prize money given by any sport-specific national governing body or Paralympic sport organization in which the prize is connected with winning the medal [Section 39-22-104(4)(x), C.R.S.].
- **Unemployment compensation.**
- **Some group-term life insurance purchased by employers for employees.**
- **Reimbursement for expenses of moving from one residence to another due to employment.**
- **Transfers of appreciated property to political organizations.**
- **Certain federal tax credits (e.g., alcohol and biodiesel fuels credits).**

Appendix B

Income Items Explicitly Excluded from Federal Gross Income

This appendix provides a list of types of items that are explicitly excluded from federal gross income with brief descriptions. Additionally, in the list, we indicate when Colorado has enacted legislation to deviate from the federal tax treatment of certain exclusions from income and the revenue impact of doing so, when data was available.

Income Item	Description
Certain Death Benefits [26 USC 101]	In general, life insurance proceeds that a beneficiary receives due to the death of the insured person are excluded from gross income. Additionally, gross income does not include any amount paid as a survivor annuity on account of the death of a public safety officer provided that certain conditions are met.
Gifts and Inheritance [26 USC 102]	In general, gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. However, gifts received by employees from their employers are subject to tax.
Interest on State and Local Bonds [26 USC 103]	Interest on State and local bonds, including the District of Columbia and possessions of the United States, is excluded from gross income, with a few exceptions such as private activity bonds. Colorado does not fully conform to this provision of the IRC. Colorado taxes non-Colorado state and local bond interest. Sections 39-22-104(3)(b) and 304(2)(b), C.R.S., require that both individual and corporate taxpayers add back any interest on state and local bonds other than interest from State of Colorado or any political subdivision thereof to federal taxable income when calculating Colorado taxable income.
Compensation for Injuries or Sickness [26 USC 104]	In general, the following amounts are excluded from income: amounts received under worker's compensation acts as compensation for personal injuries or sickness, amounts received through accident or health insurance for personal injuries or sickness, and damages (except punitive damages) received on account of personal injuries or physical sickness from settlements from lawsuits and agreements are excluded from gross income. However, IRS guidance provides that the facts and circumstances surrounding each settlement payment must be considered because not all amounts received from settlements are exempt from taxes.
Amounts Received Under Accident and Health Plans [26 USC 105(b)]	Amounts received by the taxpayer as reimbursement for medical care of themselves, their spouse, their dependents, or their child under 27 years old are excluded from gross income. Medical care may include a chronic or acute condition or illness but does not include reimbursement for items used for general health (e.g., dietary supplements). An example of this kind of arrangement is an employer flexible spending account (FSA) in which the employer reimburses the employee for expenses for medical care.

Contributions by Employer to Accident and Health Insurance Plans [26 USC 106(a) and (d)]	In general, the amount of an employee's health or accident insurance plan premium that is paid for by the employer is excluded from the employee's gross income. Additionally, employer contributions to employees' health savings accounts (HSAs), subject to a limit, are not included in the employees' gross income if the employee is on a high deductible insurance plan.
Income from Discharge of Indebtedness [26 USC 108]	Certain discharges of indebtedness are excluded from gross income, including if the discharge occurred in a Title 11 bankruptcy case, when the taxpayer is insolvent, when the discharge is qualified farm indebtedness, when the indebtedness is qualified real property indebtedness (but not for C corporations), and when the indebtedness discharged is qualified principal residence indebtedness that is discharged before January 1, 2026.
Improvements by Lessee on Lessor's Property [26 USC 109]	Gross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.
Qualified Lessee Construction Allowances for Short-term Leases of Retail Space [26 USC 110(a)]	Gross income of a lessee does not include any amount received in cash or as a rent reduction by a lessee from a lessor under a short-term lease (i.e., 15 years or less) of retail space and for the purposes of constructing or improving qualified long-term real property for use in the lessee's trade or business as long as the lessee's trade or business is selling tangible personal property or services to the general public. The exclusion is only allowed to the extent that the amount does not exceed the amount expended by the lessee for the construction or improvement.
Recovery of Tax Benefit Items [26 USC 111]	Gross income does not include income attributable to the recovery of any amount deducted or taken as a credit in a prior tax year to the extent that it did not reduce the amount of income tax imposed. Although this section applies to a variety of deductions and credits, the most common application is for state and local tax refunds.
Certain Combat Zone Pay [26 USC 112]	Compensation received for active service in the United States Armed Forces for any month in which the member served in a combat zone or was hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone (for up to 2 years) is excluded. The amount excluded depends on the rank of the member.
Qualified Scholarships [26 USC 117]	Any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on is excluded from gross income. A qualified scholarship is the amount received as a scholarship or fellowship grant that is used for tuition, fees, books, supplies, and equipment required for enrollment/attendance at the institution and for classes.
Contributions to the Capital of a Corporation [26 USC 118]	In the case of a corporation, any contribution of money or property to the capital of the taxpayer is excluded from gross income; if a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special account, such amounts do not constitute income, although there is no increase in the outstanding shares of stock of the corporation. The exclusion also applies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities.

Meals or Lodging Furnished for the Convenience of Employer [26 USC 119]	In general, the value of any meals or lodging furnished to employees, their spouse, or their dependents by or on behalf of their employer for the convenience of the employer are excluded from gross income. The meals must be furnished on the business premises of the employer and the employee must be required to accept the lodging on the business premises of the employer as a condition of employment in order to qualify.
Exclusion of Gain from Sale of Principal Residence [26 USC 121]	Up to $250,000 ($500,000 if married filing a joint return) of the gain from the sale of the taxpayer's principal residence is excluded from gross income. To qualify, for the 5-year period ending on the date of the sale, the property had to have been owned and used by the taxpayer for at least 2 of those years.
Amounts Received Under Insurance Contracts for Certain Living Expenses [26 USC 123]	When an individual's principal residence is damaged or destroyed by a casualty or their access to the principal residence is restricted by the government because of the occurrence or threat of a casualty, the individual's gross income does not include amounts received under an insurance contract, which are paid to compensate or reimburse the individual for living expenses incurred for themselves and members of their household resulting from the loss of use or occupancy of the residence. The exclusion is limited to the amount of expenses incurred above the normal living expenses that would have been incurred by the individual and their household members during the period.
Cafeteria Plans [26 USC 125]	According to Bloomberg Law, "A cafeteria plan is a type of employee benefit plan that permits each participating employee of the employer to choose among two or more benefits consisting of cash and qualified benefits. In making this choice, the employee may obtain nontaxable benefits by foregoing taxable cash compensation." Benefits/plans include health savings accounts, flexible savings accounts, health insurance premiums, and dependent care assistance programs. In order for an employer to sponsor a Section 125 plan, the business must employ an average of 100 or fewer employees during either of the 2 preceding years.
Educational Assistance Programs [26 USC 127]	Gross income of an employee does not include amounts paid or expenses incurred by an employer for educational assistance to the employee if the assistance is for an eligible program, up to $5,250 per calendar year. Gross income also excludes principal or interest payments on qualified education loans made by the employer on behalf of the employee if they are made after March 27, 2020 and before January 1, 2026.
Dependent Care Assistance Programs [26 USC 129]	Gross income of an employee does not include amounts paid or incurred by the employer for dependent care assistance provided to such employee if the assistance is furnished pursuant to a dependent care assistance program. The exclusion is generally limited to $5,000 per year.
Certain Foster Care Payments [26 USC 131]	Amounts received by a foster care provider as qualified foster care payments are excluded from gross income.
Certain Fringe Benefits [26 USC 132]	Gross income does not include certain, specified fringe benefits, including no-additional cost services, qualified employee discounts, working condition fringe, de minimus fringe, qualified transportation fringe, qualified moving expense reimbursement fringe (this fringe benefit is available only for certain military through January 1, 2026, after which it will be available to other taxpayers if the provision that suspended this benefit is not extended), qualified retirement planning services, and qualified military base realignment and closure fringe. Several of these are subject to limits.
Income from United States Savings Bonds Used to Pay Higher Education Tuition and Fees [26 USC 135]	Income from qualified United States savings bonds may be excluded from gross income provided that certain conditions are met. The bonds must be series EE or I U.S. savings bonds issued after 1989 that were issued to the taxpayer when they were at least 24 years old. The bond has to have been cashed in the year in which qualified higher expenses were incurred. There are income restrictions, which are adjusted annually, on who is allowed to claim this exclusion.

Energy Conservation Subsidies Provided by Public Utilities [26 USC 136]	Gross income does not include the value of any subsidy (e.g., a rebate) provided directly or indirectly by a public utility to a customer for the purchase or installation of installations or modifications designed to reduce consumption of electricity or natural gas, or improve the management of energy demand, of a house, apartment, condominium, mobile home, boat, or similar property.
Adoption Assistance Programs [26 USC 137]	In general, gross income of an employee does not include amounts paid or expenses incurred by an employer for qualified adoption expenses if the amounts are provided pursuant to an adoption assistance program. The exclusion is subject to a $10,000 cap, which is indexed for inflation. There is a higher cap if the adoption is of a child with special needs. The exclusion amount is reduced for taxpayers with over a certain amount of adjusted gross income.
Medicare Advantage MSA [26 USC 138]	Gross income does not include any payment to a Medicare Advantage medical savings account (MSA) of an individual by the Secretary of Health and Human Services under certain provisions of the Social Security Act [42 USC 1395w-21 et seq].
Disaster Relief Payments [26 USC 139]	In general, amounts received by individuals as qualified disaster relief payments are excluded from gross income. Qualified disasters are disasters resulting from terrorism or a military action, federally declared disasters, or an accident that the Secretary of the Treasury determines to be catastrophic. Qualified disaster relief payments are amounts provided to an individual to reimburse or pay for qualifying expenses incurred as a result of a qualified disaster
Benefits Provided to Volunteer Firefighters and Emergency Medical Responders [26 USC 139B]	Volunteer firefighters and emergency medical responders can exclude from their gross income any qualified state and local tax benefit (i.e., reductions or rebates of state and local income and property taxes) and payments from state and local governments of up to $50 per month.
Certain Disability-related First Responder Retirement Payments [26 USC 139C]	Qualified first responders, including law enforcement officers, firefighters, paramedics, and emergency medical technicians, may exclude a portion of their disability retirement payments from gross income.
Certain Amounts Received by Wrongfully Incarcerated Individuals [26 USC 139F]	Gross income for wrongfully incarcerated individuals does not include any civil damages, restitution, or other monetary award relating to the incarceration of the individual for a criminal offense under Federal or State law (including any criminal offense arising from the same source of conduct as that criminal offense) for which the individual was convicted. Colorado generally conforms to this provision of the IRC, but also allows a deduction to be claimed if the compensation or damages is provided to an immediate family member of the exonerated person [Section 39-22-104(4)(q), C.R.S.].

Qualified Tuition Program Distributions [26 USC 529(c)]	Distributions from qualified tuition programs (often referred to as "Section 529 plans") are generally excluded from gross income when the distributions are used to pay for qualified higher education expenses for the beneficiary of the account. Additionally, up to $10,000 per year may be used for tuition expenses for the account beneficiary's attendance at an elementary or secondary public, private, or religious school. After December 31, 2023, the beneficiary of a qualified tuition program may roll over some of a distribution to a Roth IRA, subject to the Roth IRA annual contribution limit and a $35,000 lifetime limit. The rollover must be paid through a direct trustee-to-trustee transfer, and the account must have been opened for at least 15 years to qualify for the tax-free Roth IRA rollover. Colorado generally conforms to the federal tax treatment of distributions from Section 529 plans when they are used to pay for qualified higher education expenses. However, if any distribution or withdrawal made from a qualified state tuition program account is used to pay for elementary or secondary education expenses, the account holder must add that amount back to their federal taxable income when calculating Colorado taxable income. Additionally, since Colorado statute only allows the deduction for higher education expenses, amounts in a 529 account that are rolled over into a Roth IRA must also be added back to federal taxable income when calculating Colorado taxable income.
Qualified ABLE Account Distributions [26 USC 529A(c)]	ABLE accounts operate similarly to qualified tuition programs authorized under 26 USC 529, except the funds are used to pay for qualified disability expenses for people with disabilities whose disabilities occurred before age 26 (this age is rising to 46 beginning January 1, 2026). When the funds are used to pay for eligible expenses for a beneficiary with a disability, the distributions are excluded from gross income. According to IRS guidance, the following type of expenses are eligible: education, housing, transportation, employment training and support, assistive technology, personal support services, health, prevention and wellness, financial management, administrative services, legal fees, expenses for oversight and monitoring, and funeral and burial expenses. ABLE accounts are also subject to different limits than qualified tuition programs. Federal law imposes a limit on the total amount of contributions that can be made to an ABLE account from all contributors during the year. In 2024, the contribution limit was $18,000. Before January 1, 2026, employed ABLE account beneficiaries may make additional contributions to their accounts, which is based on the poverty line for one person.
Foreign Earned Income [26 USC 911]	An individual whose tax home is in a foreign country and is either a citizen of the United States and a resident of another country or a United States citizen or resident who spent the majority of the tax year in a foreign country may be eligible to exclude a portion of their foreign earned income (i.e., wages, salaries, or professional fees) from gross income. In Tax Year 2024, the maximum exclusion amount was $126,500 per person.

Source: Office of the State Auditor analysis of federal laws, Internal Revenue Service taxpayer guidance documents, Internal Revenue Service data, Colorado laws, Colorado Department of Revenue taxpayer guidance documents, Colorado Department of Revenue data, and Bloomberg Law documents.

Appendix C

Above-the-Line Deductions

This appendix provides a list of above-the-line deductions (with descriptions and claims data, when available) that can be taken from federal gross income to determine federal adjusted gross income. Additionally, we indicate when Colorado has enacted legislation to deviate from the federal tax treatment of above-the-line deductions and the revenue impact of doing so, when data was available.

Deduction	Description
Trade and Business Deductions [26 USC 62(a)(1), 26 USC 1 et seq but not including 26 USC 211 through 223]	The taxpayer may claim deductions for trade or business expenses that are attributable to a trade or business that is carried on by the taxpayer, as long as the trade or business does not consist of the performance of services by the taxpayer as an employee. This includes, for example, ordinary and necessary business expenses such as salaries and other compensation for services, traveling expenses, rentals or other payments for use of property the business does not own, taxes paid by the business, business interest, and business bad debts. An individual may have trade and business expenses if they own and operate a business, for example, as a sole proprietor. Trade and business expenses allowed in 26 USC 162 are discussed more in depth in Appendix E. Taxpayers may not deduct any expenses incurred in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any state in which such trade or business is conducted [26 USC 280E]. In certain circumstances, Colorado law deviates from federal tax treatment of trade and business deductions. Specifically: • Colorado statutes [Section 39-22-104(3)(i) and 529, C.R.S.] require that companies that deducted on their federal returns expenses related wages or remuneration paid to unauthorized aliens in excess of $600 pursuant to 26 USC 162(a)(1) to add back the amount deducted on their federal return, subject to a few exceptions. • Under the IRC, businesses may be able to deduct 50 percent of business meal expenses. Note, however, for Tax Years 2024 through 2030, Colorado does not conform to this provision of the IRC and requires that individuals who claimed a deduction for business meals on their federal return to add the amount claimed back when calculating their Colorado taxable income [Section 39-22-104(3)(s)(I), C.R.S.]. • To the extent that a taxpayer claimed a deduction on their federal return for expenses or payments to a club that has a policy to restrict membership on the basis of sex, sexual orientation, gender identity, gender expression, marital status, race, creed, religion, color, ancestry, or national origin, the taxpayer must add those back to their federal taxable income when calculating Colorado taxable income [Section 39-22-104(3)(e)(I), C.R.S.]. • Statutes [Section 39-22-104(4)(r) and (r.5), C.R.S.] allow individuals

	licensed under the Colorado Marijuana Code or Colorado Natural Medicine Code to deduct amounts equal to expenditures that would be eligible to be claimed as a deduction under federal law except that the deduction is disallowed under Section 280E because marijuana/natural medicine are considered controlled substances under federal law. According to statute [Section 44-50-103(13)(a), C.R.S.], natural medicine is psilocybin or psilocin. According to Department of Revenue data, in Tax Year 2022, the marijuana business expense deduction was claimed on 354 individual returns for a total revenue impact of about $2.9 million to the State. The Department does not have data available for the natural medicine expenses deduction since that deduction did not go into effect until Tax Year 2024.
Reimbursed Expenses of Employees [26 USC 62(a)(2)(A)]	The taxpayer (employee) may claim a deduction for certain trade or business expenses paid or incurred by the taxpayer (employee) in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with their employer, to the extent that those reimbursements from their employer were included in their gross income.
Certain Expenses of Performing Artists [26 USC 62(a)(2)(B)]	A taxpayer who is a qualified performing artist may claim a deduction for trade or business expenses (e.g., traveling expenses, rentals of property) paid or incurred in connection with the performance of services in the performing arts as an employee.
Certain Expenses of Officials [26 USC 62(a)(2)(C)]	A taxpayer who is an official may claim a deduction for trade or business expenses (e.g., traveling expenses, rentals of property) paid or incurred with respect to services performed as in their capacity as an official of an employee of a state or political subdivision if they are in a position that is compensated wholly or partially on a fee basis.
Certain Expenses of Elementary and Secondary School Teachers [26 USC 62(a)(2)(D)]	A taxpayer who is an eligible elementary or secondary school teacher may deduct up to $250 in expenses paid or incurred for professional development related to the curriculum the educator provides or for books, supplies, computer and other equipment, and supplementary materials used by the educator in their classroom. The $250 statutory cap is adjusted for inflation. In 2024, the amount was $300. If two eligible educators file a joint return, they may each claim up to the cap. According to Internal Revenue Service Statistics of Income data for federal returns filed by taxpayers with a Colorado address, in Tax Year 2022, which was the most recent year of data available, this deduction was claimed on about 59,000 returns for a total of about $17.1 million in federal deductions. Based on Colorado's 4.4 percent tax rate, we estimate that this deduction could have reduced state revenue by about $751,100 in Tax Year 2022.
Certain Expenses of Members of Reserve Components of the Armed Forces of the United States [26 USC 62(a)(2)(E)]	A taxpayer who is a member of the National Guard or is a military reservist may deduct certain expenses (e.g., travel) when they travel more than 100 miles away from home for work in their capacity as a member of the National Guard or military reservist. According to Department of Revenue data, in Tax Year 2020, this deduction was claimed on 2,621 federal returns filed by full-year Colorado residents for a total of about $13.1 million in deductions. Based on Colorado's 4.55 percent tax rate in Tax Year 2020, we estimate that this deduction could have reduced state revenue by about $593,900.

Losses from Sale or Exchange of Property [26 USC 62(a)(3)]	An individual taxpayer may deduct a loss incurred from the sale or exchange of property when the loss is incurred in a trade or business or in a transaction that is entered into for profit, though not connected with a trade or business. Additionally, individuals may deduct capital losses to the extent of personal gains plus an additional $3,000 that they can use to offset other income.
Deductions Attributable to Rents and Royalties [26 USC 62(a)(4), 26 USC 161 through 198, 26 USC 212, 26 USC 611]	An individual may deduct trade or business expenses, expenses for the production of income, and depletion that are attributable to property held for the production of rents or royalties. Examples of this kind of property are rental real estate and oil and gas producing property.
Certain Deductions of Life Tenants and Income Beneficiaries of Property [26 USC 62(a)(5), 26 USC 167, 26 USC 611]	If the taxpayer is a life tenant of property (i.e., they have the right to use the property during their lifetime but do not own it), the income beneficiary of property held in a trust, or an heir, legatee, or devisee of an estate, they are allowed to claim a deduction for depreciation or depletion for property.
Pension, Profit-sharing, and Annuity Plans of Self-employed Individuals [26 USC 62(a)(6), 26 USC 401(c)(1), 26 USC 404]	Any deduction allowed under 26 USC 404 (relating to contributions to pension, profit-sharing, annuity, or other qualified retirement plan) for a self-employed taxpayer is allowed from gross income.
Retirement Savings [26 USC 62(a)(7), 26 USC 219]	An individual taxpayer may deduct amounts contributed to qualifying individual retirement accounts or individual retirement annuities.
Penalties Forfeited Because of Premature Withdrawal of Funds from Time Savings Accounts or Deposits [26 USC 62(a)(9), 26 USC 165]	An individual taxpayer is allowed to claim a deduction for losses (as allowed under 26 USC 165) incurred in any transaction entered into for profit, though not connected with a trade or business, to the extent that such losses include amounts forfeited to a bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank or homestead association as a penalty for premature withdrawal of funds from a time savings account, certificate of deposit, or similar class of deposit.
Reforestation Expenses [26 USC 62(a)(11), 26 USC 194]	Eligible individual taxpayers are allowed to deduct up to $10,000 (with amounts over $10,000 allowed to be amortized) for certain reforestation expenses that result in the establishment of commercial timber.
Certain Required Repayments of Supplemental Unemployment Compensation Benefits [26 USC 62(a)(12), 26 USC 165, 26 USC 501(c)]	Certain repayments of supplemental unemployment compensation benefits can be deducted.
Jury Duty Pay Remitted to Employer [26 USC 62(a)(13)	An individual who remits any portion of their jury pay to their employer in exchange for their employer continuing to pay them during their jury service is allowed to deduct the amount of the jury pay remitted to their employer.

Moving Expenses [26 USC 62(a)(15), 26 USC 217]	A taxpayer who moves for work (either for an employer or for self-employment at a new location) may deduct reasonable expenses relating to (1) moving their household goods and personal effects from the former residence to the new residence, and (2) traveling from the former residence to the new residence. To qualify, the taxpayer's new principal place of work must be at least 50 miles greater than the distance between their former residence and former principal place of work or if they had no former place of work, then the new principal place of work must be at least 50 miles from their former residence. Additionally, in the 12-month period immediately following arrival in the new principal place of work, the taxpayer must be employed full time by an employer or in the 24-month period immediately following arrival in the new location, the taxpayer must be self-employed on a full-time basis. For Tax Years 2018 through 2025, this deduction is only available for members of the U.S. Armed Forces who move pursuant to a military order incident to a permanent change of station.
Archer MSAs [26 USC 62(a)(16), 26 USC 220]	Subject to limitations, taxpayers may deduct amounts contributed to Archer medical savings accounts (MSAs). According to IRS guidance, "Archer MSAs were created to help self-employed individuals and employees of certain small employers meet the medical care costs of the account holder, the account holder's spouse, or the account holder's dependent(s). After 2007, you can't be treated as an eligible individual for Archer MSA purposes unless: 1. You were an active participant for any tax year ending before 2008, or 2. You became an active participant for a tax year ending after 2007 by reason of coverage under a high deductible health plan (HDHP) of an Archer MSA participating employer."
Interest on Education Loans [26 USC 62(a)(17), 26 USC 221]	Individual taxpayers may deduct the lesser of the amount of interest paid on eligible higher education loans or $2,500. The deductible amount is phased out and eventually eliminated as taxpayer adjusted gross income increases. According to IRS Statistics of Income data for federal returns filed by taxpayers with a Colorado address, in Tax Year 2022, which was the most recent year of data available, this deduction was claimed on about 84,000 returns for a total of about $75.4 million in federal deductions. Based on the State's 4.4 percent income tax rate, we estimate that this deduction could have reduced state tax revenue by about $3.3 million in Tax Year 2022.
Health Savings Accounts [26 USC 62(a)(19), 26 USC 223]	In general, an eligible taxpayer may deduct amounts contributed to a health savings account (HSA). According to IRS guidance, "An HSA is a tax-exempt trust or custodial account you set up with a qualified HSA trustee to pay or reimburse certain medical expenses you incur. You must be an eligible individual to contribute to an HSA… To be an eligible individual and qualify for an HSA contribution, you must meet the following requirements. You are covered under a high deductible health plan (HDHP)… on the first day of the month. You have no other health coverage except what is permitted under Other health coverage. You aren't enrolled in Medicare. You can't be claimed as a dependent on someone else's 2024 tax return." There are limits on the amounts that may be contributed annually to HSAs. In 2024, the limit for individuals with self-only coverage was $4,150 and $8,300 for family coverage. Individuals who are at least 55 years of age can contribute an additional $1,000. According to Department of Revenue data, in Tax Year 2020, this deduction was claimed on 63,335 federal returns filed by full-year Colorado residents for a total of about $215.3 million in deductions. Based on the State's 4.55 percent income tax rate in 2020 we estimate that this deduction could have reduced state tax revenue by about $9.8 million in Tax Year 2020.

Costs Involving Discrimination Suits [26 USC 62(a)(20)]	According to Bloomberg Law, taxpayers are allowed to claim a deduction for "attorney fees and court costs that satisfy two conditions…First, the fees and costs must be paid by, or on behalf of, the taxpayer. Second, they must be paid in connection with any action involving a claim of unlawful discrimination, a claim of a violation of 31 U.S.C. 3721 et seq, or a claim made under 1862(b)(3)(A) of the Social Security Act. Only the portion of the fees and costs that do not exceed the amount includible in the taxpayer's gross income for the tax year on account of a judgment or settlement…resulting from the claim are allowable in computing adjusted gross income." There are various federal acts that a claim of unlawful discrimination can fall under, including, but not limited to the Civil Rights Act of 1991 and certain sections of the Civil Rights Act of 1964, the National Labor Relations Act, the Fair Labor Standards Act of 1938, certain sections of the Family and Medical Leave Act of 1993, certain sections of the Fair Housing Act, and certain sections of the Americans with Disabilities Act of 1990.
Attorneys' Fees Relating to Awards to Whistleblowers [26 USC 62(a)(21)]	An individual may deduct attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with an award related to being a whistleblower.
Casualty and Losses [26 USC 165(h)(4)]	In general, individuals may claim a deduction for the loss of property arising from fire, storm, shipwreck, or other casualty, or from theft. The loss may only be claimed to the extent of a personal casualty gain, which is a gain from any involuntary conversion of property arising from fire, storm, shipwreck, or other casualty, or from theft. A personal casualty gain could occur when insurance or other reimbursement for a loss of property exceeds the taxpayer's adjusted basis in the property. Additionally, the loss is only allowed to the extent that each casualty or theft loss exceeds $100. For Tax Years 2018 through 2025, casualty and theft losses of property not connected with a trade or business or transaction entered into for profit are deductible only if the loss is attributable to a federally declared disaster.
Alimony and Separate Maintenance Payments [former 26 USC 62(a)(10), former 26 USC 71, former 26 USC 215]	According to IRS guidance, "Generally, alimony or separate maintenance payments are deductible by the payer spouse and includible in the recipient spouse's income if paid under a divorce or separation agreement executed before 2019. [The payor] can't deduct alimony or separate maintenance payments made under a divorce or separation agreement (1) executed after 2018, or (2) executed before 2019 but later modified if the modification expressly states the repeal of the deduction for alimony payments applies to the modification." According to Department of Revenue data, in Tax Year 2020, this deduction was claimed on 10,776 federal returns filed by full-year Colorado residents for a total of about $306.4 million in deductions. Based on Colorado's 4.55 percent income tax rate at this time, we estimate that this deduction could have reduced state tax revenue by about $13.9 million.
Housing Costs While Living and Working Outside the United States [26 USC 911(c)(4)(A)]	An individual whose tax home is in a foreign country and is either a citizen of the United States and a resident of a foreign country or a United States citizen or resident who spent the majority of the tax year in a foreign country may be eligible to deduct qualified housing expenses. To be eligible to be deducted, the individual's employer may not have provided the housing or covered the costs of the housing. There are several limitations on this deduction. According to IRS guidance, for 2024, it was $37,950. However, the limit also varies depending on the location of the individual's foreign source income, foreign tax home, and the number of qualifying days in the tax year.

Source: Office of the State Auditor analysis of federal laws, Internal Revenue Service taxpayer guidance documents, Internal Revenue Service data, Colorado laws, Colorado Department of Revenue taxpayer guidance documents, Colorado Department of Revenue data, and Bloomberg Law documents.

Appendix D

Itemized Deductions

This appendix provides a list of the itemized deductions that taxpayers can claim at the federal level (instead of the standard deduction). This list includes brief descriptions of the federal deductions and IRS statistics of income data showing the number of federal returns for which taxpayers used a Colorado address for filing that claimed the deductions and the total amount claimed. The data is from Tax Year 2022, which was the most recent year available. For miscellaneous itemized deductions subject to a limit, we used Tax Year 2017, which was the most recent year these deductions were available. Additionally, we indicate when Colorado has enacted legislation to deviate from the federal tax treatment of itemized deductions and the revenue impact of doing so, when data were available.

Deduction	Description
Medical and Dental Expenses [26 USC 213]	Individual taxpayers are allowed to claim as an itemized deduction eligible medical and dental care expenses incurred by themselves, their spouse, or their dependent if the expenses exceed 7.5 percent of the taxpayer's adjusted gross income. To qualify, the expenses cannot have been compensated by insurance (or otherwise). According to IRS data for Tax Year 2022, the medical and dental care expenses deduction was claimed on 65,410 federal returns filed by Coloradans with a total amount of about $1.3 billion of deductions. Based on the State's 4.4 percent income tax rate, we estimate that this deduction could have reduced state tax revenue by about $58.9 million in Tax Year 2022.
State and Local Income Taxes or General Sales Taxes [26 USC 164(a)(3) and (b)(5)]	Individual taxpayers are allowed to claim as an itemized deduction either state and local income taxes or state and local sales taxes paid. For Tax Years 2018 through 2025, individual taxpayers are limited to deducting a maximum of $10,000 of all state and local taxes (that are not paid or accrued in connection with a business), including income or sales taxes, real property taxes, and personal property taxes. According to IRS data for Tax Year 2022, state and local income taxes were deducted on 313,550 federal returns filed with a Colorado address, for a total of $4.9 billion in deductions. State and local sales taxes were claimed on 23,980 federal returns with a Colorado address, for a total of $43.8 million in deductions. Colorado does not fully conform to this provision of the IRC. Individuals must add back to their federal taxable income (when calculating Colorado taxable income) any state income taxes deducted as an itemized deduction on their federal return, subject to certain limitations [Section 39-22-104(3)(d), C.R.S.]. According to Department of Revenue data, in Tax Year 2020, Colorado taxpayers claimed $2.5 billion in deductions on their federal returns based on this provision and added back about $981.3 million. Based on the amount deducted on Colorado taxpayers' federal returns, the amount added back for state income taxes, and the State's 4.55 percent income tax rate at this time, we estimate that this deduction could have reduced state tax revenue by about $68.7 million in Tax Year 2020.

State and Local Real Estate Taxes [26 USC 164(a)(1)]	Individual taxpayers are allowed to claim as an itemized deduction state and local real property taxes. For Tax Years 2018 through 2025, individual taxpayers are limited to deducting a maximum of $10,000 of all state and local taxes (that are not paid or accrued in connection with a business), including income or sales taxes, real property taxes, and personal property taxes. According to IRS data for Tax Year 2022, state and local real property taxes were deducted on 301,210 federal returns filed with a Colorado address, for a total of $1.5 billion in deductions. Based on Colorado's 4.4 percent income tax rate, we estimate that this deduction could have reduced state tax revenue by about $65 million in Tax Year 2022.
State and Local Personal Property Taxes [26 USC 164(a)(2)]	Individual taxpayers are allowed to claim as an itemized deduction state and local personal property taxes. For Tax Years 2018 through 2025, individual taxpayers are limited to deducting a maximum of $10,000 of all state and local taxes (that are not paid or accrued in connection with a business), including income or sales taxes, real property taxes, and personal property taxes. According to IRS data for Tax Year 2022, state and local personal property taxes were deducted on 191,270 federal returns filed with a Colorado address, for a total of $123.0 million in deductions. Based on the State's 4.4 percent income tax rate, we estimate that this deduction could have reduced state tax revenue by about $5.4 million in Tax Year 2022.
Home Mortgage Interest, including Buyer Points [26 USC 163(h)]	Individual taxpayers are allowed to claim as an itemized deduction interest and points (if the taxpayer is the buyer) the taxpayer paid on a loan secured by their main home or a second home. There may be some limitations to the deduction depending on when the mortgage was taken out. If the mortgage was taken out between October 13, 1987 and December 15, 2017, only the interest on up to $1 million of debt is deductible. If the mortgage was taken out after December 15, 2017 and before January 1, 2026, only the interest on $750,000 or less is deductible. Beginning January 1, 2026, taxpayers will be able to deduct the interest on up to $1 million of mortgage debt. According to IRS data for Tax Year 2022, home mortgage interest was deducted on 294,350 federal returns filed with a Colorado address, for a total of $4.0 billion in deductions. Points were deducted on 22,060 federal returns with a Colorado address for a total of $25.8 million in deductions. Based on the State's 4.4 percent income tax rate, we estimate that this provision reduced state tax revenue by about $179.3 million in Tax Year 2022.
Investment Interest Paid [26 USC 163(d)]	According to IRS guidance, individual taxpayers are allowed to claim as an itemized deduction investment interest paid on money the taxpayer borrowed that is allocable to property held for investment. It does not include any interest allocable to passive activities or to securities that generate tax-exempt income. According to IRS data for Tax Year 2022, investment interest was deducted on 18,950 federal returns filed with a Colorado address, for a total of $468.8 million in deductions. Based on the State's 4.4 percent income tax rate, we estimate that this provision reduced state tax revenue by about $20.6 million in Tax Year 2022.

Charitable Contributions [26 USC 170]	Individual taxpayers are allowed to claim a deduction for contributions of eligible property to qualifying organizations, subject to limitations. In general taxpayers may donate cash (which includes donations made by check or credit card) as well as other types of property such as stock, artwork, land or real estate, vehicles, and conservation easements. Charitable contributions must be given to the following types of organizations as a gift or for the use of the organization: (1) A State, possession of the United States, any political subdivision of a State/possession, the United States, or the District of Columbia but only if the contribution is made for exclusively public purposes. (2) A corporation, trust, community chest, fund, or foundation that is created and organized in the United States and organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals. Additionally, no part of the earnings of the organization may inure to the benefit of any private shareholder or individual and the organization cannot attempt to influence legislation and does not participate or intervene in any political campaign (either on behalf of or in opposition to) for any candidate for public office. These types of organizations, which are defined in 26 USC 501(c)(3) are classified as either public charities or private foundations. Public charities receive the majority of their support from the general public or government units and have greater interaction with the public. Common examples of public charities are museums, animal rescues, churches, schools, hospitals, and medical research organizations. According to IRS guidance, a private foundation "is typically controlled by members of a family or by a small group of individuals, and derives much of its support from a small number of sources and from investment income." (3) A post or organization of war veterans. (4) A domestic fraternal society, order, or association operating under the lodge system, but only if the contribution is used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. (5) A cemetery company owned and operated exclusively for the benefit of its members if the company is not operated for profit and none of its earnings inure to the benefit of a private shareholder or individual. (6) An organization described in section 501(c)(19) [26 USC 501(c)(19)] that is a federally chartered corporation. These are organizations in which at least 75 percent of the members are current or past members of the United States Armed Forces and substantially all of the other members are cadets or spouses, widows, widowers, ancestors, or lineal descendants or past or current members of the United States Armed forces or of cadets. Additionally, none of the earnings of the organization can inure to the benefit of a private shareholder or individual. There are limitations on the deduction amount based on what type of property is given and to what type of organization it is given. For example, donations of cash to public charities by individuals are limited to 60 percent of the taxpayer's adjusted gross income. Note that this amount is scheduled to decrease to 50 percent at the end of 2025. Although Colorado generally conforms with this deduction, if a taxpayer claims a charitable contribution deduction on their federal return for the donation of a conservation easement on property located in Colorado and claims the Colorado Conservation Easement Credit pursuant to Section 39-22-522, C.R.S., they must add back the amount of the charitable contribution deduction claimed on their

	federal return when calculating their Colorado taxable income [Section 39-22-104(3)(g), C.R.S.]. According to IRS data for Tax Year 2022, charitable contributions were deducted on 256,140 federal returns filed with a Colorado address, for a total of $3.8 billion in deductions. Based on the State's 4.4 percent income tax rate, we estimate that this provision reduced state tax revenue by about $168.1 million in Tax Year 2022. We were not able to account for the State addback for conservation easement donations for which a state credit was claimed in our estimate because the Department of Revenue does not publish data related to this addback.
Casualty and Theft Losses [26 USC 165(c)(3)]	In general, individuals may claim as an itemized deduction for a loss of property arising from fire, storm, shipwreck, or other casualty, or from theft. The loss is only allowed to the extent that each casualty or theft loss exceeds $100 and 10 percent of the taxpayer's adjusted gross income, and taxpayers must reduce their deduction by $100 for each casualty or theft loss and 10 percent of their adjusted gross income. For Tax Years 2018 through 2025, casualty and theft losses of property not connected with a trade or business or transaction entered into for profit are deductible only if the loss is attributable to a federally declared disaster. Note that the distinction between this itemized deduction for casualty and theft losses and the above-the-line casualty and theft loss deduction allowed to be taken in calculating adjusted gross income is that this itemized deduction for a loss may be taken in excess of casualty and theft gains, which are gains that arise from insurance payments or other reimbursements received for property damaged or destroyed by casualty or theft (whereas the above-the-line deduction for losses may only be taken to the extent of casualty and theft gains). The IRS does not publish statistics related to claims of this deduction.
Wagering Losses [26 USC 165(c)(2) and (d)]	Individual taxpayers may claim as an itemized deduction a loss from wagering transactions (e.g., gambling) only to the extent of the gains from such transactions. For Tax Years 2018 through 2025, this limitation applies to any deductions otherwise allowable that are incurred in carrying on any wagering transactions. For example, prior to 2018, professional gamblers could deduct certain expenses associated with gambling, such as hotels, travel, and legal and accounting fees, even when the expenses were in excess of any gains from wagering activities. The IRS does not publish statistics related to claims of this deduction.
Other Miscellaneous Itemized Deductions (non-limited)	Individual taxpayers may claim as itemized deductions several other deductions, including deductions related to impairment-related work expenses, estate tax in the case of income in respect of the decedent [26 USC 691(c)], personal property used in a short sale, computation of tax where taxpayer restores substantial amount held under claim of right [26 USC 1341], annuity payments ceasing before investment recovered [26 USC 72(b)(3)], amortizable bond premium [26 USC 171], and in connection with cooperative housing corporations [26 USC 216]. Collectively, these other itemized deductions do not have a limitation as other miscellaneous itemized deductions do (see immediately below). According to IRS data for Tax Year 2022, these other itemized deductions were deducted on 15,080 federal returns filed with a Colorado address, for a total of $535.3 million in deductions. Based on the State's 4.4 percent income tax rate, we estimate that this provision reduced state tax revenue by about $23.6 million in Tax Year 2022.

Other Miscellaneous Itemized Deductions (limited)	Individual taxpayers may claim several other deductions, but they are subject to a limit. Specifically, these miscellaneous itemized deductions for any taxable year are only allowed to the extent that the aggregate of the deductions exceeds 2 percent of adjusted gross income. According to IRS guidance, the following types of expenses are included in other miscellaneous itemized deductions that are subject to this limit: appraisal fees for a casualty loss or charitable contribution, casualty and theft losses from property used in performing services as an employee, costs for clerical help and office rent in caring for investments, credit or debit card convenience fees, depreciation on home computers used for investments, fees to collect interest and dividends, hobby expenses (but generally not more than hobby income), indirect miscellaneous deductions from pass-through entities, investment fees and expenses, legal fees related to producing or collecting taxable income or getting tax advice, loss on deposits in an insolvent or bankrupt financial institution, loss on traditional IRAs or Roth IRAs when all amounts have been distributed to the taxpayer, repayments of income, repayments of social security benefits, safe deposit box rental (except for storing jewelry and other personal effects), service charges on dividend reinvestment plans, tax advice fees, trustee's fees for the taxpayer's IRA (if separately billed and paid). These deductions are not available for Tax Years 2018 through 2025. According to IRS data for Tax Year 2017, which was the most recent year in which these deductions were allowed, these other itemized deductions were deducted on 196,080 federal returns filed with a Colorado address, for a total of $1.8 billion in deductions. Based on the State's 4.63 percent income tax rate at this time, we estimate that this provision reduced state tax revenue by about $81.4 million in Tax Year 2017.

Source: Office of the State Auditor analysis of federal laws, Internal Revenue Service guidance documents, Internal Revenue Service data, and Department of Revenue data.

Appendix E

Ordinary and Necessary Business Expenses

This appendix provides a list with descriptions of the types of expenses that businesses can generally claim as ordinary and necessary business expenses under 26 USC 162. Additionally, we indicate when Colorado has enacted legislation to deviate from the federal tax treatment of business expenses and the revenue impact of doing so, when data was available. The IRS and Colorado Department of Revenue do not publish Colorado-specific data related to these provisions.

Ordinary and Necessary Business Expense	Description
Advertising Expenses	In general, expenses associated with promoting a business in order to generate more business are deductible. If the advertising is expected to increase business for over a year, the advertising expense must be capitalized. Advertising includes traditional advertising (e.g., ads in magazines, billboards, or social media, television commercials), business gifts or samples given to prospective customers, and event or sports team sponsorship.
Charitable Contributions (as Business Expenses)	Certain charitable contributions may be deductible as business expenses rather than charitable contributions. In order to qualify as a business expense deductible under 26 USC 162, the charitable contribution must be made to a charitable organization (as defined in 26 USC 170(c)) and the contribution must have a direct relationship to the business and the contribution must be made with a reasonable expectation of financial return. Charitable contributions made not as a business expense are discussed in Appendix F.
Commuting Costs	This includes traveling between jobs or clients but not commuting between the taxpayer's residence and work location.
Compensation	Businesses may deduct a reasonable allowance for salaries or other compensation for personal services actually rendered. Although compensation (which includes wages, bonuses, and severance pay) is generally an allowable business expense deduction, the compensation must be reasonable. Publicly held corporations generally cannot deduct excessive compensation (i.e., more than $1 million) paid to certain employees [26 USC 162(m)]. Colorado statutes [Section 39-22-304(2)(h) and 529, C.R.S.] require that companies that deducted on their federal returns expenses related wages or remuneration paid to unauthorized aliens in excess of $600 pursuant to 26 USC 162(a)(1) to add back the amount deducted on their federal return, subject to a few exceptions. First, if the business is exempt from compliance with federal employment verification procedures under federal law that makes the employment of unauthorized aliens unlawful, then they do not have to add the deduction back. They also do not have to add back the deduction if the individual was hired prior to December 31, 2006, the individual is not directly compensated or employed by the taxpayer, or the individual holds and presents a valid license or identification card issued by the Department of Revenue.

Conventions and Seminars	Businesses can deduct the cost of sending employees to business conventions and seminars if it is directly related to the business.
Costs to Protect the Business	Businesses can deduct costs to protect the business. Examples of these costs include some litigation expenses like patent infringement, and costs of investigating employees to minimize theft and embezzlement.
Educational Expenses for Employees	Educational expenses employers incur to provide education and training to employees are deductible. To qualify for a deduction, the expense must maintain or improve the employee's skills related to the position in the business or the education the employee is receiving is to meet a legal or regulatory requirement necessary for the employee to stay in their position. However, the expenses are not deductible if either the education is required for the employee to meet the minimum education requirements of the position in the business or if the education is being pursued by the employee so they can work in a new trade or business.
Employee Business Expenses	An employer can deduct expenses that an employee incurred and that the employer reimbursed for business expenses as long as the expenses are ordinary and necessary business expenses related to the trade or business.
Expenses Related to Vehicles Used in the Business	Expenses related to vehicles used by a business can be deducted. Examples of these expenses include gas, oil, and insurance or the standard mileage rates. The vehicle itself typically must be capitalized and depreciated.
Government Taxes and Fees	Taxes and fees imposed on businesses by governments are deductible. Note that some taxes are generally deductible under 26 USC 164 even if they are not connected to a trade or business, such as foreign, state, and local income taxes; foreign, state, or local real property taxes; and state and local personal property taxes. Additional taxes and fees imposed by governments may be deducted under 26 USC 162 as ordinary and necessary business expenses, including automobile inspection or emissions testing fees if the vehicles are used in the business, license fees, utility charges, sales taxes, excise taxes, severance taxes, and tolls paid while using a vehicle for business reasons. Colorado does not fully conform to this provision of the IRC. Corporations are required to add back any income, war profits, or excess profits paid to a foreign country or possession of the United States and Colorado income taxes deducted on their federal return per Section 39-22-304(2)(a) and (d), C.R.S. According to Department of Revenue data, in Tax Year 2021, Colorado income taxes were added back on 7,570 corporate returns with a total amount of about $1.5 billion added back.
Insurance	Various types of insurance premiums may be deductible by a business, including, for example, insurance to cover theft, flood, merchandise and inventory, fire, public or employer liability, malpractice, automobile, workers' compensation, unemployment, disability, and employees' group health. Note that health insurance premiums paid by the corporation on behalf of its employees are deductible only if, when viewed together with all of the employee's other compensation, the premiums do not amount to unreasonable compensation.
Interest Expense	Interest paid on loans made for business purposes is generally deductible. However, interest on loans used to purchase property must be capitalized.

Meal Expenses	These are deductible only if they are ordinary and necessary trade expenses, and only 50 percent of the business meal expenses are deductible. In general, business entertainment expenses are not deductible [26 USC 274]. For Tax Years 2024 through 2030, Colorado does not conform to this provision of the IRC. During those tax years, a corporation that claims a federal deduction for business meals must add back the amount deducted when calculating their Colorado taxable income [Section 39-22-304(2)(k)(I), C.R.S.].
Membership Dues	Membership dues are deductible business expenses only if related to the business, for example, membership in a trade association or chamber of commerce.
Moving Expenses	Moving expenses related to moving the business's equipment, machinery, office contents, and personnel are deductible.
Phone Expenses	The cost of making calls for business purposes is deductible, such as when businesses provide cell phones to their employees for business purposes.
Professional Services	Fees paid for professional services, such as accounting, actuarial services, appraisals, investment and business advice, and legal services, are generally deductible.
Repairs	Expenses associated with repairing property used in the business is generally deductible as long as the work does not improve the property in a way that makes its value appreciate or extends its life significantly; in those cases, the repair costs must be capitalized.
Safety Devices	Expenses related to maintaining and operating safety devices are deductible. The safety devices themselves may need to be capitalized, depending on their expected useful life.
Supplies	Supplies and materials that are consumed during the year are deductible.
Transportation	The cost of moving people, goods, or equipment between business locations for a business reason is deductible.

Source: Office of the State Auditor analysis of federal laws, Colorado laws, Bloomberg Law documents, and Colorado Department of Revenue data.

Appendix F

Various Business Expenses Deductions

This appendix provides a list with descriptions of the types of expenses that businesses can generally deduct under various sections of the IRC. Additionally, we indicate when Colorado has enacted legislation to deviate from the federal tax treatment of business expenses and the revenue impact of doing so, when data was available.

Deduction	Description
Amortization of Certain Intangibles [26 USC 197]	Allows businesses to claim a deduction for amortization, which is the process of spreading the cost of intangibles over their useful life, of certain intangibles, including goodwill; going concern value; workforce in place including its composition and terms and conditions of its employment; business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers); patents, copyrights, formulas, processes, designs, patterns, knowhow, format, or other similar items; licenses, permits, or other rights granted by a government unit; covenants not to compete entered into in connection with an acquisition of an interest in a trade or business; franchise, trademark, or trade name; customer-based intangibles (e.g., composition of market, market share); and supplier-based intangibles (i.e., any value resulting from future acquisition of goods or services pursuant to relationships in the ordinary source of business with suppliers to be used or sold by the taxpayer). Certain types of intangibles are not allowed to be amortized under 26 USC 197, including financial interests in a corporation, partnership, trust, or estate; financial interests under an existing futures contract, foreign currency contract, or other similar financial contract; land; and certain types of computer software. The amortization period is 15 years. The annual deductible amount is determined by dividing the adjusted basis of the asset by 15. For example, if the adjusted basis of the intangible asset is $15,000, the taxpayer could claim $1,000 per year for 15 years.
Antitrust, Infringement, and Contractual Losses [26 USC 186]	If the taxpayer includes in gross income a compensatory amount that is received or accrued during the year for a compensable injury, they may deduct the lesser of the compensatory amount or the amount of the unrecovered losses sustained as a result of the injury. According to United States Treasury Regulations [26 CFR 1.186-1(b)(1)], there are three types of compensable injuries: (1) an injury sustained as a result of an infringement of a patent issued by the United States, (2) an injury sustained as a result of a breach of contract or a breach of fiduciary duty or relationship, and (3) an injury sustained in business or to property by reason of any conduct forbidden in the antitrust laws for which a civil action may be brought under the Clayton Act.
Architectural and Transportation Barrier Removal Expenditures [26 USC 190]	A taxpayer may elect to deduct (rather than capitalize) expenditures for removing architectural and transportation barriers to make the facility used in connection with their trade or business more accessible to and usable by handicapped and elderly individuals. The deduction is limited to $15,000. Any remaining expenditures over $15,000 must be capitalized.

Asset Expensing [26 USC 179]	A taxpayer may elect to deduct (rather than capitalize and depreciate) the cost of certain property, up to a certain amount in the year in which the property is placed into service. The aggregate cost that can be deducted is limited to $1 million, but that limit is reduced if the cost of the property exceeds $2.5 million. Additionally, only up to $25,000 may be deducted for the cost of a sport utility vehicle. These amounts are adjusted annually for inflation. Property eligible to be deducted under 26 USC 179 includes tangible property normally required to be depreciated, certain computer software normally required to be depreciated, and certain real property (i.e., improvements to interiors of nonresidential real property, roofs, HVAC property, fire protection and alarm systems, security systems), which is acquired for use in the active conduct or a trade or business. Deductions claimed under 26 USC 179 cannot create or increase a business's net operating loss.
Bad Debts [26 USC 166]	Corporations may deduct bad debts that are bona fide legally enforceable debts that have become worthless.
Charitable Contributions [26 USC 170]	Corporations may deduct charitable contributions made to qualifying organizations (i.e., governmental units, certain charitable organizations recognized under 26 USC 501(c)(3), certain veterans' organizations, and nonprofit cemetery companies). A corporation may only deduct an amount up to 10 percent of its federal taxable income; qualifying donation amounts that exceed 10 percent of the corporation's federal taxable income can be carried forward for 5 years. If a taxpayer claims a charitable contribution deduction on their federal return for the donation of a conservation easement on property located in Colorado and claims the Colorado Conservation Easement Credit pursuant to Section 39-22-522, C.R.S., they must add back the amount of the charitable contribution deduction claimed on their federal return when calculating their Colorado taxable income [Section 39-22-304(2)(f), C.R.S.].
Contributions to Employee Plans [26 USC 404]	Subject to numerous rules and limitations, employers may deduct contributions to stock bonus, pension profit-sharing, or annuity plans and payments or accruals of deferred compensation.
Depreciation [26 USC 167, 26 USC 168]	Taxpayers are allowed to claim a deduction for depreciation, which is reasonable allowance for the exhaustion, wear, and tear (including a reasonable allowance for obsolescence) of property used in a trade or business or property held for the production of income. The IRC [26 USC 168] generally provides the method and recovery period over which different classes of property must be depreciated. Most types of tangible property (real and personal) are depreciated over 3, 5, 7, 10, 15, 20, 25, 27.5, 39, or 50 years. For businesses that cannot use full asset expensing under 26 USC 179, the TCJA in 2017 created a special bonus depreciation provision in 26 USC 168(k) that allowed businesses to fully depreciate certain assets in the year in which they were placed in service through 2022. Bonus depreciation began phasing out in 2023 by 20 percent per year (i.e., 80 percent bonus depreciation allowed in 2023, 60 percent in 2024, 40 percent in 2025, 20 percent in 2026).
Energy Efficient Commercial Building Property [26 USC 179D]	Taxpayers may elect to deduct the costs of installing energy-efficient commercial building property rather than capitalizing and depreciating it. The deductible amount is limited based on a dollar amount set in statute (between $0.50 and $1.00 depending on reduction in energy and power costs) and the square footage of the building. If the property satisfies certain prevailing wage requirements and apprenticeship requirements, then the deduction amount can be increased.

Losses Incurred by the Business [26 USC 165]	In general, businesses are allowed to deduct "any loss sustained during the taxable year and not compensated for by insurance or otherwise."
Start-up Expenditures [26 USC 195]	Start-up expenditures are any amounts paid or incurred in connection with (1) investigating the creation or acquisition of an active trade or business, (2) creating an active trade or business, or (3) any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business, and which, if paid or incurred in connection with the operation of an existing active trade or business would be allowable as a deduction for the taxable year in which paid or incurred. Start-up expenditures do not include interest on indebtedness normally deductible under 26 USC 163(a), taxes normally deductible under 26 USC 164, or amortization of research and experimental expenditures normally amortized and deducted under 26 USC 174. Some examples of start-up expenditures include surveys and market/feasibility studies; advertising done in advance of the business opening; compensation paid to employees that join the company before it opens; and training employees before the company opens. Start-up expenses are generally not deductible; however, 26 USC 195 allows taxpayers to elect to deduct start-up expenditures, up to a certain amount. The taxpayer may deduct up to $5,000 of start-up expenditures, but the $5,000 is reduced by the amount by which the start-up expenditures exceed $50,000. Any remaining start-up expenditures are allowed as a deduction ratably over the 180-month period beginning in the month that the active trade or business begins.
Unused Business Credits [26 USC 196]	Businesses can deduct parts of certain business credits that were not able to be fully claimed because the carryforward period for the credit expired or the taxpayer ceased to exist. This deduction applies to the following credits: the investment credit (limited to 50 percent of the unused credit) [26 USC 46], the work opportunity credit [26 USC 51(a)], the alcohol fuels credit [26 USC 40(a)], the research credit [26 USC 41(a)], the enhanced oil recovery credit [26 USC 43(a)], the empowerment zone employment credit [26 USC 1396(a)], the Indian employment credit [26 USC 45A(a)], the employer Social Security credit [26 USC 45B(a)], the new markets tax credit [26 USC 45D(a)], the small employer pension plan startup cost credit [26 USC 45E(a)], the biodiesel fuels credit [26 USC 40A(a)], the low sulfur diesel fuel production credit [26 USC 45H(a)], the new energy efficient home credit [26 USC 45L(a)], and the small employer health insurance credit [26 USC 45R(a)].

Source: Office of the State Auditor analysis of federal laws and regulations, Internal Revenue Service guidance, and Colorado laws.

Appendix G

Corporate "Special Deductions"

Corporations are allowed to claim additional "special deductions" when calculating federal taxable income [26 USC 241]. This appendix provides a list with descriptions of the special deductions allowed. Additionally, we indicate when Colorado has enacted legislation to deviate from the federal allowance of special deductions.

Special Deduction	Description
Dividends Received by Corporations [26 USC 243]	Domestic corporations are allowed to claim a deduction for a portion of the dividends received from domestic corporations for which they have an ownership interest. The percentage that they are allowed to claim depends on the ownership percentage in the company. Corporate shareholders that own less than 20 percent of the corporation from which they are receiving dividends are allowed to claim a deduction for 50 percent of the dividends received. If the company owns 20 percent or more of the stock of the distributing company, the company receiving dividends can deduct 65 percent of the dividends received. If a company is a part of the same affiliated group for federal tax purposes, it may generally deduct all of the dividends received. According to Bloomberg Law, the purpose of the dividends received deduction is "to impose a single corporate income tax on the same domestic income. Without the DRD [dividends received deduction], domestic corporate income could be subjected to double taxation; first when earned, and then when distributed to corporate shareholders…without the relief of the DRD, the same earnings could be subject to more than two levels of taxation as distributions are made to corporate shareholders and then to individual shareholders."
Dividends Received from Certain Foreign Corporations [26 USC 245]	Domestic corporations that own at least 10 percent of a foreign corporation are allowed to claim a deduction for a portion of the dividends they receive from the foreign corporation with respect to the domestic source portion of the dividends received from the foreign corporation, which is generally the U.S.-source portion of a dividend that is attributable to income of the corporation that is connected with a U.S., business or dividends received by the foreign corporation from a U.S. subsidiary. The percentage of the deduction is typically determined by the same stock ownership percentages for the dividends received deduction in 26 USC 243. The deduction is allowed for all of the dividends distributed from wholly owned foreign subsidiaries in certain circumstances.
Dividends Received by Domestic Corporations from Certain 10-percent Owned Foreign Corporations [26 USC 245A]	Domestic corporations are allowed to claim a deduction for the foreign-source portion of dividends received from certain foreign corporations. The foreign source dividend that may be deducted is calculated by multiplying the dividend received by the U.S. corporation by a fraction, which is calculated as the undistributed foreign earnings of the corporation divided by the total undistributed earnings.

Organizational Expenditures [26 USC 248]	An organizational expenditure is defined in federal law [26 USC 248(b)] as "any expenditure which – (1) is incident to the creation of the corporation; (2) is chargeable to capital account; and (3) is of a character which, if expended incident to the creation of a corporation having a limited life, would be amortizable over such life." Treasury regulation [26 CFR 1.248-1(b)(2)] provides examples of organizational expenditures that qualify for this election and include "legal services incident to the organization of the corporation, such as drafting the corporate charter, by-laws, minutes of organizational meetings, terms of original stock certificates, and the like; necessary accounting services; expenses of temporary directors and of organizational meetings of directors or stockholders; and fees paid to the State of incorporation." A corporation may elect to deduct organizational expenditures, subject to a limit, in the taxable year in which it begins business. If the corporation makes the election, it may deduct up to $5,000 of organizational expenditures, but the $5,000 is reduced by the amount that exceeds $50,000. The remainder of the organizational expenditures is deducted ratably over the 180-month period beginning with the month in which the corporation begins business.

Foreign-derived Intangible Income and Global Intangible Low-taxed Income [26 USC 250]	The TCJA created new taxing regimes for global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII). Overall, the GILTI and FDII policies are intended to disincentivize companies from locating their intangible assets in foreign jurisdictions. GILTI is meant to discourage companies from locating intangibles in foreign jurisdictions and does so by ensuring U.S. multinational companies pay a minimum level of tax on their foreign earnings; prior to the TCJA, only certain types of foreign income were taxed annually (e.g., royalties, interest, dividends) but other types of foreign income were only taxed when they were repatriated to the U.S. GILTI seeks to discourage companies from locating intangibles in foreign jurisdictions by assuming a certain level of return on its assets and taxing it annually but at a lower effective tax rate than the standard corporate income tax rate. The lower effective tax rate on GILTI is achieved through a deduction in 26 USC 250(a)(1)(B), which allows domestic (U.S.) companies to deduct 50 percent of the GILTI included in gross income plus the amount treated as a dividend received by the corporation under 26 USC 78 that is attributable to GILTI. For taxable years after December 31, 2025, the percentage of GILTI allowed to be deducted decreases to 37.5 percent. Colorado statute [Section 39-22-304(3)(j), C.R.S.] allows corporations to deduct amounts treated as dividends under 26 USC 78 when calculating their Colorado taxable income. However, the deduction is not allowed for amounts treated as a dividend under 26 USC 78 that are attributable to GILTI and deducted under 26 USC 250(a)(1)(B)(ii). FDII is meant to encourage companies to locate intangible assets (specifically intellectual property such as patents and trademarks) on which they earn income from exports in the U.S. FDII is income derived from exports related to its U.S.-located intellectual property. According to Department of Revenue staff, FDII "is the result of an elaborate calculation based on 'deemed intangible income', which is itself an amount computed, roughly speaking, by deducting from gross income the 'deemed tangible income return', which is 10% of the corporation's 'qualified business asset investment'." FDII encourages locating intellectual property in the U.S. by taxing the income from the exports related to that intellectual property at a lower effective tax rate. As with GILTI, the lower effective tax rate is achieved through a deduction for FDII under 26 USC 250(a)(1). Domestic corporations are allowed to deduct 37.5 percent of the FDII of the domestic corporation. For taxable years after December 31, 2025, the percentage of FDII allowed to be deducted decreases to 21.875 percent.

Source: Office of the State Auditor analysis of federal laws and regulations, Internal Revenue Service guidance, Department of Revenue guidance, and Bloomberg Law documents.

Appendix H

Colorado Tax Credits Calculated Based on Similar Federal Tax Credits

This appendix provides descriptions of three Colorado income tax credits, which are all available to individuals, that are calculated based on a percentage of a similar federal credit.

The Child and Dependent Care Expenses Income Tax Credit [Section 39-22-119, C.R.S.] allows Colorado resident individual taxpayers who claim a credit for child and dependent care expenses on their federal tax return, as allowed under 26 USC 21, to claim a refundable Colorado income tax credit equal to 50 percent of the federal credit. The federal credit is not refundable. The Colorado credit is limited to taxpayers with $60,000 or less in federal adjusted gross income. Beginning in Tax Year 2026, the Colorado credit amount will be increased to 70 percent of the federal credit and is calculated as if the federal credit were fully refundable, which will make it available to low income taxpayers who lack sufficient tax liability to qualify for the federal credit due to it not being refundable. Beginning in Tax Year 2027, the adjusted gross income cap to qualify for the credit will be adjusted for inflation.

The Department of Revenue combines data for this credit with another similar child and dependent care expenses income tax credit that is specifically for low income taxpayers who are not eligible for the federal credit due to lacking sufficient tax liability. That credit is going to expire at the end of 2025 and the credit in Section 39-22-119, C.R.S. has been amended so that low income taxpayers can claim it instead. According to Department of Revenue data, in Tax Year 2022, which was the most recent year of data available, the combined revenue impact of both child and dependent care expense tax credits was about $6.1 million, with the average credit being $299. It was claimed by about 20,400 taxpayers. Our office published an **evaluation** of this credit in 2023; note that the credit was amended in the 2024 Legislative Session and changes to the credit are not reflected in our 2023 evaluation of it.

The Colorado Earned Income Tax Credit (EITC) [Section 39-22-123.5, C.R.S.] is a refundable income tax credit for low- and middle-income working taxpayers whose earned income is below a certain amount and who claim the federal earned income tax credit. In general, in order to be eligible for the Colorado EITC, the taxpayer must have been eligible for the federal EITC. The Colorado EITC amount is a percentage of the taxpayer's federal EITC, and the percentage varies by year. In Tax Years 2024 and 2025, the Colorado EITC is 50 percent of the federal EITC, and in 2026 the Colorado EITC will be 25 percent of the federal EITC. Beginning in Tax Year 2025, the percent may be increased based on an adjustment factor, which is calculated as the forecasted compound annual growth of state revenue subject to TABOR. The federal EITC amount varies depending on filing status (e.g., single, married filing jointly), number of children, and adjusted gross income. For

example, in 2024, the maximum amount of adjusted gross income a single taxpayer with one child could have had to qualify was $49,084 and the maximum EITC they could claim was $4,213.

There are a couple of exceptions for when a Colorado taxpayer may claim the Colorado EITC when they were not eligible for the federal EITC. First, according to Department of Revenue guidance, "the Colorado EITC…is allowed to resident individuals based on the federal EITC they would have been allowed, but were not allowed solely because the resident individual, their spouse, or one or more of their dependents did not have a social security number (SSN) that is valid for employment." Second, resident individuals who are under 25 years of age and do not have a qualifying child and do not qualify for the federal EITC may be eligible if they have a work-eligible social security number and either 24 years of age and a specified student, between 19 and 24 and not a specified student, or between 18 and 24 and are a qualified former foster youth or qualified homeless youth.

According to Department of Revenue data, in Tax Year 2022, which was the most recent year of data available, about 293,000 Colorado taxpayers that claimed the federal EITC claimed about $127 million in Colorado EITCs, with an average credit of $433. About an additional 18,000 Colorado taxpayers claimed about $3.8 million in Colorado EITCs under one of the two exceptions above, with an average credit of $217. Our office published an **evaluation** of this credit in 2022; note that the credit was amended in the 2023 Regular and Extraordinary Sessions as well as the 2024 Legislative Session, and changes made to the credit are not reflected in our 2022 evaluation of it.

Colorado Minimum Tax Credit [Section 39-22-105(3), C.R.S.] Some individual taxpayers may need to calculate and pay federal alternative minimum tax (AMT). To determine whether they owe federal AMT, taxpayers must generally calculate their federal AMT income by first adding exclusion and deferral items to their regular federal taxable income. Exclusion items include things that permanently reduce their federal taxable income like business operating expenses and interest. Deferral items are things that generally do not cause a permanent difference in taxable income because there is a corresponding increase in taxable income in later years, such as accelerated depreciation. After adding exclusion and deferral items to their regular federal taxable income, taxpayers then subtract a federal AMT exemption amount. In Tax Year 2024, the exemption amount was $85,700 for single filers and $133,300 for joint filers (the exemption amount is phased out for taxpayers with over a certain amount of income). They then multiply their federal AMT income by a rate, set between 26 and 28 percent based on their income level and filing status, to determine their federal AMT. Federal AMT is only paid to the extent that it exceeds their regular federal tax liability. For example, if a taxpayer's federal AMT is $20,000 and their regular federal income tax liability is $18,000, they would owe $2,000 in federal AMT as well as $18,000 in regular federal income tax. According to Department of Revenue guidance, "Colorado law establishes an alternative minimum tax (AMT) for individuals. Colorado AMT is based largely on federal alternative minimum taxable income, making it likely that a taxpayer who owes federal AMT will also owe Colorado AMT. The Colorado AMT is in addition to the normal Colorado income tax a taxpayer owes and is equal to the amount by which the tentative minimum tax exceeds the normal tax."

Federal law allows individuals who were liable for federal AMT in the prior tax year, but are no longer liable for it in the current tax year, to claim a federal AMT credit against their federal income

tax. The credit allows taxpayers to recoup the additional taxes they paid due to deferral items they claimed in the prior year that caused them to owe AMT. For example, if a taxpayer was subject to the federal AMT in the prior year solely because they claimed a deferral item, such as the accelerated depreciation deduction, but they no longer owe federal AMT in the current year, they could claim the federal AMT credit. The taxpayer would also then qualify for the Colorado Minimum Tax Credit against their Colorado income tax, which is calculated as 12 percent of the federal AMT credit amount. According to Department of Revenue data, in Tax Year 2022, which was the most recent year of data available, the revenue impact of the Colorado Minimum Tax Credit was about $4.3 million, with the average credit being $1,126. It was claimed by about 3,800 taxpayers. Our office published an **evaluation** of this credit in 2021. It has not been changed since our evaluation of it.

Appendix I

Organizations Exempt from Federal Income Tax

This appendix provides a list of the types of organizations that are exempt from federal income tax under federal law and the IRC section under which they receive their tax-exempt status.

- A trust created or organized in the United States that forms a part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of its employees or their beneficiaries that is described in 26 USC 401(a) [26 USC 501(a)]. According to Bloomberg Law, these types of organizations "comprise a substantial segment of exempt organizations."
- Corporations Organized Under an Act of Congress [26 USC 501(c)(1)].
- Title Holding Corporations [26 USC 501(c)(2)].
- Charitable, Religious, Educational, Scientific, etc. Organizations [26 USC 501(c)(3)]. Only organizations described in this section (except for testing for public safety organizations) are eligible to receive tax-deductible contributions [26 USC 170]. As such, there are additional qualifications for these types of organizations to receive tax-exempt status. Organizations exempt under 26 USC 501(c)(3) must be organized and exclusively for exempt purposes set forth in 26 USC 501(c)(3), including "religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals…" Additionally, no part of the net earnings of the organization may inure to the benefit of a private individual. There are also substantial limitations of the amount of political activities that organizations exempt under 26 USC 501(c)(3) are allowed to engage in: no substantial part of the activities of the organization may involve carrying on propaganda or otherwise attempt to influence legislation (with some exceptions provided in statute), and the organization cannot participate in or intervene in political campaigns on behalf of or in opposition to any candidates for public office.
- Civic Leagues and Social Welfare Organizations [26 USC 501(c)(4)].
- Labor, Agricultural, and Horticultural Organizations [26 USC 501(c)(5)].
- Business Leagues, etc. [26 USC 501(c)(6)].
- Social and Recreation Clubs [26 USC 501(c)(7)].
- Fraternal Beneficiary and Domestic Fraternal Societies and Associations [26 USC 501(c)(8) and (c)(10)] .
- Voluntary Employees' Beneficiary Associations [26 USC 501(c)(9)].
- Teachers' Retirement Fund Associations [26 USC 501(c)(11)].
- Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies, etc. [26 USC 501(c)(12)].

- Cemetery Companies [26 USC 501(c)(13)].
- State-Chartered Credit Unions, Mutual Reserve Funds [26 USC 501(c)(14)].
- Insurance Companies or Associations Other Than Life [26 USC 501(c)(15)].
- Cooperative Organizations to Finance Crop Operations [26 USC 501(c)(16)].
- Supplemental Unemployment Benefit Trusts [26 USC 501(c)(17)].
- Employee Funded Pension Trusts (created before June 25, 1959) [26 USC 501(c)(18)].
- Organizations of Past or Present Members of the Armed Forces [26 USC 501(c)(19) and (c)(23)].
- Black Lung Benefit Trusts [26 USC 501(c)(21)].
- Withdrawal Liability Payment Funds [26 USC 501(c)(22)].
- Trusts described in section 4049 of the Employer Retirement Income Security Act [26 USC 501(c)(24)].
- Title Holding Corporations or Trusts [26 USC 501(c)(25)].
- State-Sponsored Organizations Providing Health Coverage for High-Risk Individuals [26 USC 501(c)(26)].
- State-Sponsored Workmen's Compensation and Insurance and Reinsurance Organizations [26 USC 501(c)(27)].
- National Railroad Retirement Investment Trust [26 USC 501(c)(28)].
- Qualified Nonprofit Health Insurance Issuers [26 USC 501(c)(29)].
- Religious and Apostolic Associations [26 USC 501(d)].
- Cooperative Hospital Service Organizations [26 USC 501(e)].
- Cooperative Service Organizations of Operating Educational Organizations [26 USC 501(f)].
- Amateur Sports Organizations [26 USC 501(j)].
- Child Care Organizations [26 USC 501(k)].
- Charitable Risk Pools [26 USC 501(n)].
- Political Organizations [26 USC 527]. According to IRS guidance, "A political organization subject to section 527 is a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function. 'Exempt functions of a political organization include "influencing or attempting to influence the selection, nomination, election or appointment of an individual to a federal, state, or local public office or office in a political organization.' A political organization must be organized and operated for the primary purpose of carrying on exempt function activities. A political organization's primary activities must be exempt function activities. A political organization may engage in activities that are not exempt function activities, but these may not be its primary activities."

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