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WHAT YOU SHOULD KNOW ABOUT THE PROPOSED COLORADO STATE INCOME TAX

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The following pages call attention to certain problems involved in the enactment of any Colorado state income tax.

These problems are:

I. How much money can be raised without retarding growth or driving out desirable citizens.

II. How will private community activities be affected.

III. Should the interest from our own municipal bonds be taxed.

IV. Should dividends of corporations carry exemption to extent such dividends are earned in Colorado.

V. Should capital gains be taxed.

VI. Should losses be carried forward as offsets against earnings in subsequent years.

FOREWORD

The Colorado Legislature now has before it the question of the adoption of an Income Tax law. This law will be passed pursuant to an amendment to the State Constitution which was carried by a majority of about two per cent at the general election in 1936.

Several questions vital to the welfare of the State are involved in drafting such an Act, and it is the intention of this study to point out certain of these questions.

No exception is taken to the theory of income taxes, but it must be recognized at once that the Federal Government has pre-empted most of the revenues that can be obtained from this source. A reasonable state income tax can be successfully levied in Colorado and the tax so received will be of material aid in adjusting our present financial chaos. But a state income tax offers no miraculous alternative to the present tax burdens and no fabulous sum can be collected annually, as the following figures conclusively show:

I.

HOW MUCH MONEY MAY THE STATE EXPECT TO RECEIVE FROM AN INCOME TAX?

(a) In arriving at an answer to this question, reference has been made to the report of the Commissioner of Internal Revenue showing returns under the Federal Income Tax from the State of Colorado for the fiscal year ended June 30, 1936.

In the amount of income taxes returned to the Federal Government, Colorado ranked twenty-fourth among the states of the Union, and the taxes received were about two-thirds of 1% of the total income taxes received that year by the Government.

The following Federal Income Tax returns, subject to tax, were filed in Colorado for that year and the amount of taxes paid:

	Number	Tax
Individual (over $5,000)	7,473	$4,272,565
Individual (under $5,000)	8,537	
Corporation	1,916	5,067,540*

*See below for explanation of this amount.

(b) Reference has also been made to certain western and mid-western states which have Income Tax laws in order to compare the amount received from those State Income Taxes with that received by the Federal Government under the Federal act.

It will be seen that the ratios of State Income Tax collections to Federal Income Tax collections vary from 1 to 2, to 1 to 9. Total personal and corporation income tax collections for 1935 in states comparable to Colorado, together with Federal collections, are listed below to illustrate this point:

	State Receipts	Federal Receipts (6-30-36)	Ratio	1930 Population
Arizona	$ 402,000	$1,203,000	(1 to 3)	435,573
Idaho	642,000	1,137,000	(1 to 2)	445,032
Iowa	2,106,000	8,231,000	(1 to 4)	2,470,939
Kansas	1,231,000	6,133,000	(1 to 5)	1,880,999
Missouri	4,429,000	34,988,000	(1 to 8)	3,629,367
Montana	565,000	2,138,000	(1 to 4)	537,606
New Mexico	91,000	729,000	(1 to 9)	423,317
North Dakota	246,000	582,000	(1 to 2)	680,845
Utah	562,000	1,909,000	(1 to 3)	507,847

(c) The Personal Income Tax—The amount to be received by the State from this source will, of course, depend upon the amount of the personal exemptions allowed under the State Act. The Federal Act provides an exemption of $1,000 for single persons, $2,500 for married persons or heads of families, and $400 for each dependent.

The following conclusion has been reached by experts in the Income Tax field upon an analysis of the 8,537 Federal returns for incomes under $5,000. After deductions and exemptions allowed to such taxpayers, the average taxable income in each case is approximately

$1,250. This income, taxable at the 4% normal Federal tax rate, would produce an average tax of $50, or a total for the 8,537 persons of $426,850.

Deducting the amount estimated to have been received from the taxable incomes under $5,000 from the total individual returns of $4,272,565, would leave a total of $3,845,715 from the 7,473 taxpayers having taxable incomes in excess of $5,000. Those conversant with conditions in Colorado realize that a major portion of the $3,845,715 was paid by considerably less than 1% of the 7,473 taxpayers having incomes in excess of $5,000.

These returns were received from a Federal Income Tax schedule which reached 59% in its highest bracket, plus a normal tax of 4% (the highest Federal Income bracket is now 75%, plus a normal tax of 4%). Considering the relatively small amount which may be paid by those with incomes under $5,000, it is apparent that a total return of between $750,000 and $1,000,000 from individual residents of Colorado is all that could be expected from a reasonable State Income Tax schedule. If we impose an unreasonable schedule and lose our largest prospective taxpayers, the tax return will be reduced to a negligible amount.

This may readily happen, for if Colorado places too high a tax on the larger individual incomes, the relatively few wealthy people we have will be driven out—that is, forced to establish their legal residences in other states which have no income tax laws (such as Florida and Nevada) or in states where state income taxes are reasonable, as in New Mexico and California. This can be readily accomplished by retired persons whose incomes are derived from estates, trust funds, etc. This would be an irreparable loss to Colorado, as these people make many investments in Colorado, spend a great deal of money, employ many people, and make very substantial contributions annually to Community Chests, the Red Cross, private relief agencies, and in many other ways contribute greatly to the welfare of the State.

If, on the other hand, we endeavor to raise too much money from incomes up to say $10,000, the tax load will be unfairly distributed and the principle of "ability to pay" as a basis of taxation will be violated.

Furthermore, Colorado should not attempt to pass an income tax more onerous in its burden than that of other states similarly situated from an economic standpoint. Of the states having an income tax, the average span of rates is from 1% to 5%. North Dakota and California reach a maximum of 15%, but in California this percentage applies only to incomes of over $250,000. North Dakota's experience with an income tax is negligible. The total Federal tax received in that state in 1936 was only $581,774.

The following table shows the per capita collections from personal state income taxes for 1935 (based on 1930 population) in the states heretofore listed as comparable with Colorado:

	Personal Receipts	Per Capita
Arizona	$ 201,000	$0.46
Idaho	258,000	.58
Iowa	1,828,000	.74
Kansas	814,000	.43
Missouri	2,657,000	.73
Montana	286,000	.53
New Mexico	37,000	.09
North Dakota	175,000	.26
Utah	212,000	.40

California personal income tax law not effective in 1935.

The per capita collections shown above were made possible by the fact that in every state the personal exemptions were lower than granted under Federal Income Tax (refer to personal exemptions table shown below).

Colorado has approximately 1,000,000 people. Considering the above schedule, it is clear that a collection in Colorado of 75c to $1 per capita would be largely in excess of that received in other similar states. This bears out the opinion expressed above that a return of approximately $750,000 to $1,000,000 from individuals is all that can be fairly expected.

Colorado has had no experience in the administration of an income tax, and for that reason it is imperative that the legislature should proceed slowly in an obviously experimental field, and acquire experience as to effect of such a law on business and population. If a maximum rate of 6% is set in the law, that figure will be above the average of the states of the union having an income tax, and it would be advisable not to go above that figure at this time for the reasons outlined. In other words, we don't want to kill the goose that lays the golden egg.

As an equitable schedule of rates on taxable incomes after personal exemptions and deductions the following are suggested:

$ 1 to $ 3,000	1%	or	$ 1 to $ 1,000	1%
3,000 to 6,000	2%		1,000 to 3,000	2%
6,000 to 10,000	3%		3,000 to 7,000	3%
10,000 to 15,000	4%		7,000 to 12,000	4%
15,000 to 25,000	5%		12,000 to 20,000	5%
Over 25,000	6%		Over 20,000	6%

In connection with the above schedule, the similar brackets of the California law must be considered, as California is also seeking to attract new citizens whose income is derived from investments, as distinguished from wages and salaries.

California Schedule

$ 1 to $ 5,000	1%	$15,000 to $20,000	4%
5,000 to 10,000	2%	20,000 to 25,000	5%
10,000 to 15,000	3%	25,000 to 30,000	6%

The corporation tax in California is 4%. Taxable brackets mean the amounts remaining after deduction of all permissible items, including personal exemptions. Very often people with apparently taxable incomes, after deducting other taxes paid, interest, charitable contributions and personal exemptions, pay no income taxes. This is proven by the Federal returns, which show only 16,010 persons paying Federal Income Taxes in Colorado for fiscal year ended in 1936. Personal exemptions play a vital part in determining taxability and while the Federal Income Tax grants liberal personal exemptions, many of the states have adopted lower exemptions in order to create a larger number of taxpayers. Variations in personal exemptions are shown below:

	Single Person	Married Status with Two Dependents
California	$1,000.00	$3,300.00
Idaho	700.00	1,900.00
Kansas	750.00	1,900.00
Missouri	1,000.00	2,400.00
Montana	1,000.00	2,600.00
New Mexico	1,500.00	2,900.00
Utah	600.00	1,800.00
Federal Government	1,000.00	3,300.00

In Arizona, Iowa and North Dakota no personal exemptions are allowed against income but small dollar deductions are authorized after tax is computed. Such dollar deductions, however, are much lower in effect than the personal exemptions granted under the Federal Income Tax.

(d) The Corporation Income Tax—If the 13¾% Federal Corporation Income Tax produced the $5,067,540 mentioned above, it would appear that a 4% State Corporation Income Tax should produce $1,474,192. However, it must be borne in mind that a number of large corporations have head offices in Colorado and make returns in Colorado, but their income is derived from operations in *many* western states. Examples of such companies are: Mountain States Telephone & Telegraph Company, Great Western Sugar Company, Colorado Fuel & Iron Company, Colorado Milling & Elevator Company, and Ideal Cement Company. Thus it will be readily realized that, considering the income received by these corporations from their Colorado business only, no such tax as $1,474,192 can be received from these corporations from any reasonable State Income Tax. Studies of other state schedules reveal that a flat tax of 4% on corporation income approximates the average *maximum* rate. Therefore, a return of somewhere between $500,000 and $750,000 is all that can be reasonably expected from this source.

From the above estimates it is indicated that total receipts from any reasonable income tax will probably produce somewhere between $1,500,000 and $2,000,000 annually.

These conclusions are based upon a State Income Tax law containing provisions of personal exemptions similar to the Federal act. As these exemptions are lowered, additional income will be received from those not now reached by the Federal act.

II.

COMMUNITY ACTIVITIES

Income taxes also raise problems in other fields than the economics of taxation. Tax levies do not support all of the health, educational, recreational, and other facilities which progressive communities require. Hospitals, schools, playgrounds, orphanages, etc., are frequently financed by private contributions, and it is believed that such activities largely depend upon the support of those who would inevitably be driven to seek other states of residence if an unduly high income tax were enacted in Colorado. It is felt that everyone endeavors to do his share in supporting such activities and will continue to do so, but additional taxation must have some effect upon ability of taxpayers to contribute. To illustrate how those able to contribute do respond the results of the Denver Community Chest campaign in 1935 are shown below:

Number of Pledges	Brackets	Amount in Dollars	Percentage of Total
40,893	Up to $5	$113,995	19.4
4,278	From $5 to $25	35,860	6.1
1,332	From $25 to $100	49,982	8.6
577	From $100 to $500	99,048	16.9
121	From $500 to $5,000	140,238	23.9
12	Over $5,000	147,584	25.1
47,213	Totals	$586,707	100.0

Similar figures for 1936 campaign not yet compiled.

The above figures show that less than one-third of 1% of contributors to the Denver Community Chest contributed 49% of the amount received. If we apply the same ratio to Federal Income Tax receipts for fiscal year ended 1936 it can be construed that driving out less than 50 of our largest taxpayers could result in cutting anticipated state income tax receipts in half.

III.

TAXING INTEREST ON COLORADO MUNICIPAL BONDS

Colorado municipal bonds have been issued under the general assumption that the interest therefrom was tax exempt. For this reason, municipalities borrowed money at lower rates than other types of borrowers. During the past two years this has been especially true, as the following examples show: Bent County High School 3%, Boulder Schools 2½%, Douglas County High School 3%, Englewood Schools 2¼%, Fowler Schools 3½%, Golden Schools 2¾%, Grand Junction Schools 2½%, Montrose 2¾%, Swink Schools 3½%, Timnath Schools 3½%, etc. This type of investment has been a favorite for funds of widows and orphans, not only on account of safety but because of assured income for living expenses. To reduce this income by income taxes would work a hardship in many cases and such a tax would undoubtedly reduce the price at which the bonds could be sold, if sale was made necessary by emergencies. Latest available compilation shows that 21 out of the 32 states having State Income Taxes do not tax the interest on their own municipal bonds, while others only tax interest on bonds issued after the income tax law went into effect. It appears evident that taxing interest on outstanding municipal bonds is not just for reasons cited. Taxing interest on future bond issues is not objectionable, but it is difficult to see any desirable results as municipalities would not be able to borrow as cheaply. Thus the additional interest the municipalities would pay would offset the income tax collected.

IV.

DIVIDENDS FROM COLORADO CORPORATIONS

The question of providing exemption for dividends paid by Colorado corporations is very important. Such distributions will be subject to the corporation income tax, so that exemption to the same percentage the corporation pays (when such dividends are received by Colorado residents) is entirely justified, in fact, this is double taxation by the same taxing authority unless so exempted. Such exemption would encourage home ownership of Colorado corporations and would be an inducement for the creation of additional industries in the state.

V.

CAPITAL GAINS

Such gains are not income. England does not tax capital gains. Many of our states having State Income Taxes do not tax capital gains. There is considerable agitation in Washington to remove this tax under the Federal Income Tax because of harm such a tax causes. Such taxes reduce the amount of capital available for new enterprises. Such taxes make for run-away markets in commodities, real estate, and securities, because owners insist on prices which will pay tax as well as reasonable gain. People are unwilling to risk their capital in development work if they take all risk of loss in event of failure and are forced to pay out most of gain in event of success. Mining is a vital local example of this condition. So also are other activities looking to the development of our other natural resources, such as oil, timber and coal.

VI.

LOSSES

Business enterprises face losses as well as profits and recognition of that fact should be contained in an income tax. As pointed out under Capital Gains, every incentive should be resorted to that will aid in the development of Colorado. The principle that losses might be deducted in subsequent years was included in the Federal Income Tax Law until repealed during the recent depression years under force of the unusual conditions then existing. Business is now improving and it would appear logical to permit losses to be carried forward as an inducement to promote mining and other industrial activities. Another method is to permit payment of taxes on a three year average. This latter method also makes for greater stability in amount of income taxes collected.

CONCLUSION

Colorado is still in the development, or pioneer stage. It is to a large degree an agricultural state. The state's biggest crop is the tourist crop, and great efforts are being made and much money is being expended to induce people to come to Colorado to live. Instead of taxing wealth heavily, we should make every effort to induce wealth to come into this state and be used in developing its resources. Colorado is a residential state and many people have moved here for the climate, or for the health of some member of their family, but their business connections are located in, or their incomes are received from other states. This class of people—and it is a numerous class—would be inclined to take up their residence in some other state if too heavy an income tax is laid upon them by Colorado.

For all of the reasons submitted in this study it is manifest that the greatest care must be exercised in drafting our first state income tax. The limited tax relief which such a law offers must be balanced against the more lasting harm that an unreasonable state income tax could cause to Colorado.

To many who have honestly studied the questions which a state income tax raises, it is inescapable that Colorado faces a fundamental decision. Shall the state continue to capitalize on its natural endowments of climate and scenic splendor to attract citizens who have acquired sufficient income upon which to live or discourage such citizens? Retired wealth does not mean great wealth. There are, probably, thousands of our fellow citizens in this class who have strictly limited incomes. It is the ambition of most Americans to accumulate enough to retire. Let us make Colorado attractive to those who attain this goal. Taxes of any kind increase all living costs and an unreasonable state income tax could thus influence the man of limited income to settle elsewhere as well as those having large fortunes. Florida welcomes wealth with a guaranty of no income taxes. California offers a very reasonable income tax. What will Colorado do?

COMMUNITY PROPERTY LAWS

Colorado must also consider the effect of community property laws in enacting a state income tax law. Community property laws govern the income of husband and wife for income tax purposes and are in force in Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington.

In community property states, each spouse is considered to be an equal partner in the marital partnership. The general rule under these laws is that income from community properties, as well as the earnings of the husband and wife, belong equally to the husband and wife and each may report one-half of this income in his or her separate return (in California this applies to property and earnings acquired or earned after July 29, 1927).

This means that by dividing the income, with each spouse making a separate return, income taxes are kept in lower tax brackets and thereby very materially reduce the amount which would be paid if the total income were reported under a single return.

The possible savings in income taxes under these community property laws and the handicap of Colorado in this respect is illustrated by the following brief table for married taxpayers with two dependents:

	COLORADO		CALIFORNIA		
	(Single Return)		(Single Return)	(Possible Payments Under Community Property Law)	
Taxable Income	Federal*	H. B. No. 148	State	State	Federal
$ 5,000.00	$ 68.00	$ 31.00	$ 17.00	$ 17.00	$ 68.00
10,000.00	383.00	356.00	84.00	67.00	268.00
25,000.00	2,383.00	1,810.00	585.00	351.00	1,587.00
50,000.00	8,677.00	4,310.00	2,286.00	1,335.00	5,447.00

*Single return under Federal Income Tax would carry same tax in California as in Colorado. Calculations on next page are all based on single return.

The above table shows it is possible for a married couple with $10,000 taxable income to pay total income taxes in California of $335, as against a total of $739 in Colorado under bracket proposed in House Bill No. 148. Without benefit of community property law the total for California would be $467, against $739 for Colorado. Other brackets show equally startling differentials.

The information contained herein has been compiled from authoritative sources. The compilers would appreciate immediate advice if any inaccuracy is discovered by anyone.