Economic Impacts of Eliminating Colorado's Fiduciary Tax on Trusts

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Economics International Corp. was engaged by Common Sense Policy Roundtable to examine the economic impacts associated with removing Colorado's fiduciary tax on trusts.

While nearby states have no taxes on trusts, Colorado's trust tax laws are unfavorable for setting up and managing trusts. Indeed, estate planners have been advised to avoid Colorado-based trustees. This is borne out by the following empirical observations:

- **The state's fiduciary tax has contributed to a decline in Colorado's trust business**. The number of trust accounts in Colorado has declined over the past decade with the state losing an average of approximately 500 accounts a year.
- **Colorado is losing trust business to more competitive states**. While Colorado's business has seen a decline, the number of accounts in the rest of the US has been stable. As a result, Colorado's share of the US trust industry has seen a decline from nearly 0.35 percent of the market to less than 0.20 percent.
- **Eliminating the fiduciary tax would not noticeably affect the state budget**. In 2010, the most recent year for which information is available, fiduciary tax collections accounted for only 10 cents of every $100 in total tax collections by the state.

Our analysis is based on the assumption that removing the tax would reverse the decline in the Colorado trust industry and boost growth in trust assets over the next decade. We employ a widely used model to calculate the impacts each year as Colorado trust assets are anticipated to grow. We also calculate the net fiscal impacts, with the following results after a decade.

- **9,370 to 21,965 more full- and part-time jobs.**
- **$1.65 billion to $3.87 billion in additional economic activity.**
- **$435 million to $1.03 billion in additional payroll and self-employment income.**
- **Eliminating the tax would "pay for itself" with increased tax collections relatively quickly.**

Thus, if the state can attract sufficient trust assets by eliminating its fiduciary tax on trusts, the Colorado economy would experience improved employment and incomes over the next decade.

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Economics International Corp. was engaged by Common Sense Policy Roundtable to examine the economic impacts associated with removing Colorado's fiduciary tax on trusts. Our analysis is based on the assumption that removing the tax would reverse the decline in the Colorado trust industry and boost growth in trust assets to as much as $150 billion over the next decade. Our analysis employs a widely used input-output model to calculate the impacts each year as Colorado trust assets are anticipated to grow. The model reports output, earnings, and employment impacts. We also employ a proprietary data set and statistical model to calculate the extent to which eliminating Colorado's fiduciary tax would affect state tax collections. All figures and tables are at the end of this report.

1 Introduction and Background

A trust is a legal entity and can be thought of as an account into which one can transfer assets. The assets become legally owned by the trust and are no longer considered part of the estate of the person transferring the assets. The creator of the trust appoints a trustee who is legally responsible for managing and distributing assets in the trusts according to the trust's directions. The trustee can be the creator of the trust, a family member, a friend, or financial-services firm.

Advantages of trusts

The most common reason for setting up a trust is to reduce estate taxes. For example, under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, the 2013 estate tax rate is 55 percent with a $1 million exclusion. Take a family with more than $2 million in assets. If the father dies first, his assets would pass to his wife. Spouses inherit assets from each other tax-free. But at her death, the children would inherit her estate and get the benefit of only her $1 million estate tax exclusion. In other word, the husband's $1 million exclusion will be lost.

If the husband had put his $1 million exemption amount into a trust, his widow could still have access to the principal or income according to instructions in the trust. And upon her death, the couple's children would inherit the $1 million in the trust, as well as $1 million of their mother's estate, estate tax free.

Trusts can also protect life insurance proceeds from estate taxes. If a life insurance policy is in an individual’s name, proceeds would be subject to estate taxes. However, if the insured created a trust to own the life insurance policy, then the beneficiaries can avoid having their benefits reduced by estate taxes.

There are a number of nontax reasons that have made trusts more attractive to those in the middle-class. For example, trusts can be used to protect assets, clarify lines of inheritance, help charities, and provide for children with special needs.

Individuals concerned about someone else laying claim to his or her assets can find some protection in a trust. In this way, a trust can protect someone from a creditor, an ex-spouse, a former business partner, or even against a personal injury judgment. Once the assets are transferred to a trust they are no longer in the creator’s name, making it difficult for anyone to get at them. For example, with the passage of the Sarbanes-Oxley Act, which makes top executives and directors accountable for their company's financial results, more executives are looking into asset protection trusts.

With death, divorce, and multiple marriages, the lines of inheritance can get muddied. A trust known as a qualified terminable interest property (QTIP) trust is one way to make the lines of inheritance—who gets what—more clear. For example, say that a husband is concerned that after he dies, his spouse will remarry and decide to name not only his children but also her new stepchildren as beneficiaries. A QTIP trust lets the husband specify that his estate will ultimately end up going only to his children.

Trusts can be used to benefit charity while shielding the trust creator’s estate from tax. For example, a charitable remainder annuity trust provides annual income from property transfer into the trust. At the end of the term, assets that remain in the trust go to charity. The trust’s creator gets the benefit of an immediate tax deduction for the present value of what will go to charity.

The most common nontax reason to create a trust is to provide for either a dependent with special needs or a child under age 18. If the inheritance is given to such heirs outside a trust, their guardians may have to go to court once a year to get authorization to administer assets. A trust allows the assets to be administered outside the court. For a child with a disability, a trust can also be a way to ensure continued government assistance for programs. Eligibility for some programs is based on a child's assets and income. With a special-needs trust, distributions can be structured in a way to allow the child to be eligible for assistance.

Colorado's taxation of trusts

Trusts are regarded as essential tools for estate planning largely because of the potential for federal estate and gift tax savings if structured properly.[1] Many states, however, impose their own taxes on estates, gifts, and trusts. In particular, some trusts may be treated by a state as separate, stand-alone taxable entities themselves subject to state fiduciary income tax in one or more states.

Colorado's trust tax laws are unfavorable for setting up and managing trusts. An attorney specializing in estate planning, estate and trust administration, and estate and trust-related litigation advises estate planners to avoid Colorado-based trustees.[2]

> The advisor must ensure that the steps taken to change a trust's tax residency do not inadvertently cause the trust to be subject to state income tax elsewhere. *For example, the advisor would presumably seek to avoid designation of a new trustee situated in, say, Colorado, whose laws subject a trust to income taxation if the trust has its place of administration there*. [emphasis added]

Nearby states such as Wyoming, South Dakota, Nevada, and Texas have no taxes on trusts. Colorado's estate and trust income tax (also known as a "fiduciary" income tax) is a flat 4.63 percent. If a trust is administered in Colorado it is considered a resident estate or trust. In addition, nonresident trusts that are not administered in Colorado must file a return if they have Colorado source income. The Colorado tax on a nonresident trust is based on the ratio of the Colorado taxable income to the modified federal taxable income. In this way, some nonresident trusts are subject to double taxation.

Colorado fiduciary tax collections are widely variable from year to year. Figure 1 shows that, on average, the state collects $27 million a year from the fiduciary tax. The

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[1] Currently, Colorado does not collect an estate tax. However, prior to 2005, Colorado, along with many other states, employed a "pickup" tax policy. The pickup is a legal mechanism that allows a state to receive a portion of federal estate tax revenue by making use the IRS's state estate tax credit. In 2005, the pick up tax was phased out under the provisions of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA). As a result, Colorado no longer collects a state estate tax. In 2010, the Taxpayer Relief Act of 2010 (TRA 2010) was signed into law. This law overrides the provisions of EGTRRA with regard to estate taxes. In new law the pickup tax was not reinstated. Thus, Colorado will not collect a state estate tax for the 2011 and 2012 tax years. Neverthelss, the provisions of TRA 2010 are set to sunset on December 31, 2012, in which case the pick up tax, as well as the Colorado estate tax, is scheduled return on January 1, 2013.

[2] Redd, C. A. (2011). State income tax issues with trusts. The 2011 Estate Planning Teleconference Series. Cannon Financial Institute, Inc.

figure also shows that collections can be nearly double the previous year's collections or a less than half the previous years' collections. In addition to the wild swings in Colorado's fiduciary tax collections, the tax itself makes up a miniscule portion of the state's total tax collections. As shown in Figure 2, on average fiduciary tax collections make up less than 0.4 percent of the state's total tax collections. In 2010, the most recent year for which information is available, fiduciary tax collections were only 0.1 percent of total tax collections by the state.

The decline of Colorado's trust industry

Figure 3 shows that the number of trust accounts in Colorado has declined over the past decade, losing an average of approximately 500 accounts a year.[3] In addition, the assets in Colorado trusts have also seen a decline over the past decade (Figure 4). In contrast, the number of accounts in the rest of the US has been stable (Figure 5) and the amount of assets in the rest of the US have increased over the past decade (Figure 6). As a result, Colorado's share of the US trust industry has seen a decline from nearly 0.35 percent of the market to less than 0.20 percent (Figure 7).[4]

Colorado's trust industry has declined relative to nearby states. Figure 8 shows that the number of accounts in Colorado has declined by 59 percent since December 2001, South Dakota, Texas, and Wyoming combined have seen an increase of 276 percent over the same period. Similarly, Figure 9 shows that trust assets in Colorado have declined by 25 percent while trust assets in the nearby states have increased by 473 percent.

2 General Research Approach

In this study, we examine the likely effects on the Colorado economy if the state were to eliminate the fiduciary tax on trusts. Market participants have noted that Colorado has established financial services industry and professional expertise. In addition, several Colorado locations such as Vail and Aspen have reputations for attracting individuals with relatively high net worth. We consider a hypothetical case in which, within a decade from now, removing the tax would allow for Colorado trusts to accumulate $65 billion in assets, or approximately the same amount of assets currently in South Dakota trusts. Some observers project that, by 2020, $12 trillion in assets will be transferred

[3] Information on the number of trust accounts and assets by state are from the Federal Deposit Insurance Corporation. For these data, the location of the accounts is reported for where the bank's main office is. Thus, tax data from the State of Colorado is not entirely consistent with account and asset data from the FDIC.

[4] For data from the Federal Deposit Insurance Corporation, the location of the accounts is based on where the trust's main office is. Thus these data represent an approximation.

across generations.[5] Thus, we also consider the hypothetical case that Colorado trusts capture a little more than one percent of this transfer, in which case the state would have approximately $150 billion in trust assets.

This study uses RIMS II to calculate how eliminating Colorado's fiduciary tax on trusts would impact the state's employment, earnings, and output. RIMS II was developed and is maintained by the US Bureau of Economic Analysis. It is widely used in both the public and private sector. According to empirical tests, the estimates based on RIMS II are similar in magnitude to the estimates provided by other input-output models, such as IMPLAN.

RIMS II is based on an accounting framework called an input-output table. For each industry, an input-output table shows the distribution of the inputs purchased and the outputs sold. A typical input-output table in RIMS II is derived mainly from two data sources: BEA's national input-output table, which shows the input and output structure of nearly 500 US industries, and BEA's regional economic accounts, which are used to adjust the national input-output table in order to reflect a region's industrial structure and trading patterns.

Economic impacts can be measured in several ways. This report focuses on three of the most common and useful measures:

1. **Employment**: the number of people working full- or part-time jobs;
2. **Output**: the value of goods and services produced, also described as economic activity;[6] and
3. **Income**: the total payroll costs (including bonuses and benefits) paid to workers as well as self-employment income earned by individuals.[7]

In addition to the estimating employment, earnings, and output, this study uses a proprietary data set and statistical model to calculate the extent to which eliminating Colorado's fiduciary tax would affect state tax collections.

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[5] Community Foundation R&D Incubator (2002). *Family Philanthropy and the Intergenerational Transfer of Wealth*.

[6] RIMS II output multipliers are used to produce estimates of changes in total gross output, which is different from gross domestic product (GDP). Gross output reported by RIMS II incudes spending on intermediate inputs, which are goods and services that are used in the production process of other goods and services and are not sold in final-demand markets. GDP, in contrast, excludes the impact of spending on intermediate inputs.

[7] Personal contributions to social insurance and employee pension plans are excluded because the model accounts for only the portion of personal income that is currently available for households to spend.

3 Effects on Employment and Income and State Tax Collections

Impacts are based on the assumption that by eliminating Colorado's fiduciary tax on trusts, trust assets in the state would grow over the next decade. Table 1 shows the net impacts over time if assets grow to $65 billion by 2022. Table 3 shows the net impacts over time if assets grow to $150 billion by 2022.

The impacts throughout this report are *net* impacts in that they measure the *difference* in impacts relative to an alternative in which Colorado's fiduciary tax remains unchanged and the state's trust business continues its slow decline. For example, if Colorado's fiduciary tax remains unchanged, it is expected that by 2022, trust assets in the state would be a little less than $1.75 billion. Thus, the *difference* between $65 billion and $1.75 billion provides a *net* change of $63.25 billion. Dollar amounts in this report are in current dollars, meaning the dollar amount in the time period being examined without any adjustment for inflation or the time value of money.[8]

Table 2 and Table 4 provide detail for a single year. If removing the state's fiduciary tax on trusts increased state trust assets to $65 billion by 2022, then the input-output model indicates that output in the state would be $1.65 billion higher. If removing the state's fiduciary tax on trusts increased state trust assets to $150 billion by 2022, then the input-output model indicates that output in the state would be $3.87 billion higher. Approximately three-quarters of additional output would be associated with direct and indirect effects; approximately one-quarter of the additional output would be associated with increased spending by households.

Direct and indirect impacts are based on Type I multipliers, which account for the supply of goods and services in the region. Induced impacts are derived from Type II multipliers which account for direct and indirect impacts, as well as impacts associated with the purchases made by employees.

The last column of Table 2 and Table 4 shows that an increase in Colorado trust assets would be associated with an additional 9,370 to 21,965 full- and part-time jobs in the state. Earnings in the state would increase by $435 million to $1.03 billion.

The finance and insurance industry would experience approximately two-thirds of the expected increase in economic activity, with additional output of $1.1 billion to $2.5 billion and 5,800 to 13,600 more full- and part-time jobs. Measured by output, the real estate and rental and leasing industry would see the next largest impacts, with an additional $116 million to $271 million in output.

[8] Note that the RIMS II employment multipliers are based on output in 2008 dollars. This study makes the appropriate adjustment to account for this feature of the model.

In addition to estimating employment, earnings, and output, this study calculates the extent to which eliminating Colorado's fiduciary tax would affect state tax collections. The anticipated increased economic activity associated with removing Colorado's fiduciary tax on trusts would be transmitted into additional state tax collections. Indeed, much of the variation in Colorado's state tax collection can be attributed to variations the state's economy. Using a proprietary data set and statistical model to quantify the relationship, this study calculates the fiscal impacts of eliminating Colorado's fiduciary tax.

The last column of Table 1 and Table 3 shows the calculated net impacts on state tax collections. It provides the difference between (1) increased tax collections resulting from the increased economic activity associated with removing Colorado's fiduciary tax on trusts and (2) the projected taxes that would be collected if the fiduciary tax remains in place. The table shows that in less than 10 years, removing the fiduciary tax on trusts would pay for itself with additional state collections elsewhere. Recall, however, that Colorado's fiduciary tax collections make up less than 40 cents of every $100 the state collects. Thus, even removing the fiduciary tax on trusts did nothing to "replace" the "lost" tax revenues, the amount would be so small as to be unnoticeable.

4 Conclusion

While nearby states have no taxes on trusts, Colorado's trust tax laws are unfavorable for setting up and managing trusts. Indeed, estate planners have been advised to avoid Colorado-based trustees. This is borne out by the following empirical observations:

- The state's fiduciary tax has contributed to a decline in Colorado's trust business. The number of trust accounts in Colorado has declined over the past decade with the state losing an average of approximately 500 accounts a year.
- Colorado is losing trust business to more competitive states. While Colorado's business has seen a decline, the number of accounts in the rest of the US has been stable. As a result, Colorado's share of the US trust industry has seen a decline from nearly 0.35 percent of the market to less than 0.20 percent.
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- $1.65 billion to $3.87 billion in additional economic activity.
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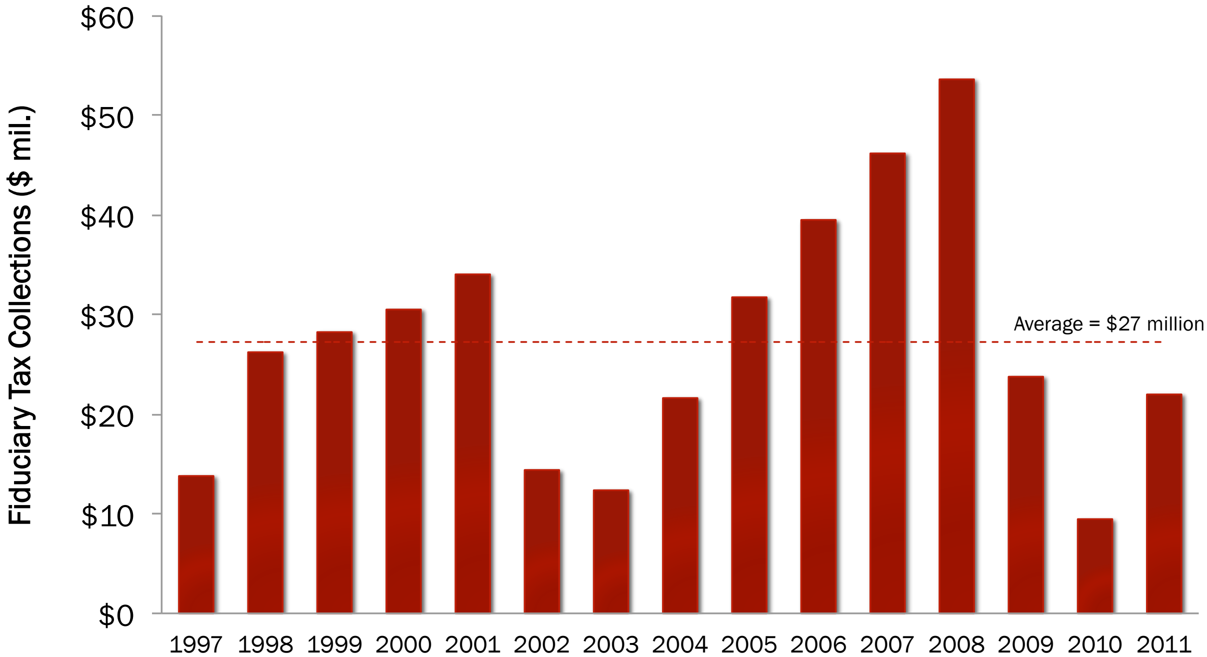
- Eliminating the tax would "pay for itself" with increased tax collections relatively quickly.

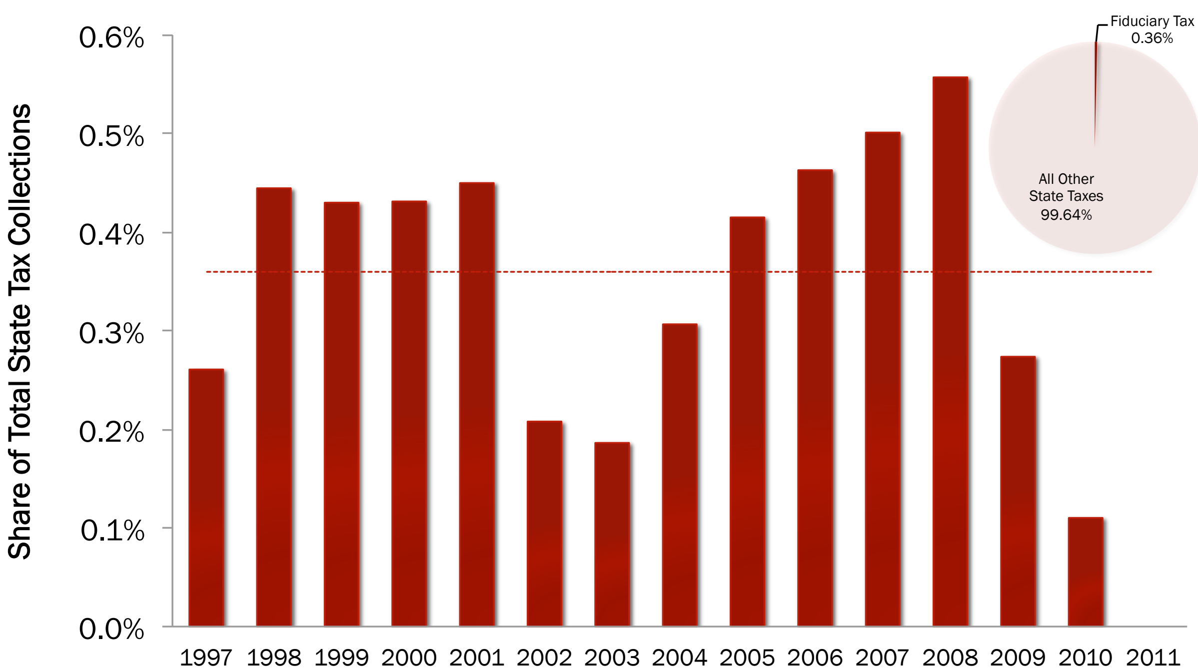
Thus, if the state can attract sufficient trust assets by eliminating its fiduciary tax on trusts, the Colorado economy would experience improved employment and incomes over the next decade.

Figure 1: Colorado fiduciary tax collections



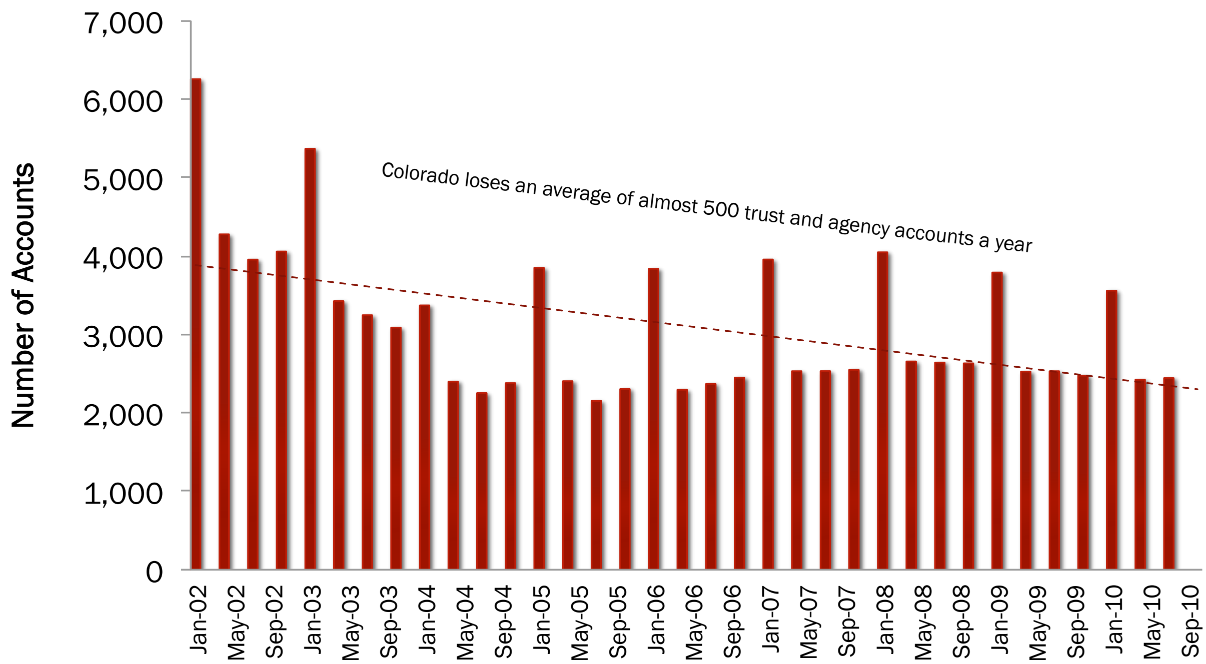
Source: Colorado Department of Revenue

Figure 2: Colorado fiduciary tax as share of total state tax collections



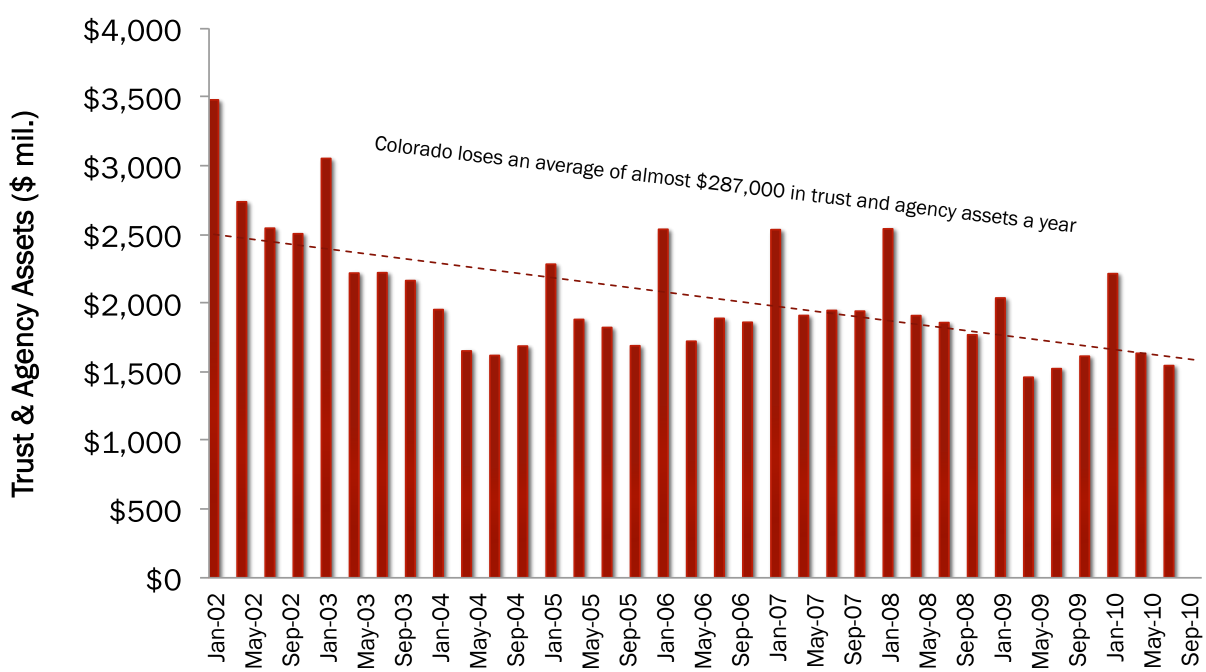
Source: Colorado Department of Revenue; US Census Bureau

Figure 3: Colorado personal trust and agency accounts



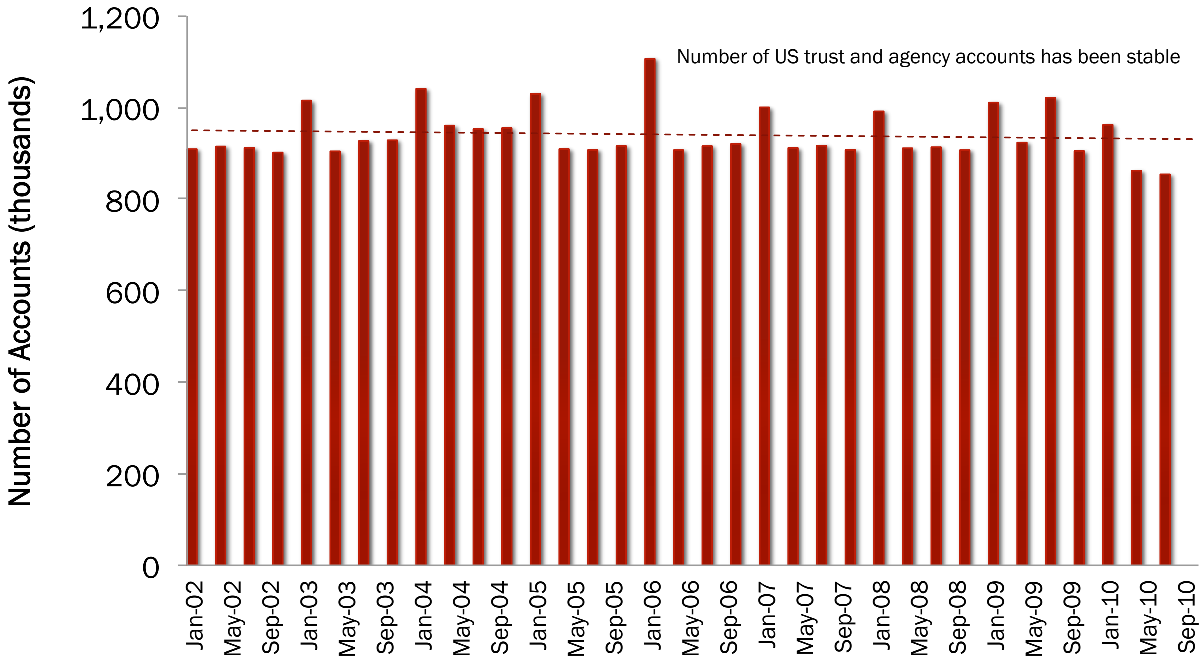
Source: US Federal Deposit Insurance Corporation

Figure 4: Colorado personal trust and agency assets



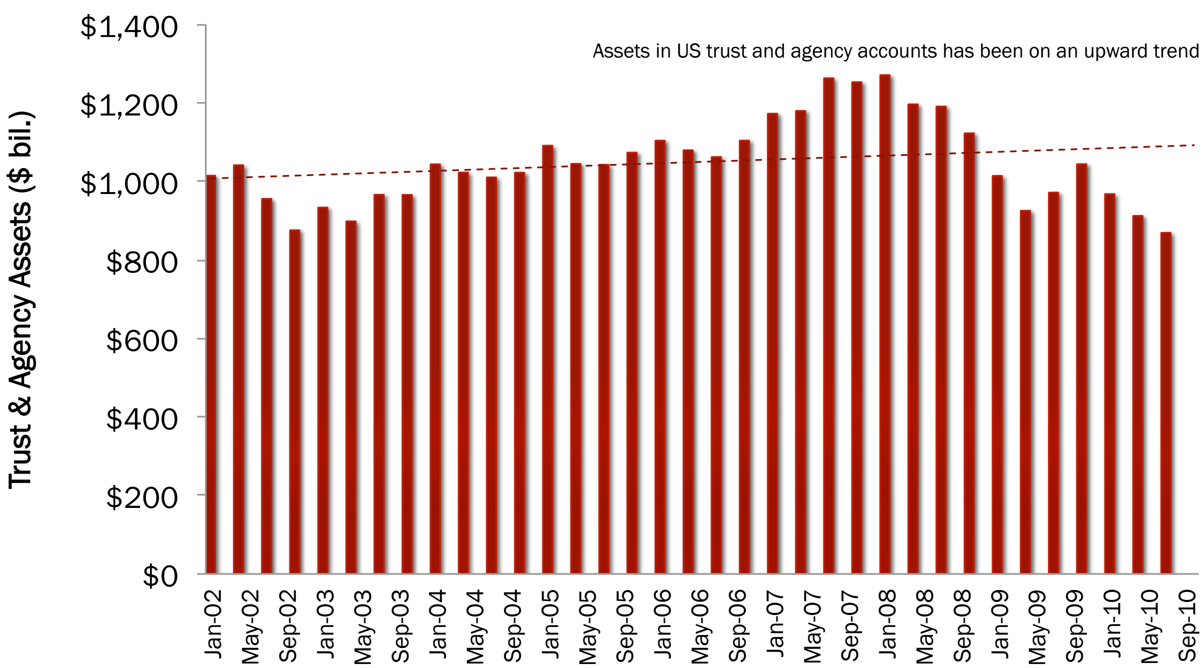
Source: US Federal Deposit Insurance Corporation

Figure 5: US personal trust and agency accounts, excluding Colorado



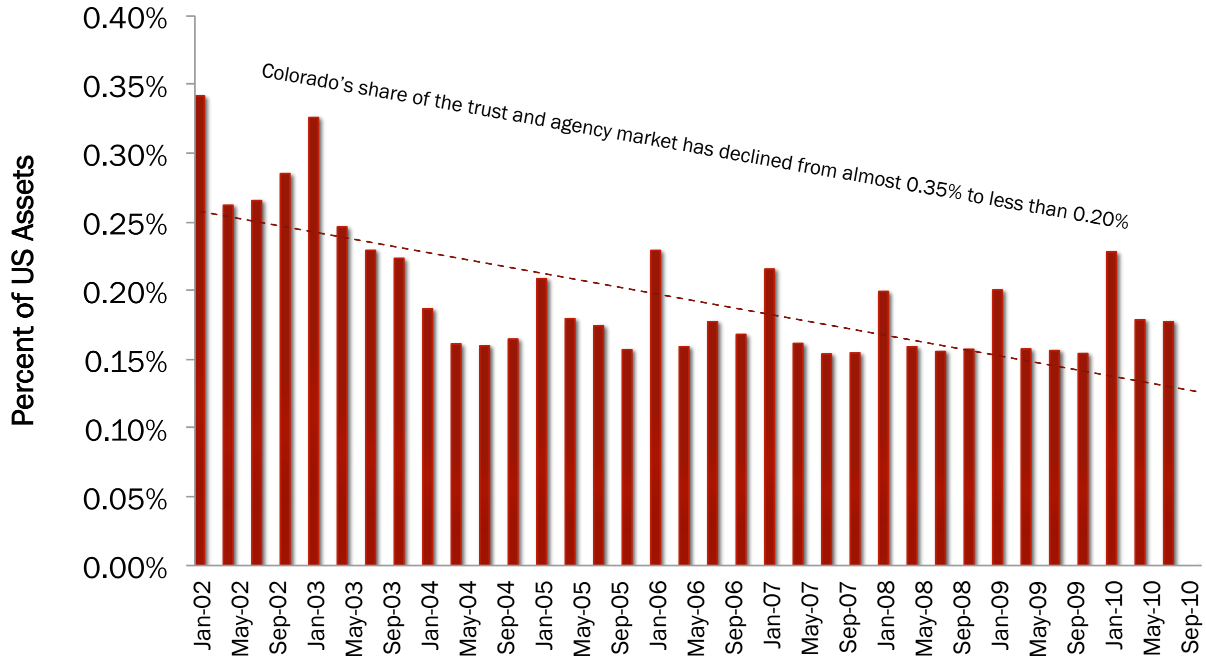
Source: US Federal Deposit Insurance Corporation

Figure 6: US personal trust and agency assets, excluding Colorado



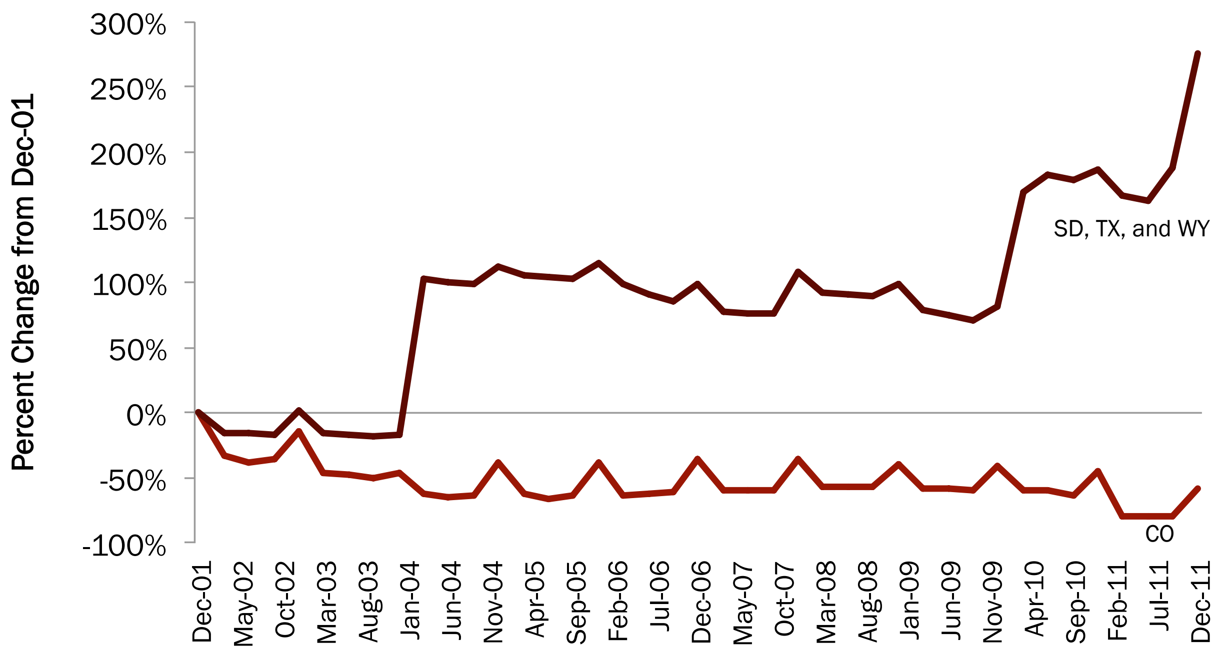
Source: US Federal Deposit Insurance Corporation

Figure 7: Colorado's share of US personal trust and agency assets



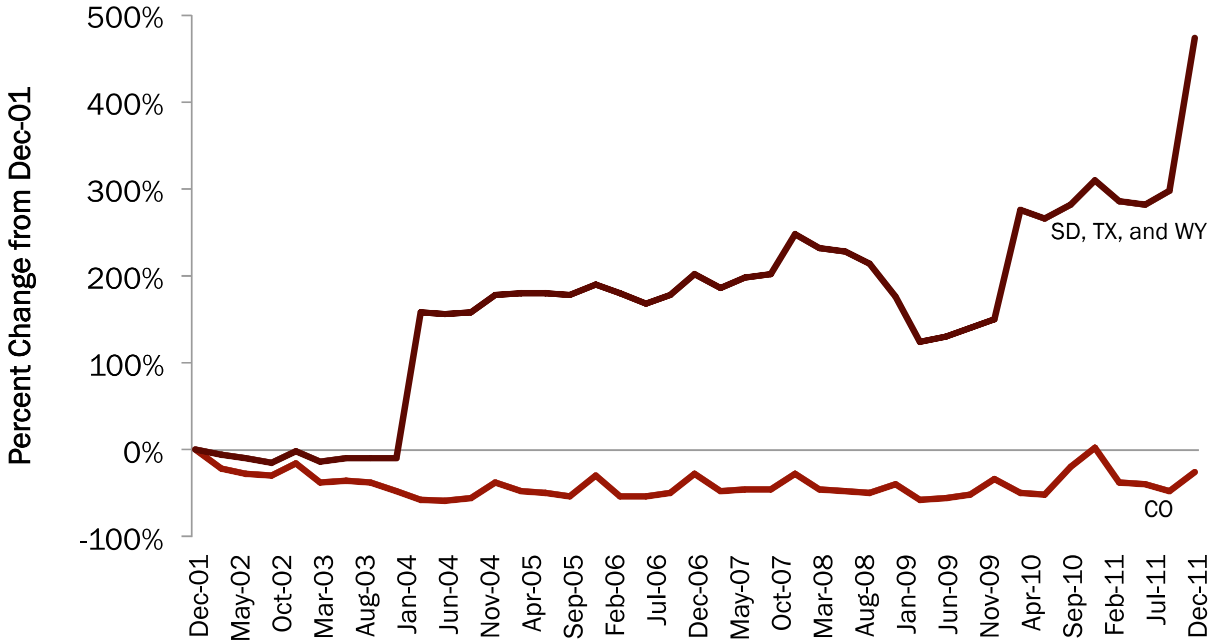
Source: US Federal Deposit Insurance Corporation

Figure 8: Change in number of trust accounts, Colorado vs. South Dakota, Texas, and Wyoming



Source: US Federal Deposit Insurance Corporation

Figure 9: Change in trust assets, Colorado v. South Dakota, Texas, and Wyoming



Source: US Federal Deposit Insurance Corporation

Table 1: Net economic and state tax impacts over 10 years associated with elimination of Colorado fiduciary tax on estates in 2012 and $65 billion in trust assets by 2022

Year	Colorado Trust Assets	Output	Earnings	Employment	Tax Collections
	($ mil.)	($ mil.)	($ mil.)	(full- and part-time)	($ mil.)
2012	$680	$20	$5	120	($25.9)
2013	1,630	40	10	280	(25.3)
2014	2,940	75	20	500	(24.6)
2015	4,770	125	35	795	(23.6)
2016	7,300	190	50	1,195	(22.2)
2017	10,820	280	75	1,740	(20.3)
2018	15,710	410	110	2,485	(17.6)
2019	22,510	585	155	3,500	(13.8)
2020	31,940	835	220	4,890	(8.6)
2021	45,050	1,175	310	6,785	(1.4)
2022	63,250	1,650	435	9,370	8.7

Table 2: Net economic impacts in 2022 associated with $65 billion in trust assets in Colorado

	Output	Earnings	Employment
	($ mil.)	($ mil.)	(full- and part-time)
Direct & Indirect	$1,220	$315	6,595
Induced	430	120	2,775
Total	**$1,650**	**$435**	**9,370**

Table 3: Net economic and state tax impacts over 10 years associated with elimination of Colorado fiduciary tax on estates in 2012 and $150 billion in trust assets by 2022

Year	Colorado Trust Assets	Output	Earnings	Employment	Tax Collections
	($ mil.)	($ mil.)	($ mil.)	(full- and part-time)	($ mil.)
2012	$870	$25	$5	155	($25.8)
2013	2,180	55	15	375	(25.0)
2014	4,140	110	30	705	(24.0)
2015	7,080	185	50	1,180	(22.3)
2016	11,490	300	80	1,880	(19.9)
2017	18,090	470	125	2,910	(16.2)
2018	27,980	730	195	4,425	(10.8)
2019	42,810	1,115	295	6,660	(2.6)
2020	65,030	1,695	450	9,955	9.7
2021	98,340	2,565	680	14,810	28.0
2022	148,250	3,870	1,025	21,965	55.6

Table 4: Net economic impacts in 2022 associated with $150 billion in trust assets in Colorado

	Output	Earnings	Employment
	($ mil.)	($ mil.)	(full- and part-time)
Direct & Indirect	$2,850	$735	15,460
Induced	1,020	290	6,505
Total	**$3,870**	**$1,025**	**21,965**