This Week in State Tax (TWIST)

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Colorado: Special legislative session called to deal with OB3 changes

Governor Jared Polis has called for the state legislature to convene in a special session on August 21 to address an estimated $800 million budget deficit for FY 2026 (which began July 1, 2025) attributable in significant part to the One Big Beautiful Bill (OB3) signed into law by President Trump on July 4, 2025. For both individual and corporation income tax purposes, Colorado conforms to the Internal Revenue Code definition of federal taxable income on a rolling or automatic basis, meaning that enacted federal changes affecting the computation of taxable income are automatically incorporated into the state tax unless the state enacts legislation to decouple from certain provisions. Current projections are that the provisions of OB3 will reduce state income tax revenues in FY 2026 by $1.2 billion, a portion of which can be offset by surplus revenues, leaving the $800 million current year budget deficit.

The Governor's budget office estimates that OB3 will reduce state corporate income tax revenues by $825 million in FY 2026, or about 35 percent, due largely to the full expensing allowed for business property and domestic research and experimentation expenses, as well as the special allowance for qualified production property and extension of the qualified business income deduction for passthrough entities from which the state had previously decoupled through tax year 2025. Individual income tax reductions, on a net basis, are estimated at about $375 million in FY 2026 (3.5 percent) with the most significant reductions occurring from the increased standard deduction, the temporary special deduction for seniors, and new deductions allowed for overtime pay and tip income. For years beyond FY 2026, the individual income tax changes are expected to be roughly revenue neutral, presuming that a state law enacted prior to OB3 providing that overtime pay will be considered taxable income becomes law in 2026. An action has been filed against this measure, alleging it violates the state tax limitation amendment (TABOR) which generally requires state tax increases to be approved by a vote of the electorate. Reductions in the corporate revenues are projected to occur at about 75 percent of their FY 2026 levels in future budget years; the first-year impact is larger certain federal changes were retroactive to the beginning of tax year 2025.

The call for a special session did not lay out a comprehensive approach to eliminating the budget deficit, but the session is expected to focus on ways to reduce state expenditures as the TABOR limitation significantly restricts the ability of the state legislature to enact state tax increases without voter approval. For a presentation regarding the income tax impacts of OB3 in Colorado, click here. Please continue to read TWIST for further developments on the Colorado special session and other state legislation dealing with OB3.

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