

# Colorado weighs a shift in tax policy

Colorado voters may face a November 2026 ballot initiative replacing the state's flat income tax with a graduated structure. While the proposal carries fiscal implications, we believe the credit impact on the state would be manageable and significant high-income earner out-migration unlikely.

## Key takeaways

- Procedural and political hurdles — including a competing rate-cap initiative — make implementation of a graduated tax uncertain despite growing momentum behind the proposal.
- Roughly 3% to 4% of Colorado households earn over \$500,000 annually; evidence suggests minimal out-migration would occur if the tax were enacted.
- Strong reserves, economic growth and constitutional balanced budget requirements protect Colorado's creditworthiness regardless of the outcome of this ballot measure.

## The proposal would reshape how Coloradans are taxed

Proposed Initiative 195 would amend the Colorado Constitution to replace the existing 4.4% flat tax rate with a graduated six-bracket structure ranging from 3.7% to 8.4%.

Beginning in 2027, taxpayers earning over \$500,000 annually would face higher rates; lower income would be taxed at 4.4% or less. Those earning \$1 million or more would face the top rate of 8.4%.

Supporters estimate the structure would generate up to \$2.7 billion in additional annual revenue, or a 27% increase relative to 2025 personal income taxes, to supplement funding for education, health care and early childhood programs.

### In Focus

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## The road to the ballot is steep

The initiative faces hurdles, and we are not confident it will qualify for the November ballot. Proponents must collect at least 124,238 valid signatures by 03 August with at least two percent of registered voters signing in each of Colorado's 35 senate districts.

A competing measure, Initiative 232, would cap the state income tax rate at 4.4%. If both measures passed, Initiative 232 could neutralize Initiative 195's revenue impact, and the interaction would likely require legislative or judicial resolution.

Colorado has been here before. A similar effort in 2020 failed to gather sufficient signatures. In that same cycle, a competing rate-reduction initiative did qualify and passed, ultimately resulting in the current 4.4% rate. That history illustrates the political difficulty of advancing higher rates through the ballot process.

## Higher rates would impact a narrow but significant group

Approximately 80,000 to 90,000 Colorado households — 3% to 4% of all households — earn more than \$500,000 annually and would face higher rates. Households with annual incomes exceeding \$1 million represent just 1.7%. Though a small share of the taxpayer base, these filers represent about one-third of total personal income tax collections.

Notably, filers earning between \$500,001 and \$1,000,000 are projected to see a modest average increase in taxes owed, with meaningful increases concentrated among those earning above \$1,000,000.

## Colorado's credit quality remains on solid footing

Colorado is currently rated Aa1/AA by Moody's and S&P with stable outlooks, reflecting sound financial practices and a growing, diversified economy. Constitutional balanced budget requirements protect bondholders by mandating that revenue shortfall be addressed through expenditure adjustments or alternative revenue measures. Deficit financing is prohibited. The graduated income tax proposal poses limited risk to the state's credit quality or municipal bond portfolios.

Tax changes have rarely triggered significant population shifts among high-income individuals. Massachusetts is instructive: a 4% surtax on income over \$1 million has raised \$5.7 billion since 2023 — more than twice the budgeted amount — with no meaningful out-migration observed.

Personal ties, business relationships and quality-of-life factors tend to outweigh relocation incentives. Colorado's outdoor recreation culture, technology and aerospace sectors, and consistent population growth reinforce this dynamic. We foresee limited credit implications for Colorado municipal bond portfolios due to the outcome of this measure.

## What this could mean for your portfolio

A higher state income tax raises the yield hurdle investors must clear when investing in muni bonds outside their state of residence. At the current 4.4% flat rate and assuming a 3.0% tax-exempt yield, an out-of-state bond must yield approximately 14 basis points (bps) more than a comparable Colorado bond to break even. Under the proposed top rate of 8.4%, that hurdle nearly doubles to 28 bps. For tax-sensitive investors, the higher rate may strengthen the case for keeping more of their allocation in-state.

Investors should also weigh geographic diversification and supply trends. Holding exposure across multiple states may reduce concentration risk and provide managers with more opportunities to enhance yield above the required hurdle. Investors should consult financial and tax professionals when aligning tax planning with portfolio strategy.

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#### Endnotes

#### Sources

Bloomberg, L.P., Standard & Poor's, Moody's Investors Services.

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