

FYI – For Your Information

Apportionment of Income

CCORPORATIONS

A C Corporation doing business only in Colorado will compute its tax on 100% of the Colorado taxable income. However, a corporation doing business in more than one state must apportion its taxable income to any states in which the corporation is doing business. The income is generally apportioned in one of two ways:

- Colorado Income Tax Act - Two factor method (Form 112 Schedule A)
- Multistate Tax Compact - Three factor method (Form 112 Schedule B)

The apportionment methods reduce the income subject to Colorado taxation by comparing certain Colorado revenue, expenses, and assets to the total revenue, expenses, and assets of the corporation. The election of the apportionment method used is made with the filing of the return and cannot be changed after the return is filed, or after the due date of the return, whichever is later. [Regulation 39-22-303.1]

Colorado Income Tax Act (Two Factor)

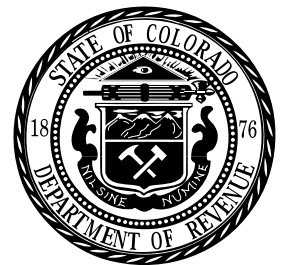
Apportionment of income under the Colorado Income Tax Act is computed using two factors; the revenue factor and the property factor. All income is apportioned using these two factors and no income is directly allocated to its source state.

Revenue Factor

The revenue factor is a fraction, the numerator of which is the gross receipts of the corporation assignable to Colorado and the denominator of which is the entire gross receipts of the corporation from all sources during the tax period. [§39-22-303(4) C.R.S.]

Gross receipts assignable to Colorado means:

- Sales, where the goods, merchandise, or property is delivered or shipped to a purchaser within Colorado, regardless of the F.O.B. point, other condition of sale, or the taxability of the corporation in the state or foreign country in which the goods are shipped or delivered. A sale in which the property sold is delivered into a state in which the corporation is not “doing business” shall not be assigned or “thrown back” to Colorado;
- Revenue from services rendered in Colorado;
- Rents and royalties from real and tangible personal property located in Colorado;
- Gross proceeds from the sale of real and tangible personal property located in Colorado exclusive of the subrentals used to compute the property factor;
- Gain from the sale of intangible personal property if the corporation’s commercial domicile is in Colorado (Note-include the gain from the sale, not the selling price);
- Interest and dividend income to the extent included in taxable income if the corporation’s commercial domicile is in Colorado. Commercial domicile means the principal place from which the trade or business of the corporation is directed or managed; and
- Patent and copyright royalties if, and to the extent that, the patent or copyright is utilized by the payer in Colorado. A patent is utilized in a state to the extent that it is employed



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in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in that state. If the basis of the receipts from the patent royalties cannot be reasonably assigned to states or if the accounting procedures do not reflect the states of utilization, the patent is utilized in the state in which the corporation's commercial domicile is located. A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties cannot be reasonably assigned to states or if the accounting procedures do not reflect the states of utilization, the copyright is utilized in the state in which the corporation's commercial domicile is located.

Property Factor

The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible property, whether owned or rented, located in Colorado during the tax year, and the denominator of which is the average value of all of the corporation's real and tangible personal property, whether owned or rented, during the tax year. [§39-22-303(3) C.R.S.]

Property owned by the corporation may be valued at its original cost or at its adjusted basis for federal income tax purposes. The same method of valuation must be used for all assets and once a method has been elected it must continue to be used in subsequent years unless written permission is obtained from the Executive Director to change from one method to the other. Real property rented by the corporation shall be valued at eight times the net annual rental rate.

Tangible personal property rented by the corporation shall be valued at three times the net annual rental rate. Net annual rental rate means the annual rental rate paid by the corporation less any annual rental rate received by the corporation from sub-rentals.

Average value of real and tangible personal property means the average of the values of such property on hand at the beginning and end of the taxable year.

However, if such computation produces an average value that is not representative of the full taxable year, the executive director may require the computation and use of an average value based on the value of property on hand at the beginning or end of each calendar month.

Multistate Tax Compact (Three Factor)

Apportionment of income under the Multistate Tax Compact is computed using three factors; the property factor, the payroll factor and the sales factor. Every corporation, other than public utilities, can elect to apportion income using this method. Business income is apportioned using the three factors. Nonbusiness income is directly allocated to the appropriate state.

Business Income

Business income is defined as income arising from transactions and activity in the regular course of the corporation's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the corporation's regular trade or business operations. [§24-60-1301(1)(a) C.R.S.]

The business income to be apportioned to Colorado shall be the modified federal taxable income not directly allocated multiplied by the average of the property factor, the payroll factor, and the sales factor. [§24-60-1301(9) C.R.S.]

Property Factor

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in Colorado during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period. Property owned by the corporation is valued at its original cost. Property rented by the corporation is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the corporation less any annual rental rate received by the corporation from subrentals. The average value of property

shall be determined by averaging the values at the beginning and ending of the tax period but the Executive Director may require the averaging of monthly values during the tax period if reasonably required to properly reflect the average value of the corporation's property. [§24-60-1301(10)C.R.S.]

Payroll Factor

The payroll factor is a fraction, the numerator of which is the total amount paid in Colorado during the tax period by the corporation for compensation and the denominator of which is the total compensation paid everywhere during the tax period. Compensation is paid in Colorado if:

- the individual's service is performed entirely within Colorado;
- the individual's service is performed both within and without Colorado, but the service performed without Colorado is incidental to the individual's service within Colorado; or
- some of the service is performed in Colorado and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in Colorado, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in Colorado. [§24-60-1301(13)C.R.S.]

Sales Factor

The sales factor is a fraction, the numerator of which is the total sales of the corporation in Colorado during the tax period, and the denominator of which is the total sales of the corporation everywhere during the tax period. [§24-60-1301 (15)C.R.S.]

Sales of tangible personal property are in Colorado if:

- the property is delivered or shipped to a purchaser (other than the United States Government) within Colorado regardless of the F.O.B. point or other conditions of the sale; or
- the property is shipped from an office, store, warehouse, factory, or other place of storage in Colorado and a) the

purchaser is the United State Government, or b) the corporation is not taxable in the state of the purchaser.

Sales, other than sales of tangible personal property, are in Colorado if:

- the income-producing activity is performed in Colorado, or
- the income-producing activity is performed both in and outside Colorado and a greater proportion of the income-producing activity is performed in Colorado than in any other state, based on costs of performance.

Nonbusiness Income

Nonbusiness income means all income other than business income. [§24-60-1301 (1) (e) C.R.S.]

The following items to the extent they constitute nonbusiness income are to be directly allocated:

- Net rents and royalties from real property shall be allocated to the state in which the property is located. Net rents and royalties from tangible personal property are allocated to a state to the extent that the property is utilized in that state. If the tangible personal property is utilized in a state in which the corporation is not taxable and such state is not the state under whose laws the corporation was organized, the income from such property shall be allocated to the state of the corporation's commercial domicile. [§24-60-1301 (4) (5) C.R.S.]

Commercial domicile means the principal place from which the trade or business of the corporation is directed or managed.

The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year.

If the physical location of the property during the rental or royalty period is unknown or unascertainable by the corporation, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

- Capital gains and losses from sales of real property are allocated to the state in which the property is located. [§24-60-1301(6) C.R.S.]

Capital gains and losses from sales of tangible personal property are allocated to the state in which such property had a situs (i.e., location) at the time of the sale; or if the corporation is not taxable in such state, such gains and losses shall be allocated to the state of the corporation's commercial domicile.

Capital gains and losses from sales of intangible personal property are allocated to the state of the corporation's commercial domicile.

Capital gains and losses that qualify for the Colorado capital gain subtraction are subtracted from federal taxable income before allocation and apportionment and are not included in the allocation section of Form 112 Schedule B.

- Interest and dividend income is allocated to the state of the corporation's commercial domicile. [§24-60-1301(7) C.R.S.]
- Patent and copyright royalties are allocated to a state to the extent that the patent or copyright is utilized by the payer in that state. To the extent the patent or copyright is utilized in a state in which the corporation is not taxable, the royalties are to be allocated to the state of the corporation's commercial domicile. [§24-60-1301(8) C.R.S.]

A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing or other processing in the state or to the extent that a patented product is produced in the state. If the basis of

receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the corporation's commercial domicile is located.

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the corporation's commercial domicile is located.

Definitions

"Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company. See "Financial Institutions" regulation under Multistate Tax Compact regulations located on the Web at www.taxcolorado.com

"Public utility" means any business entity:

- (1) that owns or operates any plant, equipment, property, franchise or license for the transmission of communications, transportation of goods or persons, except by pipeline, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and,
- (2) whose rates of charges for goods or services have been established or approved by a federal, state or local government or governmental agency.

If a taxpayer has income from business activities as a public utility but derives the greater percentage of its income from activities subject to the provisions of the Multistate Tax Compact, the taxpayer may elect to allocate and apportion its entire net income as provided in the Compact. [§24-60-1301(2) C.R.S.]

“Compensation” means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

“Sales” means all gross receipts of the taxpayer that are not directly allocated.

Other Apportionment Methods

If the apportionment provisions do not fairly measure the corporation’s income from Colorado sources, the corporation may request, or the executive director may require; separate accounting, the exclusion of one of the factors, or the use of any other method to provide an equitable apportionment of the income. [§39-22-303(5)C.R.S.][§24-60-1301(18)C.R.S.] In the case of two or more corporations owned or controlled directly or indirectly by the same interest, the Department of Revenue may distribute or allocate the gross income and deductions between or among such corporations in order to clearly reflect income. [§39-22-303(6) C.R.S.]

Special apportionment regulations apply to the following industries to facilitate more accurate apportionment of income:

- Airlines
- Contractors
- Publishing
- Railroads
- Television & Radio Broadcasting
- Trucking
- Financial Institutions

PASS THROUGH ENTITIES

S Corporations

S corporations must determine Colorado source income by either the Colorado Income Tax Act two-factor formula or the Multistate Tax Compact three factor formula unless written permission from the Department of Revenue has been received to use some other method. The S Corporation return must include QSub information if the QSub is included for federal purposes.

Partnerships

Partnerships must elect on behalf of their nonresident partners whether to determine Colorado source income by use of the Colorado Income Tax Act two-factor formula, the Multistate Tax Compact three factor formula, or §39-22-109 C.R.S. relating to Colorado source income of non-resident individuals. A new election may be made each tax year but it may not be changed after the due date or the filing date of the partnership return, whichever is later.

Section 39-22-109 C.R.S. provides that income is from Colorado sources when such income *is attributable to*:

- The ownership of any interest in real or tangible personal property in Colorado;
- A business, trade, profession, or occupation carried on in Colorado;
- The distributive share of partnership income, gain, loss, and deduction determined under §39-22-203 C.R.S.;
- The share of estate or trust income, gain, loss, and deduction determined under section §39-22-404 C.R.S.;
- Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in Colorado. A nonresident, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, shall not be deemed to carry on a business, trade, profession, or occupation in Colorado solely by reason of the purchase and sale of property for his own account.
- The share of S corporation income, gain, loss, credit, and deduction allocable or apportionable to Colorado.

If Colorado source income is determined under the provisions of §39-22-109 C.R.S., attach a schedule to the partnership return explaining how Colorado source income was determined. Additions and subtractions may be sourced to Colorado only to the extent that the income to which they relate is sourced to Colorado.

FURTHER INFORMATION

FYIs and commonly used forms are available on the Web at www.taxcolorado.com

For additional income tax information, visit the "Tax Information Index" at www.taxcolorado.com

FYIs provide general information concerning a variety of Colorado tax topics in simple and straightforward language. Although the FYIs represent a good faith effort to provide accurate and complete tax information, the information is not binding on the Colorado Department of Revenue, nor does it replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having authority to bind the Department, has not formally reviewed and/or approved these FYIs.