



COLORADO
Department of Revenue

Taxation Division

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PLR-16-005

April 6, 2016

XXXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Enterprise Zone Investment Tax Credit

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXXXXXX ("Taxpayer") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Department Rule 24-35-103.5. This private letter ruling cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Issue¹

1. Does the conversion of the Project Company to a partnership, or, alternatively, the technical dissolution of original Project Partnership and transfer of Project to newly formed New Project Partnership, within one year of the Project being placed into service disqualify Taxpayer from claiming the Colorado enterprise zone investment tax credit?
2. Is Taxpayer disqualified from claiming the credit if it (including Project Company, Project Partnership, and/or New Project Partnership) is granted a new certificate or an extension of the original certificate and places the Project into service during the new or extended period?

Conclusion

1. The conversion of the Project Company from a disregarded entity to a partnership or, alternatively, the technically dissolution of the original Project Partnership and transfer of Project to newly formed New Project Partnership, within one year of Project being placed into service does not disqualify Taxpayer from claiming the enterprise zone investment tax credit.

¹ Taxpayer initially asked the Department to rule on whether it is proper to allocate 100% of the enterprise zone investment tax credit to Taxpayer. This request was subsequently withdrawn and is not ruled upon in this ruling.

2. Taxpayer is not disqualified from claiming the credit if it (including Project Company, Project Partnership, and/or New Project Partnership) is granted a new certificate or an extension of the original certificate and places the Project into service in the new or extended period.

Background

Taxpayer is undertaking construction of alternative energy resources (Project) and is considering two alternative business structures. In both scenarios, Taxpayer creates a wholly owned single member limited liability company (Project Company) that is disregarded for federal and state income tax purposes. Taxpayer will initially include Project Company in Taxpayer's Colorado combined income tax report.

In the first scenario, Project Company places the Project into service and, within one year thereafter, enters into an agreement with an investor (Investor) who will purchase a sixty percent equity interest in Project Company. Taxpayer will own the remaining forty percent equity interest. Project Company will no longer be treated as a disregarded entity and, instead, will be treated as a partnership (Project Partnership)² and will be excluded from Taxpayer's combined report.

The second scenario is similar to the first except Taxpayer forms another wholly owned limited liability company (Holding) that initially will elect to be taxed as a corporation for federal and state income tax purposes and will be included in Taxpayer's Colorado combined income tax report. Before Project is placed into service, Taxpayer will sell to Holding a 5% equity interest in Project Company. Project Company will then be treated as a partnership (Project Partnership) and, therefore, will not be included in Taxpayer's combined income tax report. Project Partnership will then place the Project into service and, within one year thereafter, Project Partnership will sell a 60% equity interest in Project Partnership to Investor and sell the remaining 35% equity interest to Holding. The sale of the 60% equity interest to Investor results in the technical termination and dissolution of the original Project Partnership and the immediate transfer of Project to a newly formed "New" Project Partnership.

Taxpayer applied for and was granted by the Colorado economic development commission a certificate to place Project into service within an enterprise zone by December 31, 2015. Due to unforeseen circumstances, Taxpayer was not able to place the Project into service by December 31, 2015. Taxpayer is applying to the commission either to obtain a new certificate or an extension of the original certificate that will expire December 31, 2016.

² A single member limited liability company is treated as a disregarded entity for federal income tax purposes. 26 C.F.R. § 301.7701-3. If the single member L.L.C. acquires another member, as is proposed in this ruling, then federal regulations treat the L.L.C. as a partnership. 26 C.F.R. § 301.7701-3(f)(2).

Structure of Analysis

1. Does the investment qualify for the enterprise zone investment tax credit?
 - a. Does a change in the form of ownership within one year of the asset being placed into service disqualify taxpayer from claiming the credit?
 - b. Can taxpayer claim the credit under a new or extend certificate issued by the Colorado economic development commission?

Discussion

1. *Taxpayer retains a substantial interest in the Property for one year.*

A taxpayer is entitled to a credit against its Colorado income tax liability for making a qualified investment in property used solely and exclusively in an enterprise zone for at least one year.³ A qualified investment is an investment that would have qualified for the federal investment tax credit as it existed immediately prior to the federal Revenue Reconciliation Act of 1990.⁴ Department Publication FYI Income 11 states that the taxpayer must own the investment for the one-year period.⁵ The issue raised in this ruling is whether, in the first scenario, the conversion of the Project Company from a disregarded single member limited liability company to a partnership or, in the second scenario, the technical termination and dissolution of the Project Partnership and the formation of the New Project Partnership, constitute a change of ownership within the one year period such that Taxpayer is disqualified from claiming the enterprise zone investment tax credit.

Colorado law directs the Department to interpret Colorado's tax code consistent with the federal tax code.⁶ The federal investment tax credit, on which the enterprise zone investment tax credit is modeled, has an ownership requirement.⁷ Under these federal rules, a taxpayer who "disposes" of qualified investment property within certain time periods is subject to recapture rules. "Recapture" means that a taxpayer must, in the tax year of the disqualifying event (e.g., sale of the asset), recognize income that was untaxed in prior year when the credit was claimed. However, a taxpayer is not subject to this federal recapture rule if the taxpayer retains a "substantial interest" in the property.⁸ For example, a taxpayer who retains a 45% interest is not disqualified.⁹

³ § 39-30-104, C.R.S.

⁴ § 39-30-104(1)(a), C.R.S.

⁵ "The enterprise zone investment tax credit is 3% of any qualified investment in section 38 property: acquired and placed in service or constructed during the tax year, and used exclusively (100%) in a Colorado enterprise zone for the first year of its ownership by the taxpayer."

⁶ § 39-22-103(11), C.R.S.

⁷ 26 U.S.C. § 50 (formerly 26 U.S.C. § 47).

⁸ See, e.g., Rev. Ruling 86-116, 1986-2 CB 9, I.R.C. 47 (transfer by lessee of investment property to partnership does not disqualify lessee from credit because lessee retains substantial interest in property as a fifty percent partner); 26 C.F.R. § 1.47-3(f) (mere change in ownership does not disqualify taxpayer from claiming credit if the taxpayer retains a substantial interest in the qualified property); 26 C.F.R. 1.47-3(f)(6) (taxpayer retaining 45% interest in property was a substantial interest in the property).

⁹ See, Federal Tax Coordinator, ¶ L-17418 ("Recapture rules affecting partners and partnerships

Federal rules reflect the more general idea that the taxpayer itself must use the asset in order to earn the credit. That is, the value earned by the taxpayer is the taxpayer's own use of the investment asset, not simply the investment itself. In the case of the enterprise zone credit, the value created by the taxpayer is its own operation of the investment for the one-year period. We think it is inconsistent with the federal tax law, by which we are guided, to eliminate the link between the taxpayer's initial investment and the taxpayer's continued use of the asset. Furthermore, an interpretation that did not tie the taxpayer's investment with taxpayer's use of the asset would create a situation in which an unlimited number of credits could be claimed for the same asset within the same one-year use period. For these reasons, FYI Income 11 states that a taxpayer who initially claims the credit but then does not both own and use the property for one year must file an amended Colorado income tax return to reflect the loss of the state credit.¹⁰ A taxpayer who retains a substantial ownership interest in the investment for the one-year period satisfies the "use" requirement in the statute.

The enterprise zone investment tax credit vests with Taxpayer in the first scenario and with Taxpayer and Holding in the second scenario on the first day the Project is placed into service. Taxpayer (and Holding) is not, under either scenario, disqualified from claiming the enterprise zone investment tax credit when the Project Partnership or New Project Partnership are formed because Taxpayer (and Holding) retains a substantial interest in the Project through its 40% partnership interest for one year.

2. Taxpayer can claim the credit if it places the Project into service under a new or extend certificate issued pursuant to §39-30-104(2), C.R.S.

Colorado law requires a taxpayer who wishes to claim the enterprise zone investment tax credit to obtain a certificate from the Colorado Economic Development Commission.¹¹ Taxpayer obtained such a certificate but represents that, due to factors beyond its control, it was not able to place the Project into service during the time period for which the certificate was issued. Taxpayer is presently requesting the commission grant it either an extension of the original certificate or a new certificate.

Taxpayer asks whether it is disqualified from claiming the enterprise zone investment tax credit because it did not place the Project into service during the period covered by the

Where a partnership is terminated as a result of a sale of 50% or more of the total interests in the partnership's capital or profits (see §§ B-4300 et seq.), the partnership is deemed to transfer all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership and the terminated partnership is deemed to distribute interests in the new partnership to the purchasing partner and the remaining partners in liquidation of the terminated partnership. This termination does not result in investment tax credit recapture because the termination is a mere change in the form of doing business.").

¹⁰ See Department Regulation 1 C.C.R. 201-13, 39-30-104. The amended return requirement is not technically a "recapture" of the credit as this term is used in the Internal Revenue Code because the recaptured income is not reflected in the tax year that the disqualifying event occurs.

¹¹ See § 39-30-104(2)(c), C.R.S.

original certificate but places the Project into service during an extended or new certificate. If the commission grants Taxpayer a new certificate or an extension of the existing certificate and Taxpayer places the Project into service during the period covered by the new or extended certificate, then Taxpayer is not disqualified from claiming the credit for not placing the Project into service during the period covered by the original certificate.

Miscellaneous

This ruling is premised on the assumption that Taxpayer has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Taxpayer's representations. The ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling and is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

This ruling is binding on the Department to the extent set forth in Department Regulation 24-35-103.5. It cannot be relied upon by any taxpayer other than the Taxpayer identified in this ruling.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Office of Tax Policy Analysis

This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.