

STATE OF COLORADO

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John Hickenlooper
Governor

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PLR-11-002

March 16, 2011

XXXXXXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXX

Re: Private Letter Ruling re: XXXXXXXXXXXXXXXX.

Dear XXXXXXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXX ("Holdings") and its subsidiaries ("Subsidiaries") (Holdings and Subsidiaries collectively referred to as the "Taxpayer") a request for a private ruling on the entities that must be included in a Colorado combined report and the manner in which the combined group must calculate its income. This letter is the Department's private letter ruling.

Issue

1. Must Taxpayer include in its Colorado combined report affiliated entities that are financial institutions with affiliated entities that are not financial institutions?
2. How must Taxpayer calculate its income in a combined report?

Conclusion

1. Taxpayer's combined income report must include both financial and non-financial affiliated entities that meet the criteria set forth in §39-22-303(11)(a), C.R.S.
2. Taxpayer must calculate its income as set forth in section 2 of this ruling.

Background

Holdings is the direct and indirect parent of numerous C corporations that comprise an "affiliated group," as defined in §39-22-303(12)(a), C.R.S. Among the members of this affiliated group are certain "financial institutions" ("FIs"), as that term is defined in 1 Colorado Code of Regulations 201-3, Special Regulation 7A ("Special Regulation 7A") and certain non-financial institutions ("non-FIs"). Certain FIs and non-FIs

included within the Holdings' affiliated group meet the test for combination set forth in §39-22-303(11)(a), C.R.S. and regulation 39-22-303.11(a).

Discussion

1. *Taxpayer must include in a combined report FIs and non-FIs that meet the criteria set forth in §39-22-303(11)(a), C.R.S.*

This ruling requires us to address the interplay between statutory provisions that require affiliated entities to file a combined report and statutory provisions and regulations that require certain types of business to use apportionment and allocation methodologies that are substantially different from the standard apportionment rules applied to most corporations.

Colorado requires affiliated C corporations to prepare and file a combined report when filing their income tax return if they satisfy three of six criteria set forth in §39-22-303(11)(a), C.R.S. The purpose of this provision is to treat affiliated entities as a single taxpayer because they act as a unitary enterprise. If some of these entities have sources of income from inside and outside Colorado, the income of the combined group must be apportioned among the relevant states.¹

Colorado recognizes that the standard apportionment methodologies may be ill suited to certain types of businesses.² For these specialized businesses, Colorado has adopted special apportionment methodologies in order to reflect accurately their Colorado income. One such class of business is financial institutions and Colorado has adopted special apportionment rules for them.³ The issue, then, is whether entities using different apportionment methodologies can be included in the same combined report.

Taxpayer represents that the FIs and non-FIs meet the statutory requirements of §39-22-303(11)(a) for combining into a single report. Taxpayer argues that there are no statutory provisions that expressly set forth an exception to the requirements of subsection 303(11). We agree with Taxpayer that this subsection requires the Taxpayer include affiliated FI entities and non-FI entities in a combined report.

2. *Department approves Taxpayer's income tax calculation methodology.*

As noted above, Colorado employs standard apportionment methodologies for most corporations, but also recognizes that certain types of businesses, such as financial institutions, require special rules for apportionment of their income. The department may also authorize and require a taxpayer to use alternative methodologies "to effectuate an equitable apportionment or allocation of the taxpayer's income, fairly

¹ For tax years beginning on or after January 1, 2009, taxpayers, including taxpayers filing a combined report, must use a single sales factor apportionment methodology to apportion income. For tax years prior to 2009, taxpayers have a choice of using a two or three factor apportionment methodology. §39-22-303 and §24-60-1301, C.R.S.

² §39-22-303.5(7), C.R.S.

³ Special Regulation 7A

calculated to determine the net income derived from or attributable to sources in Colorado.” §39-303.5(7)(b)(III), C.R.S.

After reviewing the facts provided in Taxpayer’s letter, we conclude that Taxpayer’s combined return, including all includible FIs and non-FIs, must be calculated as follows:

1. The sub-group of FIs and the sub-group of non-FIs must separately calculate their modified federal taxable income. This calculation must be made as though all members of both sub-groups are included in the same federal consolidated pro-forma return, including the elimination of all intercompany transactions, regardless of whether between or among FIs and/or non-FIs.
2. The FI sub-group and the non-FI sub-group must separately allocate any allocable income/loss, with the FI sub-group applying Special Regulation 7A and the non-FI sub-group applying standard allocation rules.
3. For the business income/loss portion of the modified federal taxable income of each sub-group, each sub-group shall separately compute its Colorado apportionment factor(s) and then apply the factor(s) to its business income/loss. In doing so, the FI sub-group will again apply the provisions of Special Regulation 7A, and the non-FI sub-group will apply standard apportionment rules.
4. All income/loss allocated and apportioned to Colorado by each of the sub-groups should be added together to produce an aggregated Colorado tax base.
5. Colorado’s income tax rate should be applied to this tax base to determine the Colorado tax due.

In addition to the methodology set forth above, the following rules apply:

1. *Assets transferred between FI members and non-FI members.* Income from the use, disposition, or otherwise of any asset that has been transferred between members of the FI sub-group and the non-FI sub-group shall be included in the modified federal taxable income of the sub-group from which such asset originated. Sales generating the income or loss subject to this rule shall be included in the sales factor calculation of the sub-group that includes the income or loss in its calculation. The following exceptions and rules will apply in the application of this paragraph 1:
 - a. In the case of income or loss from the sale or disposition of an asset, if the greater proportion of the increase in value of such asset was created while the asset was a part of the sub-group to which the asset was transferred, the income or loss from such sale or disposition shall be included in the calculation of the sub-group to which the asset was transferred.

- b. In the case of income or loss from the use of an asset, if the asset is a working asset and not cash or another fungible commodity, and the asset generates income or loss from sales to third parties, then such income or loss shall be included in the calculation of the sub-group to which the asset was transferred. Conversely, income or loss from the use of such working asset shall be included in the calculation of the sub-group from which the asset was transferred if the income or loss is generated by sales to an affiliated entity.
 - c. If the amount of income or sales is not material, then the taxpayer may choose to include the income in the group to which the asset was transferred.
 - d. The burden of establishing that any of these exceptions apply shall be upon the party seeking to assert the exception to the rule.
2. *Application of §39-22-303(6), C.R.S.* Nothing in this ruling shall restrict application of §39-22-303(6), including the distribution or allocation of income or deductions between corporations in different sub-groups.

This ruling applies to tax years 2008 forward until superseded by specific guidance from the department, which could take the form of a letter from the department withdrawing its approval or a regulation that contradicts this ruling.

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. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached 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,

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