



**COLORADO**  
Department of Revenue

Taxation Division

Physical Address:  
1375 Sherman Street  
Denver, CO 80203

Mailing Address:  
P.O. Box 17087  
Denver, CO 80217-0087

GIL-16-004

May 3, 2016

XXXXXXXXXXXXXXXXXXXX  
Attn: XXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXXXX  
XXXXXXXXXXXXXXXXXXXX

Re: Sales and Income Tax Nexus

Dear XXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXXXXXX ("Company") a request for guidance to determine whether Company has sales or income tax nexus in Colorado.

The Colorado Department of Revenue ("Department") issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department Rule 1 CCR 201-1, 24-35-103.5.

The Department treats your request as a general information letter. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction. If you would like the Department to issue a private letter ruling on the issues you raise, you must submit a new request and provide the fee in compliance with Department Rule 1 CCR 201-1, 24-35-103.5.

**Issue**

Does Company have sales or income tax nexus in Colorado?

**Background**

Company is a C-Corporation located outside of Colorado. Company is a franchisor, which sells franchises that sell products that clean cooking oils in restaurants and other commercial cooking facilities. The business encompasses four sales lines:

1. Company advertises its franchises on websites where prospective franchisees can find information about the company, request information, or request someone to contact them. They then attend a discovery day in a state other than Colorado to see the business and discuss the opportunity. Once a franchisee decides to purchase, they complete an application, pay a deposit, and wait for their application to be approved. If the applicant is approved, Company prepares a franchise agreement in a state other than Colorado and the franchisee comes to such state to sign the agreement, receive training in such state, and pay the franchise fee for their machine, training, and territory rights. The franchisee also brings a franchisee-owned van to the warehouse in such state to have the equipment installed and advertising placed on the van.
2. After the franchisee begins operations, there are additional services and supplies that are purchased. These consist of filters for the machine, spare parts as needed, monthly royalty fees, and monthly advertising fees.
3. There are other items that the franchisee could purchase from Company that would be resold to the franchisee customers. These include cooking oil, cleaning chemicals, and trays and filters for restaurant refrigerators.
4. Lastly, Company also offers a service of disposal of used cooking oil. The cooking oil is collected by the franchisee and picked up by a disposal company and the franchisee and Company share the profits of the sale of such oil.

### **Structure of Analysis**

To determine whether a Company is obligated to pay taxes in Colorado, the Department will examine the following questions:

- 1) Is Company "doing business in this state" pursuant to § 39-26-102(3), C.R.S.?
- 2) Does Company have substantial nexus in Colorado pursuant to Department Rule 1 CCR 201-2, 39-22-301.1, Doing Business in Colorado?

### **Discussion**

#### **1. Sales Tax Nexus**

A determination of nexus for sales tax is a fact-intensive process that cannot be adequately addressed in a general information letter. Therefore, the Department cannot address the issue in this letter.

#### **2. Income Tax Nexus**

A company is presumed to have nexus for purposes of Colorado income tax if it exceeds the minimum standards of Public Law 86-272 (15 U.S.C. 381) and meets any one of the four thresholds below. Department Rule 1 CCR 201-2, 39-22-301.1 states in pertinent part,

(b) Substantial nexus is established if any of the following thresholds is exceeded during the tax period:

- (i) a dollar amount of \$50,000 of property<sup>1</sup>; or
- (ii) a dollar amount of \$50,000 of payroll<sup>2</sup>; or
- (iii) a dollar amount of \$500,000 of sales; or
- (iv) twenty-five percent of total property, total payroll or total sales.

Company represents that it does not have payroll in Colorado. Company also appears not to have have property<sup>3</sup> in Colorado. Company, however, may have sufficient sales in Colorado. In Department Rule 1 CCR 201-2, 39-22-301.1, the Department describes how the sales factor is computed.

(iii) Sales counting toward the threshold include the total dollar value of the taxpayer's gross receipts from

- ...
- (B) the lease or license of tangible personal property located in this State;
- (C) the sale of tangible personal property ... received in this State as indicated by receipt at a business location of the seller in this State or by instructions, known to the seller, for delivery or shipment to a purchaser (or to another at the direction of the purchaser) in this State;
- (D) the sale of software or digital products for primary use by a purchaser known to the seller to be in this state; and
- (E) the sale, lease or license of services and intangibles for primary use by a purchaser known to the seller to be in this State. If the seller knows that a service or intangible will be used in multiple States because of separate charges levied for, or

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<sup>1</sup> Property in this rule is defined as follows: "(i) Property counting toward the threshold is the average value of the taxpayer's real property and tangible personal property owned or rented and used in this State during the tax period. Property owned by the taxpayer is valued at its original cost basis. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer 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 reflect properly the average value of the taxpayer's property."

<sup>2</sup> Payroll in this rule is defined as follows: "(ii) Payroll counting toward the threshold is the total amount paid by the taxpayer for compensation in this State during the tax period. Compensation means wages, salaries, commissions and any other form of remuneration paid to employees and defined as gross income under Internal Revenue Code § 61. Compensation is paid in this State if:

- (A) the individual's service is performed entirely within the State;
- (B) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or
- (C) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) 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 this State."

<sup>3</sup> Intangible property is not included in the definition of property under this rule.

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measured by, the use at different locations, because of other contractual provisions measuring use, or because of other information provided to the seller, the seller shall apportion the receipts according to usage in each State.

(F) If the seller does not know where a service or intangible will be used or where a tangible (including software or a digital product) will be received, the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is available from the business records of the seller maintained in the ordinary course of business when such use does not constitute bad faith. If that is not known, then the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is obtained during the consummation of the sale, including the address of the purchaser's payment instrument, if no other address is available, when the use of this address does not constitute bad faith.

Company's sales of equipment, supplies and other tangible personal property delivered to franchisees in other states are not counted toward the sales threshold because they are not received in Colorado. Company's franchise agreement, which includes contractual rights and licenses to use Company's trademark and tradename, is an intangible. Payments received from franchisees pursuant to this agreement, including royalty payments and territory fee, will likely be counted in computing the sales threshold because the trademark or tradename is primarily used in Colorado. The monthly fee received from franchisees for advertising is likely treated as a sale of a service and therefore is apportioned according to Department Rule 1 CCR 201-2, 39-22-301.1(2)(c)(iii)(E), as set forth above, if the service is performed in more states than Colorado. Training is also a service but likely allocated entirely to another state because Company represents that all training is performed in another state. Sales of the equipment and supplies shipped by Company to a Colorado franchisee in Colorado will also count toward this threshold because the franchisee's business address is in Colorado.

### **Miscellaneous**

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at [www.colorado.gov/tax](http://www.colorado.gov/tax) for more information about state and local sales taxes.

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Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter 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 letter.

Sincerely,

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