

STATE OF COLORADO

DEPARTMENT OF REVENUE
State Capitol Annex
1375 Sherman Street, Room 409
Denver, Colorado 80261
Phone (303) 866-3091
FAX (303) 866-2400



John W. Hickenlooper
Governor

Barbara J. Brohl
Executive Director

GIL-13-024

October 2, 2013

XXXXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX

Re: Colorado Source Income

Dear XXXXXXXX,

You submitted a request for guidance to determine whether Company needs to file Form 106 and report Colorado source income.

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 regulation 24-35-103.5 at www.colorado.gov/revenue/tax > Tax Library > Rulings.

The Department initially treats your request as one of a general information letter. If you would like the Department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with regulation 24-35-103.5. 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.

Issue

Is the Company required to file Form 106 and report Colorado source income?

Background

Company is an S corporation located outside of Colorado that provides accounting and tax services. An employee of Company has worked remotely from Colorado Springs, Colorado since the summer of 2012 when her spouse was reassigned to Ft. Carson Army Base, located just outside Colorado Springs. Company filed Form DR 1059, "Exemption from Withholding for a Qualifying Spouse of a U.S. Armed Forces Servicemember."

The employee's spouse was killed while completing a tour in Afghanistan. Company's employee was told she would continue to have the same status and benefits for one year from the date of death. The employee has decided to reside permanently in Colorado, at which point the employee's payroll will become subject to Colorado income tax and Company will begin withholding state income tax.

Discussion

S corporations are not subject to Colorado income tax.¹ However, each shareholder's pro rata share of the S corporation's income attributable to Colorado is subject to Colorado income tax.² If the shareholder is a nonresident individual, then the Colorado tax is apportioned in the ratio of Colorado nonresident federal adjusted gross income to total federal adjusted gross income.³ The Colorado nonresident federal adjusted gross income is the income that is derived from sources within Colorado.⁴ A shareholder's income from an S Corporation is derived from sources in Colorado to the extent that the income, gain, loss, and deductions are allocated and apportioned to Colorado.⁵ Company is a service provider. Income from services, such as accounting services, is apportioned based on where the costs to perform the services are incurred.⁶ Because some portion of Company's cost of performing its accounting service is incurred in Colorado, a portion of Company's income is apportionable to Colorado.

You note that the employee filed DR 1059, "Exemption from Withholding for a Qualifying Spouse of a U.S. Armed Forces Servicemember." This is a declaration by the employee that she is not a resident of Colorado, and is in Colorado solely because her spouse is in active military service and is stationed in Colorado.⁷ Although the employee may not be treated as a resident of Colorado and her income may not be subject to Colorado income tax, this does not mean that the income of an S Corporation or its shareholders is not apportionable to Colorado.

For example, a corporation whose headquarters are located outside Colorado may temporarily locate some of its employees in Colorado to work on a project. Income from this work in Colorado is apportioned to Colorado because a portion of the cost of that service is incurred in Colorado. Neither the residency of the employees nor their liability for Colorado income tax is relevant to the question of whether the cost of the performance of a service is performed in Colorado. Thus, Company's income is apportioned to Colorado in proportion to the costs incurred in Colorado to perform such service.

Finally, your inquiry raises the question of nexus for non-resident shareholders of the S corporation. Members of a pass-through entity have nexus with Colorado if the pass-

¹ §39-22-322(1), C.R.S.

² §39-22-322(2), C.R.S.

³ §39-22-109(1), C.R.S.

⁴ §39-22-109(2), C.R.S.

⁵ §39-22-109(2)(a)(VI), C.R.S.

⁶ §39-22-303.5, C.R.S.

⁷ §39-22-103(8), C.R.S. (defining resident individuals to exclude an individual who is in Colorado only because their spouse is an active member of the military and is stationed in Colorado).

through entity has nexus with Colorado. A corporation will have nexus in Colorado if it has, among other qualifiers, fifty thousand dollars in payroll in Colorado.⁸

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.

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
Tele: (303)866-5627
Email: neil.tillquist@state.co.us

⁸ Department Regulation 39-22-301.1.