

DEPARTMENT OF REVENUE

Taxation Division

INCOME TAX

1 CCR 201-2

Rule 39-22-303.6–1. Apportionment and Allocation Definitions.

Basis and Purpose. The bases of this rule are §§ 39-21-112, 39-22-301, 39-22-303, and 39-22-303.6, C.R.S. The purpose of this rule is to provide definitions for the terms used throughout Rules 39-22-303.6–1 through –17. Consistent with the General Assembly’s adoption of § 39-22-303.6, C.R.S., these rules are intended to conform the state’s income tax laws to the Multistate Tax Commission’s model statute and regulation except when those model provisions are inconsistent with Colorado statute. See 2018 Colo. Sess. Laws, ch. 369, § 1(2).

- (1) **Definitions.** In addition to the definitions provided in § 39-22-303.6, C.R.S., and unless the context otherwise requires, the following terms, as used throughout Rules 39-22-303.6–1 through –17, are defined or further defined as follows:
- (a) “Allocation” refers to the assignment of nonapportionable income to a particular state.
 - (b) “Apportionment” refers to the division of apportionable income among states by use of a formula containing apportionment factors.
 - (c) “Billing address” means the location indicated in the books and records of the taxpayer as the primary mailing address relating to a customer’s account as of the time of the transaction and kept in good faith in the normal course of business and not for tax avoidance purposes.
 - (d) “Business activity” refers to the transactions and activities occurring in the regular course of a particular trade or business of a taxpayer and includes the acquisition, employment, development, management, or disposition of property that is or was related to the operation of the taxpayer’s trade or business.
 - (e) “Business customer” means a customer that is a business operating in any form, including a sole proprietorship. Sales to a nonprofit organization, to a trust, to the U.S. Government, to a foreign, state, or local government, or to an agency or instrumentality of that government are treated as sales to a business customer and must be assigned consistent with the rules for those sales.
 - (f) “Code” has the same meaning as “internal revenue code” in section 39-22-103(5.3), C.R.S.
 - (g) “Gross receipts” are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital in a transaction that produces apportionable income for which the income or loss is recognized under the Internal Revenue Code, and, where the income of foreign entities is included in apportionable income, amounts that would have been recognized under the Internal Revenue Code if the relevant transactions or entities were in the United States. Amounts realized on the

sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold.

- (h) "Individual customer" means a customer that is not a business customer.
- (i) "Intangible property" generally means property that is not physical or whose representation by physical means is merely incidental and includes, without limitation, copyrights; patents; trademarks; trade names; brand names; franchises; licenses; trade secrets; trade dress; information; know-how; methods; programs; procedures; systems; formulae; processes; technical data; designs; literary, musical, or artistic compositions; ideas; contract rights including broadcast rights; agreements not to compete; goodwill and going concern value; securities; and, except as otherwise provided in this rule, computer software. Receipts from the sale of intangible property may be excluded from the numerator and denominator of the taxpayer's receipts factor pursuant to § 39-22-303.6(6)(d)(III), C.R.S., and paragraph (1)(d) of Rule 39-22-303.6-12.
- (j) "Place of order" means the physical location from which a customer places an order for a sale, other than a sale of tangible personal property from a taxpayer, resulting in a contract with the taxpayer.
- (k) "Population" means the most recent population data maintained by the U.S. Census Bureau for the year in question as of the close of the taxable period.
- (l) "Receipts" means all gross receipts of the taxpayer that are not allocated under § 39-22-303.6, C.R.S., and that are received from transactions and activity in the regular course of the taxpayer's trade or business. The following are additional rules for determining "receipts" in various situations:
 - (i) In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "receipts" includes all gross receipts from the sale of such goods or products (or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales less returns and allowances.
 - (ii) In the case of cost-plus-fixed-fee contracts, such as the operation of a government-owned plant for a fee, "receipts" includes the entire reimbursed cost plus the fee.
 - (iii) In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, "receipts" includes the gross receipts from the performance of such services including fees, commissions, and similar items.
 - (iv) In the case of a taxpayer engaged in the sale of equipment used in the taxpayer's trade or business, where the taxpayer disposes of the equipment under a regular replacement program, "receipts" includes the gross receipts from the sale of this equipment. For example, a truck express company that owns a fleet of trucks, and sells its trucks under a regular replacement program, the gross receipts from the sale of the trucks would be included in "receipts."

- (v) In the case of a taxpayer with insubstantial amounts of gross receipts arising from sales in the ordinary course of business, the insubstantial amounts may be excluded from the receipts factor unless their exclusion would materially affect the amount of income apportioned to Colorado.
- (vi) Receipts of a taxpayer from hedging transactions, or from holding cash or securities, or from the maturity, redemption, sale, exchange, loan, or other disposition of cash or securities, shall be excluded except as otherwise provided in 1 CCR 201-2, Special Rule 9A. Receipts arising from a business activity are receipts from hedging if the primary purpose of engaging in the business activity is to reduce the exposure to risk caused by other business activities. Whether events or transactions not involving cash or securities are hedging transactions shall be determined based on the primary purpose of the taxpayer engaging in the activity giving rise to the receipts, including the acquisition or holding of the underlying asset. Receipts from the holding of cash or securities, or maturity, redemption, sale, exchange, loan, or other disposition of cash or securities are excluded from the definition of receipts whether or not those events or transactions are engaged in for the purpose of hedging. The taxpayer's treatment of the receipts as hedging receipts for accounting or federal tax purposes may serve as indicia of the taxpayer's primary purpose, but shall not be determinative.
- (vii) Receipts, even if apportionable income, are presumed not to include such items as, for example:
 - (A) damages and other amounts received as the result of litigation;
 - (B) property acquired by an agent on behalf of another;
 - (C) tax refunds and other tax benefit recoveries;
 - (D) contributions to capital;
 - (E) income from forgiveness of indebtedness;
 - (F) amounts realized from exchanges of inventory that are not recognized by the Code; or
 - (G) amounts realized as a result of factoring accounts receivable recorded on an accrual basis.
- (viii) Notwithstanding any other provision of law, foreign source income that is included in taxable income is not included as receipts of the taxpayer in Colorado for purposes of apportioning apportionable income under § 39-22-303.6, C.R.S., but may be included in the denominator as otherwise required by § 39-22-303.6, C.R.S., and its accompanying rules.
- (ix) Exclusion of an item from the definition of "receipts" is not determinative of its character as apportionable or nonapportionable income. Certain gross receipts that are "receipts" under the definition are excluded from the "receipts factor" under § 39-22-303.6(6), C.R.S. Nothing in this definition shall be construed to modify, impair, or supersede any provision of § 39-22-303.6(9), C.R.S.
- (m) "Related party" means:

- (i) a stockholder who is an individual, or a member of the stockholder's family as set forth in section 318 of the Code, if the stockholder and the members of the stockholder's family own, directly, indirectly, beneficially, or constructively, in the aggregate, at least 50 percent of the value of the taxpayer's outstanding stock;
 - (ii) a stockholder, or a stockholder's partnership, limited liability company, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts, and corporations own directly, indirectly, beneficially, or constructively, in the aggregate, at least 50 percent of the value of the taxpayer's outstanding stock; or
 - (iii) a corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of the Code, if the taxpayer owns, directly, indirectly, beneficially, or constructively, at least 50 percent of the value of the corporation's outstanding stock. The attribution rules of the Code shall apply for purposes of determining whether the ownership requirements of this definition have been met.
- (n) "Security" means any interest or instrument commonly treated as a security as well as other instruments that are customarily sold in the open market or on a recognized exchange, including, but not limited to, transferable shares of a beneficial interest in any corporation or other entity, bonds, debentures, notes, and other evidences of indebtedness, accounts receivable and notes receivable, cash and cash equivalents including foreign currencies, and repurchase and futures contracts.
- (o) "State where a contract of sale is principally managed by the customer" means the primary location at which an employee or other representative of a customer serves as the primary contact person for the taxpayer with respect to the day-to-day execution and performance of a contract entered into by the taxpayer with the customer.
- (p) "Trade or business," as used in the definition of apportionable income and in the application of that definition means the unitary business of the taxpayer, part of which is conducted within Colorado.

Rule 39-22-303.6–7. Sales Other Than Sales of Tangible Personal Property in Colorado.

Basis and Purpose. The bases of this rule are §§ 39-21-112, 39-22-301, 39-22-303, and 39-22-303.6, C.R.S. The purpose of this rule is to provide guidance for determining which gross receipts from sales other than sales of tangible personal property are included in a taxpayer's receipts factor. Consistent with the General Assembly's adoption of § 39-22-303.6, C.R.S., these rules are intended to conform the state's income tax laws to the Multistate Tax Commission's model statute and regulation except when those model provisions are inconsistent with Colorado statute. See 2018 Colo. Sess. Laws, ch. 369, § 1(2).

(1) **General Rule.**

- (a) In general, § 39-22-303.6(6), C.R.S., provides for the inclusion in the numerator of the receipts factor of gross receipts arising from transactions other than sales of tangible personal property
- (b) Receipts, other than receipts described in § 39-22-303.6(5), C.R.S., (from sales of tangible personal property) are in Colorado within the meaning of § 39-22-303.6(6), C.R.S., and Rules 39-22-303.6–7 through –13 if and to the extent that the taxpayer's market for the sales is in Colorado. In general, the provisions in this section establish

uniform rules for (1) determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Colorado, (2) reasonably approximating the state or states of assignment when the state or states cannot be determined, (3) excluding receipts from the sale of intangible property from the numerator and denominator of the receipts factor pursuant to § 39-22-303.6(6)(d)(III), C.R.S., and (4) excluding receipts from the denominator of the receipts factor, pursuant to § 39-22-303.6(6)(f), C.R.S., where the state or states of assignment cannot be determined or reasonably approximated.

(2) **General Principles of Application.** In order to satisfy the requirements of Rules 39-22-303.6–7 through –13, a taxpayer’s assignment of receipts from sales of other than tangible personal property must be consistent with the following principles:

- (a) A taxpayer shall apply the rules set forth in Rules 39-22-303.6–7 through –13 based on objective criteria and shall consider all sources of information reasonably available to the taxpayer at the time of its tax filing including, without limitation, the taxpayer’s books and records kept in the normal course of business. A taxpayer shall determine its method of assigning receipts in good faith, and apply it such method consistently with respect to similar transactions year to year. A taxpayer shall retain contemporaneous records that explain the determination and application of its method of assigning its receipts, including its underlying assumptions, and shall provide those records to the Department upon request.
- (b) Rules 39-22-303.6–7 through –13 provide various assignment rules that apply sequentially in a hierarchy. For each sale to which a hierarchical rule applies, a taxpayer must make a reasonable effort to apply the primary rule applicable to the sale before seeking to apply the next rule in the hierarchy, and must continue to do so with each succeeding rule in the hierarchy, where applicable. For example, in some cases, the applicable rule first requires a taxpayer to determine the state or states of assignment, and if the taxpayer cannot do so, the rule requires the taxpayer to reasonably approximate the state or states. In these cases, the taxpayer must attempt to determine the state or states of assignment (i.e., apply the primary rule in the hierarchy) in good faith and with reasonable effort before it may reasonably approximate the state or states.
- (c) A taxpayer’s method of assigning its receipts, including the use of a method of approximation, where applicable, must reflect an attempt to obtain the most accurate assignment of receipts consistent with the standards set forth in Rules 39-22-303.6–7 through –13, rather than an attempt to lower the taxpayer’s tax liability. A method of assignment that is reasonable for one taxpayer may not necessarily be reasonable for another taxpayer, depending upon the applicable facts.

(3) **Rules of Reasonable Approximation.**

- (a) In general, Rules 39-22-303.6–7 through –13 establish uniform rules for determining whether and to what extent the market for a sale other than the sale of tangible personal property is in Colorado. Each rule also sets forth rules of reasonable approximation, which apply if the state or states of assignment cannot be determined. In some instances, the reasonable approximation must be made in accordance with specific rules of approximation prescribed in Rules 39-22-303.6–7 through –13. In other cases, the applicable rule in Rules 39-22-303.6–7 through –13 permits a taxpayer to reasonably approximate the state or states of assignment using a method that reflects an effort to approximate the results that would be obtained under the applicable rules or standards set forth in Rules 39-22-303.6–7 through –13.
- (b) *Approximation Based Upon Known Sales.* In an instance where, applying the applicable rules set forth in Rule 39-22-303.6–10 (Sale of a Service), a taxpayer can ascertain the

state or states of assignment for a substantial portion of its receipts from sales of substantially similar services (“assigned receipts”), but not all of those sales, and the taxpayer reasonably believes, based on all available information, that the geographic distribution of some or all of the remainder of those sales generally tracks that of the assigned receipts, it shall include receipts from those sales that it believes tracks the geographic distribution of the assigned receipts in its receipts factor in the same proportion as its assigned receipts. This rule also applies in the context of licenses and sales of intangible property where the substance of the transaction resembles a sale of goods or services. See *paragraph (5) of Rule 39-22-303.6–11 and paragraph (1)(c) of Rule 39-22-303.6–12.*

- (c) *Related-Party Transactions.* Where a taxpayer has receipts subject to these Rules 39-22-303.6–7 through –13 from transactions with a related-party customer, information that the customer has that is relevant to the sourcing of receipts from these transactions is imputed to the taxpayer.

(4) **Rules with Respect to Exclusion of Receipts from the Receipts Factor.**

- (a) The receipts factor only includes those amounts defined as receipts under § 39-22-303.6(1)(d), C.R.S., and applicable rules.
- (b) Certain receipts arising from the sale of intangibles are excluded from the numerator and denominator of the receipts factor pursuant to § 39-22-303.6(6)(d)(III), C.R.S. See *paragraph (1)(d) of Rule 39-22-303.6–12.*
- (c) In a case in which a taxpayer cannot ascertain the state or states to which receipts of a sale are to be assigned pursuant to the applicable rules set forth in Rules 39-22-303.6–7 through –13 (including through the use of a method of reasonable approximation, when relevant) using a reasonable amount of effort undertaken in good faith, the receipts must be excluded from the denominator of the taxpayer’s receipts factor pursuant to § 39-22-303.6(6)(f), C.R.S., and these rules.
- (d) Receipts of a taxpayer from hedging transactions, or from holding cash or securities, or from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded pursuant to §§ 39-22-303.6(1)(d) and (6), C.R.S., except as provided in 1 CCR 201-2, Special Rule 9A.

(5) **Changes in Methodology; Department Review.**

- (a) *No Limitation on § 39-22-303.6(9), C.R.S., or Rules 39-22-303.6–16 and –17.* Nothing in the rules adopted here pursuant to § 39-22-303.6(6), C.R.S., is intended to limit the application of § 39-22-303.6(9), C.R.S., or the authority granted to the Department under § 39-22-303.6(9), C.R.S. To the extent that rules adopted pursuant to § 39-22-303.6(9), C.R.S., conflict with provisions of these rules adopted pursuant to § 39-22-303.6(6), C.R.S., the rules adopted pursuant to § 39-22-303.6(9), C.R.S., control. If the application of § 39-22-303.6(6), C.R.S., or the rules adopted pursuant thereto result in the attribution of receipts to the taxpayer’s receipts factor that do not fairly represent the extent of the taxpayer’s business activity in Colorado, the taxpayer may petition for, or Department may require, the use of a different method for attributing those receipts.
- (b) *General Rules Applicable to Original Returns.* In any case in which a taxpayer files an original return for a taxable year in which it properly assigns its receipts using a method of assignment, including a method of reasonable approximation, in accordance with the rules stated in Rules 39-22-303.6–7 through –13, the application of such method of assignment shall be deemed to be a correct determination by the taxpayer of the state or

states of assignment to which the method is properly applied. In those cases, neither the Department nor the taxpayer (through the form of an audit adjustment, amended return, abatement application or otherwise) may modify the taxpayer's methodology as applied for assigning those receipts for the taxable year. However, the Department and the taxpayer may each subsequently, through the applicable administrative process, correct factual errors or calculation errors with respect to the taxpayer's application of its filing methodology.

- (c) *Department's Authority to Adjust a Taxpayer's Return.* The provisions contained in this paragraph (5)(c) are subject to paragraph (5)(b). The Department's authority to review and adjust a taxpayer's assignment of receipts on a return to more accurately assign receipts consistently with the rules or standards of Rules 39-22-303.6-7 through -13 includes, but is not limited to, each of the following potential actions.
- (i) In a case in which a taxpayer fails to properly assign receipts from a sale in accordance with the rules set forth in Rules 39-22-303.6-7 through -13, including the failure to properly apply a hierarchy of rules consistent with the principles of paragraph (2)(b), the Department may adjust the assignment of the receipts in accordance with the applicable rules in Rules 39-22-303.6-7 through -13.
 - (ii) In a case in which a taxpayer uses a method of approximation to assign its receipts and the Department determines that the method of approximation employed by the taxpayer is not reasonable, the Department may substitute a method of approximation that the Department determines is appropriate or may exclude the receipts from the taxpayer's numerator and denominator, as appropriate.
 - (iii) In a case in which the Department determines that a taxpayer's method of approximation is reasonable, but has not been applied in a consistent manner with respect to similar transactions or year to year, the Department may require that the taxpayer apply its method of approximation in a consistent manner.
 - (iv) In a case in which a taxpayer excludes receipts from the denominator of its receipts factor on the theory that the assignment of the receipts cannot be reasonably approximated, the Department may determine that the exclusion of those receipts is not appropriate, and may instead substitute a method of approximation that the Department determines is appropriate.
 - (v) In a case in which a taxpayer fails to retain contemporaneous records that explain the determination and application of its method of assigning its receipts, including its underlying assumptions, or fails to provide those records to Department upon request, the Department may treat the taxpayer's assignment of receipts as unsubstantiated, and may adjust the assignment of the receipts in a manner consistent with the applicable rules in Rules 39-22-303.6-7 through -13.
 - (vi) In a case in which the Department concludes that a customer's billing address was selected by the taxpayer for tax avoidance purposes, the Department may adjust the assignment of receipts from sales to that customer in a manner consistent with the applicable rules in Rules 39-22-303.6-7 through -13.
- (d) *Taxpayer Authority to Change a Method of Assignment on a Prospective Basis.* A taxpayer that seeks to change its method of assigning its receipts under Rules 39-22-303.6-7 through -13 must disclose, in the original return filed for the year of the change, the fact that it has made the change. If a taxpayer fails to adequately disclose the

change, the Department may disregard the taxpayer's change and substitute an assignment method that the Department determines is appropriate.

- (e) *Department Authority to Change a Method of Assignment on a Prospective Basis.* The Department may direct a taxpayer to change its method of assigning its receipts in tax returns that have not yet been filed, including changing the taxpayer's method of approximation, if upon reviewing the taxpayer's filing methodology applied for a prior tax year, the Department determines that the change is appropriate to reflect a more accurate assignment of the taxpayer's receipts within the meaning of Rules 39-22-303.6-7 through -13, and determines that the change can be reasonably adopted by the taxpayer. The Department will provide the taxpayer with a written explanation as to the reason for making the change. In a case in which a taxpayer fails to comply with the Department's direction on subsequently filed returns, the Department may deem the taxpayer's method of assigning its receipts on those returns to be unreasonable, and may substitute an assignment method that the Department determines is appropriate.
- (f) *Further Guidance.* The Department may issue further public written statements with respect to the rules set forth in this rule. These statements may, among other things, include guidance with respect to: (1) what constitutes a reasonable method of approximation within the meaning of the rules, and (2) the circumstances in which a filing change with respect to a taxpayer's method of reasonable approximation will be deemed appropriate.