

# ***FYI – For Your Information***

## ***Combined and Consolidated Corporation Returns***

There are four possible filing alternatives for an affiliated group of corporations in Colorado. The alternatives include separate, consolidated, combined, and combined/consolidated filing. The group may elect or be required to file a combined return, a combined/consolidated return, a consolidated return, or each corporation in the group may file a separate return, depending on the facts of the situation.

### ***Separate Filing***

Each corporation in an affiliated group may file a separate return so long as the corporation does not elect to be part of a consolidated return or meet the mandatory combined reporting rules (see below). With separate filing, each corporation will file its own return, on which it will report its individual income, expenses, tax liability and credits.

### ***Consolidated Return***

An affiliated group of C corporations may elect to file a single consolidated income tax return rather than filing separate returns for each corporation.

[§39-22-305, C.R.S. and Regulation 39-22-305.1]

A consolidated Colorado corporate income tax return may be filed for those corporations that:

- are members of an affiliated group of corporations, as defined in section 1504 of the Internal Revenue Code, and
- are doing business in Colorado.

Example: P Company, a parent corporation filing a federal consolidated return, has four subsidiaries, A, B, C, and D. The parent and the first three subsidiaries all do business in Colorado. D does business only in Nebraska. P Company and its subsidiaries, A, B and C, may elect to file a consolidated Colorado income tax return. D may not be part of the consolidated return.

The net income of all corporations included in the consolidated return will be computed using one apportionment method, using consolidated factors computed with only those assets, liabilities, income or expenses of those corporations included in the return (including their investments in pass-through entities).

Example: P Company owns a 30% interest in ABC Partnership. If P Company uses three-factor apportionment, it will include 30% of ABC's property, payroll, and sales with its own factors. If P Company uses two-factor apportionment, it will include 30% of ABC's property and sales with its own factors.

### ***Consolidated Election***

The making of a consolidated return requires all corporations, included under the standards above, which at any time during the taxable year have been members of the affiliated group, to consent to be included in such return. The making of a consolidated return shall be considered as such consent.



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The election to file a consolidated return shall be binding for the year initially elected plus the three subsequent years unless written permission is obtained from the Executive Director to cease filing consolidated returns. An amended return changing from separate returns to a consolidated return, or from a consolidated return to separate returns, cannot be filed after the due date of the return.

#### *Net Operating Losses*

A net operating loss deduction is allowed in the same manner as allowed under the Internal Revenue Code and section 1502 Treasury Regulations (Net Operating Loss Carrybacks are not allowed). A corporation may not carry forward a net operating loss to any year in which it uses a different apportionment method (two or three factor) from the method used in the loss year. If the loss corporation would not have been includible in a consolidated return in the loss year, the loss carry forward allowed in the carry forward year may not exceed its share of the consolidated income in such year pursuant to Treasury Regulations section 1502. [§39-22-504, C.R.S.]

#### *Filing the Return*

The election to file a consolidated return is made by filing of the return. The filing method must be accurately indicated on page 1 of the C Corporation Income Tax Return, Form 112, using line B.

#### *Combined Return*

A combined return is an income tax return filed for the includible members of an affiliated group of corporations. A corporation is includible if (1) an average of 20% of its property and payroll factors as determined under the Multistate Tax Compact (§24-60-1301, C.R.S.) and accompanying Regulations) is assigned to locations within the United States, and (2) it meets three or more of the six-part test of unity for the current and two preceding tax years as defined below. In a combined return, the tax is based on the entire taxable income of all of the includible corporations, but the tax is assessed only against the corporation or corporations doing business in Colorado. [§39-22-303(11), C.R.S.]

#### *Affiliated Group of Corporations*

For purposes of filing a Colorado com-

bined report, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if:

- Stock possessing more than 50% of the voting power of all classes of stock and more than 50% of each class of the nonvoting stock of each of the includible corporations, except the common parent corporation, is owned directly by one or more of the other includible corporations; and
- The common parent corporation directly owns stock possessing more than 50% of the voting power of all classes of stock and more than 50% of each class of the nonvoting stock of at least one of the other includible corporations. [§39-22-303(12), C.R.S.]

"Stock" does not include a) nonvoting stock which is limited and preferred as to dividends, b) employer securities within the meaning of section 409A(1) of the Internal Revenue Code while such securities are held under a tax credit employee stock ownership plan, or c) qualifying employer securities within the meaning of section 4975(e)(8) of the Internal Revenue Code while such securities are held under an employee stock ownership plan which meets the requirements of section 4975(e)(7) of the Internal Revenue Code.

#### *Tests of Unity*

A combined return must include only those members of an affiliated group of corporations to which any three of the following facts have been in existence in the tax year and the two preceding tax years:

- Sales or leases by one affiliated corporation to another affiliated corporation constitute fifty percent or more of the gross operating receipts of the corporation making the sales or leases; or, purchases or leases from one affiliated corporation by another affiliated corporation constitute 50% or more of the cost of goods sold or leased by the corporation making the purchases or leases. This paragraph shall not apply to the following transactions between affiliated corporations: the issuance of commercial paper or other debt obligations and the use of the proceeds therefrom to make loans or to purchase receivables between affiliated corporations.

- Five or more of the following services are provided by one or more affiliated corporation for the benefit of another affiliated corporation: advertising and public relations services; accounting and bookkeeping services; legal services; personnel services; sales services; purchasing services; research and development services; insurance procurement and servicing exclusive of employee benefit programs; and employee benefit programs including pension, profit-sharing, and stock purchase plans. A service shall be deemed provided if 50% or more of the service is provided without provision for an “arm’s length charge” within the meaning of the United States treasury regulation 1.482-2(b)(3).
- Twenty percent or more of the long-term debt (due more than one year after incurred) of one affiliated corporation is owed to or guaranteed by another affiliated corporation.
- One affiliated corporation substantially uses the patents, trademarks, service marks, logo-types, trade secrets, copyrights, or other proprietary materials owned by another affiliated corporation.
- Fifty percent or more of the board of directors of one affiliated corporation are members of the board of directors or are corporate officers of another affiliated corporation.
- Twenty-five percent or more of the twenty highest-ranking officers of any affiliated corporation are members of the board of directors or are corporate officers of another affiliated corporation. [§39-22-303(11), C.R.S.]

#### *Foreign Corporations*

A combined return will not include the income of any corporation that conducts business outside the United States (the 50 states and the District of Columbia) if 80% or more of the average of the corporation’s property and payroll, as determined under the Multistate Compact apportionment rules (§24-60-1301, C.R.S. and accompanying regulations), are assigned to locations outside the United States. [§39-22-303(8), C.R.S.]

#### *Taxable Income*

- The Colorado taxable income of the affiliated corporations included in a

combined report shall be determined using the Rules and Regulations promulgated pursuant to section 1502 of the Internal Revenue Code, as modified by Colorado additions and subtractions.

- The taxable income shall include foreign source income modified as provided under §39-22-303(10) C.R.S.
- Dividends received by a corporation in the combined report, from another corporation included in the same combined report, are not included in taxable income.

#### *Apportionment Factors*

When required to file a combined report, the affiliated group of corporations shall file one return, using either the two or three factor apportionment method, summing the numerators to derive one set of factors and one apportioned taxable income for the combined group.

In the combined report, intercompany transactions among the affiliated corporations shall be excluded from the numerator and denominator of the apportionment factor; and the numerators of the apportionment factors shall be, to the extent applicable, the sum of the revenue, the sum of the property, and the sum of the payroll factors of those affiliated corporations subject to Colorado income tax under 15 U.S.C. 381-384, 391.

#### *Net Operating Losses*

If the loss corporation was not includible in a combined return in the loss year, the loss carry forward allowed in the carry forward year may not exceed its share of the combined income in such year pursuant to U.S. Treasury regulations section 1502 or section 368 as applicable. If the loss year was a separate filing and the carry forward year is a combined filing the loss must be recomputed under combined procedures to determine the applicable loss, provided the member(s) of the affiliated group meet the combined report requirements in the loss year.

If the loss corporation was included in a combined return in the loss year and the loss is being carried forward to a separate return, the loss must be identified by entity to determine the amount of the loss that can be claimed.

### ***Combined and Consolidated Return***

All corporations in an affiliated group that meet three of the six tests of unity for the current and two preceding tax years must file a combined return. However, if one of these corporations is part of an affiliated group that also includes one or more corporations that do not meet three of the six tests of unity, that affiliated group may also be included in a combined and consolidated return if they meet the requirements for inclusion in a consolidated return.

Example: P Company, a parent corporation filing a federal consolidated return,

has four subsidiaries, A, B, C, and D. P and the first three subsidiaries all do business in Colorado. A was acquired on January 1, 2005 and D does business only in Nebraska. P Company meets the six-part test for filing a combined report with B, C, and D. Thus, P, B, C, and D must file a combined report. A, however, does not qualify for the combined report because it has not been owned for the requisite two years. P Company may elect to file a consolidated return with A. Thus, P will be filing a combined/consolidated return: combined with B, C, and D, and consolidated with A.

### **Summary Illustration**

The following example illustrates the key filing differences between separate, consolidated, and combined reporting.

P Company, a parent corporation owns 80% of the outstanding stock of Subsidiary A and 60% of the stock of Subsidiary B. The Parent and Subsidiary A do business in Colorado. Subsidiary B does business only in Nebraska. They have the following income and apportionment factors.

<u>Corporation</u>	<u>Income</u>	<u>Apportionment Factor</u> *
Parent	\$1,000	60/500
Subsidiary A	\$ 500	30/500
Subsidiary B	\$ 300	0/500
Totals	\$1,800	90/1500

#### Separate Filing:

Parent      \$1,000 x 60/500 = \$120 Taxable Income

Subsidiary A    \$ 500 x 30/500 = \$ 30 Taxable Income

Under separate filing each corporation doing business in Colorado files its own return. As a consequence, only the Parent and Subsidiary A file returns and collectively their taxable income totals \$150.

#### Consolidated Filing:

Parent and Subsidiary A      \$1,500 x 90/1000=\$135 Total taxable income

The Parent and Subsidiary A elect to file a consolidated return. (Subsidiary B cannot be part of a consolidated return because it is not doing business in Colorado.) As a consequence, the consolidated taxable income is \$135.

#### Combined Reporting:

Parent, Subsidiary A, and Subsidiary B    \$1,800 x 90/1500=\$108 Total taxable income

If the Parent and subsidiaries meet three or more of the six-part combined reporting test for the current and preceding two tax years, they must file a combined report. Procedurally, the report will be filed on one return for the Parent and Subsidiary A, but will include the income and factors of all three corporations. In short, you are measuring the taxable income of the Parent and Subsidiary A by using the income and factors of the entire group.

\*The apportionment factor is summarized for purposes of illustration.

### ***FURTHER INFORMATION***

FYIs and commonly used forms are available on the Web at *www.taxcolorado.com*

For additional Colorado tax information visit the "Tax Information Index" which covers a variety of topics including links to forms, publications, regulations, statutes and general questions and answers. The "Tax Information Index" is located at *www.taxcolorado.com*

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