

## Chapter 25

# COLORADO STATE AND LOCAL TAXATION OF THE CONSTRUCTION INDUSTRY

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## § 25.1 • INTRODUCTION

In Colorado, the state and a number of local governmental entities impose several types of taxes that affect the construction industry. The state and local taxes that create the most confusion and the largest compliance burden for the construction industry are the sales and use taxes imposed by the state and by many local jurisdictions. Property taxes levied by many local jurisdictions and administered by county assessors and county treasurers also affect the construction industry. The state income tax laws contain only a few provisions that are unique to the construction industry. Municipal occupation taxes may also apply to the operations of members of the construction industry within the municipalities imposing such taxes.

This chapter provides an overview of the Colorado state and local tax system and focuses on specific aspects of that system that are important to the construction industry.

## § 25.2 • STATE AND LOCAL SALES AND USE TAXES

### § 25.2.1—What Is Sales Tax?

Sales tax is an excise imposed by a taxing jurisdiction on the sale within the taxing jurisdiction of tangible personal property and certain services. In Colorado, sales tax is considered to be imposed on the purchaser and can be collected by the taxing jurisdiction directly from the purchaser.<sup>1</sup> Usually, however, the seller collects sales tax from the purchaser, if the seller is licensed to collect sales tax for the taxing jurisdiction.

The amount of the excise is ordinarily a percentage of the purchase price paid by the purchaser for the tangible personal property or for the taxable services. In Colorado, the taxable purchase price includes the amount of money and the fair market value of any other consideration paid by the purchaser for the tangible personal property or for the taxable services.<sup>2</sup> The purchase price excludes any direct tax imposed by the federal government and any sales tax.<sup>3</sup> In the case of an exchange of property, the purchase price includes the fair market value of the property exchanged, unless the exchanged property is to be resold in the usual course of the seller's business or is a vehicle that is exchanged for another vehicle and both vehicles are subject to registration in the state.<sup>4</sup>

### § 25.2.2—What Is Use Tax?

Use tax is an excise that is supplementary to sales tax. Use tax is usually imposed on the storage, use, or consumption within a taxing jurisdiction of tangible personal property purchased at retail. The amount of the excise is usually a percentage of the purchase price paid by the purchaser to acquire the tangible personal property. The use tax laws of most taxing jurisdictions provide an exemption for the use of property that is acquired in a transaction in which sales tax is paid to the same taxing jurisdiction, so that only one tax (either sales tax or use tax) is collected

by the taxing jurisdiction with respect to a particular retail sale of tangible personal property.<sup>5</sup> Use tax is usually paid directly to the taxing jurisdiction by the purchaser.

### **§ 25.2.3—Which Jurisdictions Impose Sales Or Use Tax?**

In Colorado, the jurisdictions that impose sales and use taxes can be divided into four categories.

#### **State Sales and Use Tax**

The first category is the state. The state imposes a sales tax at the rate of 2.9 percent on all retail sales in the state of tangible personal property and on certain taxable services, described below.<sup>6</sup> The state also imposes a use tax at the rate of 2.9 percent on the storage, use, or consumption in the state of tangible personal property purchased at retail.<sup>7</sup>

#### **Sales and Use Taxes of the Regional Transportation District, the Scientific and Cultural Facilities District, and the Football Stadium District**

The second category of taxing jurisdictions consists of three special districts in the Denver metropolitan area, namely, the Regional Transportation District (RTD), the Scientific and Cultural Facilities District (SCFD), and the Football Stadium District (FD).<sup>8</sup> These districts impose sales taxes of 1.0 percent (RTD), 0.1 percent (SCFD), and 0.1 percent (FD), on all transactions that occur in the districts and that are subject to the state sales tax, with certain exceptions. The districts also impose use taxes at the same rates on all transactions that occur in the districts and that are subject to the state use tax, with certain exceptions.<sup>9</sup>

#### **State-Administered Local Sales Taxes**

The third category of taxing jurisdictions consists of local jurisdictions (including counties, statutory cities and towns, home rule cities that have elected to have the state collect their sales taxes, and certain other special districts) whose sales taxes are collected by the state Department of Revenue. These state-administered local sales taxes are imposed by a large number of jurisdictions, which are listed on a form<sup>10</sup> published by the Department of Revenue in January and July each year. Each state-administered local sales tax is imposed on all transactions that occur within the taxing jurisdiction and that are subject to the state sales tax, with certain exceptions. Counties and statutory cities and towns are permitted to impose use taxes, but only on motor vehicles and building and construction materials.<sup>11</sup> The use taxes imposed by these local jurisdictions are collected by the local jurisdictions.

#### **Sales and Use Taxes of Home Rule Cities**

The fourth, and most difficult, category of taxing jurisdictions consists of home rule cities that impose their own sales and use taxes. Under Colorado law, every home rule city is authorized to impose and administer its own sales and use tax, and as of the date of this writing, 61 home rule cities have chosen to do so.<sup>12</sup> While the sales and use taxes of the home rule cities are generally similar to the state sales and use tax, significant differences do exist between the sales and use taxes of home rule cities and the sales and use taxes of the state. In addition, significant differences exist between the sales and use taxes of different home rule cities.

**§ 25.2.4—Which Sales Are Taxable?**

The state sales tax is imposed on “sales and purchases of tangible personal property at retail.”<sup>13</sup> Nearly every word in that phrase has been the subject of interpretation.

**Definition of “Sale”**

A *sale* is any transfer of ownership or possession of tangible personal property for a consideration.<sup>14</sup> The term includes installment sales, credit sales, and conditional sales as well as exchanges of tangible personal property. The term also includes leases of more than three years, and may include leases of three years or less if the lessor has made an election to treat short-term leases as sales.<sup>15</sup>

Certain transactions are excluded by statute from the definition of “sale.” These excluded transactions include some (but not all) of the transactions involved in the formation, reorganization, and dissolution of corporations, partnerships, and limited liability companies and some (but not all) transactions between affiliated entities.<sup>16</sup> The repossession of personal property by a chattel mortgage holder and foreclosure by a lienholder are excluded from the definition of “sale.”<sup>17</sup> While these transactions are excluded from the definition of “sale” for purposes of state sales and use taxes, they may not be excluded from the definition of “sale” for purposes of the sales and use taxes imposed by a home rule city.

**Definition of “Retail”**

A *retail* sale is any sale other than a wholesale sale.<sup>18</sup> A wholesale sale is any sale by a wholesaler to a retailer, jobber, dealer, or other wholesaler for resale.<sup>19</sup>

Certain purchases of ingredients or component parts are deemed to be wholesale purchases that are not subject to sales or use tax.<sup>20</sup> This exclusion applies to purchases of tangible personal property “by a person engaged in the business of manufacturing, compounding for sale, profit, or use, any article, substance or commodity, which tangible personal property enters into the processing of or becomes an ingredient or component part of the product or service which is manufactured, compounded, or furnished, and the container, label, or the furnished shipping case of such product.” So-called manufacturing aids (such as machinery, tools, furniture, office equipment, and catalysts) do not qualify for this exclusion.<sup>21</sup>

If an item of tangible personal property is purchased tax-free in a wholesale transaction but is subsequently withdrawn from inventory for the use of the purchaser, the original purchase transaction is converted into a taxable retail sale and the purchaser owes sales tax on its purchase price for the item.<sup>22</sup> If a purchaser buys materials and manufactures the materials into a product which is then withdrawn from inventory, the original purchase of the materials is converted into a retail purchase and the purchaser owes sales tax on its purchase price of the materials (not on the value or list price of the final product).<sup>23</sup>

In determining whether purchases of items that are ultimately re-sold are subject to sales tax, the Colorado Supreme Court applies a “primary purpose” test. If the primary purpose of a transaction is the acquisition of an item for resale in an unaltered condition and basically unused

by the purchaser, the transaction is a wholesale purchase and is not subject to sales tax.<sup>24</sup> Where a contractor purchased tangible personal property for its use in performing its contract with the federal government, the contractor's purchase was taxable, even though the contract provided that the contractor was reimbursed for the amount paid and that title to all such property purchased by the contractor vested in the federal government prior to or at the commencement of the contractor's use of the property.<sup>25</sup> On the other hand, the diversion of raw materials in a "brief utilization" of such raw materials is not a taxable event.<sup>26</sup>

Purchases of electricity, coal, gas, fuel oil, steam, coke, or nuclear fuel, for use in processing, manufacturing, mining, refining, irrigation, construction, telegraph, telephone, and radio communication, street and railroad transportation services, and all industrial uses, are deemed to be wholesale purchases that are exempt from state sales and use taxes.<sup>27</sup>

#### **Definition of "Tangible"**

*Tangible* property includes all corporeal things and substances that are dealt in or are capable of being processed or exchanged.<sup>28</sup> The statutory definition of tangible property excludes newspapers, preprinted newspaper supplements distributed with newspapers, and direct mail advertising materials distributed in Colorado by a person engaged solely and exclusively in the business of providing cooperative direct mail advertising.<sup>29</sup> Water in pipes, conduits, ditches, or reservoirs is not considered to be tangible personal property, but water in bottles, wagons, tanks, or other containers is considered to be tangible personal property.<sup>30</sup>

#### **Definition of "Personal"**

*Personal* property is property other than real property such as land, buildings, and other permanent improvements to land. Personal property becomes real property when it loses its identity by becoming an integral and inseparable part of real estate that can be removed only with substantial damage to the premises.<sup>31</sup>

#### **§ 25.2.5—Which Services Are Taxable?**

The state sales tax does not apply to all services, but rather applies only to certain services specifically identified in the taxing statute. The state sales tax statute identifies the following services as taxable:

- intrastate telephone and telegraph service;
- gas and electric service for gas and electricity furnished and sold for commercial consumption and not for resale;
- steam when consumed or used by the purchaser and not resold in original form;
- food or drink served or furnished in restaurants and similar establishments, including cover charges; and
- furnishing of rooms or accommodations in hotels and similar establishments.<sup>32</sup>

While the state and state-administered local sales taxes apply only to the services listed above, many home rule cities impose sales taxes on other services.<sup>33</sup>

**§ 25.2.6—What Constitutes A Taxable Use?**

Any storage, use, or consumption in Colorado of tangible personal property purchased at retail constitutes a taxable use of that property under the state use tax statute, unless a specific exemption otherwise applies to the storage, use, distribution, or consumption.<sup>34</sup>

**§ 25.2.7—How Is Sales Tax Paid?**

Any person who engages in selling tangible personal property at retail in Colorado is required to obtain a retail sales tax license and to collect state and state-administered local sales tax on such sales.<sup>35</sup> A licensed retailer is required to add the sales tax to the purchase price of tangible personal property sold at retail and must collect the sales tax from the purchaser.<sup>36</sup> When added to the purchase price by a licensed retailer, the sales tax becomes a debt due from the purchaser to the seller.<sup>37</sup> It is illegal for a licensed retailer to represent that sales tax will not be added to the purchase price or that the seller will absorb the sales tax.<sup>38</sup>

A licensed retailer who fails to collect from the purchaser the sales tax on a taxable sale becomes liable, along with the purchaser, to the state for the sales tax on the transaction.<sup>39</sup> A licensed retailer is relieved of the obligation to collect sales tax on a sale if the purchaser provides the retailer with satisfactory documentation that the transaction is exempt from sales tax. Such documentation includes: (1) a certificate of exemption issued by the Department of Revenue to the purchaser designating the purchaser as an entity that is exempt from sales tax; (2) a retail sales tax license issued by the Department of Revenue to the purchaser, along with a representation by the purchaser that the item is being purchased for resale; (3) a certificate of exemption issued by the Department of Revenue to a contractor or a subcontractor designating a construction project as an exempt project, if the transaction is a purchase of construction or building materials by the contractor or subcontractor to be used on the exempt project; (4) a declaration of entitlement issued by the purchaser certifying that the item purchased constitutes manufacturing machinery that is exempt from state sales tax; or (5) a direct pay permit issued by the Department of Revenue to the purchaser.<sup>40</sup>

A qualified purchaser may obtain a direct pay permit, which allows the purchaser to purchase tangible personal property or taxable services without paying sales tax to the seller. Instead, the purchaser pays the sales tax (including state-administered local sales tax) directly to the Department of Revenue. In order to be a qualified purchaser, a person must:

- have purchased in Colorado at least \$7 million of taxable tangible personal property and taxable services (excluding building and construction materials and fixtures) within the preceding 12 months;
- have filed timely returns and made timely payment of tax for all taxes administered by the Department of Revenue for the three preceding years (or for the entire period for which the person was required to file returns and pay taxes, if that period is less than three years); and
- have in place an accounting system acceptable to the Department of Revenue that will allow the Department of Revenue to fully and accurately collect state-administered local taxes.<sup>41</sup>

**§ 25.2.8—How Is Use Tax Paid?**

Every person who stores, uses, or consumes tangible personal property in the state is required to report and pay use tax on the purchase price paid for that tangible personal property, unless the state sales tax was paid on the purchase of the tangible personal property.<sup>42</sup> If sales or use tax was previously paid to another state with respect to the user's purchase of the tangible personal property, that sales or use tax is credited against the use tax owed to Colorado.<sup>43</sup> The use tax is reported and paid directly to the state through the filing of a monthly use tax return.<sup>44</sup>

**§ 25.2.9—How Do The State Sales And Use Taxes Apply To The Construction Industry?****The Contractor's Rule**

The application of the state sales and use tax laws to the construction industry is significantly affected by the so-called "Contractor's Rule." This rule, which is described in the Department of Revenue's *Special Sales Tax Regulation: Contractors*, states that a contractor is considered to be the retail purchaser of all tangible personal property purchased by the contractor to be built into any building or structure. This means that a contractor must pay sales tax to the vendor on all materials purchased by the contractor to be incorporated into a construction project (unless the vendor does not hold a Colorado retail sales tax license, in which case the contractor must pay use tax on those purchases). The contractor is not considered to be reselling the materials to the owner of the project as tangible personal property, and the contractor is therefore not permitted to claim that the contractor's purchase of the materials is a nontaxable wholesale purchase.

Of course, a contractor is required to pay tax on the contractor's purchases of items of tangible personal property (such as tools, consumable supplies, and equipment) that are used by the contractor in performing the work under a construction contract. The tax should be paid as a sales tax to the vendor if the vendor holds a Colorado retail sales tax license and should be paid directly to the Department of Revenue as a use tax if the vendor does not hold a Colorado retail sales tax license.

**Contractors and Retailer-Contractors**

While the Contractor's Rule can be stated unequivocally in the abstract, the application of the rule in practice is substantially less clear. Many contractors are also retailers of building and construction materials. The *Special Sales Tax Regulation: Contractors* acknowledges this reality and attempts to distinguish between contractors (who are always considered to be the retail purchasers of the materials purchased by them to be incorporated into a construction project) and "retailer-contractors." Under the Special Regulation, a retailer-contractor may be treated as a retailer of items of tangible personal property in some cases but a contractor in other cases, depending on the nature of the transaction between the retailer-contractor and its customer. The Special Regulation provides that if the contract involves separate charges for labor and materials, then the retailer-contractor is considered to be selling the materials at retail to its customer. In that case, the retailer-contractor must hold a Colorado retail sales tax license and must collect sales tax on the price charged to the customer for the materials. On the other hand, if the transaction involves a lump sum contract, the retailer-contractor is treated as a contractor and is required to pay sales or use tax with respect to its purchase of materials incorporated into the construction

project. The retailer-contractor may have acquired the materials without paying sales tax, because the retailer-contractor did not know at the time of acquisition of the materials whether the materials would be resold in a retail sale or would be used in performing a contract to improve a building or structure. In that case, the retailer-contractor must report and pay directly to the Department of Revenue the sales tax on the retailer-contractor's purchase price for these materials when they are withdrawn from the retailer-contractor's inventory to be used in the construction contract.

#### **Over-the-Counter Sales of Completed Units Not Made to Order**

The Special Regulation also identifies certain situations in which the Contractor's Rule does not apply, apparently even if the contract provides for a lump sum price. The Special Regulation defines these situations as over-the-counter sales of completed units not made to order, with an agreement for installation of the units. Examples of these transactions in the Special Regulation include sales of stoves, refrigerators, furnaces, air conditioners, washing machines, dryers, carpets, electrical fixtures, ready-made cabinets, storm doors, garage doors, storm windows, screens, sod, and similar items. The Special Regulation states that the retailer-contractor must collect sales tax from its customers on these transactions, although the installation charges may be excluded from the taxable purchase price if the installation charges are separately stated in the bid or on the invoice.

The Special Regulation's requirement that the retailer-contractor always treat the listed transaction as retail sales to the retailer-contractor's customer rather than construction contracts appears to be overly broad. While the installation or replacement of these items in an existing structure may be a retail sale of the items to the owner of the structure, the installation of many of the items as part of new construction would appear to be more in the nature of a construction contract to which the Contractor's Rule should apply. In fact, the Department of Revenue was rebuffed by the courts when it attempted to require a garage door contractor to treat its sales and installation of garage doors as retail sales of the garage doors rather than contracts to improve buildings or structures.<sup>45</sup>

#### **Consequences of the Characterization of the Transaction**

The stakes involved in the characterization of a transaction as a retail sale of an item to the owner with an agreement for installation or as a contract to improve a building or structure can be substantial. If the retailer-contractor treats the transaction as a contract to improve a building or structure and pays sales or use tax on its cost to purchase the materials incorporated into the project, the Department of Revenue may claim that the transaction should have been treated as a retail sale of the item to the owner. In that case, the Department of Revenue will seek to collect from the retailer-contractor the tax on the difference between the retailer-contractor's cost of materials and the amount charged by the retailer-contractor to its customer (including the installation charges, unless those charges are separately stated), plus interest, penalty-interest, and penalty on that tax amount. If any doubt exists as to the proper characterization of a transaction, the retailer-contractor is best protected by treating the transaction as a retail sale to its customer and collecting the sales tax on the price charged to the customer (less any separately stated installation charges).



**§ 25.2.10—Exemptions From State Sales And Use Taxes**

The state sales and use tax law provides exemptions for many transactions. The following discussion addresses the most significant exemptions applicable to contractors.

**Construction and Building Materials for Use on Exempt Projects**

The state sales and use tax statute includes an exemption for sales of construction and building materials to contractors and subcontractors for use in the building, erection, alteration, or repair of structures, highways, roads, streets, and other public works owned and used by the U.S. government, the State of Colorado and its subdivisions, charitable organizations, and nonprofit schools.<sup>46</sup> The exemption for sales of construction and building materials for use on exempt projects is not a local option exemption, so all of the local taxing jurisdictions for which the state collects sales tax must include this exemption. However, most home rule cities do not include this exemption in their sales and use tax ordinances.

**Manufacturing Machinery and Machine Tools**

Purchases and use of machinery or machine tools, or parts thereof, in excess of \$500, to be used in Colorado directly and predominantly in manufacturing tangible personal property for sale or profit, are exempt from the state sales and use tax.<sup>47</sup> “Machinery” is defined as any apparatus consisting of interrelated parts used to produce an article of tangible personal property, including both the basic unit and any adjunct or attachment necessary for the basic unit to accomplish its intended function.<sup>48</sup> Materials for the construction of machinery, machine tools, or parts are not exempt.<sup>49</sup> “Manufacturing” is the operation of producing a new product, article, substance, or commodity different from and having a distinctive name, character, or use from raw or prepared materials.<sup>50</sup>

In order to be used “predominantly” in manufacturing, the “greatest use” of the property must be its use in manufacturing. If an item of machinery has uses in addition to manufacturing use, the manufacturing use must be greater than 50 percent of all use to qualify for the exemption. In computing the percentage of use that is manufacturing use, machinery is not considered to be in use when it is shut off, including time when the machinery is shut off for repair or maintenance.<sup>51</sup>

In an enterprise zone, purchases of materials for the construction or repair of machinery or machine tools qualify for the exemption.<sup>52</sup> In addition, purchases may qualify for the exemption whether the purchases are capitalized or expensed.<sup>53</sup> In an enterprise zone, the term “manufacturing” includes refining, blasting, exploring, mining and mined land reclamation, quarrying for, processing and beneficiation, or otherwise extracting from the earth or from waste or stockpiles or from pits or banks any natural resource.<sup>54</sup>

The manufacturing machinery and machine tools exemption is a local option exemption, which means that the exemption does not apply to state-administered local sales taxes unless the local taxing jurisdiction specifically chooses to adopt the exemption. Most local taxing jurisdictions for which the state collects sales taxes have not adopted this exemption. The RTD/SCFD/FD sales tax does not include the machinery and machine tools exemption, so the RTD/SCFD/FD

sales tax applies to sales of machinery and machine tools. Oddly, the machinery and machine tools exemption does apply to the RTD/SCFD/FD use tax, so the use of machinery and machine tools within these special districts is exempt from the districts' use tax, even though the purchase of machinery and machine tools in the districts is subject to the district sales tax.<sup>55</sup>

Only a few home rule cities provide exemptions for machinery and machine tools in their sales and use tax ordinances. Some of the home rule cities that do provide exemptions for machinery and machine tools have rules that are different from those that apply to the state's exemption for machinery and machine tools.

#### **Exemption for Testing, Modification, Inspection, or Similar Activities**

The state sales and use tax statute contains an exemption for tangible personal property that is purchased in the state or is brought into the state for testing, modification, inspection, or similar type activities, if such tangible personal property will ultimately be used outside of Colorado in manufacturing or similar activities and the test, modification, or inspection period in Colorado does not exceed 90 days.<sup>56</sup>

#### **§ 25.2.11—Refund Of State Sales And Use Taxes On Pollution Control Equipment**

If the state's revenue surplus exceeds certain targets (\$350 million) for a fiscal year, then a taxpayer may apply for a refund of state sales and use taxes paid with respect to pollution control equipment during that fiscal year. The application for the refund must be filed between January 1 and April 1 of the calendar year following the end of the fiscal year.<sup>57</sup>

#### **§ 25.2.12—Special Issues Involving State-Administered Local Sales And Use Taxes**

As noted above, the state Department of Revenue administers the sales taxes imposed by many local jurisdictions, including the RTD/SCFD/FD, other special districts, counties, statutory cities, and home rule cities that have elected state administration. While the sales tax ordinances of these local jurisdictions are required to follow the state sales tax statute in most respects, a few differences exist. In addition, these local jurisdictions may impose limited use taxes on motor vehicles and construction and building materials, and a few special rules apply to these use taxes that are different from the state's use tax rules. These differences can be a source of substantial confusion for the construction industry.

#### **No Local Use Tax on Storage of Building and Construction Materials**

Local taxing jurisdictions are not permitted to impose their use taxes on the mere storage of building and construction materials. This prohibition does not apply to the RTD/SCFD/FD use tax, but it does apply to the use taxes imposed by home rule cities as well as to the use taxes imposed by jurisdictions for which the state administers sales taxes.<sup>58</sup>

#### **No Local Sales Tax on Sales of Building and Construction Materials if a Local Use Tax Will Be Paid**

Ordinarily, if a purchaser picks up items of tangible personal property at the vendor's place of business, the vendor is required to collect the local sales tax of the taxing jurisdictions in which that place of business is located, even if the purchaser immediately removes the purchased

items from those taxing jurisdictions. However, when the items purchased are building and construction materials, the local sales taxes are not imposed on the transaction if the purchaser presents the vendor with a building permit or other documentation showing that a local use tax has been paid or is required to be paid with respect to such materials.<sup>59</sup> This rule is designed to ensure that the local tax on building and construction materials is paid to the local jurisdictions in which the construction project is located, rather than the local jurisdictions in which the vendor's place of business is located. Note, however, that the exemption does not apply if the local jurisdiction in which the construction project is located does not impose a use tax. This exemption does not apply to the RTD/SCFD/FD sales tax, but it does apply to the sales taxes of home rule cities as well as all state-administered sales taxes other than the RTD/SCFD/FD sales tax.

### **§ 25.2.13—Special Issues Involving Home Rule Cities**

As noted above, home rule cities in Colorado are permitted to enact their own sales and use tax ordinances that do not contain the same provisions with respect to taxable transactions, exemptions, administration, and enforcement as the state sales and use tax statute. Sixty-one home rule cities have adopted their own sales and use tax ordinances. While these home rule city sales and use tax ordinances are often similar to the state sales and use tax statute, they also contain many differences, and some of the most significant such differences are directly relevant to the construction industry. Even when a provision of a home rule city's sales and use tax ordinance is identical to the corresponding provision of the state sales and use tax statute, the local tax administrators may interpret or administer that provision in a manner that is different from the interpretation or administration of the provision in the state statute.

It is beyond the scope of this chapter to catalog the unique provisions and nuances of the sales and use tax ordinances of all 61 home rule cities that have adopted their own ordinances. Any contractor or member of the construction industry in Colorado should become familiar with the specific provisions of the sales and use tax ordinances of the home rule cities in which the entity conducts business and with the local tax administrators' interpretation and administration of those provisions. A few of the most significant peculiarities of the sales and use tax ordinances of home rule cities are described in this section.

#### **Local Use Tax on Construction Equipment**

When tangible personal property (including, for example, tools, machinery, and other construction equipment) that was purchased at retail is brought into a taxing jurisdiction that imposes a use tax (including a home rule city), the taxing jurisdiction's use tax applies to that equipment. The use tax generally applies to the entire purchase price paid for the equipment, even if the equipment is only used in the taxing jurisdiction for a short period of time. The user of the equipment is required to file a use tax return with the taxing jurisdiction and pay the local use tax. However, the user may take a credit for any sales or use tax previously paid to a comparable taxing jurisdiction with respect to the equipment.

This rule creates significant administrative and tax burdens for members of the construction industry in Colorado, who often move expensive equipment among many home rule cities. When an item of equipment is moved into a home rule city for the first time, that home rule city's

use tax is due on the amount paid for the item of equipment, even if the item was purchased years earlier. Of course, the user is entitled to a credit against that use tax for any sales or use tax previously paid to another home rule city with respect to that item of equipment, but the user will bear the burden of proving that such sales or use tax was paid (and, in some cases, was legally required to be paid). This imposes a substantial record-keeping burden on the user of the equipment. Moreover, in some cases equipment may first be brought into a taxing jurisdiction that imposes a use tax long after the purchase of the equipment, at a time when the value of the equipment has declined substantially. The use tax, however, is usually still measured by the original purchase price of the equipment.

In an effort to alleviate this problem in the construction industry, the state legislature adopted legislation requiring home rule cities to pro-rate their use taxes on construction equipment under certain circumstances. Under this legislation, construction equipment that is located in a home rule city for 30 consecutive days or less can be taxed at only one-twelfth of the equipment's purchase price.<sup>60</sup> In order to take advantage of this rule, the taxpayer must file a declaration with the home rule city on or before the date on which the equipment is brought into the city.<sup>61</sup> The legislature also provided that local use taxes could not be imposed with respect to the use or consumption of tangible personal property in the taxing jurisdiction that occurs more than three years after the most recent sale of the property if, within that three-year period, the property was significantly used in Colorado for the principal purpose for which it was purchased.<sup>62</sup>

Some home rule cities have incorporated these requirements into their sales and use tax ordinances. Others have not, and some home rule cities have refused to comply with the state statute, contending that the state legislature has no power to impinge upon the right of home rule cities to define their own sales and use tax base. The Colorado Supreme Court has agreed with this position. In *Winslow Construction Co. v. Denver*,<sup>63</sup> the court held that the prohibition on taxing tangible personal property purchased more than three years before its initial use in a taxing jurisdiction does not apply in Denver.

This decision by the Colorado Supreme Court leaves this area unsettled. Home rule cities that have not incorporated the requirements of the state statute into their sales and use tax ordinances may not be required to do so, although many of those cities may apply the requirements of the state statute even though those rules are not expressly incorporated into the ordinances. Cities that have incorporated those provisions into their ordinances must continue to apply them and may be precluded from removing the provisions from their ordinances unless they obtain voter approval of the changes.<sup>64</sup> Cities that have never adopted the requirements of the state statute are apparently free to disregard the state law, although some of those cities may provide relief in some other fashion. Denver, for example, provides that tangible personal property first distributed, stored, used, or consumed in Denver more than one year after its retail sale is subject to use tax on the market value, rather than the original purchase price, of the property.<sup>65</sup>

#### **Exemption for Construction Materials Used on Projects for Exempt Owners**

As noted above, the state sales and use tax statute contains a specific exemption for sales of construction and building materials to contractors and subcontractors for use in construction

projects owned and used by the U.S. government, the State of Colorado and its subdivisions, charitable organizations, and nonprofit schools. The sales and use tax ordinances of most home rule cities (including Denver) do not contain a similar exemption. Therefore, in many construction projects for exempt owners, the sales or use taxes of home rule cities will be due with respect to the materials incorporated into the project, even though no state sales or use tax is due on those materials.

## § 25.3 • PROPERTY TAX

### § 25.3.1—General Description Of Property Tax

All tangible property located in Colorado on January 1 (the assessment date) of each year is subject to property tax based on the value of that property, as determined by the county assessor of the county in which the property is located on the assessment date.<sup>66</sup> Unlike some states, the property tax in Colorado applies to both real property and tangible personal property. Various exemptions operate to exclude most non-business personal property from the property tax.<sup>67</sup> In addition, inventories of merchandise and materials and supplies that are held for consumption by any business or are held primarily for sale are exempt from property taxes.<sup>68</sup>

### § 25.3.2—Determination Of Value

Property taxes are imposed against the “assessed value” of taxable property. In general, the assessed value of most property other than residential real property is 29 percent of the actual value of the property.<sup>69</sup> The actual value of property is determined by the county assessor by appropriate consideration of the cost approach, the market comparison approach, and the income approach to appraisal.<sup>70</sup> These three approaches are applied by considering data arising during an 18-month “base period” that ends on June 30 of each even-numbered year.<sup>71</sup> The actual value determined for real property normally remains in effect for two tax years. Personal property is valued annually and the actual value is then multiplied by a factor to arrive at the appropriate base year level of value for the personal property.<sup>72</sup>

### § 25.3.3—The Assessment, Levy, And Collection Process

The actual value of property for property tax purposes is determined by the county assessor in the spring of each tax year. The property tax statutes require the county assessor to provide the owner of the property with notice of the actual value assigned to the property and provide the taxpayer with protest and appeal rights.<sup>73</sup> The mill levy (tax rate) is established by the board of county commissioners in the fall of the tax year.<sup>74</sup> Tax statements are issued in January of the following year, and the taxes are due by April 30 of that year or in two equal installments due on the last day of February and June 15.<sup>75</sup>

### § 25.3.4—Application Of Property Taxes To The Construction Industry

The property tax statutes do not contain provisions that are unique to the construction industry. Certain aspects of the property tax statutes do, however, affect the construction industry to a greater extent than other industries.

**Reporting of Movable Personal Property**

An owner of personal property is generally required to file a personal property declaration schedule by April 15 of each year with the county assessor of the county in which the personal property is located, in order to report the original acquisition cost and date of the personal property.<sup>76</sup> If the personal property is portable or movable equipment that may be located in two or more counties during the year, the taxpayer must include with the personal property declaration schedule a statement identifying the portable or movable equipment and indicating the counties in which the equipment is likely to be located and the estimated period of time during which the equipment is likely to be located in each such county.<sup>77</sup> The county assessor for the county in which the equipment is located on the assessment date determines the value of the equipment and the value is then apportioned among the counties in which the taxpayer indicated that the equipment would be located.<sup>78</sup>

**Construction in Progress**

Real property that is under construction on the assessment date is subject to property tax for the tax year, based on the actual value of the real property construction in progress on the assessment date. Personal property, however, is not subject to property tax until the personal property is first used in the business after acquisition.<sup>79</sup> Therefore, in the case of a construction project that includes items of tangible personal property, the portion of the value attributable to the personal property should not be subject to property tax until the tax year after the tax year in which the personal property is placed in service.

**§ 25.4 • STATE INCOME TAX****§ 25.4.1—General Description Of The Colorado Income Tax**

The state imposes a tax on the taxable income of individuals, trusts, and estates, and on the net income of C corporations doing business in the state.<sup>80</sup> The state income tax is imposed at the rate of 4.63 percent and is generally based on the taxpayer's federal taxable income, with certain adjustments. In the case of C corporations, the tax is imposed on the net income of the C corporation derived from sources within Colorado.<sup>81</sup>

Local government entities are prohibited from imposing income taxes in Colorado.<sup>82</sup>

**§ 25.4.2—Determination Of Net Income Derived From Sources Within Colorado**

If a C corporation carries on no business outside of Colorado, the entire net income of the C corporation is considered to be derived from sources within Colorado.<sup>83</sup> If the C corporation derives income from sources within and without Colorado, then the net income derived from Colorado sources must be determined by the application of an apportionment formula. Colorado law provides the taxpayer with an election to use a two-factor apportionment formula (based on property and revenue)<sup>84</sup> or a three-factor apportionment formula (based on property, revenue, and payroll) that is contained in the Multistate Tax Compact.<sup>85</sup>

**§ 25.4.3—Affiliated Groups Of C Corporations**

If a C corporation is part of an affiliated group of C corporations, then the C corporation must file a combined report with the other members of the affiliated group of C corporations.<sup>86</sup> An affiliated group of C corporations consists of one or more chains of C corporations connected by 50 percent stock ownership.<sup>87</sup> Only C corporations with more than 20 percent of their property and payroll assigned to locations within the United States are included in the affiliated group of C corporations.<sup>88</sup> In addition, only members of the affiliated group of C corporations that have met at least three of six factual tests set out in the statute during the tax year and the two preceding tax years are included in the combined report.<sup>89</sup> This means that a new C corporation or a C corporation that is acquired by an affiliated group of C corporations will not be included in the combined report for the first two tax years of the new C corporation's existence or for the first two tax years after the acquisition.<sup>90</sup>

An affiliated group of C corporations (as defined in the federal Internal Revenue Code) may elect to file a consolidated Colorado income tax return.<sup>91</sup> The Department of Revenue takes the position that only C corporations that would otherwise be required to file Colorado income tax returns (that is, C corporations that are doing business in Colorado) may be included in a consolidated Colorado income tax return.<sup>92</sup> An election to file a consolidated Colorado income tax return may not be revoked in less than four years unless such revocation is approved by the Department of Revenue.<sup>93</sup>

**§ 25.4.4—Application Of Apportionment Formula To Contractors**

Colorado has adopted a Special Regulation<sup>94</sup> for contractors that provides special apportionment rules for contractors using the completed contract method of reporting taxable income. Under this Special Regulation, the revenue factor is calculated by considering the revenue attributable to contract jobs (those reported on the completed contract method) on the basis of progress billings and receipts from completed and incomplete jobs during the tax year. The gross profit from a completed contract during a tax year to be apportioned to Colorado is determined by weighing the average property, payroll, and revenue factors for each year of the contract, based on the percentage of the contract completed during that year. For this purpose, the gross profit from a completed contract is determined by deducting from the gross revenue attributable to a specific contract the costs that are directly attributable to that contract, as determined under generally accepted accounting principles.

**§ 25.5 • LOCAL OCCUPATION TAXES**

While local governmental entities are prohibited from imposing income taxes in Colorado, some municipalities impose occupation taxes for the privilege of operating a business or for the privilege of engaging in an occupation or profession within the municipality.<sup>95</sup> These occupation taxes include so-called “head taxes” imposed by certain home rule cities, which are imposed at a flat rate per month based on the number of employees of the business who work

within the city during the month.<sup>96</sup> The employees' share of the head taxes usually must be withheld by employers and paid to the taxing jurisdiction.

Other occupation taxes are imposed on specific types of businesses that operate within the local taxing jurisdiction. These taxes are usually measured by some element that measures the amount of business conducted in the taxing jurisdiction. Taxes that are measured by income (net or gross), however, violate the prohibition on the imposition of local income taxes in Colorado.<sup>97</sup>

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## NOTES

1. *J. A. Tobin Constr. Co. v. Weed*, 158 Colo. 430, 435-36, 407 P.2d 350, 353 (1965); Colorado Sales and Use Tax Regulation 39-26-104.1(a).
2. Colorado Sales and Use Tax Regulation 39-26-102.7(a).
3. C.R.S. § 39-26-102(7)(a).
4. C.R.S. §§ 39-26-102(7)(a) and -104(1)(b)(I).
5. *See, e.g.*, C.R.S. § 39-26-713(2)(a).
6. C.R.S. § 39-26-106(1)(a)(II).
7. C.R.S. § 39-26-202(1)(b).
8. The RTD includes all of Denver, Jefferson, and Boulder Counties, and parts of Broomfield, Adams, Arapahoe, Douglas, and Weld Counties. The boundaries of the SCFD and the FD are identical to the RTD, except for certain areas of Douglas County.
9. *Howard Elec. & Mech., Inc. v. Department of Revenue*, 771 P.2d 475, 480 (Colo. 1989); Revenue Bulletin 90-6.
10. Form DRP 1002.
11. C.R.S. § 29-2-109(1).
12. *See* Form DRP 1002, page 4 (Aug. 12, 2005).
13. C.R.S. § 39-26-104(1)(a).
14. C.R.S. § 39-26-102(10); Regulation 26-102.10.
15. C.R.S. §§ 39-26-102(23) and -713(1)(a).
16. C.R.S. §§ 39-26-102(10)(a) through (i), and (k).
17. C.R.S. § 39-26-102(10)(j).
18. C.R.S. § 39-26-102(9).
19. C.R.S. § 39-26-102(19).
20. C.R.S. §§ 39-26-102(20) and -713(2)(e)(I).
21. Colorado Sales and Use Tax Regulation 26-102.20.
22. *See* Instructions for Form DR 0100, line 10.
23. *International Bus. Machines Corp. v. Charnes*, 601 P.2d 622, 625-26 (Colo. 1979). Note, however, that a different rule applies with respect to the sales and use tax ordinances of some home rule cities. *See, e.g.*, Denver Revised Municipal Code §§ 53-37(a) and 53-106(a).
24. *Regional Transp. Dist. v. Martin Marietta Corp.*, 805 P.2d 1102, 1104-05 (Colo. 1991); *A.B. Hirschfeld Press, Inc. v. City & County of Denver*, 806 P.2d 917, 920-21 (Colo. 1991).
25. *Regional Transp. Dist.*, 805 P.2d at 1105-06.
26. *CF&I Steel Corp. v. Charnes*, 637 P.2d 324, 330 (Colo. 1981).
27. C.R.S. §§ 39-26-102(21) and -715(2)(b).



28. Colorado Sales and Use Tax Regulation 39-26-102.15.
29. C.R.S. § 39-26-102(15).
30. Colorado Sales and Use Tax Regulation 39-26-102.15.
31. *Id.*
32. C.R.S. § 39-26-104(1).
33. *See, e.g.,* Denver Revised Municipal Code §§ 53-25(3) and (6) (imposing the Denver sales tax on all telecommunications services and on certain informational or entertainment services).
34. C.R.S. § 39-26-202(1)(b).
35. C.R.S. § 39-26-103(1)(a).
36. C.R.S. §§ 39-26-106(2)(a) and -108.
37. *Columbine Beverage Co. v. Continental Can Co.*, 662 P.2d 1094, 1096 (Colo. App. 1982).
38. C.R.S. § 39-26-108.
39. Colorado Sales and Use Tax Regulation 39-26-104.1(a).
40. FYI Sales 1, “How to Document Sales to Retailers, Tax-Exempt Organizations and Direct Pay Permit Holders,” Colorado Dept. of Revenue, Taxpayer Service Division.
41. C.R.S. § 39-26-103.5.
42. C.R.S. § 39-26-204.
43. C.R.S. § 39-26-713(2)(f).
44. *See* Form DR 0252.
45. *Raynor Door, Inc. v. Charnes*, 765 P.2d 650, 651 (Colo. App. 1988).
46. C.R.S. § 39-26-708.
47. C.R.S. § 39-26-709.
48. C.R.S. § 39-26-709(1)(c)(I).
49. Revenue Bulletin 88-1.
50. C.R.S. § 39-26-709(1)(c)(II).
51. Colorado Sales and Use Tax Regulation 39-26-709.1.
52. C.R.S. § 39-30-106(1)(a).
53. *Id.*
54. C.R.S. § 39-30-106(1)(b).
55. *Ball Corp. v. Fisher*, 51 P.3d 1053 (Colo. App. 2001).
56. C.R.S. §§ 39-26-713(1)(c) and -713(2)(j).
57. C.R.S. § 39-26-502.
58. C.R.S. § 29-2-109(7).
59. C.R.S. § 29-2-105(2).
60. C.R.S. § 29-2-109(3).
61. C.R.S. § 29-2-109(4).
62. C.R.S. § 29-2-109(2).
63. *Winslow Constr. Co. v. Denver*, 960 P.2d 685, 692-96 (Colo. 1998).
64. *See* Colo. Const., art. X, § 20.
65. Denver Revised Municipal Code § 53-95(17).
66. C.R.S. § 39-1-105.
67. *See* C.R.S. §§ 39-3-102, -103, and -123.
68. C.R.S. § 39-3-119.
69. C.R.S. § 39-1-104(1).
70. C.R.S. § 39-1-103(5)(a).
71. C.R.S. § 39-1-104(10.2).
72. C.R.S. § 30-1-104(12.3).
73. *See generally* C.R.S., Title 39, Articles 5 and 8.
74. C.R.S. § 39-1-111(1).
75. C.R.S. §§ 39-10-103(1)(a) and -104.5.
76. C.R.S. § 39-5-107.
77. C.R.S. § 39-5-113(1).

78. C.R.S. § 39-5-113(2).
79. C.R.S. § 39-3-118.5.
80. *See generally* C.R.S., Title 39, Article 22.
81. C.R.S. § 39-22-301(1)(d)(I)(H).
82. Colo. Const., art. X, § 17; *City & County of Denver v. Sweet*, 329 P.2d 441 (Colo. 1958).
83. C.R.S. § 39-22-303(2)(a).
84. C.R.S. § 39-22-303(2)(b).
85. C.R.S. § 24-60-1301, Article IV.
86. C.R.S. § 39-22-303(11)(a).
87. C.R.S. § 39-22-303(12)(a).
88. C.R.S. § 39-22-303(12)(c).
89. C.R.S. § 39-22-303(11)(a).
90. Revenue Bulletin 92-10, part II.B.
91. C.R.S. § 39-22-305(1).
92. Revenue Bulletin 85-4, rescinding and replacing Revenue Bulletin 84-2, which provided that all members of the affiliated group as defined in the federal Internal Revenue Code (including members not doing business in Colorado) were to be included in a consolidated Colorado income tax return.
93. C.R.S. § 39-22-305(1).
94. *Special Regulations for Allocation and Apportionment of Corporate Income: Contractors*, issued under C.R.S. § 24-60-1301.
95. Statutory authority to impose occupation taxes is found at C.R.S. § 31-15-501(1)(c).
96. *See, e.g.*, Denver Revised Municipal Code, chapter 53, articles V and VI.
97. *Board of Trustees v. Foster Lumber Co.*, 548 P.2d 1276, 1277-78 (Colo. 1976).