Tracking Changes in Computation of Colorado Corporate Taxable Income

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Nelson and Kozik discuss recent changes in the calculation of Colorado corporate taxable income:

- *Prior to enactment of the Tax Cuts and Jobs Act (TCJA)*[1]*, signed into law, Dec. 22, 2017;*
- *After enactment of the TCJA;*
- *After enactment of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)*[2]*, signed into law, March 27, 2020;*
- *After enactment of Colorado H.B. 20-1024, Concerning Modifications to the State's Net Operating Loss Deduction (no short title), signed into law, June 26, 2020 and Colorado H.B. 20-1420 (Tax Fairness Act), signed into law, July 11, 2020; and*
- *After enactment of Colorado H.B. 21-1002, Concerning Reductions to Certain Taxpayers' State Income Tax Liability Related to State Tax Law Changes Made in 2020, and, in Connection therewith, Making an Appropriation (no short title), signed into law, Jan. 21, 2021.*

States generally employ one of the two following methods in calculating corporate taxable income:

1. **Moving (or rolling) Conformity** – The determination of state-level taxable income begins with federal taxable income as calculated for the current year under the current applicable provisions of the Internal Revenue Code.

   While this is the easiest of the two methods to implement in practice, one drawback is that, absent a state modification, changes made at the federal level in determining federal taxable income automatically filter down to the determination of state-level taxable income. Consequently, states that use moving conformity typically provide a number of increasing and decreasing modifications that are added to or subtracted from federal taxable income to determine state-level taxable income. For example, a state might provide an *increasing* modification to offset all or part of the federal-level benefit of accelerated depreciation. To illustrate, if federal taxable income were $500,000 after claiming bonus depreciation of $100,000, a state decoupling from bonus depreciation would add back the $100,000 (an increasing modification), making state taxable income $600,000.

If asked, most experienced Colorado income tax practitioners would immediately respond that Colorado is a "moving conformity" state.

2. **Static Conformity** – The determination of state-level taxable income begins with federal taxable income *as it would have been calculated* under the Internal Revenue Code as of a specified date.

   For example, the starting point for determining a particular state's taxable income might be federal taxable income as calculated under the Internal Revenue Code as of Dec. 31, 2016. Assuming such a reference date, the determination of state-level taxable income would obviously not include the TCJA changes. Typically, states that use static conformity enact legislation every year or so, updating their reference date to the Internal Revenue Code, and enacting any new desired modifications to "counter" federal provisions they do not wish to incorporate. One advantage of this approach is that federal-level changes do not automatically filter down to the state level. However, a significant disadvantage is the practical difficulty in determining federal taxable income for one year (say, 2020) as it would have been calculated under a prior version of the Internal Revenue Code (say, the Code as it existed on Dec. 31, 2016).

If asked, most experienced Colorado income tax practitioners would immediately respond that Colorado is a "moving conformity" state. This follows from the Colorado tax statute, which provides that "the net income[3] of a C Corporation means the C Corporation's federal taxable income, as defined in the Internal Revenue Code, for the taxable year, with the modifications specified in this section."[4] However, in June 2020, the Colorado Department of Revenue (CDOR or Department) issued "CARES Act Tax Law Changes & Colorado Impact," (revised in Sept. 2020), a 14-page publication that explains the Colorado decoupling from the CARES Act

[1] Public Law 115-97 (Dec. 22, 2017)
[2] Public Law 116-136 (March 27, 2020)
[3] This statute uses the term "net income," and so does CRS § 39-22-301, which states that Colorado corporate income tax is determined by applying the applicable rate for the year to "net income." However, Department of Revenue Form 112, Colorado C Corporation Income Tax Return, uses the term "taxable income." See lines 16-20 of the 2020 Form 112.
[4] CRS § 39-22-304(1). The statute goes on to provide a list of items that are added back to federal taxable income (the increasing modifications) and a list of items that are subtracted from federal taxable income (the decreasing modifications).

and provides some helpful Frequently Asked Questions and charts. In addition, it states:

> Although Colorado adopts the Internal Revenue Code on a rolling basis, Colorado's definition of "Internal Revenue Code" does not incorporate federal statutory changes that are enacted after the last day of the tax year (and thus, neither do Colorado statutory references to "federal taxable income"). Accordingly federal statutory changes enacted after the end of a tax year do not impact the taxpayer's Colorado tax liability for that tax year.

The Department has adopted regulations that reflect this position (C.C.R. § 39-22-103(5.3) for individual taxpayers and C.C.R. § 39-22-303.6-1(1)(f) for corporations). Therefore, at least as far as the Department is concerned, it is not so clear that Colorado is a moving conformity state.

In the event a corporation does business in multiple states, the portion of the pre-NOL taxable income attributable to Colorado is apportioned using Colorado's single-factor sales factor. The result is then reduced by the corporation's Colorado NOL, and the Colorado tax rate is applied to the final sum.[5] Note that additional considerations come into play if a corporation is a member of a group filing a Colorado consolidated return and/or a Colorado unitary/combined return.

PRE-TCJA

Historically, and prior to the TCJA, the determination of Colorado corporate taxable income closely followed the methodology described above as "moving conformity." A corporation's current-year federal taxable income was increased or decreased by the applicable Colorado modifications set out in CRS § 39-22-304(2) (increasing modifications), CRS § 39-22-304(3) (decreasing modifications), and CRS § 39-22-303(10) (the foreign-source income modification).

For corporations, the most common increasing modifications (added to federal taxable income) include the following:[6]

1. Foreign income tax deducted on a corporation's federal income tax return
2. Interest income (less premium amortization) on obligations issued by any state or political subdivision thereof (other than obligations issued by Colorado or a political subdivision of Colorado on or after May 1, 1980, and certain such obligations issued before May 1, 1980)
3. The federal net operating loss deduction
4. Colorado income tax deducted in determining federal taxable income
5. Expenses/payments related to certain discriminatory clubs
6. The federal charitable deduction allowed on a contribution for which a Colorado income tax conservation easement credit is available under CRS § 39-22-522
7. Certain wages paid to "unauthorized aliens" as defined in CRS § 39-22-529

The most common decreasing modifications (subtracted from federal taxable income) include the following:[7]

1. Interest income on obligations of the United States
2. Interest or dividend income on obligations or securities of an authority, commission, or instrumentality of the United States to the extent included in federal taxable income but exempt from state income tax under federal law
3. All/part of the gain or loss from the sale or disposition of property that has a higher adjusted basis for Colorado income tax purposes than it does for federal income tax purposes
4. All/part of the gain from a sale to a purchaser who could have condemned the property
5. The refund or credit for overpayment of Colorado state income tax to the extent included in federal taxable income
6. The Colorado net operating loss deduction under CRS § 39-22-504
7. An amount equal to the difference between the depletion allowance allowed for federal income tax purposes for oil shale and the amount that would have been allowed for depletion under a specified set of assumptions set out in CRS § 39-22-304(3)(h)
8. The portion of wages/salaries paid/incurred for the tax year that are disallowed as a deduction for federal income tax purposes under Internal Revenue Code 280C
9. The amount of Internal Revenue Code § 78 dividend
10. The amount contributed to a medical savings account under CRS § 39-22-504.7(2)(e) to the extent such amount is not claimed as a deduction on the federal income tax return
11. For licensed marijuana dealers, the amount otherwise eligible to be claimed as a federal income tax deduction but disallowed under Internal Revenue Code § 280E because marijuana is a controlled substance under federal law
12. The foreign-source income modification provided in CRS § 39-22-303(10)[8]

So, under the historical method of calculating Colorado corporate taxable income, changes incorporated *at the federal level* that increased or decreased federal taxable income were generally implicitly incorporated into the calculation of Colorado taxable income by virtue of Colorado starting its taxable income calculation with current-year federal taxable income. The exceptions to this implicit incorporation of the federal provisions were the modifications that increased or decreased federal taxable income.

For example, assume a corporation with $50,000,000 in sales in 2017 had $1,000,000 of federal taxable income before an interest deduction of $400,000. Because the TCJA business interest limitation became effective only for tax years beginning on or after Jan. 1, 2018, and assuming no other applicable Colorado modification, both federal and state taxable income for 2017 would be $600,000.

The calculation of Colorado corporate taxable income has become much more complicated for recent years, not just because of the federal tax legislation but also because of actions by the Colorado state legislature and the Colorado Department of Revenue in response to the federal legislation. These changes include the following:

1. H.B. 20-1024, where the Colorado legislature adjusted the treatment of Colorado NOLs
2. H.B. 20-1420, where Colorado decoupled from several major provisions of

CONTINUED ON PAGE 24

[5] See 2020 Department of Revenue Form DR 112, line 16, Schedule RF (apportionment schedule), and line 17.

[6] For corporations, the modifications increasing federal taxable income are found at CRS §39-22-304(2).

[7] For corporations, the modifications decreasing federal taxable income are found at CRS §§ 39-22-304(3) and 39-22-303(10).

[8] Note that while most of the increasing and decreasing corporate modifications are listed in CRS § 39-22-304, the foreign-source income modification is listed in CRS 39-22-303(10).

CONTINUED FROM PAGE 23

the federal CARES Act, including those related to net operating losses (NOLs) (CARES Act § 2303), business interest expense deductions (CARES Act § 2306), and qualified improvement property (QIP) (CARES Act § 2307)

3. H.B. 21-1002, where the Colorado legislature prospectively restored, in part, some of the benefits lost by Colorado taxpayers because of the decoupling provisions enacted in H.B. 20-1420
4. Department of Revenue Regulation (now called "Rule") C.C.R. § 39-22-103(5.3), where the Department claims that Colorado's rolling conformity statute applies only on a prospective basis.[9] Thus, any retroactive CARES Act changes are effective for Colorado purposes only for tax years ending on or after March 27, 2020. For example, the CARES Act technical correction of providing QIP with a 15-year depreciable life and bonus depreciation, rather than a 39-year life and no bonus depreciation dictated under the TCJA, allows taxpayers to amend their 2018 and 2019 federal returns for any QIP placed in service in those years. But under this rule, the CDOR states that Colorado will conform to the federal changes regarding QIP only for tax years ending on or after March 27, 2020, the date of the enactment of the CARES Act.

TCJA

The TCJA was signed into law on Dec. 22, 2017. Some of its provisions took effect prospectively, and some applied retroactively.

Business Interest Limitation

The TCJA limited the amount of certain deductible business interest to 30% of adjusted taxable income (as defined) for tax years beginning after Dec. 31, 2017. [See IRC § 163(j).]

The federal and Colorado treatment of the TCJA limitation on the deduction for business interest is illustrated in the following *simplified* example. Assume that for 2018 a corporation had both adjusted taxable income and taxable income before consideration of interest of $50,000,000, with $20,000,000 of business interest otherwise deductible. Under the 30% TCJA limitation, only $15,000,000 of the interest ($50,000,000 x 30%) could be deducted on the federal return. Thus, what would have been a $20,000,000 federal interest deduction is reduced to a $15,000,000 deduction, making federal taxable income $35,000,000. That federal taxable income of $35,000,000 is the starting point in calculating 2018 Colorado taxable income. Since there are no applicable Colorado modifications with respect to the disallowed interest, Colorado taxable income is also $35,000,000 (subject to CARES Act discussion which follows).

Qualified Improvement Property

For federal income tax purposes, the TCJA treated QIP as 39-year real property that did not qualify for bonus depreciation.[10] With no applicable depreciation modification, Colorado would follow this treatment, which generally applied for property placed in service after 2017 (subject to CARES Act discussion which follows).[11]

Corporate NOLs

Prior to the TCJA, most federal NOLs could be carried back two years and/or forward for 20 years. Colorado has prohibited the carryback of corporate NOLs since 1984, but it did follow the federal 20-year carryforward rule.

For NOLs arising in tax years ending after Dec. 31, 2017, the TCJA eliminated the federal carryback provision but allowed an indefinite carryforward. However, for NOLs arising in tax years beginning after Dec. 31, 2017, the NOL can only offset 80% of a taxpayer's federal taxable income in the year deducted.[12]

Initially, Colorado conformed to the TCJA changes to the federal NOL provisions. However, after enactment of the CARES Act, Colorado decoupled from some of the federal changes to NOLs (discussed in more detail below).

CARES ACT

The CARES Act was signed into law on March 27, 2020. As with the TCJA, some of the CARES Act provisions were effective prospectively, and some took effect retroactively. The Colorado corporate income tax provisions most impacted by the CARES Act include business interest deduction limitation, the depreciation of QIP, and the treatment of NOLs.

Business Interest Limitation

As noted previously, the TCJA imposed a 30% limitation (based on adjusted taxable income, as defined) on business interest deductions for tax years beginning after Dec. 31, 2017. The CARES Act increased the TCJA limitation to 50% for tax years beginning in 2019 and 2020. Colorado H.B. 20-1420 blocks the increased deduction available under the CARES Act for tax years beginning or ending on or after the enactment of the CARES Act but before Jan. 1, 2021 (which would be calendar year <u>2020</u> but possibly two fiscal years, such as the fiscal year ending June 30, 2020 and the fiscal year beginning July 1, 2020). [See CRS §39-22-304(2)(i).] According to the Department:

> For tax years beginning or ending between March 27, 2020 and Dec. 31, 2020, section 39-22-104(3)(n), C.R.S., requires taxpayers to add back to federal taxable income business interest deductions taken on the federal return to the extent they are in excess of the limits imposed under section 163(j) of the Internal Revenue Code prior to the amendment of that section by section 2306 of the CARES Act. This includes, but is not limited to, additional deductions related to the increase in the applicable percentage and additional deductions resulting from the election to use 2019 adjusted taxable income in lieu of 2020 adjusted taxable income to

However, after enactment of the CARES Act, Colorado decoupled from some of the federal changes to NOLs.

[9] See C.C.R. § 39-22-103(5.3) and C.C.R § 39-22-303.6-1(1)(f).

[10] The TCJA eliminated the 15-year MACRS property classifications for qualified restaurant, leasehold, and retail improvement property and replaced them with a single classification: qualified improvement property (QIP). Congress clearly intended that QIP have a 15-year life. See H.R. Rep. No. 115-466, at 366-367 and 366 n.567 (2017) (Conf. Rep.); Joint Committee on Taxation, "General Explanation of Public Law 115- 97," JCS-1-18, at 138, (Dec. 20, 2018); §§ 168(k)(2)(A)(i)(IV), (k)(3) (2017); TCJA § 13204(a)(4), (b). Unfortunately, QIP was omitted from the statutory list of 15-year property, § 168(e)(3)(e), thereby defaulting to 39-year property. And to add insult to injury, bonus depreciation is only available to property with a 20-year life or less (§ 168(k)(2)(A)(i)(I)).

[11] C.C.R. § 39-22-103(5.3) and C.C.R § 39-22-303.6-1(1)(f).

[12] We are ignoring here specific NOL rules for farming and casualty losses, insurance companies, REITs, and others.

calculate the limitation under section 163(j) of the Internal Revenue Code.[13]

The CARES Act suspension of the limitation for federal purposes for 2019 is blocked for Colorado purposes under the Department's rule, described above, that federal changes do not apply for Colorado purposes in tax years ending before the federal change is enacted.

For federal purposes, any interest expense that cannot be deducted as a result of the TCJA limitation may be carried forward. In the carryover year, federal taxable income would reflect the application of any business interest deduction carried from an earlier year. With no applicable Colorado increasing modification, Colorado taxable income would likewise reflect the application of the federal carryover. However, the result does not appear to be the same with respect to the amount of interest allowed for federal purposes under the relaxed 50% limitation but still subject to the 30% limitation for Colorado purposes. That "layer" of interest deduction is not allowed for Colorado purposes in the year paid/incurred, *and* Colorado does not provide for a carryover of the disallowed amount to a future year, or a decreasing modification in a future year to take into account the interest deduction lost for Colorado purposes in the year the federal limitation was based on 50% of income but the Colorado limitation was based on 30%. Again, as the Department states:

> Section 39-22-304(3), C.R.S., lists the amounts C corporations must subtract from federal taxable income in calculating their Colorado income tax liabilities. That section does not provide a subtraction for prior-year business interest deductions that were subject to a higher limit for federal tax purposes than for Colorado tax purposes. C corporations may not take a subtraction from federal taxable income on their Colorado returns for tax years ending on and after March 27, 2020 to reflect additional deductions claimed on federal returns for prior tax years.[14]

The following chart summarizes the treatment of federal and Colorado business interest limitation (based on calendar years):

FEDERAL			
BUSINESS INTEREST LIMIT	PERCENTAGE	ATI BASE	CARRYFORWARD EXCESS
2018	30%	2018	Yes
2019	50%	2019	Yes
2020	50%	2019 or 2020	Yes
COLORADO BUSINESS INTEREST LIMIT			
2018	30%	2018	No
2019	30%	2019	No
2020	30%	2020	No

See discussion about 2021 legislation (H.B. 21-1002), below.

Qualified Improvement Property

As mentioned above, the CARES Act provided a technical correction to the TCJA regarding the depreciation of QIP. Under the CARES Act provision, QIP qualifies for a federal 15-year depreciable life and bonus depreciation, rather than a 39-year life and no bonus depreciation "mistakenly" provided for in the TCJA. Also, the CARES Act allows federal taxpayers to amend their 2018, and 2019 returns for any QIP placed in service in those years. However, because the Colorado rule now applies such changes only prospectively, Colorado will conform to the federal changes regarding QIP only for tax years ending on or after March 27, 2020, the date of the enactment of the CARES Act. The following chart summarizes the treatment of federal and Colorado QIP (based on calendar years):

FEDERAL		
QIP	RECOVERY PERIOD	BONUS DEPRECIATION
2018	15 years	Yes
2019	15 years	Yes
2020	15 years	Yes
COLORADO QIP		
2018	39 years	No
2019	39 years	No
2020	15 years	Yes

See discussion about 2021 legislation (H.B. 21-1002), below.

MORE ON THE CDOR POLICY ON RETROACTIVE FEDERAL TAX LEGISLATION

Put simply, under the Department's policy/regulation, absent Colorado legislation (see discussion of 2021 legislation, below), Colorado will conform to the CARES Act only for tax years ending after the March 27, 2020 CARES Act enactment date. This rule/policy was not previously widely known and is arguably an example of executive departmental overreach into what has traditionally been the purview of the state legislature. For example, what this means is that the H.B. 20-1420 legislative decoupling impacting years 2018 and 2019 was arguably unnecessary. The provisions enacted by the legislature prohibiting the CARES Act suspension of the 80% taxable income limitation for 2018 and 2019 were moot when the bill was signed on July 11, 2020, because the Department's new rule already preempted the application of the retroactive provisions of the CARES Act to 2018 and 2019 Colorado taxable income. The interplay and overlap of the Department's new rule on rolling conformation with the legislative changes in the Tax Fairness Act (H.B. 20-1420) causes confusion for both individual and corporate taxpayers. In fact, the legislature's own Office of Legislative Legal Services recommended the Department's rule be discontinued because it "conflicts with the statute."[15]

CONTINUED ON PAGE 26

[13] CARES Act Tax Law Changes & Colorado Impact, Colorado Department of Revenue (Sept. 2020) p. 8.

[14] Ibid.

[15] Memorandum to the Committee on Legal Services, Summary of Problem Identified and Recommendation, (December 1, 2020).

CONTINUED FROM PAGE 25

The rule's impact reaches far beyond the CARES Act. Almost every year there are expiring federal income tax provisions that are temporarily reinstated. Often called "tax extenders" these provisions are routinely extended retroactively.

For example, the provision allowing mortgage insurance premiums to be federally deductible as home mortgage interest expired on Dec. 31, 2017. The Taxpayer Certainty and Disaster Tax Relief Act of 2019 extended the provision retroactively through Dec. 31, 2020. The extension allowed individuals, who were unable to claim the deduction on their 2018 federal returns, the opportunity to amend their federal returns and claim a refund.

However, the Department's rule prevents individuals from similarly amending their 2018 Colorado return because the Disaster Act was enacted after the 2018 year-end, meaning that the deduction is only available to Colorado taxpayers prospectively for tax years 2019 and 2020. Similarly, a score of extenders in the Disaster Act and other federal bills that were extended retroactively remain unavailable to Colorado taxpayers.[16]

CORPORATE NOLS

As previously noted, the TCJA lifted the 20-year carryover period that was otherwise generally applicable to federal NOLs. For NOLs incurred in tax years ending after Dec. 31, 2017, it provided an indefinite carryover period. However, it also limited the deduction of these NOLs to 80% of federal taxable income for NOLs arising in tax years beginning after Dec. 31, 2017.

First, let's walk through the NOL carryback/carryforward changes addressed in H.B. 20-1024.

CRS §39-22-504(1)(a) states that, "A net operating loss deduction shall be allowed in the same manner that it is allowed under the Internal Revenue Code except as otherwise provided in this section."

For tax years beginning before Jan. 1, 2018, Colorado corporate net operating losses could/can be carried forward the same as federal (so, 20 years). [CRS §39-22-504(3)(a).]

For tax years beginning on or after Jan. 1, 2018 but before Jan. 1, 2021 (so, calendar years 2018, 2019, 2020), Colorado corporate NOLs could/can be carried forward indefinitely (to match up with the federal indefinite carryforward period enacted by the TCJA). [CRS §39-22-504(3)(a).]

For tax years beginning on or after Jan. 1, 2021, Colorado corporate NOLs can only be carried forward 20 years, thereby decoupling from the continuing indefinite federal carryforward provision. [CRS §39-22-504(3)(b).]

Colorado corporate NOL carrybacks are not allowed for any year. [CRS §39-22-504(3).]

Next, let's walk through the NOL changes addressed in H.B. 20-1420 (the Tax Fairness Act)which address the Colorado treatment of the 80% taxable-income limitation as provided in the TCJA and modified in the CARES Act.

The CARES Act suspended the 80% taxable-income limitation for federal NOL deductions that would otherwise apply in taxable years beginning on or after Jan. 1, 2018 but before Jan. 1, 2021 (so, calendar years 2018, 2019, 2020).

Absent Colorado legislation, the CRS §39-22-504(1)(a) wording that, "[a] net operating loss deduction shall be allowed in the same manner that it is allowed under the Internal Revenue Code except as otherwise provided in this section" would presumably limit the deduction of the Colorado NOL to 80% of Colorado taxable income before the Colorado NOL deduction. Likewise, the CARES Act relief from the 80% limitation for federal NOL deductions taken in 2018, 2019, and 2020 would presumably relax the corresponding Colorado NOL deductions to 100% of Colorado taxable income before the loss is deducted in those three years.

However, the Colorado legislature decoupled from the CARES Act's relaxation of the 80% taxable-income limitation. In other words, the Colorado legislature wanted to retain the 80% limitation on the deduction of those NOLs in 2018, 2019, and 2020, so it enacted CRS §39-22-504(1)(b), which provides that the 80% limitation shall apply for Colorado purposes to NOLs incurred after Dec. 31, 2017 without regard to the CARES Act's three-year relief.

The following chart summarizes the treatment of federal and Colorado corporate NOLs (based on calendar years):

FEDERAL			TAXABLE INCOME
NOLS INCURRED IN TAX YEARS	CARRYBACK	CARRYFORWARD	OFFSET PERCENTAGE
Beginning before 12-31-17	2 years	20 years	100%
2018-2020	5 years	Indefinite	100% prior to 2021 80% after 2020
2021 and after	None	Indefinite	80%
COLORADO NOLS INCURRED IN TAX YEARS			
Beginning before 12-31-17	None	20 years	100%
2018-2020	None	Indefinite	80%
2021 and after	None	20 years	80%

2021 COLORADO LEGISLATION

For Tax Year 2021 Returns Due in 2022

Realizing that the Colorado budget was not in as bad shape as anticipated in 2020, the state legislature enacted H.B. 21-1002, providing an opportunity for taxpayers to reclaim some, if not all, of the deductions lost by the state's decoupling from the CARES Act. In brief, Colorado corporate taxpayers are provided a new subtraction from Colorado taxable income for the calendar year 2021.

[16] Legislation still open under the state's statute of limitations and thus subject to the Department's new rule include the Tax Cuts and Jobs Act (TCJA) (12-22-17); the Consolidated Appropriations Act of 2020 (12-20-19), which includes the Setting Every Community Up for Retirement Act of 2019 (SECURE Act) and the Taxpayer Certainty and Disaster Tax Relief Act of 2019; the Families First Coronavirus Response Act (3-18-20); the Coronavirus Aid, Relief, and Economic Security (CARES) Act (3-27-20); and the Consolidated Appropriations Act of 2021 (12-27-20). Any "tax extenders" that expired prior to the year of passage of any of these Acts may be unavailable until the years ending after the Act's passage.

H.B. 21-1002 readdresses the interplay between the federal CARES Act, on the one hand, and the related Colorado legislation and Department regulations, on the other. The effect of this legislation, signed Jan. 21, 2021, is to move Colorado corporate income tax treatment of several CARES Act items back *toward* conformity with the federal treatment.

In general, H.B. 21-1002 creates a new corporate *decreasing* modification for tax years beginning on or after Jan. 1, 2021 but before Jan. 1, 2022 (so for calendar taxpayers, 2021). This decreasing modification is set out in CRS § 39-22-304(p) and is equal to the *sum* of the amounts described in (1) and (2), below.

1. "Taxable Income for the Specified Tax Years" *minus* "Taxable Income for the Modified Specified Tax Years," computed separately for each tax year.[17]
   a. "Taxable Income for the Specified Tax Years" is defined as Colorado taxable income for tax years ending before March 27, 2020, *as calculated* under "Colorado law applicable to the taxpayer's return as of the date the return was due." So, for 2019, this would be Colorado taxable income as computed under the Colorado law as of the due date of the 2019 Colorado return.[18] Presumably, this would simply be Colorado taxable income shown on the 2019 Colorado return as originally filed.
   b. "Taxable Income for the Modified Specified Tax Years" is defined as Colorado taxable income for tax years ending before March 27, 2020, *as calculated* under "the internal revenue code and Colorado law applicable to the taxpayer's return as of the date the return was due, as modified by the application of the retroactive provisions of the CARES Act applied to the calculation of the taxpayer's federal taxable income, but only to the extent the taxpayer appropriately applied those provisions to the taxpayer's federal income tax returns for each tax year."[19]

   In effect, this component of the modification is essentially the difference between Colorado taxable income as originally reported and that which would have been reported had Colorado conformed to the federal CARES Act benefits, to the extent such benefits were taken on the taxpayer's federal return.
2. The amount added back to federal taxable income as an increasing modification for business interest under CRS § 39-22-304(2)(i). CRS § 39-22-304(2)(i) applies to income tax years ending after March 27, 2020 and before Jan. 1, 2021. The amount of this modification is equal to the excess of the business interest deduction under IRC § 163(j) taken for the year over the amount that would have been allowed absent the CARES Act. In general, this modification is equal to the difference between the business interest deduction as calculated under the 30%-taxable income limitation that applied prior to enactment of the CARES Act, and the deduction as calculated under the 50%-taxable income limitation provided in the CARES Act.[20]

Overall, if that were the end of the story, this modification would essentially get the taxpayer to a place where its Colorado taxable income would reflect conformity to the federal benefits realized by the taxpayer under the CARES Act. However, the story does not end there. This modification (CRS § 39-22-304(p)) applies only after all of the other subtracting modifications set out in CRS § 39-22-304(3).[21] Also, the subtraction is capped at:

1. the lesser of Colorado taxable income or $300,000 the first year (2021 for calendar-year taxpayers),
2. the lesser of Colorado taxable income or $150,000 for tax years beginning on or after Jan. 1, 2022 but before Jan. 1, 2026, and
3. taxable income per year after Jan. 1, 2026.[22]

The amount that cannot be taken due to the limitation is carried forward until used.[23]

Additional guidance is provided for corporations that allocate/apportion income. See CRS §§ 39-22-304(3)(p)(I)(B) and 39-22-304(3)(p)(II)(C).

Taxpayers taking advantage of the CRS § 39-22-304(3)(p) modification with respect to QIP must use the QIP's federal income tax basis at the time of a sale or disposition of the QIP.[24]

CONCLUSION

It is an understatement to describe the interplay of recent federal changes and related Colorado adjustments as confusing. Some questions may be answered through the compliance process of "putting the numbers to the paper." However, answers to others may wait on the Department's issuance of additional guidance, litigation, or subsequent legislation. In the meantime, taxpayers and tax practitioners will need to proceed thoughtfully and carefully.

Finally, we would be remiss if we did not point out that this confusion could have been avoided had the state legislature simply continued to "piggyback" off federal taxable income as it had done in the past. Instead, with the passage of H.B. 21-1002, the legislature is just giving back in 2021 and future years the additional taxes collected in 2018 through 2020. Granted, from a state budget standpoint, the timing difference arguably may have been significant, but at an unmeasurable additional cost and confusion to taxpayers.

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[17] CRS § 39-22-304(p)(1)(A).

[18] CRS § 39-22-304(3)(p)(IV)(E).

[19] CRS § 39-22-304(3)(p)(IV)(D).

[20] At first glance it appears that adding the amounts in (1) and (2) double up the deduction but it doesn't. The first part is for tax years ending before March 27, 2020. The second part is for tax years ending from March 27, 2020 to Dec. 31, 2020.

[21] Note that the foreign income modification under CRS § 39-22-303(10) is not mentioned here.

[22] CRS § 39-22-304(3)(p)(II)(A).

[23] CRS § 39-22-304(3)(p)(II)(B).

[24] CRS § 39-22-304(3)(p)(III).