



COLORADO FISCAL POLICY INSTITUTE

Colorado Taxation—Apportionment and Decoupling

For the 97 years that the federal income tax has been in place, states have largely followed the lead of Congress in determining how to tax people and businesses. However, in the early nineteen-eighties states began to modify and expand their internal tax code based on state economic and fiscal need.

Apportionment

To determine the amount of money that is taxed at the state level, a business begins by calculating its federal taxable income. At the federal level, a business subtracts its federal deductions from its gross receipts to calculate federal taxable income. Federal taxable income is then “apportioned”—or allocated—among the states to determine a business’s tax liability in each of the states where business income is generated. A variety of apportioning methods are used in different states.

In 2008, the Colorado Legislature voted to make Colorado a single-sales factor apportionment state. This means that when a business is apportioning its federal taxable income among states, it will assign to Colorado the share of its federal taxable income proportionate to the percentage of total sales made in the state. Other states use factors such as property owned within the state, number of employees within the state and actual presence within the state to determine state tax liability. These factors are irrelevant for computing Colorado taxes. **Federal taxable income is apportioned to Colorado based entirely on the amount of sales a business has within the state.**

Decoupling

Like most states, Colorado’s income tax system is “coupled” with the federal income tax system. This means that Colorado taxpayers begin with federal taxable income on their state tax income return. As such, the Colorado income tax system automatically incorporates all federal tax provisions. While this coupled system contributes to the simplicity of the state income tax system, it also can result in reduced state revenue based solely on Congressional tax policy changes. The considerations of federal tax policy makers are different and often in conflict with Colorado’s needs based on our economy and our policy objectives. In all cases, the federal policy is not specifically tailored to the unique components of state conditions.

Colorado, along with all other states, has the option to insulate portions of its internal tax code from federal income tax changes by “decoupling”. Decoupling simply means that state tax provisions do not follow the federal tax code.

When a state chooses to decouple from the federal income tax system, it often results in a change in the federal taxable income that the state tax return begins with.

For example:

XCo has \$1 billion in revenue. It is also eligible for \$600 million in federal tax deductions. XCo makes 5% of its sales in Colorado.

FEDERAL TAX RETURN:	
Business Income	\$1,000,000,000
Less Deductions	\$(600,000,000)
Federal Taxable Income:	\$ 400,000,000
COLORADO TAX RETURN:	
Federal Taxable Income	\$ 400,000,000
Sales within Colorado	5%
Income Apportioned to Colorado	\$ 20,000,000

Now, Colorado votes to decouple from a federal tax deduction that is worth \$5 million at the federal level. This will increase XCo's federal taxable income by \$5 million for Colorado tax purposes.

FEDERAL TAX RETURN:	
Business Income	\$ 1,000,000,000
Less Deductions	\$(600,000,000)
Add Back Decoupled Deduction	\$ 5,000,000
Federal Taxable Income:	\$ 405,000,000
FOR COLORADO TAX PURPOSES:	
Federal Taxable Income	\$ 400,000,000
State Adjusted Federal Taxable Income	\$ 405,000,000
Sales within Colorado	5%
Amount Apportioned to Colorado	\$ 20,250,000

As can be seen from this example, by decoupling from a federal tax deduction, Colorado raised its taxable income by \$250,000. That increased taxable income would then be subject to the State Corporate income tax rate of 4.63%.

For more information please contact:

Ali Mickelson
amickelson@cclponline.org
303-573-5669 x 304