



# Legislative Council Staff

## Research Note

Version: Final

Date: 9/9/2016

### Bill Number

House Bill 16-1275

### Sponsors

*Representatives Foote and  
Pettersen  
Senators Jones and Donovan*

### Short Title

*Taxation of Corporate Income  
Sheltered In Tax Haven*

### Research Analyst

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### Status

This research note reflects the reengrossed version of the bill, which was postponed indefinitely by the Senate Committee on State, Veterans, & Military Affairs on March 28, 2016.

### Summary

Conditional on voter approval, the bill requires corporations filing a Colorado combined income tax return on or after January 1, 2017, to add income from affiliated corporations incorporated in tax haven jurisdictions. The bill identifies criteria for which jurisdictions are considered tax havens. The Department of Revenue (DOR) will use this criteria to determine what constitutes a tax haven through administrative rule. The director of DOR may allow corporations with subsidiaries incorporated in tax havens to not report tax haven income if the subsidiary is incorporated in the tax haven for reasons that meet the economic substance doctrine.

The bill refers a measure to the voters authorizing the state to retain and spend revenue received by the taxation of a corporation's income that is held in offshore tax havens. If the voters approve this measure, the increase in corporate income tax revenue will be transferred from the General Fund to the State Education Fund. The voter approved revenue increase is exempt from TABOR.

### Background

**Combined report.** This bill affects corporations that file a “combined” income tax return. A combined income tax return is a state filing method used by certain groups of affiliated corporations. Colorado law defines an affiliated group as one or more chains of corporations

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connected through stock ownership with a common parent corporation, where the parent corporation owns more than 50 percent of both the voting and nonvoting stock in each includable corporation.

The combined income tax return is required to report the income of all member corporations that have 20 percent or more of their property and payroll within the United States and that meet three out of six designated tests. For example, one of the tests is if an affiliated C corporation uses the intellectual property and proprietary materials of another affiliated C corporation. Requiring corporations incorporated in tax haven jurisdictions to be included in the combined report increases Colorado corporate income.

**Apportionment factor.** Corporate income is apportioned to Colorado based on the percent of sales that occur in Colorado relative to total sales of the combined corporation.

**Tax havens.** There is no precise definition of a tax haven. Five factors are listed in the bill for DOR to use when determining which countries are tax havens. Some of the factors include:

- whether a jurisdiction has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefitting from the tax regime; and
- whether a jurisdiction has created a tax regime that is favorable for tax avoidance, based on an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore finance or other services sector relative to its overall economy.

**Economic substance doctrine.** Under 26 U.S.C. §7701(o), a transaction between businesses is considered to have economic substance if:

- the transaction provides a meaningful change in the business's economic position besides a better tax position; and
- there is a substantial purpose for entering into the transaction beyond the tax effects.

## House Action

**House Finance Committee (February 24, 2016).** At the hearing, representatives of the Small Business Majority, the Colorado Education Association, the Colorado Association of School Executives, the Colorado Public Interest Research Group (CoPIRG), and several individuals representing themselves testified in support of the bill. Representatives of World Trade Center Denver, the Colorado Association of Commerce and Industry (CACI), the Colorado Competitive Council, the Council on State Taxation, the Colorado Bar Association, Terumo BCT, the Metro Denver Economic Development Corporation, the Denver Metro Chamber of Commerce, and an individual representing herself testified against the bill. A DOR representative answered committee questions. The committee adopted amendments L.001 and L.003. Amendment L.001 made technical changes to the bill. Amendment L.003 allowed corporations with subsidiaries incorporated in tax havens to not report tax haven income if the subsidiary is incorporated in the tax haven for reasons that meet the economic substance doctrine, instead of a legitimate business purpose standard. The committee referred the bill, as amended, to the House Appropriations Committee.

**House Appropriations Committee (March 4, 2016).** The committee referred the bill to the House Committee of the Whole unamended.

**House second reading (March 7, 2016).** The House adopted the House Finance committee report and two additional amendments. Amendment L.004 (Amendment No. 2) added a new section to the bill clarifying the state's taxation of foreign income. Amendment L.005 (Amendment No. 3) added language to the legislative declaration regarding the taxation of foreign

income.

**House third reading (March 9, 2016).** The House passed the bill on third reading with no amendments.

## Senate Action

**Senate State, Veterans, & Military Affairs Committee (March 28, 2016).** At the hearing, representatives of the American Sustainable Business Council, Agility Solutions, and CoPIRG testified in support of the bill. Representatives of the Colorado Bar Association, the Council on State Taxation, CACI, the Colorado Competitive Council, the Denver Metro Chamber of Commerce, and an individual representing himself testified against the bill. A DOR representative answered committee questions. The committee postponed the bill indefinitely.