Denver Law Review

Volume 30 | Issue 1 Article 4

June 2021

Variations in Colorado and Federal Income Tax Law

Edward P. Kurz

Follow this and additional works at: https://digitalcommons.du.edu/dlr

Recommended Citation
Edward P. Kurz, Variations in Colorado and Federal Income Tax Law, 30 Dicta 24 (1953).

This Article is brought to you for free and open access by the Denver Law Review at Digital Commons @ DU. It has been accepted for inclusion in Denver Law Review by an authorized editor of Digital Commons @ DU. For more information, please contact jennifer.cox@du.edu,dig-commons@du.edu.

VARIATIONS IN COLORADO AND FEDERAL INCOME TAX LAWS

EDWARD P. KURZ *
Certified Public Accountant

While the United States Income Tax Laws were used as a model for the Colorado Income Tax Acts, there are a number of differences between the laws in effect today. Certain of these differences are not included here as they are considered beyond the scope of this article because of their limited application, the extent of the differences, or the complications involved.

The basic date of the Federal law is March 1, 1913, while the basic date of the Colorado law is July 1, 1937.

ALIMONY

Alimony and separate maintenance payments pursuant to a divorce or legal separation and qualifying as "periodic payments" (generally payable over a period of more than ten years) are deductible by the payor and includible in the payee's income. However, any amount payable for the support of minor children of the payor is not deductible, neither is it income to the payee (sec. 22(k), 23(u), I. R. C.)

Sec. 3797(a) (17), I. R. C., provides that the law can be applied reciprocally to allow a wife deduction for payment of alimony to a husband, and to include such payments in the husband's income.

There are no comparable provisions in the Colorado law. Art. 6(a) (1), Colorado Regulations (hereinafter referred to as Colo. Reg.) provides that "attorney's fees paid in a suit for separation, alimony, and all allowance paid under a separation agreement are not deductible from gross income." Art. 4(b) (3), Colo. Reg., provides that "neither alimony nor an allowance based on a separation agreement is taxable income."

ALLOCATION OF INCOME

Art. 16, 17, 18, Colo. Reg., set forth the methods of allocation of income in the case of non-resident taxpayers whose gross income is from sources in part within and in part without the state. There are no comparable provisions in the Federal Law.

ALTERNATIVE TAX

Sec. 117(c), I. R. C., provides for an alternative tax computation so that the total effective income tax on the excess of net long-term capital gain over net short-term capital loss will not exceed 26% of such excess. There are no alternative tax provisions in the Colorado law.

AMORTIZATION OF BOND PREMIUM

Amortization of bond premium on fully tax-exempt bonds is mandatory but is not an allowable deduction, the amortization simply lowering the basis of the bond. Amortization of bond

* Student, University of Denver College of Law.

premium on fully taxable bonds is elective and the amortization is applicable both as an adjustment to the basis and as a deduction in the current year. In the case of partially tax-exempt bonds, amortization is mandatory as to corporations but is elective in the case of other taxpayers. If the accrual basis of accounting is used for income tax purposes, amortization is required for every taxable year for which interest on the bond is accruable (sec. 125, I. R. C.).

Art. 15(d)(1), Colo. Reg., deals only with amortization of bond premium on bonds the interest from which is taxable under Colorado law. This includes municipal bonds and corporate bonds for all taxpayers, and for banks it includes bonds issued by the United States, its agencies and instrumentalities, as interest thereon is included in the measure of tax imposed upon them. This article provides that amortization is elective and is deductible from gross interest income.

BAD DEBTS—NON-BUSINESS

Sec. 23(k)(4), I. R. C., provides that the loss resulting from non-business debts (other than any debt evidenced by a security) which become entirely worthless within the taxable year shall be considered as a short term capital loss. Thus, the limitations on capital losses later considered are applicable.

Art. 5(i)-1, Colo. Reg., does not provide for any special treatment of non-business bad debts. They are deductible as "miscellaneous" or "other deductions" on page 3, Form 104, if the standard deduction is not used.

CAPITAL ASSETS

In sec. 117(a), I. R. C., capital assets are defined as property held by the taxpayer (whether or not connected with his trade or business) but does NOT include—

(a) inventoriable assets;

(b) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(c) depreciable business property;

(d) real property used in the trade or business of the taxpayer;

(e) certain government obligations issued at a discount and maturing within one year of issue; and

(f) certain copyrights or artistic compositions, etc.

However, sec. 117(j), I. R. C., provides in effect that gains or losses from transactions covered by that section shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets. Sec. 117(j), I. R. C., deals with gains and losses arising from—

(a) sale, exchange, or involuntary conversion, of land (in-

cluding in certain cases unharvested crops sold with the land) and depreciable property used in the trade or business and held for more than six months;

(b) sale, exchange or involuntary conversion of livestock held for draft, breeding, or dairy purposes (but not including poultry) and held for one year or more;

(c) the cutting of timber or the disposal of timber or coal to which sec. 117(k), I. R. C., applies; and

(d) the involuntary conversion of capital assets held more than six months.

Art. 15(b), Colo. Reg., defines capital assets as property held by the taxpayer (whether or not connected with his trade or business) but not including inventoriable assets or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. It specifically includes livestock held for draft, breeding, or dairy purposes. Thus, in the computation of capital gains and losses for Colorado purposes you may include transactions not included for Federal purposes.

As to corporations, under both laws, the entire gain or loss is recognized upon the sale or exchange of capital assets, except that the alternative tax provisions are available to corporations in the computation of federal income tax. Note that the old rule still applies in Colorado.

Capital Loss Limitations

In the case of taxpayers other than a corporation, the deductible capital loss is limited to $1,000 in excess of the capital gains. Any non-deductible excess of capital losses may be carried forward by all taxpayers, including corporations, into the next five succeeding years (sec. 117 (d), (e), I. R. C.).

However, under Colorado law (art. 15(d), Colo. Reg.) the total deductible loss from the sales or exchange of capital assets of all taxpayers, including corporations, cannot exceed $2,000. There is no provision in the Colorado law for "carry-over losses."

Casualty Losses

Certain involuntary conversions receive sec. 117(j), I. R. C., treatment. The Revenue Act of 1951 permits the use of a casualty loss in computation of a net operating loss, even though the casualty loss is on non-business property (sec. 23(e), I. R. C.). There are no comparable Colorado provisions.

Charitable Contributions

Under sec. 23(o), I. R. C., the charitable contributions deduction by individuals may not exceed 20% of the taxpayer's adjusted gross income, unless the provisions of sec. 120, I. R. C., are applicable. The deduction by a corporation is limited to 5% of its net income computed without the contributions deduction (sec. 23(q), I. R. C.). The contributions must be actually paid within the taxable year to be deductible, except that a corporation on the accrual basis may deduct contributions authorized by the

board of directors in the taxable year if paid before the 15th day of the third month following the close of the taxable year.

Under art. 5(m), Colo. Reg., deductible contributions in the case of an individual may not exceed 15%, and in the case of a corporation 5% of the taxpayer's net income as computed without the benefit of the contributions deduction. In all cases, the contributions must be actually paid during the taxable year to be deductible.

CREDITS AGAINST TAX

Credits for foreign income taxes paid are dealt with in sec. 131, I. R. C. State income taxes are deductible from income prior to computation of tax.

No credit against the Colorado income tax is allowed for income taxes paid to the United States or any foreign country or any city nor for any so-called "gross income taxes" which some states impose. These may be taken as deductions in a proper case but are not allowed as credits. The provisions of art. 31, Colo. Reg., are limited to the amount of net income taxes paid by an individual resident of Colorado to another state, the District of Columbia, a territory or possession of the United States and allow a credit against the Colorado tax of the smallest of the three following amounts:

(1) The amount of net income tax paid or accrued to another state.

(2) Credit is to Colorado tax as other state net income is to total net income.

(3) Credit is to Colorado tax as out of Colorado net income is to total net income.

No credit can be taken if the standard deduction is claimed.

DECEDENTS

This topic is covered in Day, *Income Taxes During Estate Administration*, 29 DICTA 19 (1952).

In general, under federal law the accounts of the decedent are closed as if it were for a regular taxable year of the decedent, *i.e.* his regular method of accounting would determine whether the cash or accrual method would be required. Also, the standard deduction or tax table may be used.

Art. 8(b)-1, Colo. Reg., provides that the final return of a decedent must include all items of income and expense accrued as of date of death, including the deduction for federal income tax. Art. 5(n)(5), Colo. Reg., provides that the standard deduction cannot be taken on a return for a deceased person.

DISTRIBUTION OF CAPITAL GAINS DIVIDENDS

A capital gain dividend, as defined in sec. 362, I. R. C. (relating to tax on regulated investment companies), is treated by the recipient as a long-term capital gain.

Art. 2(a) (2)a, Colo. Reg., provides that "there is no capital gain dividend recognized in the Act."

ESTATES AND TRUSTS—65 DAY RULE

A distribution during the first 65 days of a taxable year of income of a prior period, in a case where payment may be made from income only, is considered to be paid, credited, or to be distributed on the last day of the preceding taxable year, to the extent of the income for the part of such period not falling within the taxable year (sec. 162, I. R. C.). There is no comparable Colorado provision.

This rule was commented upon in Day, *Income Taxes During Estate Administration,* 29 DICTA 19, 23 (1952).

ESTATES AND TRUSTS—EXEMPTIONS

Sec. 163(a)(1), I. R. C., provides for an exemption of $600 for an estate but an exemption of $100 for a trust.

Art. 7(a)-2, Colo. Reg., provides for an exemption of $600 for an estate or a trust.

ESTIMATED TAX DECLARATIONS

Sec. 58(a), I. R. C., provides that certain individuals must file declarations of estimated tax. This is to provide for current payment of taxes not collected through withholding. There is no comparable Colorado provision. In fact, payments of Colorado income tax will not be accepted prior to the end of the taxable year.

EXCESS PROFITS TAX

For the purposes of this article, it is sufficient to say that the United States Excess Profits Tax Act of 1950 applies only to corporations, applies only to taxable years ending after June 30, 1950 and will expire as of June 30, 1953 unless extended by law. There are no comparable Colorado provisions.

HEAD OF HOUSEHOLD

The Revenue Act of 1951 provides special tax treatment for any individual who qualifies as a "Head of a Household." The head of a household is an unmarried individual, other than a nonresident alien, who maintains at his home a household constituting the principal place of abode, as a member of such household, of one or more of the following—

(a) any person for whom the taxpayer is entitled to an exemption, or

(b) an unmarried child, grandchild, or stepchild, even though such child is not a dependent.

The taxpayer must furnish over one-half of the cost of maintaining the home during the taxable year.

There are no comparable Colorado provisions.

IMPROPER ACCUMULATIONS OF SURPLUS

The surtax on improper accumulations of surplus (27½% on the first $100,000 of "undistributed sec. 102 net income" and 38½% on the remainder of "undistributed sec. 102 net income") may be applied to any corporation (domestic or foreign) which permits earnings or profits to be accumulated instead of being distributed,

for the purpose of avoiding the individual surtax on its shareholders or on the shareholders of any other corporation (sec. 102, I. R. C.). There are no comparable provisions in the Colorado law.

INSTALLMENT PAYMENT OF TAXES

Advance payments by way of withholding and estimated declarations are required in the case of individuals, any balance due being payable on or before the 15th day of the third month after the close of the taxable year. A decedent's estate may pay its tax in four equal installments. The privilege of paying tax by installments has been eliminated in the case of trusts. Corporate taxes are payable on an accelerated basis each year so that for a taxable year ending in 1955 or thereafter only two 50% payments will be made, one with the return and the other in the second quarter.

Art. 24(a), Colo. Reg., provides that any taxpayer may elect to pay his tax in four equal installments on or before the 15th day of the fourth, seventh, tenth and twelfth month after the close of the taxable year.

INTEREST INCOME

All interest received or accrued except in the case of state or municipal obligations and a few United States obligations issued prior to March 1, 1941 is fully taxable (sec. 22(b) (4), I. R. C.).

Art. 4(b), Colo. Reg., provides that interest derived from obligations of the United States, and its possessions, agencies and instrumentalities is exempt from Colorado tax. However, in accordance with art. 2(e), Colo. Reg., this does not apply to banks. All interest received is taxable to banks.

JOINT RETURNS—INCOME SPLITTING

A husband and wife may elect to file a joint return combining their income and deductions. This may be done even where one spouse has no gross income (sec. 51(b) (1), I. R. C., art. 19(a)-1, Colo. Reg.).

The Colorado law has no provision comparable to the income-splitting provisions of the federal law. The federal law permits a surviving spouse to file a joint return with the deceased spouse in the year of death, but the Colorado law specifically prohibits same. The Revenue Act of 1951 allows taxpayers who have filed separate returns to elect at any time within three years to substitute joint returns, while the Colorado law does not permit a change of mind once the time for filing a return has expired.

LIVESTOCK

Livestock held for draft, breeding, or dairy purposes are not capital assets under federal law (sec. 117(a), I. R. C.) but are treated as sec. 117(j), I. R. C., assets, and are now required to be held for one year or more to receive such treatment.

Under Colorado law (art. 15(b), Colo. Reg.) livestock held for draft, breeding, or dairy purposes are capital assets and are only required to be held for six months or more to receive capital gains treatment.

MEDICAL EXPENSES

Under both the federal law (sec. 23(x), I. R. C.) and the Colorado law (art. 5(p), Colo. Reg.), a deduction is allowed to every individual (residents only for Colorado tax) for expenses paid during the taxable year for medical care of the taxpayer, his spouse, or a dependent of the taxpayer, but only such amount as exceeds 5% of the taxpayer's adjusted gross income and not to exceed $1250 per individual exemption (not for "over 65" or blindness exemptions), $2,500 per separate return or $5,000 per joint return. However, the Revenue Act of 1951 removed the 5% limitation (for federal returns only) for both the taxpayer and his spouse (but not for medical expenses as to their dependents) if either husband or wife attained age 65 before the end of the taxable year.

NET OPERATING LOSS DEDUCTION

A "net operating loss" from a trade or business may be carried back to the first preceding taxable year as a deduction against that year's income, the excess loss, if any not absorbed, may then be carried to the next five succeeding taxable years. The Revenue Act of 1951 allows all casualty losses to be considered in computing the net operating loss whether or not the property destroyed or damaged was used in the individual's trade or business (sec. 122, I. R. C.). There are no comparable provisions in the Colorado law.

MILITARY EXEMPTIONS

Under sec. 22(b) (13), I. R. C., all service pay received by an enlisted man or warrant officer for any part of a month during which he was in service in a combat area is exempted from tax. The exemption for a commissioned officer is $200 in service pay for any part of a month during which he was in a combat area. The Revenue Act of 1951 extended these exemptions to include the compensation of military personnel received while hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone.

Colorado law (art. 4(b) (8), Colo. Reg.) excluded the first $2,000 of compensation received from the United States Government for each taxable year by any member of the Armed Forces. Included in the term compensation is mustering out pay *and* all payments made by the United States Government to dependents of the taxpayer.

NON-PROFIT ORGANIZATIONS

For purposes of this article, it is sufficient to say that art. 3-2, Colo. Reg., was amended by COLO. LAWS, c. 47, p. 122 (1952) so that only religious organizations and insurance companies are not required to file annual returns. All other exempt organizations must file annual returns with the Colorado Department of Revenue.

Under federal law (sec. 101, I. R. C.) all exempt organizations are required to file annual returns.

OPTION—FAILURE TO EXERCISE

Sec. 117(g), I. R. C., provides that a gain or loss attributable to failure to exercise a privilege or option to buy or sell property is considered as a short-term capital gain or loss.

Art. 5(d)-1, Colo. Reg., states that no deductible loss occurs from the payment of a sum of money for an option to purchase property where the option was not exercised unless the transaction was connected with a trade or business or entered into for profit. Where there is a profit in the non-exercise of an option presumably there is taxable income.

PERCENTAGE DEPLETION

The method of computing allowable percentage depletion is similar under both laws (sec. 114(b), I. R. C., art. 12(c), Colo. Reg.). However, while the percentages provided for oil, gas, and coal are the same under both laws, there is a substantial difference in the percentages provided for other minerals.

PERSONAL HOLDING COMPANIES

For purposes of this article, it will suffice to say that in addition to the regular corporate normal tax and surtax, a special surtax is imposed on the "undistributed subchapter A net income" of a personal holding company at the rate of 75% of the amount not in excess of $2,000 plus 85% of the amount in excess of $2,000. Those practitioners doing corporate work should become intimately familiar with sec. 501, I. R. C., and subsequent sections. There are no comparable Colorado provisions.

RETURNS ON LIQUIDATION OF CORPORATIONS

Sec. 29.148-2, Reg. 111, provides that within 30 days after adoption of a resolution or plan of dissolution or liquidation of all or part of its capital stock, a corporation must file an information return on Form 966. In addition, Form 1099L must be filed by February 28 of the following year.

Art. 19(b)-1, Colo. Reg., provides that upon liquidation or dissolution of a corporation there shall be attached to the final return a Form DR 166 D-1-A giving certain information with reference to the dissolution or liquidation.

RETURN REQUIRED AFTER REVENUE AGENT'S EXAMINATION

Art. 19(e), Colo. Reg., provides that the taxpayer whose federal income tax return has been changed by competent authority must notify the Colorado Department of Revenue of such change in net income within 30 days after the final determination thereof, and the Statute of Limitation shall not apply in the instance of any taxpayer who fails to make a report within the time specified.

There are no comparable federal provisions.

SALE OF RESIDENCE

The Revenue Act of 1951 provided for the allowing of a postponement of the recognition of gain on the sale of a taxpayer's residence under certain circumstances (sec. 112(n), I. R. C.). The new provision treats an involuntary conversion as a sale, and provides that in such cases the new provision, and not sec.112(f),

I. R. C., is to apply. This new treatment only applies to sales of a taxpayer's principal residence made after 1950.

The Colorado law was amended in 1952 (COLO. LAWS, c. 47, p. 124) (1952) to provide similar treatment for Colorado income tax purposes. However, it only applies where both the sale and purchase is of Colorado property.

SOCIAL SECURITY

The Bureau of Internal Revenue has ruled that payments made under sec. 202 of the Social Security Act are exempt from federal income tax (I. T. 3447, 1941). However, art. 4(a)-16(d), Colo. Reg., provides that "Old Age Retirement Benefits and Unemployment Compensation payments constitute income taxable under the income tax law of Colorado. Payments made by an employee under that law are deductible. . . . "

STANDARD DEDUCTION

On a final return of a decedent, sec. 29.23(aa)-1(a), Reg. 111, provides that the standard deduction may be taken, while art. 5(n)(5), Colo. Reg., provides that it cannot be taken.

The election to take the standard deduction in lieu of actual deductions is binding and irrevocable per art. 5(n)(3), Colo. Reg. However, the Revenue Act of 1951 provided for the revocation of an election to take the standard deduction or to itemize deductions on the Federal income tax return. To result in a refund or credit, a change of election will have to be filed within the applicable period of limitations (sec. 23(aa)(7), I. R. C.).

While the optional standard deduction under federal law is 10% of the adjusted gross income or $1,000 whichever is less, the deduction under Colorado law is 10% of the adjusted gross income or $1,000 whichever is less, plus the federal income tax deduction.

STATUTE OF LIMITATIONS

Generally, under federal law (sec. 275, I. R. C.) income taxes must be assessed within three years from the date the return was filed, except that if the return was filed prior to the due date the three year period commences on the due date. If an amount in excess of 25% of the gross income reported has been omitted from the return, the limitation is five years. In case of a failure to file a return or in a case of a false or fraudulent return, there is no statute of limitations.

Art. 29, Colo. Reg., provides generally for a four year statute of limitations on additional assessment, except that the period is increased to six years if a deficiency exceeds by 25% the amount of net income shown on the return. In a case of failure to file a return or in a case of a false or fraudulent return the tax may be assessed at any time.

On claims for refunds, the federal law (sec. 322, I. R. C.) provides that the claims must be filed within three years from the due date of the return or two years from the date of payment of the tax, whichever is later. Art. 29, Colo. Reg., provides that a claim must be filed within four years from the date of the last payment on account of the tax for the year in question.

SURTAX—COLORADO

Art 2(a) (2)a, Colo. Reg., imposes a two percent surtax on natural persons upon such income as exceeds $600 which consists of or is derived from dividends and interest. This surtax is in addition to the normal tax. Thus, it is possible to be subject to the surtax and not to the normal tax as no deductions are permitted from surtaxable income.

There are no comparable federal provisions.

STOCK OPTIONS—EMPLOYEES

Special treatment is provided for "restricted stock options" granted to employees by corporations. Detailed rules are provided, but generally, the option price must be at least 85% of the market price at the time the option is granted and if the employee holds the stock until at least two years after he receives the option and six months after he receives the stock he is deemed to realize no taxable income upon exercise of the option (sec. 130A, I. R. C.). There are no comparable Colorado provisions.

TAX DEDUCTION

Whereas under federal law, the deduction for taxes paid is determined by the accounting method used by the taxpayer, art. 8(b)-5, Colo. Reg., permits the accrual basis taxpayer to elect to deduct federal income taxes on either the cash or accrual basis. The election once made is binding for all future years. The election was or is made on the first return filed after 1942.

TRAVEL TO AND FROM WORK

Art. 4(a) (1), Colo. Reg., provides that actual expenses paid in traveling to and from the place or places of employment are deductible in arriving at adjusted gross income. A deduction of $75 is permitted in lieu of itemizing travel expenses. There are no comparable federal provisions.

UNRELATED BUSINESS INCOME OF TAX EXEMPTS

Certain organizations exempt from income tax under sec. 101, I. R. C., are now subject to income tax on income from operation of a business enterprise which is unrelated to the purpose for which such an organization received its exemption (sec. 421, I. R. C., and subsequent sections). There are no comparable Colorado provisions.

As previously stated, this article is not all-inclusive of the differences between the Colorado and federal income tax laws. However, it would be of great value to all tax practitioners to have a publication which would tell quickly in general terms what the Colorado law provides and which would also tell whether the Colorado provision is the same as the federal or whether there is a difference. Included therein could be cross reference tables so that knowing the applicable section of one law you could consult the tables for the comparable section in the other law. It is hoped that some group or groups will undertake the preparation of such a publication.