Second Regular Session
Seventieth General Assembly
STATE OF COLORADO

ENGROSSED

This Version Includes All Amendments Adopted on Second Reading in the House of Introduction

LLS NO. 16-0166.01 Esther van Mourik x4215 **HOUSE BILL 16-1275**

HOUSE SPONSORSHIP

Foote and Pettersen,

SENATE SPONSORSHIP

Jones and Donovan,

House Committees
Finance
Appropriations

Senate Committees

A BILL FOR AN ACT

CONCERNING THE TAXATION OF A CORPORATION'S STATE INCOME THAT IS SHELTERED IN A FOREIGN JURISDICTION FOR PURPOSES OF TAX AVOIDANCE.

Bill Summary

(Note: This summary applies to this bill as introduced and does not reflect any amendments that may be subsequently adopted. If this bill passes third reading in the house of introduction, a bill summary that applies to the reengrossed version of this bill will be available at http://www.leg.state.co.us/billsummaries.)

The bill pertains to an affiliated group of corporations filing a combined report. In a combined report filing, the tax is based on a percentage of the entire taxable income of all of the includable corporations, but the tax is assessed only against the corporation or corporations doing business in Colorado. Including more affiliated

HOUSE
Amended 2nd Reading
March 7, 2016

corporations in the combined report may result in an increase in income subject to tax.

There are jurisdictions located outside of the United States with no tax or very low rates of taxation, strict bank secrecy provisions, a lack of transparency in the operation of its tax system, and a lack of effective exchange of information with other countries. There are several common legal strategies for sheltering corporate income in such jurisdictions, often called "tax havens".

Notwithstanding a current requirement in state law that those corporations with 80% or more of their property and payroll assigned to locations outside of the United States be excluded from a combined report, the bill makes a corporation that is incorporated in a foreign jurisdiction for the purpose of tax avoidance an includable C corporation for purposes of the combined report.

The bill defines a corporation incorporated in a foreign jurisdiction for the purpose of tax avoidance to mean any C corporation that is incorporated in a jurisdiction that has no or nominal effective tax on the relevant income and that meets one or more of 5 factors listed in the bill, unless it is proven to the satisfaction of the executive director of the department of revenue that such corporation is incorporated in that jurisdiction for a legitimate business purpose.

The bill requires the state controller to credit a specified amount per fiscal year to the state education fund to be used to help fund public school education.

The bill requires the secretary of state to submit a ballot question, to be treated as a proposition, at the statewide election to be held in November 2016 asking the voters:

- To increase taxes annually by the taxation of a corporation's state income that is sheltered in a foreign jurisdiction for the purpose of tax avoidance;
- To use the resulting tax revenue to help fund elementary and secondary public school education; and
- To allow an estimate of the resulting tax revenue to be collected and spent notwithstanding any limitations in section 20 of article X of the state constitution (TABOR).

Be it enacted by the General Assembly of the State of Colorado:

SECTION 1. Legislative declaration. (1) The general assembly hereby finds and declares that:

(a) Every year, some corporations use complicated strategies to shift money earned in Colorado to subsidiaries in tax havens, countries with minimal or no taxes, in order to reduce their state income tax liability. Tax haven users benefit from the markets, public infrastructure, educated workforce, security, and rule of law in Colorado, and all of those benefits are supported in one way or another by tax dollars, but these corporations then use tax havens to escape supporting these public structures and benefits. Ultimately, ordinary taxpayers end up picking up the tab, either in the form of higher taxes or cuts to public spending priorities.

(b) Sheltering state income in a tax haven reduces the state's income tax revenue. Colorado has the authority to set its own income tax laws and the general assembly has the responsibility to make sure our tax laws are fairly applied to all taxpayers.

(c) School district administrators, parents of students, teachers, business leaders, higher education officials, local elected officials, and Coloradans from all parts of the state have made clear to the legislature their desire to see such education better funded.

(d) One reflection of the pressures on Colorado's elementary and secondary education funding is the existence of the "negative factor". The negative factor is the difference between the total program funding, including the state's share, as calculated in statute and the amount the state can pay for the state's share and still afford other budget obligations. As of fiscal year 2015-16, the negative factor currently stands at approximately $855 million.

(e) Colorado should continue to explore ways to reduce the negative factor and otherwise improve its funding of its elementary and secondary public education systems. The use of foreign tax havens enables certain corporations to avoid paying Colorado taxes. This behavior contributes to the underfunding of the state's elementary and secondary public education systems. It is the general assembly's intent to collect tax revenue already owed to Colorado from corporations avoiding that tax liability and invest that newly collected revenue in the state's elementary and secondary public education systems.

(2) The general assembly further finds and declares that it is not the intention of the general assembly to disallow any foreign source income deduction that is otherwise allowed pursuant to section 39-22-303 (1), C.R.S., even though a corporation that is otherwise excludable from the combined report is included as a result of House Bill 16-1275.

SECTION 2. In Colorado Revised Statutes, 39-22-303, **amend** (12) as follows:

39-22-303. Combined report - foreign source income - dividends - affiliated groups - definitions. (12) ~~(a)~~ As used in ~~subsections (10) and (11) of~~ this section, UNLESS THE CONTEXT OTHERWISE REQUIRES:

(a) ~~The term~~ "Affiliated group" means one or more chains of includable C corporations connected through stock ownership with a common parent C corporation ~~which~~ THAT is an includable C corporation if:

(I) (A) EXCEPT AS PROVIDED IN SUB-SUBPARAGRAPH (B) OF THIS SUBPARAGRAPH (I), stock possessing more than fifty percent of the voting power of all classes of stock and more than fifty percent of each class of the nonvoting stock of each of the includable C corporations, except the common parent C corporation, is owned directly by one or more of the other includable C corporations; ~~and~~ OR

(B) A CORPORATION IS INCORPORATED IN A FOREIGN JURISDICTION

FOR THE PURPOSE OF TAX AVOIDANCE, AND IF STOCK POSSESSING MORE THAN FIFTY PERCENT OF THE VOTING POWER OF ALL CLASSES OF STOCK AND MORE THAN FIFTY PERCENT OF EACH CLASS OF THE NONVOTING STOCK OF EACH OF THE INCLUDABLE C CORPORATIONS, EXCEPT THE COMMON PARENT C CORPORATION, IS OWNED DIRECTLY OR INDIRECTLY BY ONE OR MORE OF THE OTHER INCLUDABLE C CORPORATIONS; AND

(II) (A) EXCEPT AS PROVIDED IN SUB-SUBPARAGRAPH (B) OF THIS SUBPARAGRAPH (II), the common parent C corporation owns directly stock possessing more than fifty percent of the voting power of all classes of stock and more than fifty percent of each class of the nonvoting stock of at least one of the other includable C corporations; OR

(B) A CORPORATION IS INCORPORATED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE, AND IF THE COMMON PARENT C CORPORATION OWNS DIRECTLY OR INDIRECTLY STOCK POSSESSING MORE THAN FIFTY PERCENT OF THE VOTING POWER OF ALL CLASSES OF STOCK AND MORE THAN FIFTY PERCENT OF EACH CLASS OF THE NONVOTING STOCK OF AT LEAST ONE OF THE OTHER INCLUDABLE C CORPORATIONS.

(b) (I) ~~As used in this subsection (12), the term "Stock" does not include nonvoting stock which is limited and preferred as to dividends, employer securities, within the meaning of section 409(1) of the internal revenue code, while such securities are held under a tax credit employee stock ownership plan, or qualifying employer securities, within the meaning of section 4975(e)(8) of the internal revenue code, while such securities are held under an employee stock ownership plan which meets the requirements of section 4975(e)(7) of the internal revenue code~~ "CORPORATION INCORPORATED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE" MEANS, EXCEPT AS PROVIDED IN

SUBPARAGRAPH (II) OF THIS PARAGRAPH (b), ANY C CORPORATION THAT IS INCORPORATED IN A JURISDICTION THAT, DURING THE TAX YEAR IN QUESTION, HAS NO OR NOMINAL EFFECTIVE TAX ON THE RELEVANT INCOME AND THAT:

(A) HAS LAWS OR PRACTICES THAT PREVENT EFFECTIVE EXCHANGE OF INFORMATION FOR TAX PURPOSES WITH OTHER GOVERNMENTS ON TAXPAYERS BENEFITING FROM THE TAX REGIME;

(B) HAS A TAX REGIME THAT LACKS TRANSPARENCY SO THAT THE DETAILS OF LEGISLATIVE, LEGAL, OR ADMINISTRATIVE PROVISIONS ARE NOT OPEN AND APPARENT OR ARE NOT CONSISTENTLY APPLIED AMONG SIMILARLY SITUATED TAXPAYERS, OR SO THAT INFORMATION NEEDED BY TAX AUTHORITIES TO DETERMINE A TAXPAYER'S CORRECT TAX LIABILITY, SUCH AS ACCOUNTING RECORDS AND UNDERLYING DOCUMENTATION, IS NOT ADEQUATELY AVAILABLE;

(C) FACILITATES THE ESTABLISHMENT OF FOREIGN-OWNED ENTITIES WITHOUT THE NEED FOR A LOCAL SUBSTANTIVE PRESENCE OR PROHIBITS THESE ENTITIES FROM HAVING ANY COMMERCIAL IMPACT ON THE LOCAL ECONOMY;

(D) EXPLICITLY OR IMPLICITLY EXCLUDES THE JURISDICTION'S RESIDENT TAXPAYERS FROM TAKING ADVANTAGE OF THE TAX REGIME'S BENEFITS OR PROHIBITS ENTERPRISES THAT BENEFIT FROM THE REGIME FROM OPERATING IN THE JURISDICTION'S DOMESTIC MARKET; OR

(E) 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.

(II) A CORPORATION IS NOT INCORPORATED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE IF IT IS PROVEN TO THE SATISFACTION OF THE EXECUTIVE DIRECTOR OF THE DEPARTMENT OF REVENUE THAT SUCH CORPORATION IS INCORPORATED IN THE FOREIGN JURISDICTION FOR REASONS THAT MEET THE ECONOMIC SUBSTANCE DOCTRINE AS DESCRIBED IN SECTION 7701 (o) OF THE FEDERAL "INTERNAL REVENUE CODE OF 1986", AS AMENDED.

(III) THE DEPARTMENT OF REVENUE SHALL PROMULGATE BY RULE, IN ACCORDANCE WITH THE "STATE ADMINISTRATIVE PROCEDURE ACT", ARTICLE 4 OF TITLE 24, C.R.S., A LIST OF COUNTRIES THAT MEET THE CRITERIA SET FORTH IN SUBPARAGRAPH (I) OF THIS PARAGRAPH (b), AND THE DEPARTMENT SHALL BIENNIALLY REVIEW SUCH RULE FOR PURPOSES OF UPDATING THE LIST OF COUNTRIES THAT MAY MEET THE CRITERIA SET FORTH IN SUBPARAGRAPH (I) OF THIS PARAGRAPH (b). THE DEPARTMENT SHALL POST THE LIST ON THE DEPARTMENT'S WEBSITE WITHIN THIRTY DAYS OF THE EFFECTIVE DATE OF THE RULE.

(c) (I) "INCLUDABLE C CORPORATION" MEANS ANY C CORPORATION THAT HAS MORE THAN TWENTY PERCENT OF THE C CORPORATION'S PROPERTY AND PAYROLL AS DETERMINED BY FACTORING PURSUANT TO SECTION 24-60-1301, C.R.S., ASSIGNED TO LOCATIONS INSIDE THE UNITED STATES. FOR PURPOSES OF THIS SUBPARAGRAPH (I), "UNITED STATES" IS RESTRICTED TO THE FIFTY STATES AND THE DISTRICT OF COLUMBIA.

(II) NOTWITHSTANDING SUBSECTION (8) OF THIS SECTION OR SUBPARAGRAPH (I) OF THIS PARAGRAPH (c), FOR INCOME TAX YEARS COMMENCING ON OR AFTER JANUARY 1, 2017, "INCLUDABLE C CORPORATIONS" ALSO MEANS A CORPORATION THAT IS INCORPORATED IN

A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE. THE INCOME OF ANY SUCH CORPORATION MAY BE INCLUDED IN A COMBINED REPORT IF THE CORPORATION IS INCLUDED IN THE COMBINED REPORT.

~~(c)~~ (d) ~~As used in this subsection (12), the term "Includable C corporations" means any C corporation which has more than twenty percent of the C corporation's property and payroll as determined by factoring pursuant to section 24-60-1301, C.R.S., assigned to locations inside the United States~~ "STOCK" DOES NOT INCLUDE NONVOTING STOCK THAT IS LIMITED AND PREFERRED AS TO DIVIDENDS, EMPLOYER SECURITIES, WITHIN THE MEANING OF SECTION 409(l), EMPLOYER SECURITIES DEFINED, OF THE INTERNAL REVENUE CODE, WHILE SUCH SECURITIES ARE HELD UNDER A TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN, OR QUALIFYING EMPLOYER SECURITIES, WITHIN THE MEANING OF SECTION 4975(e)(8) OF THE INTERNAL REVENUE CODE, WHILE SUCH SECURITIES ARE HELD UNDER AN EMPLOYEE STOCK OWNERSHIP PLAN THAT MEETS THE REQUIREMENTS OF SECTION 4975(e)(7) OF THE INTERNAL REVENUE CODE.

SECTION 3. In Colorado Revised Statutes, 39-22-303, **add** (15) as follows:

39-22-303. Dividends in a combined report - foreign source income - affiliated groups - definitions - voter approved revenue change - repeal. (15) (a) AS USED IN THIS SUBSECTION (15), "BALLOT ISSUE" MEANS THE QUESTION REFERRED TO VOTERS IN PARAGRAPH (b) OF THIS SUBSECTION (15).

(b) AT THE ELECTION HELD ON NOVEMBER 8, 2016, THE SECRETARY OF STATE SHALL SUBMIT TO THE REGISTERED ELECTORS OF THE STATE FOR THEIR APPROVAL OR REJECTION THE FOLLOWING BALLOT

ISSUE: "SHALL STATE TAXES BE INCREASED BY $75 MILLION ANNUALLY IN THE FIRST FULL FISCAL YEAR AND BY SUCH AMOUNTS AS ARE RAISED ANNUALLY THEREAFTER BY THE TAXATION OF A CORPORATION'S STATE INCOME THAT IS SHELTERED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE, WITH THE RESULTING ESTIMATED TAX REVENUE BEING USED TO HELP FUND ELEMENTARY AND SECONDARY PUBLIC SCHOOL EDUCATION, AND WITH AN ESTIMATE OF THE RESULTING TAX REVENUE BEING ALLOWED TO BE COLLECTED AND SPENT NOTWITHSTANDING ANY LIMITATIONS PROVIDED BY LAW?"

(c) IF A MAJORITY OF THE ELECTORS VOTING ON THE BALLOT ISSUE VOTE "YES/FOR", THEN THE STATE MAY RETAIN AND SPEND ALL OF THE TAX REVENUE ESTIMATED TO BE RECEIVED BY THE TAXATION OF A CORPORATION'S STATE INCOME THAT IS SHELTERED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE AS A VOTER-APPROVED REVENUE CHANGE TO THE LIMITATION ON STATE FISCAL YEAR SPENDING.

(d) FOR PURPOSES OF SECTION 1-5-407 (5) (b), C.R.S., THE BALLOT ISSUE IS A PROPOSITION. SECTION 1-40-106 (3) (d), C.R.S., DOES NOT APPLY TO THE BALLOT ISSUE.

(e) (I) IF A MAJORITY OF THE ELECTORS VOTING ON THE BALLOT ISSUE VOTE "NO/AGAINST", THEN THIS SUBSECTION (15) IS REPEALED, EFFECTIVE FEBRUARY 1, 2017.

(II) IF A MAJORITY OF THE ELECTORS VOTING ON THE BALLOT ISSUE VOTE "YES/FOR", THEN THIS PARAGRAPH (e) IS REPEALED, EFFECTIVE FEBRUARY 1, 2017.

SECTION 4. In Colorado Revised Statutes, 39-22-303.5, **amend** (1) (a) as follows:

39-22-303.5. Single-factor apportionment of business income - allocation of nonbusiness income - rules - definitions. (1) As used in this section, unless the context otherwise requires:

(a) "Business income" means the net income of the taxpayer arising from the transactions and activity in the regular course of a taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. For purposes of administration of this section, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income. FOR INCOME TAX YEARS COMMENCING ON OR AFTER JANUARY 1, 2017, THE INCOME OF A CORPORATION INCORPORATED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE AS DEFINED IN SECTION 39-22-303 (12), TO THE EXTENT TAXABLE, IS CONSIDERED BUSINESS INCOME SUBJECT TO APPORTIONMENT UNDER THIS SECTION.

SECTION 5. In Colorado Revised Statutes, 39-22-304, **add** (3) (o) and (3) (p) as follows:

39-22-304. Net income of corporation. (3) There shall be subtracted from federal taxable income:

(o) THE AMOUNT OF SUBPART F INCOME, AS DEFINED IN SECTION 952 OF THE INTERNAL REVENUE CODE, THAT:

(I) ARISES ON OR AFTER THE EFFECTIVE DATE OF THIS PARAGRAPH (o);

(II) IS NOT OTHERWISE SUBTRACTED FROM FEDERAL TAXABLE INCOME, EXCEPT FOR THE SUBTRACTION ALLOWED BY SECTION 39-22-303 (10); AND

(III) IS FROM A CORPORATION INCORPORATED IN A FOREIGN

JURISDICTION FOR THE PURPOSES OF TAX AVOIDANCE AND SUCH CORPORATION IS INCLUDED IN THE COMBINED REPORT FILED PURSUANT TO SECTION 39-22-303 (11).

(p) THE AMOUNT OF ANY DIVIDEND, INCLUDING ANY DEEMED DIVIDEND PURSUANT TO SECTION 1248 OF THE INTERNAL REVENUE CODE, THAT:

(I) IS RECEIVED BY A C CORPORATION INCLUDED IN THE COMBINED REPORT FILED PURSUANT TO SECTION 39-22-303 (11);

(II) IS NOT OTHERWISE SUBTRACTED FROM FEDERAL TAXABLE INCOME, EXCEPT FOR THE SUBTRACTION ALLOWED BY SECTION 39-22-303 (10); AND

(III) IS DISTRIBUTED OUT OF EARNINGS AND PROFITS OF A CORPORATION INCORPORATED IN A FOREIGN JURISDICTION FOR THE PURPOSES OF TAX AVOIDANCE AND SUCH EARNINGS AND PROFITS AROSE IN A YEAR IN WHICH SUCH CORPORATION WAS INCLUDED IN THE COMBINED REPORT FILED PURSUANT TO SECTION 39-22-303 (11) IN SUCH YEAR.

SECTION 6. In Colorado Revised Statutes, 22-55-103, **amend** (5) introductory portion; and **add** (4.5) as follows:

22-55-103. State education fund - creation - transfers to fund - use of moneys in fund - permitted investments - exempt from spending limitations. (4.5) FOR THE 2017-18 FISCAL YEAR AND EACH FISCAL YEAR THEREAFTER, THE STATE CONTROLLER SHALL CREDIT AN AMOUNT OF TAX REVENUE ESTIMATED TO BE RECEIVED BY THE TAXATION OF A CORPORATION'S STATE INCOME THAT IS SHELTERED IN A FOREIGN JURISDICTION FOR THE PURPOSE OF TAX AVOIDANCE AS A RESULT OF HOUSE BILL 16-1275, ENACTED IN 2016, EVERY FISCAL YEAR FROM THE GENERAL FUND TO THE STATE EDUCATION FUND. THE MONEY CREDITED TO

THE FUND AS A RESULT OF THIS SUBSECTION (4.5) IS IN ADDITION TO ANY MONEYS CREDITED TO THE FUND PURSUANT TO SECTION 17 (4) OF ARTICLE IX OF THE STATE CONSTITUTION, AND SHALL BE APPROPRIATED EVERY FISCAL YEAR TO INCREASE THE LEVEL OF FUNDING APPROPRIATED FROM THE STATE EDUCATION FUND, THE STATE PUBLIC SCHOOL FUND, AND THE GENERAL FUND FOR THE PREVIOUS FISCAL YEAR FOR TOTAL PROGRAM EDUCATION FUNDING UNDER THE "PUBLIC SCHOOL FINANCE ACT OF 1994", ARTICLE 54 OF THIS TITLE, AND FOR CATEGORICAL PROGRAMS.

(5) Pursuant to section 17 (3) of article IX of the state constitution, all moneys credited to the STATE EDUCATION fund, INCLUDING THE MONEYS CREDITED TO THE FUND PURSUANT TO SUBSECTION (4.5) OF THIS SECTION, appropriated by the general assembly out of the fund, or distributed from the fund and expended by any school district shall be exempt from:

SECTION 7. Effective date. (1) Except as specified in subsection (2) of this section, this act takes effect upon passage.

(2) (a) Sections 2, 4, 5, and 6 of this act, amending sections 39-22-303 (12), 39-22-303.5 (1) (a), 39-22-304 (3), and the introductory portion to 22-55-103 (5) and adding section 22-55-103 (4.5), Colorado Revised Statutes, take effect only if, at the November 2016 statewide election, a majority of the voters approve the ballot issue submitted pursuant to section 39-22-303 (15), Colorado Revised Statutes, enacted in section 3 of this act.

(b) If the voters at the November 2016 statewide election approve a measure described in paragraph (a) of this subsection (2), then sections 2, 4, 5, and 6 of this act take effect on the date of the official declaration of the vote thereon by the governor.

SECTION 8. Safety clause. The general assembly hereby finds, determines, and declares that this act is necessary for the immediate preservation of the public peace, health, and safety.