# FYI Income 15
## Colorado Capital Gain Subtraction

Qualifying Colorado taxpayers can deduct certain qualified capital gain income if it is included in their federal taxable income. [§39-22-518, C.R.S.] This subtraction is available to those who meet the following qualifications:

**TAX YEARS 2010 FORWARD**
Real or tangible personal property located within Colorado;

- Acquired on or after May 9, 1994, but before June 4, 2009
- Has been owned by the qualified taxpayer for at least five uninterrupted years prior to the sale
- Transaction(s) from which the net capital gain arise occurred during an income tax year that commenced on or after January 1, 2010
- Must be included in federal taxable income as reported on the Colorado income tax return
- Subtraction may not exceed $100,000

**OR**

Tangible personal property located within or outside Colorado;

- Acquired on or after June 4, 2009
- Has been owned by the qualified taxpayer for at least five uninterrupted years prior to the sale
- Transaction(s) from which the net capital gain arise occurred during an income tax year that commenced on or after January 1, 2010
- Must be included in federal taxable income reported on the taxpayer's Colorado income tax return
- Subtraction may not exceed $100,000

**TAX YEARS 2002 - 2009**
On real or tangible personal property located within Colorado or income earned on the sale of stock or ownership interest in a Colorado company, limited liability company or partnership;

- Acquired on or after May 9, 1994
- Has been owned by the qualified taxpayer for at least five uninterrupted years prior to the sale
- Transaction(s) from which the net capital gain arise occurred during an income tax year that commenced before January 1, 2010
- Must be included in federal taxable income reported on the taxpayer's Colorado income tax return.

**COLORADO SOURCES**

**Tax Years 2010 Forward**
The subtraction applies to the net capital gain earned from property located in Colorado that was acquired after May 9, 1994, but before June 4, 2009. Thus, capital gains realized from the sale of real property or tangible personal property, qualifies for this subtraction only if the property is located in Colorado at the time of the transaction that gave rise to the gain.

The subtraction also applies to tangible personal property located either within or outside of Colorado that was acquired on or after June 4, 2009.

**Tax Years 2002 - 2009**
The subtraction applies only to the net capital gains earned from property located in Colorado. Thus, capital gains realized from the sale of real property or tangible personal property, qualifies for this subtraction only if the property is located in Colorado at the time of the transaction that gave rise to the gain.

The gain from the sale of stock or ownership interest also qualifies if the stock or ownership interest is of a "Colorado company, limited liability company, or partnership." These are entities that have 50% or more of their property and 50% or more of their payroll assigned to Colorado under the Multi-state Tax Compact [§24-60-1301, C.R.S.] for the required five year holding period. Taxpayers must report the property and payroll percentages on the DR 1316 (any such information the department may have is confidential and cannot be disclosed) and must keep appropriate records that demonstrate that the company meets the requirements of this subtraction.

## SOLE PROPRIETORSHIPS

Because the sale of a sole proprietorship is not considered a sale of an entity, but only of its assets, such a sale does not qualify as a sale of "ownership interest." Therefore, gains earned from intangibles owned by a sole proprietorship do not qualify for this subtraction.

## PASS-THROUGH ENTITIES

The department will closely examine subtractions involving "pass-through" entities (entities that pass capital gains through to the partner/stockholder/member) that have only de minimis tangible property and payroll, and hold only stock, intangibles, or ownership interests in other entities. In such cases, the department will require the intangible assets owned by the pass-through entity meet the requirements of the "Colorado source," holding period, and other requirements of this subtraction.

**Example:** A Colorado taxpayer owns stock in a pass-through entity that has de minimus tangible property and payroll and whose only significant asset is stock held in another company. The department will apply the "Colorado source" and applicable holding period requirements to the underlying company to determine whether the pass-through of capital gain income from the sale of such stock qualifies for this subtraction.

## ACQUISITION DATE/HOLDING PERIOD

The acquisition date and holding period computations for the purpose of this subtraction are not necessarily the same as federal rules. The specific property must be directly and without interruption owned by the specific taxpayer for five years to qualify for this subtraction. The Colorado holding periods for the purposes of this subtraction are in addition to any holding period provisions of the federal Internal Revenue Code.

In order to qualify for the subtraction for gains on the sale of individual assets of a pass-through entity, both the entity and the partner/Sub S stockholder/member of the pass-through entity must satisfy the applicable holding period for each asset.

**Example:** Partnership purchases an asset on May 10, 2000 and sells it on June 1, 2005. Partner A, who became a partner prior to May 10, 2000, satisfies the five-year holding period and qualifies for the subtraction. Partner B, who became a partner June 2, 2000, does not satisfy the five-year holding requirement and can not claim the capital gain subtraction.

**Example:** If a taxpayer acquired a 25% interest in Colorado real property on May 20, 2000, and a 25% additional interest on November 1, 2001, and the whole property is sold on July 1, 2005, only the gain on the first 25% interest can be subtracted. The taxpayer did not hold the second 25% interest for the required five year holding period.

### Grantor trusts

Due to the unique attributes of a grantor trust, the transfer of an asset to a grantor trust does not interrupt the holding period. Therefore, to determine if the sale of an asset meets the holding period requirements of the subtraction, the acquisition date of the asset will be considered to be the date when the individual originally acquired title to the asset. This is only the case when property is re-titled between a grantor trust and the creator of the trust who is also the owner of the property.

"Grantor Trust" refers only to those trusts that qualify for the definitions, and treatment for income tax, found in sections 671 through 677 of the federal Internal Revenue Code.

## DIVORCE SETTLEMENTS

When calculating the holding period, the acquisition date of property held by an individual after a divorce will be determined by the status of that property during the marriage. The acquisition date of property that is not jointly titled and controlled during the marriage will be the date the asset is transferred to the spouse during the divorce.

## TRANSFERS BETWEEN A PASS-THROUGH ENTITY AND ITS MEMBERS

When determining the "qualified taxpayer" in the case of a pass-through entity, the taxpayer is considered to be the pass-through entity and the individual member in aggregate.

The acquisition date for determining the members' holding period of property that is transferred by a pass-through entity to its members is the date the pass-through entity acquired the property. This assumes the members owned their share of the entity for the entire period that the property was owned by the pass-through entity. If any member acquired their share of the pass-through entity after the entity already owned the property, then the acquisition date of the property in the hands of the member would be the date they acquired their share of the entity.

The acquisition date for determining the members' holding period of property that is transferred by one member to a pass-through entity is, for the transferor, the date that member acquired the property, and, for all other members, the date of the transfer to the pass-through entity. This assumes the members owned their share of the entity for the entire period that property was owned by the pass-through entity. If any member acquired their share of the pass-through entity after the entity already owned the property, then the acquisition date of the property in the hands of the member would be the date they acquired their share of the entity.

**Example:** Colorado property was acquired on May 1, 1994, by an individual, transferred to an S corporation on July 1, 1994, that is wholly owned by the individual, and then sold by the S corporation on July 30, 1999. Therefore, the acquisition date of the asset is May 1, 1994. The holding period is May 1, 1994, through July 30, 1999. In this example, the gain does not qualify as the property was acquired before May 9, 1994.

**Example:** Colorado property was acquired on October 1, 1999 by an LLC and distributed to its members on November 15, 2002. The acquisition date to be used for determining if the capital gain subtraction applies when a member sells the property is October 1, 1999.

**Example:** Colorado property was acquired on June 1, 2002 by an individual. The property was transferred to a partnership in which the individual was a 40% partner on July 1, 2003. The property is sold on June 15, 2008 by the partnership. The individual's holding period for the property was from June 1, 2002 through June 15, 2008, which qualifies for the capital gain subtraction. However, the other partners' holding period for the property was from July 1, 2003 through June 15, 2008, which does not meet the five-year holding period for the subtraction.

**Example:** Colorado property was acquired on June 1, 1992 by an individual. The property was transferred to a partnership in which the individual was a 40% partner on July 1, 2000. The property is sold on June 15, 2008 by the partnership. The individual's acquisition date for the property was June 1, 1992, which does not qualify for the capital gain subtraction. However, the other partners' acquisition date for the property was July 1, 2000, which does qualify for the subtraction.

**GENERAL PARTNERSHIP CONVERSION TO A LLC**

A general partnership that is converted to an LLC is not a new legal entity. Therefore, the ownership of the property is not interrupted when the conversion to an LLC occurs.

**QUALIFIED TAXPAYER**

A "qualified taxpayer" is any individual, firm, corporation, partnership, LLC, joint venture, estate, trust or group or combination acting as a unit. A taxpayer must not have any overdue state tax liabilities and not be in default on any contractual obligations owed to the state or to any local government within Colorado at the time the Colorado source capital gain subtraction is claimed.

**DOCUMENTATION**

The Colorado capital gain subtraction requires the DR 1316 be submitted when the return is filed. The DR 1316 requests basic information regarding the capital gain, as well as an affidavit attesting that the taxpayer qualified to claim the subtraction. List on the DR 1316 only the capital gains and losses that are used to compute the subtraction. This form is available on our Web site at www.TaxColorado.com. The Department may request additional documentation if clarification is needed during the validation of the subtraction.

**LIMITATIONS**

The Colorado capital gain subtraction is limited to the lesser of the amount of the federal net capital gain reported on Schedule D or the qualifying Colorado net capital gain.

**Example:** A taxpayer has a qualifying Colorado capital gain of $4,000, a non-Colorado capital gain of $500 and a non-Colorado capital loss of $1000, for a federal net capital gain of $3,500. The subtraction allowed on the Colorado return will be $3,500 (the lesser of $3,500 and $4,000).

**Example:** Same facts as in Example 1, except the $1,000 loss is a qualifying Colorado capital loss. The subtraction allowed in this example would be $3,000 (the lesser of $3,500 and $3,000).

**INSTALLMENT SALES**

If an asset is sold on an installment basis, the transaction must qualify for the subtraction in both the year the asset is sold and the year the gain is received

**Example:** An asset is purchased June 1, 2000, and sold on April 1, 2005, with deferred payments received monthly from July 1, 2005, to December 31, 2008. The capital gains from this transaction does not qualify for the subtraction because the five year holding period was not met when the asset was sold.

**Example:** Same facts as in Example 1, except the asset was acquired January 1, 2000. The capital gains from this transaction would qualify for the subtraction because the asset was held for the required holding period of five years.

**DEEMED SALES**

For federal Schedule D purposes, Section 311 of the Relief Act of 1997 allows a taxpayer to elect to treat certain assets held on January 1, 2001 as having been sold and reacquired on the same date so that future gain on the asset is eligible for the 18% instead of 20% capital gains tax rate. The capital gain recognized under this scenario does not qualify for the Colorado capital gain subtraction.

While federal law allows the recognition of gain in this situation, no actual sale or transaction takes place. The mere recognition of gain does not qualify as a sale or transaction under the Colorado source capital gain subtraction laws. Any gain recognized in this situation will be taxable by Colorado.

The holding period of the asset in this scenario will continue to begin on the original acquisition date of the asset.

**Example:** An asset is acquired on January 1, 1995, and a $9,000 gain is recognized on January 2, 2001, under the federal deemed sale rule. The asset is then sold on February 1, 2002, and an additional $2,000 capital gain is recognized at that time. The $9,000 gain will be taxable on the 2001 Colorado income tax return and will not qualify for the Colorado capital gain subtraction. However, the $2,000 gain will qualify for the Colorado capital gain subtraction in 2002 because the asset will meet the five-year holding period requirement (January 1, 1995 to February 1, 2002) for the purposes of the subtraction.

**COMMON QUESTIONS**

*Is the holding period for Colorado computations always the same as the federal holding period for the capital gain computation?*

No. The holding requirement for the Colorado subtraction may be different than the federal holding period requirements. The Colorado holding period must be satisfied in addition to any holding period required to qualify as net capital gains under section 1222 (11) of the Internal Revenue Code.

*Does income reported as ordinary income after the sale of depreciated property qualify for the exclusion?*

No. Taxpayers can only subtract income which qualifies under Internal Revenue Code Section 1222 (11) as net capital gain. The qualifying gains receiving capital treatment are only federal net capital gains earned from Colorado property.

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FYIs provide general information concerning a variety of Colorado tax topics in simple and straightforward language. Although the FYIs represent a good faith effort to provide accurate and complete tax information, the information is not binding on the Colorado Department of Revenue, nor does it replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having the authority to bind the Department, has not formally reviewed and/or approved these FYIs.