1955

0009-2b Colorado Tax Structure: The Income Tax: Selected Problems Part II

Colorado Legislative Council

STATE OF COLORADO
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LEGISLATIVE COUNCIL

REPORT TO THE

COLORADO GENERAL ASSEMBLY

COLORADO TAX STRUCTURE

THE INCOME TAX

SELECTED PROBLEMS

PART II

RESEARCH PUBLICATION NO. 9-2

1955

LEGISLATIVE COUNCIL

OF THE

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The Legislative Council, which is composed of five Senators, six Representatives, and the presiding officers of the two houses, serves as a continuing research agency for the legislature through the maintenance of a trained staff. Between sessions, research activities are concentrated on the study of relatively broad problems formally proposed by legislators, and the publication and distribution of factual reports to aid in their solution. During the sessions, the emphasis is on supplying legislators on individual request with personal memoranda providing them with information needed to handle their own legislative problems. Reports and memoranda both give pertinent data in form of facts, figures, arguments, and alternatives, without these involving definite recommendations for action. Fixing upon definite policies, however, is facilitated by the facts provided and the form in which they are presented.

LEGISLATIVE COUNCIL

REPORT TO THE

COLORADO GENERAL ASSEMBLY

COLORADO INCOME TAX

SELECTED PROBLEMS

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Colorado, Legislative Council,

(Research Publication) No. 9-2

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FOREWORD

This study of selected state income tax problems was undertaken by the Legislative Council under the terms of House Joint Resolution No. 20 (Wade and Markley), passed at the First Regular Session of the 40th General Assembly. This resolution directed the Council to

> "(a) present a reasonable number of alternative schedules of statutory income tax rates which would produce, with consideration for various exemption and deduction provisions, approximately the same gross revenue to the state government as was produced by income tax rates in effect during 1954 and 1955 and which statutory rates would be reasonably competitive with other western states; and (b)present and discuss the feasibility of possibilities for simplifying the state income tax laws by relating them to federal income tax laws and returns, with specific reference to producing for the state government approximately the same gross revenue as was produced in 1954 and 1955."

The Legislative Council, at its regular quarterly meeting on April 22, 1955, appointed a committee to conduct the study, consisting of:

Senators	Representatives
Ray B. Danks, Chairman	David J. Clarke
Sam T. Taylor	Blanche Cowperthwaite
Ernest Weinland	Ferd S. Markley
	Oakley Wade

Harry S. Allen, Senior Research Analyst of the Legislative Council, was assigned the primary responsibility for the conduct of the staff work for this study.

At its initial meeting, the committee reviewed the exhaustive historical and comparative analysis of the Colorado Income Tax (Research Publication No. 9), which Dr. Earl Crockett completed for the Council in 1954. The committee then determined that its studies would deal first with the problem of simplification of the income tax return preparation by providing a tie-in with the Federal Internal Revenue Code, and then, following completion of this part of the study, the rate schedules and exemptions would be examined. To-date, the study has been limited principally to an intensive review of the problems relating to the tie-in with the federal income tax provisions. Therefore, it is suggested that the General Assembly direct the committee to continue its studies on Colorado income taxation and report on the matter of possible rate revisions to the 1957 session of the General Assembly.

The committee conducted a series of hearings on the subject of the survey. Among those who testified were Mr. William B. Paul, Chairman of the Taxation Committee of the Colorado Society of Certified Public Accountants; Mr. John F. Healy, Jr., Deputy Director, Colorado Department of Revenue; Professor Jerome Kesselmann, Accounting Department, University of Denver; Mr. R.E.Olson and Mr. Robert Lattimore, of the accounting firm of Ernst and Ernst. The committee also wishes to acknowledge the assistance of Professor Al Menard of the University of Colorado Law School in preparing a legal analysis of the constitutional problems involved in correlating the federal and state income tax laws and Attorney General Duke Dunbar for his cooperation and legal opinions. The invaluable assistance of these men is gratefully acknowledged. Much of the detail in this report could not have been presented without their help.

The study is presented in two parts. Part I is for general distribution and consists of a non-technical summary of the research material. Part II, copies of which are available upon request for those who wish to study the question more intensively, contains the detailed and technical analysis of the problems. The material is handled in "topic form", rather than as a narrative text. Each topic is a self-contained presentation of the facts relating to that particular subject. The topics are:

The Surtax
The Withholding Provision
Comparison of the Colorado Income Tax Law with the Federal Income Tax Law.
Constitutional Problems Involved in Basing the Colorado Income Tax Law on the Federal Income Tax Statute and Returns
Optional Filing of Income Tax Based on Federal Net Taxable Income

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While cases from other jurisdictions have upheld the adoption of the federal Revenue Code by reference, in none of these cases were the same constitutional hurdles present as exist in Colorado. 16

TOPIC V - TIEING-IN THE COLORADO AND FEDERAL INCOME TAX LAW ON AN OPTIONAL BASIS

In an opinion to the study committee, the Attorney General has ruled that an optional system of tieing-in the state and federal income tax laws would probably be valid in the state. 1

Under an optional filing system, the taxpayer would report as his "net income" to the state the same figure as shown on his return to the federal government. This would eliminate having to make two separate sets of tax calculations. 4

Adjustments to "net income" may be allowed as state policy dictates when an optional filing system is used. 5

It is possible to adopt a tax table to be used with optional filing, which would aliminate all tax computations on the part of the taxpayer and would allow for all special considerations in the Colorado law, with the exception of the surtax. 7

A system of optional filing seems to offer a reasonable method of simplifying the Colorado personal income tax, and it is therefore suggested that the General Assembly give serious consideration to this plan. 8

TOPIC I

THE SURTAX

The committee investigated the surtax on income received from intangibles as one possible simplification of the Colorado Income Tax. This tax was discussed from a historical standpoint in the 1954 Legislative Council study of income tax (Research Publication 9), and that study noted that further investigation should be made into the surtax. Accordingly an intensive statistical study was made of the tax to determine its impact on various income brackets, the effect on each adjusted gross income bracket of eliminating the surtax, and the extent to which the tax worked a hardship on small taxpayers whose income is mostly derived from surtaxable sources. The committee concluded on the basis of the staff analysis of this matter that: (1) the surtax should remain unchanged, (2) the surtax offers a better method of taxing intangibles than an ad-valorem tax.

A further question on the surtax centered on the ability of partnerships having surtaxable income to deduct their business expenses prior to distributing the income to each of the partners, whereas an individual having surtaxable income must pay the surtax on the gross income prior to business deductions. This is true even though the entire business may involve income from surtaxable sources. In discussing this problem, the committee determined that this is a legal question which has been reviewed by the Colorado courts, and it has been determined repeatedly that the partnership laws, which allow the deduction of all business expenses prior to the distribution of the income among the partners take precedence over the surtax law which require the surtax to be calculated on the gross surtaxable income.

On the following pages is the detailed statistical analysis of surtax returns in Colorado.

Purpose of Analysis

This study was made to arrive at a distribution of surtax payers by adjusted gross income brackets, and to provide a basis for more accurately calculating the effects on income tax revenue of changing the level of surtax exemptions. Statistical data available in the Department of Revenue provided only estimates of the total number of surtax returns and total surtax collections for 1953 based on actual 1952 returns; these surtax figures were not, however, distributed according to the adjusted gross income brackets. This survey marks the first effort to accurately tabulate surtax data by income groupings. On the basis of the data in this survey it is possible to estimate the number of surtax returns within each adjusted gross income bracket as well as the amount of surtax paid within each of these groupings. There are also data on the number of persons whose entire adjusted gross income is subject to the surtax, and the number of taxpayers who would be completely exempted from the tax by changes in the exemptions.

Method of Making Study

The estimates used in the study are based on a stratified random sampling of current individual full-pay taxable income tax returns filed in 1954 on 1953 income. This statistical sampling was made by the Council staff on proper authorization.

These were the latest returns which were available for the survey, since at the time the data were accumulated (June, 1955), the returns, filed in 1955, were still in the active processing channels. The part-pay returns and the delinquents for current and prior years were excluded from the sample.

In order to properly understand the sampling methods used, it is necessary to explain the procedure followed by the Revenue Department in processing income tax returns. As returns are received by the Department, the payments are detached therefrom and an initial audit of the returns is made for mathematical accuracy. After this procedure, the returns are separated into two categories, the full-pays and the part-pays. Next, each of these types of returns is separated into two major income divisions: adjusted gross income of $8,000 or less, and adjusted gross income of $8,000 and over. Next, the returns are numbered serially without reference to geographical distribution and filed into batches of one-hundred for future reference.

Only the full-pay returns were sampled since the part-pays had been sent to the filing department, where each return is filed in alphabetical order as a separate account for active processing. It was therefore not possible to sample those returns without going through the entire file of individual accounts. The full-pay returns which were sampled constituted about 95 percent of the total number of returns, though not 95 percent of the total dollars of tax paid.

Sampling Techniques

Consultation with the statistician of the Revenue Department indicated that, in order to arrive at a valid set of conclusions, the sample should comprise two percent of the returns with adjusted gross income under $8,000 and approximately 12.5 per cent of all returns over $8,000 adjusted gross income. The larger proportion of returns sampled in the over $8,000 income classes was suggested because it was felt that surtax payments predominated in these classes (a contention which was amply borne out by the study and also by the fact that the over-$8,000 adjusted gross income returns made up only seven per cent of the total number of 326,563 current returns and therefore, a larger sampling in the higher brackets was required for statistical purposes.

For the random selection a starting batch file number on incomes under $8,000 was selected. Also 10 batches of 100 returns each, paid in person by the taxpayer at the cashier's window at the Revenue Department, were chosen without systematic selection. For returns on income over $8,000 the same procedure was used, except that every fourth batch was used in the sample. A total of 6,000 individual returns on income under $8,000 were sampled and 3,000 on incomes over $8,000.

As the returns were sampled, the pertinent information on each surtax return was noted for future tabulation and interpretation. Each batch was recorded separately in order to determine whether or not there was uniformity of data between groups of returns. The fact that each batch of 100 returns produced quite similar statistical data indicates that the sample has a good degree of statistical reliability and that the interpretation and expansion made from the sample may be used with a reasonable degree of confidence.

Expanding the Sample

In order to apply the study to specific figures, the sample results had to be expanded in terms of actual surtax dollars collected and returns filed. The control figure used was the Revenue Department's estimate of $1,120,896 in surtax collections for 1954 (on 1953 income) and 18,526 returns.

The first step in expanding the sample data was to multiply both the dollars collected and the number of returns in each adjested gross income bracket under $8,000 by a factor of 50(based upon 2% sampling procedure). For example, in the sample study there were six surtax returns in the under $1,000 adjusted gross income bracket. This number was multiplied by 50 to give an estimated 300 returns in this bracket. For incomes over $8,000 the sample data were multiplied by a factor of 8(based upon a 12.5 percent sampling procedure). These expanded figures for each adjusted gross income bracket.were totaled but were short of the control figures in both the number of returns and the dollars collected, because the part-pays, which are generally large returns and usually have surtax payments, and delinquents were excluded from the sample. These differences were distributed to each adjusted gross income bracket on a percentage basis. For example, if on the basis of the first expansion of the sample data it was indicated that 37.1% of the surtax was paid in the over $25,000 income bracket, then 37.1% of the difference between the total collections based on the sample and actual collections were distributed to this category.

In other words, the sample data was first expanded by the relative size of the sample to the total number of returns. It was then expanded on a percentage basis by distributing the difference in totals to each income bracket . This distribution is presented in Table I.

Results of the Study

It is possible to draw the following conclusions from the study:

1. The surtax, as a revenue producer, is relatively minor on adjusted gross incomes under $8,000. Table I indicates that all brackets under $8,000 account for approximately 20% of the total surtax collected. It is interesting to note that the $7,000-$8,000 bracket pays the lowest proportion of surtax of any adjusted gross income bracket except the under $1,000 class.
2. Approximately 5.9% of all Colorado income tax returns pay a surtax, but this average varies widely as between adjusted gross income brackets. For example, the smallest proportion of income tax returns with surtax is in the $3,000-$4,000 bracket (1.9%), while the highest percentage of returns with surtax is found in the $20,000-$25,000 bracket where approximately 81% of all returns have a surtax. The average surtax payment for all income brackets is $60.46, but the average payment in each bracket ranges from a low of $2.15 in the under $1,000 bracket to $302.37 in the over $25,000 bracket.
3. More than half, 55.4%, of the surtax is collected on adjusted gross incomes of $15,000 or more.
4. The number of persons whose entire income is surtaxable is extremely small. The largest percentages are found in the under $1,000 bracket where 3.0% of all income tax returns are on incomes which are entirely surtaxable, and in the $20,000 to $25,000 bracket where 4.0% of all income tax returns are

on income which is entirely surtaxable. These percentages increase when calculated only on the surtax returns themselves. In other words, in the under $1,000 income bracket, there were 442 surtax returns out of 8,163 income tax returns. Of the 442 returns with surtax, 250 or 56.5%, had no income except that which was surtaxable. However, in the $20,000 to $25,000 bracket 4.9% of the surtax returns were on incomes which were entirely subject to surtax as contrasted to 4.0% of all tax returns in this bracket.

5. Increasing the surtax exemption from its present $600 figure to $1,000 would result in an estimated minimum revenue loss of $148,000. This is calculated on the number of surtax returns in each income bracket multiplied by $8.00, which would be the amount of actual tax reduction resulting from a $400 increase in exemption. This figure is given as the minimum, since it is not known how many taxpayers are entitled to a double deduction on the basis of husband and wife owning securities in joint tenancy. Percentage-wise an increase in deductions to $1,000 would eliminate the surtax in the under $1,000 bracket, and virtually eliminate it in the $1,000 to $2,000 and the $7,000 to $8,000 adjusted gross income brackets. These conclusions are based on the estimated number of taxpayers in each adjusted gross income bracket whose surtaxable income was $1,000 or less.

6. Even though the average surtax payment, as well as the amount of surtaxable income, generally increases as the adjusted gross income increases, this is not uniformly true. Some cases were found where persons in the lower adjusted gross

income brackets had larger surtax payments than those in the higher brackets. This would seem to indicate that the principal justification of the surtax is as an ad-valorem levy rather than as a tax based on ability to pay.

7. As a general observation, and one which was not proven statistically, it seemed obvious that the instructions on computing the surtax should be clarified. The fact that a taxpayer who owns securities or interest-bearing notes jointly with his spouse is entitled to a $1,200 deduction instead of a $600 deduction is probably not fully understood. If it were, the chances are that a far greater number of surtax returns would claim the $1,200 deduction. Virtually none of the returns in the lower brackets, which by and large were prepared by the taxpayers themselves rather than accountants, took a $1,200 deduction.

The principal statistical data in the study are summarized on Tables I through IV which follow on pages 9 through 12.

TABLE I

DISTRIBUTION OF SURTAX COLLECTIONS
BY ADJUSTED GROSS INCOME BRACKET

Gross Income Bracket 000 omitted	(1) Total Dollars in Sample	(2) Estimated Dollars Expanded on Size of Sample	(3) % of Total	(4) Distrib. of Unaccounted Surtax	(5) Estimated Total Surtax	(6) % of Total
Under 1	$ 19	$ 950	%	$	$ 950	%
1- 2	205	10,250	1.4	5,473	15,723	1.4
2- 3	391	19,550	2.7	10,556	30,106	2.7
3- 4	429	21,450	2.9	11,338	32,788	2.9
4- 5	539	26,950	3.7	14,465	41,415	3.7
5- 6	592	29,600	4.0	15,638	45,238	4.0
6- 7	705	35,250	4.8	18,766	54,016	4.8
7- 8	97	4,850	.7	2,737	7,587	.7
8- 9	4,849	38,792	5.3	20,720	59,512	5.3
9-10	3,787	30,296	4.1	16,030	46,326	4.1
10-11	3,198	25,584	3.5	13,683	39,267	3.5
11-12	2,648	21,184	2.9	11,338	32,522	2.9
12-13	2,559	20,472	2.8	10,947	31,419	2.8
13-14	3,031	24,248	3.3	12,902	37,150	3.3
14-15	2,274	18,192	2.5	9,774	27,966	2.5
15-16	2,774	22,192	3.1	12,119	34,311	3.1
16-20	6,532	52,256	7.2	28,148	80,404	7.2
20-25	7,672	58,376	8.0	31,276	89,652	8.0
Over 25	33,813	270,504	37.1	144,040	414,544	37.1
TOTAL	$76,114	$730,946	100.0%	$389,950	$1,120,896	100.0%

Col. (1) This is the actual dollars by adjusted gross income bracket as tabulated from a sample of 2% of income tax returns under $8,000 and 12.5% of income tax returns over $8,000.

Col. (2) The expanded total is derived by multiplying the dollars in the sample by 50 for brackets under $8,000 and by 8 in brackets over $8,000.

Col. (3) This is the total of Col. (2) divided into each component of Col.(2).

Col. (4) The total of Col. (3) is $389,950 less than the estimated surtax collections of $1,120,896 for 1953. This difference has been allocated to each gross income bracket according to the percentage in Col.(3).

Col. (5) The estimated total surtax collections in each gross income bracket for 1953.

Col. (6) The percentage of total surtax paid in each income bracket.

Source: All compilations were made on the basis of Legislative Council sampling of 1953 income tax returns, except the estimates of total surtax collections and total surtaxable returns, which were made by the Department of Revenue.

TABLE II

DISTRIBUTION OF SURTAX RETURNS BY ADJUSTED GROSS INCOME BRACKETS

Adjusted Gross Income Bracket	Total 1953 State Income Tax Returns	Estimated Number of Surtax Returns	Percentage of Income Tax Returns with Surtax	Estimated Total Surtax Payments	Estimated Average Surtax Payment
Under $1,000	$ 8,163	442	5.4%	$ 950	$ 2.15
1,000- 2,000	36,889	1539	4.2	15,723	10.22
2,000- 3,000	66.626	1613	2.4	30,106	18.66
3,000- 4,000	74,428	1392	1.9	32,788	23.55
4,000- 5,000	54,166	1687	3.1	41,415	24.54
5,000- 6,000	27,312	1539	5.6	45,238	29.39
6,000- 7,000	15,686	1177	7.5	54,016	45.89
7,000- 8,000	9,274	589	6.4	7,587	12.88
8,000- 9,000	6,071	1256	20.9	59,512	47.38
9,000-10,000	3,815	1043	27.3	46,326	44.42
10,000-11,000	2,696	704	26.1	39,267	55.78
11,000-12,000	1,776	654	36.8	32,522	49.73
12,000-13,000	1,447	460	31.8	31,419	68.30
13,000-14,000	1,052	468	44.5	37,150	79.38
14,000-15,000	942	402	42.7	27,966	69.57
15,000-20,000	2,796	1372	49.1	114,715	83.61
20,000-25,000	1,010	818	81.0	89,652	109.60
Over $25,000	2,267	1371	60.2	414,544	302.37
TOTAL	$316,146	18,526	5.86%	$1,120,896	$ 60.46

Source: Compiled from Sampling of Income Tax Returns by the Legislative Council.

TABLE III

ESTIMATED DISTRIBUTION OF TAXPAYERS WHOSE ENTIRE GROSS INCOME IS SUBJECT TO SURTAX

Adjusted Gross Income Bracket (1)	Total Tax Returns (2)	Estimated Total Surtax Returns (3)	Estimated Number of Incomes 100% Surtaxable (4)	Percentage Col. 4 of Col. 3 (5)	Percentage Col. 4 of Col. 2 (6)
Under $1,000	8,163	442	250	56.5	3.0
1,000- 2,000	36,889	1,539	450	29.2	1.2
2,000- 3,000	66,626	1,613	400	24.8	.6
3,000- 4,000	74,428	1,392	300	21.6	.4
4,000- 5,000	54,166	1,687	100	5.9	.18
5,000- 6,000	27,312	1,539	100	6.5	.37
6,000- 7,000	15,686	1,177	100	8.5	.64
7,000- 8,000	9,274	589	-[a]	-[a]	-[a]
8,000- 9,000	6,071	1,256	96	7.6	1.6
9,000-10,000	3,815	1,043	40	3.8	1.0
10,000-11,000	2,696	704	24	3.4	.9
11,000-12,000	1,776	654	32	4.9	1.8
12,000-13,000	1,447	460	24	5.2	1.7
13,000-14,000	1,052	468	24	5.1	2.3
14,000-15,000	942	402	24	6.0	2.5
15,000-20,000	2,796	1,372	64	4.7	2.3
20,000-25,000	1,010	818	40	4.9	4.0
Over $25,000	2,267	1,371	64	4.7	2.8
	316,146	18,526	2,132	11.5	.67

(a) Less than .5%.

TABLE IV

ESTIMATED LOSS OF REVENUE
FROM RAISING SURTAX EXEMPTIONS FROM $600 TO $1,000

Adjusted Gross Income Bracket	Estimated Number of Surtax Returns	Estimated Surtax Paid in 1953	Estimated Loss	Percentage of Loss
Under $1,000	442	$ 950	$ 950	100.0%
1,000- 2,000	1,539	15,723	12,312	78.3
2,000- 3,000	1,613	30,106	12,904	42.9
3,000- 4,000	1,392	32,788	11,136	33.9
4,000- 5,000	1,687	41,415	13,496	32.6
5,000- 6,000	1,539	45,238	12,312	27.2
6,000- 7,000	1,177	54,016	9,416	17.4
7,000- 8,000	589	7,857	4,712	60.0
8,000- 9,000	1,256	59,512	10,048	16.9
9,000-10,000	1,043	46,326	8,344	18.0
10,000-11,000	704	39,267	5,632	14.3
11,000-12,000	654	32,522	5,232	16.1
12,000-13,000	460	31,419	3,680	11.7
13,000-14,000	468	37,150	3,744	10.1
14,000-15,000	402	27,966	3,216	11.5
15,000-20,000	1,372	114,715	10,976	9.6
20,000-25,000	818	89,652	6,544	7.3
Over $25,000	1,371	414,544	10,968	2.6
	18,526	$1,120,896	$148,208	13.2%

TOPIC II

THE WITHHOLDING PROVISION

The committee considered whether or not the withholding provisions in the Colorado income tax law had contributed sufficiently to increased revenue to offset the cost of its administration and whether or not withholding should be extended to income other than salaries and wages.

Withholding Tax Revenue and Administration Cost

The evidence indicates that the withholding provision of the Colorado law has been effective in increasing the amount of income tax revenue, and has proven inexpensive to administer. For fiscal year 1955, the first full year of the withholding law operation, approximately $1,300,000 in additional revenue was attributed to the withholding tax, excluding refunds.(1) Cost of administering the tax during the year was $53,495.(1), distributed as follows:

Salaries	$34,017
Capital equipment	1,314
IBM rentals	7,249
Supplies	4,225
Postage	6,690

Approximately 455,000 Colorado taxpayers were subject to the withholding law, and the Department of Revenue maintained, in addition, some 31,000 employer accounts. Since the employers are required to file quarterly, there were approximately 102,000(2) employer returns processed.

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(1) Source: Department of Revenue.

(2) Figure for three quarters of 1955 fiscal year only, since employers have one month after close of fiscal year to file final quarter's return.

Refunds to taxpayers were made in 68,713 cases and a total of $277,231 in overpayments was refunded. The average refund was $4.03. In addition ot the refunds actually paid, there were another 11,545 cases in which the refund due was $1.00 or less and which under the statute was not made by the Department of Revenue(3). The cost of processing refunds was $.05 per refund check written.

The principal problem in withholding appeared to be whether or not 4% of the federal income tax is the proper amount which should be withheld. In reply to a question, Mr. John F. Healy, Jr., Deputy Director of the Department of Revenue testified as follows:

> "Of the persons subject to the withholding tax, the larger number do not have sufficient tax withheld, which would indicate that, if anything, the percentage of federal income tax now being withheld should be increased. The Revenue Department can process overpayments for less than it can process additional collections, but we have no strong feelings about the matter either way. If, however, the General Assembly makes any changes in the amount witheld, 5% of the federal income tax might be a proper figure."

Extension of Withholding to Income Other than Salaries and Wages

The committee considered the desirability of extending the withholding provisions to incomes other than salaries and wages. In testifying on this point, Mr. Healy indicated that, in his judgment, little would be gained from such a program since there is no evidence that income taxes were being avoided by those groups not included in the withholding provisions. He also indicated that to administer the withholding on incomes other than salaries and wages would present a number of problems which, under the present provisions, do not exist.

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(3) Session Laws of Colorado, Second Extraordinary Session, 1954, Chapter 4, Article 10.

On the basis of Mr. Healy's discussion, the committee felt that no extension of the withholding act should be recommended without substantial, additional study.

TOPIC III

COMPARISON OF THE COLORADO INCOME TAX WITH THE FEDERAL INCOME TAX

There are numerous and substantial differences between the Colorado and federal income taxes. These differences, discounting differences in rates, may roughly be grouped into thirteen categories as follows:

1. Imposition of Tax
2. Definition of Gross Income
3. Definition of Adjusted Gross Income
4. Exclusions from Gross Income
5. Deductions
6. Deductions not allowed, as distinguished from different methods of handling the same deductions as in 5 above.
7. Exemptions
8. Accounting methods
9. Non-capital gains or losses
10. Estates and Trusts
11. Partnerships
12, Capital Gains and Losses
13. Split Income Filing

There are approximately ninety-four seperate items which are handled differently under the state and federal income tax statutes. These difference have led to a number of suggestions that there be a correlation between the state and federal income tax laws. These suggestions will be discussed under Topics IV and V.

The summary of the specific differences between the state and federal income tax laws, as contained in this topic, was prepared, at the committee's request, by the staff of the Colorado State Revenue Department, under the supervision of Mr. John F. Healy, Deputy Director.

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DIFFERENCES EXISTING BETWEEN THE STATE OF COLORADO INCOME TAX REGULATIONS AND THE 1954 FEDERAL INTERNAL REVENUE CODE

	Federal	State
HEAD OF HOUSEHOLD	Sec. 1(b). Special rate of tax made applicable to an individual maintaining a home as a household for qualified dependents or exemptions.	No provision for.
SPLITTING OF INCOME (JOINT RETURN)	Sec. 2(a). Taxable income on a joint return that is reduced by one-half for purpose of computing tax. Tax on the one-half is multiplied by two in determining the tax payable. (Results in tax benefits allowable to a husband and wife on a joint return with limitations.)	No provision for.
SURTAX	Sec. 11(c). A rate applied (present rate 22%) on the taxable income (computed without regard to the deduction, if any, for partially tax-exempt interest) which exceeds $25,000.00.	Sec. 2(a)(2). A 2% rate applied to income received from interest and dividends directly, or such income received through an estate, trust or partnership. An exemption of $600.00 being allowed per individual taxpayer to reduce this taxable income.
TAXABILITY OF PARTNERSHIPS AND PROPRIETORSHIPS (UNINCORPORATED BUSINESSES)	Sec. 1361. Certain proprietorships and partnerships permitted to elect to be taxed as corporations applicable only under certain qualifications and limitations.	Sec. 2(d). Partnerships are not taxable. The partners are taxed as individuals on their share of partnership income, capital gain or losses.
GROSS INCOME ALIMONY AND SEPARATE MAINTENANCE PAYMENTS	Sec. 71. Amounts received periodic by a divorced or legally separated wife must be included in her gross income. 1954 Code provisions extended to include payments received under written separation agreements, also, to the inclusion of support payments under any court decree. Payor is allowed benefit of deduction.	No provision for alimony payment reportable as income or claimed as a deduction. Art. 4(b)(3) - Sec. 6(a)(1).
ANNUITIES AND INSURANCE CONTRACTS	Sec. 72. (1) New Method and Rules permits recovery of cost (investment in the contract) based on the annuitant's life expectancy from the starting date of the annuity. 3% annuity rule abandoned. Sec. 72(b) and (e).	Art. 4(a)-11 - Sec. 4(b)(2). Each year's annuity payments are taxed up to 3% of the annuity's cost until cost is recovered tax free.

	Federal	State
	(2) Where lump sum payment is made of the proceeds of a life insurance, endowment, or annuity contract, (paid for reasons other than death) the tax on the portion to be included in gross income is to be computed as though received ratably over the taxable year and the two preceding years. Sec. 72(e)-(3).	
	(3) Where amounts payable under an employee's annuity in the first three years will equal, or exceed, his cost for the annuity, the employee or his beneficiary is to exclude all annuity payments until he has recovered his capital tax free. Sec. 72(d).	
	(4) If an insured under an option in an endowment or other life insurance contract elects within 60 days after the maturity of the policy to take the proceeds as an annuity instead of a lump sum, the constructive receipt doctrine will not apply. Sec. 72(h).	
	These annuity provisions do not apply to proceeds of life insurance, endowment, or annuity policies paid in lieu of alimony.	
ADJUSTED GROSS INCOME	Sec. 62.	Sec. 4(a)
EMPLOYEES' LOCAL TRANSPORTATION EXPENSES	Sec. 62(2)(C). An employee is permitted to deduct all his business transportation expenses and also take the Standard deduction. Business transportation include fares and automobile expenses including depreciation and cost of gas and oil while not traveling away from home, excluding commuting expenses, meals and lodging.	Sec. 4(a)(1)(b)(c) and (g). No provision allowing employee to deduct unreimbursed expenses, other than the cost of travel, meals and lodging while away from home, from gross income in arriving at adjusted gross income. Commuting expense allowed.

	Federal	State
BUSINESS EXPENSES OF OUTSIDE SALESMEN	Sec. 62(2)(D). Outside salesmen, under 1954 Code, who are employees are allowed to deduct from gross income expenses of soliciting business for their employer, away from the employer's place of business, whether or not reimbursed.	Sec. 4(a)(1)(b)&(c). An "outside salesman" who is an employee, deducts expenses connected with his employment in computing adjusted gross income only if the expenses were reimbursed or if they are "travel expenses".
EXCLUSIONS FROM GROSS INCOME CERTAIN DEATH BENEFITS --- LIFE INSURANCE	Sec. 101(a) and (d). New law taxes the after-death interest element that is included in the fixed installments paid in conjunction with a life insurance contract. But where the beneficiary is the surviving spouse of the insured, the interest element up to $1,000.00 a year is not taxable income.	Sec 4 (b)(1) No limitation on exclusion of interest element on fixed installments.
EMPLOYEE DEATH BENEFITS	Sec. 101(b) Exclusion from gross income of up to $5000.00 of death benefits paid by or on behalf of an employer by reason of death of an employee. Exclusion liberalized under 1954 code--(1) the payment does not have to be made under a contract of the employer. (2) A payment to an employee's beneficiary from a qualified pension or profit sharing plan qualifies even though the deceased employee had a non-forfeitable right to the amount - provided the payment is made by the reason of the employee's death and within one taxable year of the beneficiary. (3) the exclusion not applicable to an employee's joint and survivors annuity, if the employee died after the due date of the first payment.	No provision for, except that life insurance proceeds paid by reason of death are non-taxable.
RENTAL VALUE OF PARSONAGES	Sec. 107 Exclusion extended to rental allowances if used to rent or provide a home.	Art 6(A)(5) Sec 4 (b)(5) - Rental value of dwelling and appurtenances furnished excluded only.
SOCIAL SECURITY BENEFITS AND UNEMPLOYMENT COMPENSATION	(Social Security Act - Sec.202). Social Security benefit payments, primary or secondary -- non-taxable.	Art. 4(a)(16) Primary benefit payment are taxable.

	Federal	State
INCOME FROM DISCHARGE OF INDEBTEDNESS	Sec.108 & 1017: A corporation realizes no income if it consents to an adjustment of basis for its property, whether or not the debt is evidenced by a security. An individual may exclude such income if cancelled indebtedness was incurred or assumed in connection with property used in his trade or business.	Art. 2(b)-2; 4(a)-13 Cancellation of indebtedness in consideration of the performance of services generally results in income by the debtor. Mere gratuitous forgiveness of a debt does not result in realization of income by debtor or creditor.
EMPLOYEE HEALTH AND ACCIDENT BENEFITS	Sec 105: The 1954 law give uniformity of treatment to payments under insured or self-insured plans, funded or non-funded, financed by the employer. Generally, amounts received by employees as reimbursements for medical care, payments for permanent injury or loss of bodily function, and wages or payments in lieu of wages during a period of injury or illness under an employer-financed accident and health plan are excludable from gross income. In the case of wages or payments in lieu of wages during a period of injury or illness, the exclusion is limited to a maximum of $100.00 per week. Employers' contribution to an accident or health plan, or for an individual policy, does not constitute taxable income to the employee -- Sec. 106.	Sec 4(b)(4) Amounts received through accident and health plans as compensation or re-imbursement expense is excludable. No limitation as to the amount of compensation in lieu of wages.
INCOME TAXES PAID BY LESSEE CORPORATION	Sec. 110-(New) Payments of corporate lessor's income taxes (arising out of rentals) by the corporate lessee under a pre - 1954 lease is excludable by the lessors, but not deductible by lessee.	No provision for.
ARMED SERVICES COMPENSATION	Sec. 112 and 692-- Combat pay to members of armed forces excluded up to $200.00 a month. Specific termination date removed for income tax exclusions and forgiveness provisions are tied to draft law.	Sec 4(b)(8) Service pay excluded up to $2,000.00 in a taxable year effective after 12/31/50 till termination of state of war.

	Federal	State
CERTAIN SPORTS PROGRAMS	Sec. 114 - Proceeds received from a sports program for the benefit of the American National Red Cross excludable from gross income.	No provision for such an exclusion.
DIVIDENDS ~~RECEIVED BY INDIVIDUALS~~ exclusion	Sec 116 — The first $50.00 of dividends received by an individual is excluded from income. On a joint return, the exclusion may be $100.00. The exclusions extends to trusts or estates to the extent that the dividends are not allocable to beneficiary.	No exemption or exclusion from gross income allowable
DIVIDENDS RECEIVED CREDIT	Sec 34 Dividends received after July 31, 1954 a credit against tax is allowed. The credit is 4% of such dividends but not exceeding 4% of taxable income. (2% taxable income limitation for years ending before 1955) The dividend exclusion and credit not applicable on dividends from (1) tax-exempt cooperatives or other tax-exempt corporation, (2) certain insurance companies, (3) foreign corporations, (4) mutual savings banks, (5) cooperative banks and (6) building and loan associations.	No provision for a dividends received credit
RETIREMENT INCOME	Sec. 37 Technically, this section is a 20% credit against tax, but its effect is to allow an exclusion of $1,200.00 of retirement income at the bottom tax bracket. The credit is available only to persons age 65 and older, but individuals under 65 who have retired under a public retirement system (other than for the U. S. Armed Forces) can qualify. Credit is available only to those who had received earned income of more than $600.00 in each of any 10 calendar years.	No provision for retirement income credit.

	Federal	State
SCHOLARSHIPS AND FELLOWSHIPS	Sec. 117 In general, a scholarship or fellowship is not taxable where the payment represents compensation for teaching, research or other services. If the student or fellow is not a candidate for a degree, any such aid (other than certain expenses) is taxable to the extent it exceeds $300.00 a month and is fully taxable after 36 months (whether or not consecutive). In the case of non-candidates for degrees, the exclusion is allowed only if the grant is from government or a tax-exempt organization.	No provision for in regulations

	Federal	State
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	Federal	State
MEALS AND LODGING FURNISHED TO EMPLOYEES	Sec. 119. Excludable if furnished at the place of employment and for convenience of the employer. In the case of lodging, there is the further requirement that the employee is required to accept as a condition of his employment. (Cash allowance for meals and lodging is income.)	Art. 4(a) - 3. Lodging is income if intended as compensation, i.e., where the value is taken into account in fixing the employee's cash pay. (This fact is immaterial under the new federal law.)
STATUTORY SUBSISTENCE ALLOWANCE	Sec. 120. New provision excludes the statutory subsistence allowances received by policemen. Exclusion limited to $5.00 per day.	No such provision under State regulations.
DEDUCTIONS TRADE OR BUSINESS EXPENSES OF CONGRESSMEN	Sec. 162 (a) (3). Incorporates deduction for Congressmen's traveling expense. Such living expense deduction not to exceed $3,000.	No provision for such.
INTEREST AND CARRYING CHARGES	Sec. 163. Carrying charges will be deductible as interest where an installment sales contract states the carrying charge separately but does not state what amount represents interest. The portion deductible is up to 6% of the average unpaid monthly balances during the tax year.	Sec. 5(b) Carrying charges not an allowable deduction. (138-1-12)
TAXES	Sec. 164. Taxes generally deductible when paid or accrued when imposed, except federal income, excess profits, estate, gift, social security and local benefit taxes. Federal import duties, excise and stamp taxes non-deductible except as trade or business expense, or in the case of an individual as expenses for the production of income.	138-1-12 Sec 5(c). Generally, taxes are deductible only by the person upon whom they are imposed and paid, including federal excise taxes. Federal import, tariffs, stamp taxes, duties are deductible as taxes or included as part of merchandise cost.
APPORTIONMENT OF REAL PROPERTY TAXES	Sec 164(d). New provision allows apportionment of real property taxes between buyer and seller in proportion to the number of days of the property tax year that each held the property.	The purchaser of real estate can not deduct any part of the real property tax which had been a lien or the personal liability of the seller prior to sale.

	Federal	State
ACCURAL OF REAL ESTATE TAXES	Sec. 461. 1954 Code permits accural-basis taxpayers to accrue real property taxes ratably over the real estate tax taxable year.	Sec. 5(c). The tax is deemed to accrue at some definite moment which is determined by reference to state or local law fixing the time when the tax becomes a lien on the property or when personal liability for the tax arises or some other basis.
TAXES LEVIED BY SPECIAL TAXING DISTRICTS	Sec 164 (b) (5). 1954 provision permits a deduction of taxes levied by a special taxing district which covers the whole country to which at least 1,000 persons are subject, if the assessment is levied at a uniform rate on the same ratable values used for the general property tax.	Sec. 5(c). Taxes assessed for local benefits are deductible only to the extent that such taxes are allocable to maintenance or interest charges.
LOSSES	Sec. 165 (g). Losses on securities of affiliated corporations, if certain tests are met, worthless stocks or bonds are ordinary loss. New law relaxes the rule to the extent that the 90% gross income test has been changed to 90% of gross receipts. Sec. 165(e). Embezzlement and theft losses deductible in year of discovery.	138-1-12 Sec. 5(d). Deduction for losses must be taken in the taxable year in which losses are sustained.

	Federal	State
HOBBY LOSSES	Sec. 270 If an individual's deductions attributable to a trade or business exceed the gross income of the business by more than $50,000 a year for 5 consecutive years, then only $50,000 of such deductions for each year can be offset against his other income. Excluded from the rule are deductions for casualty and abandonment losses incurred in business, farmers' losses due to drought, and all expenses which a taxpayer can elect to deduct or to capitalize. A net operating loss deduction is not taken into account in figuring whether the 5 year, $50,000 test is net; but if such test is otherwise net, the net operating loss deduction attributable to such trade or business is disallowed as a deduction in recomputation of income for the 5 year period.	No such limitation provision.
BAD DEBTS	Sec. 166 Business bad debts are fully deductible; non-business bad debts are short-term capital losses. Under prior 1954 law, the character at time of worthlessness controlled -- now where a business bad debt becomes worthless at a time when the taxpayer is no longer carrying on a trade or business, the debt no longer becomes a non-business bad debt but remains a business bad debt. Payments by an individual guarantor, endorser, or indemnitor to discharge a business loan of a non-corporate obligor shall be treated as a debt becoming worthless if the right to collect from the principal debtor is worthless. To be treated as a business bad debt.	Sec. 5 (i) Business bad debts are deductible in full when determined to be worthless. Non-business bad debts are not treated as short-term capital losses, but are an allowable deduction, if the taxpayer itemizes.

	Federal	State
CHARITABLE CONTRIBUTIONS--INDIVIDUALS	Sec. 170 (b) (1) General rule; an individual taxpayer may deduct charitable contributions up to 20% of his adjusted gross income, computed without regard to any net operating loss carryback to the taxable year. The limit is 30%, if the additional 10% consists of contributions to a church, a tax-exempt educational organization, or an exempt hospital. Such charitable contribution must be paid to the organization and not just for the use of the organization. No charitable deduction will be allowed for a gift in trust if the grantor retains a reversionary interest in either the corpus or income, and at the time of transfer the value of such reversionary interest exceeds 5% of the value of such property. Non-profit cemetery and burial companies added to list of charitable organizations. Unlimited contribution allowed under certain tests.	Sec. 5 (m) 138-1-12 Deduction for contributions or gifts shall not exceed 15% of the net income computed without benefit of the deduction.
CORPORATE CONTRIBUTIONS	Sec. 170 (b) (2) New code provides that in determining taxable income for the purpose of the 5% limitation on the contribution deduction, corporation organizational expenses shall be taken into consideration. Taxable income shall be determined without regard to any net operating loss carry-back. Contributions in excess of the 5% limitation will be a carryover for 2 years. Contributions are now allowable to (1) organizations for the prevention of cruelty to animals, (2) Political subdivisions of U. S. Possessions, and (3) certain cemetery companies. No allowance for corporate contributions for veterans' rehabilitation.	Sec. 5 (m) 5% of net income computed without benefit of the deduction for contribution shall be allowable as a deduction for contributions.

	Federal	State
AMORTIZATION OF BOND PREMIUM	Sec. 171. For taxable bonds issued after January 22, 1951 and acquired after January 22, 1954, bond premium can be amortized only to a call date more than 3 years after issue. If the call date is earlier, amortization would have to be figured to maturity. If such a bond is actually called, an ordinary loss deduction for the unamortized premium can be taken. The requirement that the bond must have interest coupons or be in registered form has been eliminated.	Sec. 15(d) (1). No such specific provision. Bond premium may be amortized with reference to the amount payable on maturity or an earlier call date. Unamortized bond premium is treated as part of the cost of the bond for purposes of determining gain or loss on a capital asset basis.
NET OPERATING LOSS DEDUCTION	Sec. 172 (a), (b), and (g)(3). Net operating loss may be offset against net income of other years by means of a 2 year carryback and a 5 year carryforward, except for excess profits tax purposes. Sec. 172 (d). New code entitles all taxpayers to include losses from the sale of business assets in computing the net operating loss. Sec. 172(b). The carryback, carryover is no longer reduced by tax-exempt interest or the excess of percentage depletion over cost depletion. Non-business deductions may be taken into consideration only to the extent of non-business income..	Sec. 15(d)(2). No provision for carryback, but after 12-31-53, any net operating loss may be offset against net income in each of 4 succeeding years until absorbed.
RESEARCH AND EXPERIMENTAL EXPENDITURES	Sec. 174. Such expenditures incurred after 1953 can be expensed or captialized at the option of the taxpayer. Mine exploration expenditures or expenditures for acquisition or improvement of land or of depreciable or depletable property not included. Depletion and depreciation allowances may be treated as research and experimental expenditures. If expenditures are capitalized, they can be amortized over a period not less than 60 months or over the determinable useful life, starting with the month in which the tax-	Art. 6(a)(2). Such expenditures are to be capitalized.

(continued)

	payer first realizes benefits from the expenditures.	
SOIL AND WATER CONSERVATION EXPENDITURES	Sec. 175. 1954 code now permits all expenditures for soil or water conservation in respect of land used in farming, or for the prevention of erosion of land used in farming. Such deduction is limited to 25% of the gross income from farming in any year. The excess over 25% can be carried over and treated as the first expenditure in the next year. An election must be made to expense or capitalize after 1953, and no switch can be made later without permission.	Art. 5(a) - 7. Expenditures made by farmers to improve their land are generally required to be capitalized rather than deducted as current expenses.
EXPENSES FOR PRODUCTION OF INCOME	Sec. 212(3). New provision for deduction of legal fees for contesting estate, gift, property, and other taxes.	Art. 5(a) - 1. No provision for such allowance of costs although generally allowed.

	Federal	State
MEDICAL EXPENSES	Sec. 213 1954 law allows the deduction of medical, dental, etc., expenses which are in excess of 3% of adjusted gross income. The Limitation does not apply to the expenses of taxpayer and his wife if either is 65 or over. Maximum medical expense deduction per exemption claimed has been raised from $1,250 to $2,500 per exemption with a maximum of $5,000 on a single return and $10,000 on a joint return and for a head of household. The cost of drugs and medicine is included in medical expenses only to the extent it exceeds 1% of adjusted gross income. Cost of transportation (excluding cost of board and lodging) deductible if primarily for and essential to medical care. If medical expense for the care of a taxpayer are paid by his estate within one year after he dies, they are treated as having been paid by the decedent, when incurred.	Sec. 5 (p) Medical, dental, etc., expenses deductible which are in excess of 5% of adjusted gross. No deduction benefit for being the age of 65 or over. Maximum expense deduction per exemption $1,250; $2,500 maximum on a separate return; and $5000 maximum on a joint return. Decedent medical expenses, if paid by estate, deductible by estate.
CHILD CARE EXPENSES	Sec. 213 (f) and 214 A deduction for child care up to $600 is allowed under certain circumstances. Child must be under 12 years of age or a dependent who is mentally or physically handicapped. Amounts which are actually deducted as child care expenses cannot also be treated as medical expenses.	No provision for.
ALIMONY PAYMENTS	Sec. 215 In reference to section 71, payments made for alimony are deductible by husband.	No provision for alimony payments.
CORPORATE ORGANIZATION EXPENSE	Sec. 248 A corporation can under the 1954 code amortize organization expenses as tax deductions over a period of not less than 60 months, excluding expenses of issuing stock and expenses of corporate reorganization which must be capitalized or charged against paid-in capital accounts.	Art. 6 (a) (2) Expenses incurred on behalf of a corporation prior to the date of its charter and incident to its creation are not deductible.

EXEMPTIONS
PERSONAL

Sec. 151-154. Liberalized provision in 1954 code:

(1) A non-relative can now qualify as a dependent, if the principal place of abode during the taxable year is the taxpayer's home and support was rendered.

(2) The "income test" is suspended for a dependent under 19 years old, and as to a child or dependent who is a full-time student at an educational institution.

(3) Individuals who otherwise qualify may be claimed as dependents, if they are United States citizens, even though they are nonresidents.

(4) A scholarship for study will not count in determining whether the parent contributed more than half the child's support.

(5) Where several contribute more than half the support of a qualified person and none of them contribute more than 50%, they can agree to let any one of them take the dependency exemption, provided that 10% or more was contributed towards the support. Each other person who contributed more than 10% must file a written statement that he will not claim the dependency exemption.

(6) A cousin receiving institutional care by reason of physical or mental disability can qualify if he was a member of the taxpayers household before such care began.

Sec. 7(a). No such liberalization under State regulation. The "income test" is applicable. Dependents must be of close relationship and if 50% of support is not furnished a dependent, exemption may not be claimed.

	Federal	State
COAL ROYALTIES	Sec. 272 & 631. A taxpayer who owns timber or who receives coal royalties may treat his receipts from the disposition of timber and coal as capital gain. Expenses which serve to reduce the amount of capital gains are disallowed as deductions in computing ordinary taxable income.	Art. 4(a) -8. All rents and royalties received to be included in gross income. No specific mention of capital gain treatment. Sec. 5(a). Expenses related to production of this income are treated as expenses incurred in carrying on a trade or business.

	Federal	State
ESTATES TRUSTS EXEMPTIONS	Sec. 642 (b) An estate shall be allowed a deduction of $600. For a trust required to distribute income currently, personal exemption is $300. For all other trusts, the exemption is $100.	Sec. 7 (a) (3) An estate or trust shall be entitled to the same exemption allowed to a single individual.
STANDARD DEDUCTION	Sec. 144 Change of election permitted under federal code to take or not to take the standard deduction after the filing of the return for such year in accordance with required conditions. Sec. 691 The standard deduction may be used on a decedents return. If the surviving spouse files using the short form or the standard deduction.	Sec. 5 (n) (3) No provision for the allowing a change of an election for any taxable year to take or not to take the standard deduction after filing date. Sec. 5 (n) (5) (c) The standard deduction may not be taken on a decedents return.
ACCOUNTING PERIODS & ACCOUNTING METHODS	Sec. 441 New code permits taxpayers to elect to use a 52 or 53 week taxable year.-- A taxable year which ends on whatever date a particular day of the week occurs for the last time in a calendar month or falls nearest to the end of a calendar month.	Sec. 8 (a) No statement pertaining to a 52 or 53 week taxable year. Approved standard methods of accounting acceptable if income is clearly reflected.
INSTALLMENT METHOD	Sec. 453 (b) 1954 code permits use of the installment basis, in the case of real property sales or casual sales of personal property, even though there is no payment in the sales year.	Sec. 9 (b) No specific wording as to no payment in year sale to qualify for installment sale reporting.

	Federal	State
CHANGE FROM ACCRUAL TO INSTALLMENT BASIS	Sec. 453 (c) Double taxation when a dealer taxpayer changed to installment accounting basis from accrual basis is eliminated. The tax on an amount included in income for the second time is decreased to the extent of the tax attributable to its inclusion under the prior method of accounting, but not in excess of the tax attributable to the item in the year in which it is includable the second time.	Sec. 9 (c) No provision for adjustment in tax on income previously taxed in prior years.
CHANGE IN METHOD OF ACCOUNTING	Sec. 481. 1954 Statute provides that for the year of change in the method of accounting, voluntary or involuntary, there shall be taken into account those adjustments (account receivable and inventory) which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or entirely omitted. If the adjustment increases income by more than $3,000.00 the tax cannot be more than if the additional income was spread over a 3-year period; or if taxpayer's records are adequate to establish the period to which the income belongs.	No such provision
GAIN OR LOSS RECOGNITION - BASIS	Sec. 1001 (b)(2) In determining the amount of and recognition of gain or loss, the amount realized does not include real property taxes paid by buyer unless treated as imposed on seller.	Sec. 11 (a)(2) Basic law the same as Federal, except that there is no provision for treatment of real property taxes paid by buyer as under Code Sec. 1001 (b)(2)
PROPERTY ACQUIRED FROM A DECEDENT	Sec. 1014. General rule that the basis of property acquired from a decedent is the fair market value at the date of death or at the optional valuation date has been made applicable to practically all property includable in the decedents gross estate for	Sec. 12 (a) (5) & (11) Basic rule same as Federal code, except that the optional valuation date is not considered.

	Federal	State
(Continued)	estate tax purposes, and which was not sold, exchanged or otherwise disposed of before the decedent's death by the person who acquired the property from the decedent.	

	Federal	State
ADJUSTMENTS TO BASIS	Sec. 1016 and 1052 adjustments to basis the same as under prior law. New code provisions require additional adjustments, (1) where an organization's status changes from tax-exempt to taxable, it must adjust the basis of its property for depreciation, etc., sustained during the tax-exempt period, (2) if a taxpayer has elected to deduct research and experimental expenditures as deferred expenses and capitalizes them, basis must be reduced for amortization deductions which resulted in a reduction of taxes, (3) adjustment must be made for nondeductible expenses under contracts for disposal of coal and iron ore.	Sec. 12 (b)(1) General rule same as federal. No adjustment provisions in relation to 1954 federal code changes.
INVOLUNTARY CONVERSION	Sec. 1033 and 1034 (i) 1954 code extends the involuntary conversion provisions to property used by a taxpayer as his principal residence. An involuntary conversion of a residence before 1-1-54 was treated as a sale. The effect is that the period for replacement may be extended beyond one year after the conversion (or beyond 18 months where a new residence is built rather than bought) with consent.	Sec. 11(c) Involuntary Conversion rules not applicable to property used as a residence. Such a conversion is considered a sale.
	Property sold pursuant to reclamation laws (i.e. disposition of land in an irrigation project) shall be treated as an involuntary conversion.	Provided for by Sec. 11(c)
	Livestock destroyed, or on account of disease, or sold or exchanged because of disease will be treated as an involuntary conversion.	No specific coverage under Sec. 11(c)
SALE OF RESIDENCE	Sec. 1034 1954 code changed prior law in that the maximum amount of gain that can be recognized is the difference between the "adjusted sales price" of the old residence and the cost of the new instead of the "selling price" after 12-31-53. (Adjusted sales price is the amount realized on the sale, reduced by expenses of fixing up the property in order to sell it.)	Sec. 11(g) No provision for allowance of "fixing up" expenses to "adjust" the "selling price."

	Federal	State
DEPLETION	Sec. 611-613 The allowance of a deduction for depletion has been extended to deposits of mine tailings worked by the mine owner or operator, but not to the purchaser of the tailings. Discovery value depleter is eliminated, because all minerals now qualify for percentage depletion at rates varying from 5% to 27½%. The 23% rate formerly available for sulphur is extended to uranium and certain other metals if from deposits in the United States. Cost depletion held allowable on topsoil when severed and sold.	Sec. 12(c) Percentage depletion allowable. Rates differ from federal in that metal and other mines, including sulphur and uranium, are allowed 40%. Discovery value a basis for depletion for other than metal or coal mines. No provision for topsoil depletion
MINE DEVELOPMENT	Sec. 614 Taxpayer permitted to elect to treat as one property, separate operating properties operated as a unit. Expenditures made after 1950 in the development of a mine or other natural deposit, a taxpayer may elect either to deduct such expenditures whether incurred before or after the production stage is reached, in the year they are incurred, or to defer expenditures (to the extent that they exceed receipts of the taxable year), and deduct them ratably as the ore or mineral is sold.	Sec. 12(a)(3) No provision for such election. Art. 6(a)(3) Development expenses are deductible in the case of natural resource or at the election of taxpayer, be capitalized.
MINE EXPLORATION	Sec. 615. Expenditures for ascertaining the existence, location, extent or quality of any deposit of ore or other mineral (but not oil or gas) before the development stage of a mine can be deducted by the taxpayer in any taxable year up to $100,000 paid or incurred in such year. Taxpayer may elect to defer any amount up to $100,000.00 not deducted in the taxable year and amortize it ratably as the minerals are sold. A taxpayer may treat exploration expenditures in either way for 4 years, each year up to $100,000.00. After 4 years, any additional expenditures must be capitalized.	Art. 6(a)(3) Such expenses are generally treated as mine development expense. (See above).

	Federal	State
ESTATES AND TRUSTS		
INCLUSION OF INCOME	Sec. 451(b) If a decedent was on the accrual method of accounting, amounts which would accrue only because of his death are <u>not</u> included in his return.	Sec. 8(b) In the death of a taxpayer, net income for the taxable year shall include all income accrued up to the date of his death.
CREDITS AND DEDUCTIONS	Sec. 642. New trust and estate provisions deal with special rules, the deduction for amounts distributed to beneficiaries, the conduit rule under which income and deductions of the trust retain the same character when taxed to a beneficiary, and the manner in which the distributive shares of beneficiaries are computed and taxed. (1) The trust or estate is allowed the $50.00 exemption and 4% credit for dividend income. (2) The "unlimited" charitable contributions deduction (reduced for exempt income allocated to contribution under the conduit rule) is allowed for decedents' estates and trusts which are not required to distribute all its income currently. (3) The deductions for depreciation and depletion are now to be allocated, for decedents' estates, between the estate and the "heirs, legatees, and devisees," on the basis of income allocable to each, instead of just between the estate and income beneficiaries. (4) Unused net operating loss or capital loss carryovers, or ordinary deductions in excess of gross income, the benefits of any such deductions are to be carried over to the beneficiaries.	Sec. 13(a)(1)(2) There is allowed deductions to an estate or trust the same deductions which are allowed to individual taxpayers. no provision for $50.00 exemption and 4% credit for dividend inincome. Depreciation and depletion is allowable to a life tenant or beneficiary of property held in trust. The allowable deduction for depreciation or depletion on property held in trust shall be apportioned between income beneficiaries and the trustee on the basis of income allocable to each, unless differently provided for in instrument creating trust.

	Federal	State
SIMPLE TRUSTS	Sec. 651. Under 1954 code, a trust (but not an estate) may qualify as a "simple trust" if all of its income is required to be distributed currently and it makes no charitable contributions. The income required to be distributed to beneficiaries is taxable to them whether or not distributed during the taxable year, up to the amount of distributable net income. If occasional distributions are made out of principal, the trust is disqualified as a "simple trust" only for the years in which the principal is distributed. If the income required to be distributed exceeds distributable net income, only a proportionate part of each item is includible in the beneficiaries income.	Sec. 13 (a). Trusts are not distinquished on the basis of income distribution methods. The total of the trust's or estate's net income is taxed currently either to the trust, estate or beneficiary. The income of an estate during the period of administration is taxable to the estate in the absence of a court order. When the will or trust agreement specifically provides for definite distribution out of income of an estate, the beneficiary is taxed. The 65 day rule of the federal law, not applicable to the State. Unless by Court order, capital gains are not considered distributable income.
COMPLEX TRUSTS	Sec. 661. The term "complex trusts" apply to any trust and estate not qualifying under the "simple trust" provisions (including discretionary trusts, trusts with charitable beneficiaries, and trusts making current distributions, but also making distributions of principal). Here either the trust, estate, or beneficiary will be taxed currently on total of the trust's or estate's current taxable income. Provision is made for elective use of the 65 day rule by a trust if the trust was in existence before 1/1/54 and the trust instrument prohibits distributions in excess of its income for the preceding year. The source of distribution - whether principal or income - will be immaterial, except that the following will not be a distribution for this purpose: (a) gifts or bequests not to be paid solely out of income if paid all at once or in not more than 3 installments, and (b) income which was required to be distributed in a prior year. In determining distributable net income, a single trust having more than one beneficiary will be treated as a separate trust for each, provided it is so administered that each beneficiary has a well defined separate share.	

	Federal	State
FIVE YEAR THROWBACK RULE	Sec. 665-668. In order to prevent the accumulation of income, and distribution in a low-income year of a beneficiary so as to avoid taxes, a 5 year throwback rule is provided. It has the effect of carrying back to the five preceding years distributions in excess of distributable net income for the distribution year, taking the same amounts into taxable income of the beneficiary as he would have done if they had been distributed in the prior year. This additional income is taxed as part of his distributive share for the distribution year, but the tax cannot be more than it would have been if he had actually received the additional amounts in the prior year. The beneficiary is allowed a credit for the proportionate part of the trust's tax for the prior year, thus eliminating any double tax on the income. The throwback rule does not apply to estates or "simple" trusts; or if the excess is $2,000.00 or less; or to distributions of accumulations during the beneficiary's minority and amounts distributed to meet the emergency needs of the beneficiary; or to final distributions made more than 9 years following the last transfer of property to the trust.	No such provision

	Federal	State
TRUSTS FOR BENEFIT OF GRANTOR	Sec. 671-678. Clifford trust regulations are now incorporated, with modifications, in the new law. (1) The grantor of a trust will not be taxed by reason of a reversionary interest in an irrevocable trust unless the reversion may occur within 10 years. (2) The grantor will not be taxed on the income from a charitable trust reverting to him after 2 years if the trust income must be paid to a designated charity. The 15 year rule of the regulations, applicable if the grantor (or his wife) as trustee retained certain administrative powers is abolished. (3) The power to apportion income or principal among different beneficiaries on the part of related or subordinate trustees will not in itself require that the grantor be taxed on trust income if proof is shown that the trustee is not acting under his direction. (4) The grantor will not be taxed under the reversionary interest rule if his reversionary interest is contingent on the death of the income beneficiary, even though the beneficiary's expectancy is less than 10 years.	Sec. 13(b). Law contains statutory provisions dealing with trusts in which the grantor retains a power of revocation; and Sec. 13(c). A provision dealing with trusts whose income is accumulated or used for the benefit of the grantor. The Clifford Regulations, which provide a series of rules to determine when trust income is to be taxed to the grantor because of: a reversionary interest within a specified period; powers to control the beneficial enjoyment; or certain broad administrative powers, are not followed. The 2 year, 10 year and 15 year exclusion rules are not applicable. Income from such trusts are taxable to the grantor in the same way if the trust had not been created.
BASIS OF PROPERTY ALTERNATE VALUATION	Sec. 2032. Existing law permits the executor, if he so elects upon his return, to value the property included in the gross estate as of a date 1 year after the decedent's death or, in the case of such property distributed, sold, exchanged, or otherwise disposed of at an earlier date, the value at such date of disposition.	Sec. 12(a)(5). If on or after the basic date the property was acquired by bequest, devisee, or inheritance, or by the decedent's estate from decedent, the basis shall be the fair market value at the time of decedents death.

	Federal	State
PARTNERSHIPS DEFINITIONS	Sec. 761(a). There can now be excluded from partnership status, at the election of the members, certain unincorporated organizations used for investment, or for the joint production, extraction or use of property, but not for the purpose of selling services. Members must be able to determine their income without the necessity of computing a partnership taxable income.	No provision for such an election.

	Federal	State
PARTNERSHIP ELECTIONS	Sec. 703 (b) It is now required that elections affecting the computation of taxable income derived from a partnership be made by partnership, that is, methods of accounting, use of installment sales provision, option to expense intangible drilling and development costs, etc. An exception permits a separate election by each partner whether to deduct or credit foreign income taxes.	Art. 14 A partnership can maintain its own method of accounting without regard to the accounting basis used by the individual partners.
DISTRIBUTIVE SHARES	Sec. 704 Statute directs that a partner's distributive share of partnership income, gain, loss, or credit be determined by the partnership agreement. If the agreement is silent as to treatment of any particular item, the general profit and loss ratios control. If property is contributed to a partnership with an adjusted basis less than its value, depreciation or gain upon the sale of the property will be allocable to each of the partners in the same manner as items arising with respect to any other property acquired by the partnership. Loss allocated to a partner can be deducted by him only to the extent of his basis for his partnership interest. Any excess shall be allowed as a deduction at the end of the partnership taxable year in which such excess is repaid.	Sec. 14 The net income of the partnership is to be distributed or distributable to the individual partners according to their respective interests in the partnership. (Though not mentioned specifically, probably the profit and loss ratio will control in the absence of a partnership agreement.)
TAXABLE YEAR	Sec. 706 Where an existing partnership uses a fiscal year and its partners the calendar year, the arrangement may continue. Adoption of, or change to different accounting periods after 4-1-54 is not allowed except by permission for valid business reasons. Specifically provided a general rule, the death, retirement or withdrawal of a partner, or the sale of his interest, or the addition of a new partner will not result in the closing of the partnership's taxable year. Also the taxable year of the	Sec. 2 (d) and Art.14 Partnership may have an annual return year different from the year for which the individual partner makes his income tax return. Death, retirement or withdrawal of a partner will terminate the partnership and its taxable year.

	Federal	State
	partnership will close with respect to a partner who sells or exchanges his entire interest in the partnership and with respect to a partner whose interest is liquidated, (other than through death.) A partnership will be considered as terminated at a discontinuance of business activities, or the sale or exchange, within a 12 month period, of an interest of 50% or more in partnership capital or profits.	
PARTNER-PARTNERSHIP TRANSACTIONS	Sec. 707 A partner who engages in a transaction with the partnership, other than in his capacity as a partner, is to be treated as though he were an outsider. Exceptions: (1) loss is disallowed to partner in the event of a sale or exchange whose interest in capital or profits is more than 50%, (2) loss between two partnerships disallowed on sale or exchange in which same persons own 50% or more of the capital or profits interest. Capital gain treatment denied on certain transfers between a partnership and a partner owning more than 80% interest in capital or profits or between two partnerships in which the same persons own more than 80%.	No specific provision.
	Any fixed or guarenteed amounts paid to the partners for services or for the use of capital are generally to be treated the same as though they paid to an outsider.	Art.14. Such payments are considered as a distributive share of partnership earnings.
CONTINUATION OF PARTNERSHIP	Sec. 708 (b)(c) Partnerships which result from mergers or divisions of partnership will under certain circumstances be considered as continuations of prior partnerships. Even if considered terminated under the general rules, a partnership can elect to be considered a continuing partnership, subject to regulations.	No such provision stated.

	Federal	State
CONTRIBUTIONS TO A PARTNERSHIP	Secs. 721 - 723. No gain or loss shall be recognized either to the partnership or to any of its partners upon a contribution of property to the partnership in exchange for a partnership interest---whether to a new or old partnership. The basis of a partner's interest acquired shall be the amount of the money contributed plus the adjusted basis to the contribution partner of any property contributed. The adjusted basis to the partnership of property contributed by a partner shall be the adjusted basis of such property in the hands of the contributing partner at the time of the contribution.	Sec. 12(a)(9). If property was acquired on or after the basic date (7/1/37), by a partnership, the basis generally shall be the same as would be in the hands of the transferor.
GAIN OR LOSS ON DISTRIBUTION	Sec. 731. The distributee partner recognizes gain only to the extent cash received exceeds the basis of partnership interest. Loss is recognized only if the distribution is in complete liquidation of his interest and consists solely of money "unrealized receivables" and non-capital assets. Such gain or loss is a capital gain or loss.	Sec. 12(a)(9). Basis for determining gain or loss upon the sale or other disposition of property shall be cost. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.
BASIS OF PROPERTY DISTRIBUTED TO PARTNER	Sec. 732. The basis of property received in distribution, other than in liquidation of a partner's interest, will be the same as the basis in the hands of the partnership immediately prior to distribution. In no case, may the basis of property in the hands of the distributee exceed the basis of his partnership interest reduced by the amount of money distributed to him in the same transaction. The basis of property distributed in liquidation of a partner's interest shall be the basis of the distributee's partnership interest less any money received. The basis to the distributee of inventory items and unrealized receivables is limited to the basis they had in the hands of the part-	Sec. 12(a)(9). A proportionate part of the partner's basis of his interest be allocated to each distributed asset.

	Federal	State
	nership.	
OPTIONAL ADJUSTMENT TO BASIS OF PARTNERSHIP ASSETS	Sec. 734. No gain or loss to a partnership as the result of a distribution of assets to a partner. If the basis of distributed assets in the hands of the distributee partner is less than the basis of the assets in the hands of the partnership, there may be an excess or "unused" basis. The new law permits the partnership to elect to adjust the basis of its remaining assets to take up this excess basis.	No such election provision. Under current practice a partnership is not permitted to adjust the basis of remaining partnership property after having made a distribution of part of its property to a partner.
UNREALIZED RECEIVABLES AND INVENTORY ITEMS	Sec.751 (c)(d). The term "unrealized receivables" is used to apply to any rights to income which have not been included in gross income under a partnership accounting method. Usually this provision would be applicable only to cash basis partnerships which have acquired a contractual or legal right for goods or services. The term "inventory items" includes assets held for ordinary business sale and other assets which are not capital assets. Inventory items are considered substantially appreciated only if their fair market value is more than 120% of their adjusted basis to the partnership and more than 10% of the fair market value of all partnership property other than money. Gain attributable to these two items will be taxed as ordinary income not as capital gain.	No such definition concepts.
SPECIAL RULE ON GAIN OR LOSS ON DISPOSITION OF DISTRIBUTED PROPERTY	Sec. 735. Gain or loss from the disposition of property (inventory items or unrealized receivables) is to be treated as a gain or loss from the sale or exchange of property	No such provision

	Federal	State
	other than capital asset. In the case of inventory items, this rule will apply only if the sale takes place within 5 years from date of distribution. If the sale takes place beyond this period, gain may be treated as capital gain, provided that these assets are capital assets in the hands of the partner at that time.	
PURCHASE OF DECEASED OR RETIRED PARTNER'S INTEREST	Sec. 736. On payments made to a retiring partner or to the estate, capital gain benefits will be available only to the extent that the payments are for an interest in partnership property, excluding amounts paid for unrealized receivables or goodwill, except to the extent that the partnership agreement provides for a payment with respect to goodwill. Any payments that are allocable to the retiring partner's interest in substantially appreciated inventory items will be treated as amounts received from the sale of a non-capital asset. Payments which are not made for an interest in the partnership are treated as income to the retiring or deceased partner and deductible by the partnership. (Rules apply to decedents dying after 1954)	No such specific rules.
PURCHASE OR SALE OF A PARTNERSHIP INTEREST	Sec. 741 and 742. Under the old law it was not clear whether the sale of an interest whose value was attributable to uncollected rights to income gave rise to capital gain or ordinary income. The new law makes it clear that any amount received by a selling partner attributable to appreciated inventory or unrealized receivable will be ordinary gain or loss.	No Specific mention.

	Federal	State
LIABILITIES TREATED AS DISTRIBUTIONS OR CONTRIBUTIONS	Sec. 752 Any increase in a partner's share of the liabilities of partnership must now be treated as a contribution of money by the partner to the partnership. Conversely, a decrease in a partner's personal liabilities because a portion of them have been assumed by the partnership will be treated as a distribution of money by the partnership to the partner. The transfer of property subject to a liability by a partner to a partnership, or by the partnership to a partner, shall, to the extent of the fair market value of the property, by considered a transfer of the amount of the liability along with the property.	No similar provision
ELECTION OF PARTNERSHIP TO BE TAXED AS A CORPORATION	Sec. 1361 New provision permits certain partnership to be taxed as corporations. The election must be made by all partners owning an interest at any time from the first day of the first tax year to which the election applies. Election is errevocable unless there is a 20% change in ownership. A new election must be made not later than 60 days after the close of the taxable year, if there is a change in ownership. Other provisions are: (1) 50 member limit, (2) capital is a material income-producing factor, or business is one in which 50% of the gross income is profit from trading as a principal or from buying and selling real property. Does not change law in respect to unincorporated association taxed as corporations.	No such election

	FEDERAL	STATE
CAPITAL GAINS AND LOSSES TREATMENT ALTERNATIVE TAX	Sec. 1201. An alternative tax computation is provided for corporations as well as individuals, so that the total effective income tax on the excess of net long-term capital gain over net short-term capital loss will not be more than 25%.	No such provision
LIMITATION ON CAPITAL LOSSES	Sec. 1211 (a) Corporation - losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges (b) Other Taxpayers. - losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges, plus the taxable income of the taxpayer or $1,000.00, whichever is smaller.	Sec 138-1-27 (4) CRS Rev. Sec 15 (d) Losses from sales or exchanges of capital assets shall be allowed to the extent of $2000.00 plus the gains from such sales or exchanges.
CAPITAL LOSS CARRY-OVER	Sec 1212 Any excess of capital losses which is not deductible in the taxable year is a "net capital loss" for that year, which may be carried forward into the next five succeeding years, until it is absorbed.	H.B. No. 74 - 3/9/54. Sec 15 (d)(2) If for any taxable year beginning after December 31, 1953, the taxpayer has a net capital loss or net operating loss, the amount thereof shall be treated as a short-term capital loss in each of the four succeeding taxable years until it is absorbed.

	Federal	State
CAPITAL GAINS AND LOSSES (CONT) GENERAL RULES DEFINED MG636	Sec. 1221. "Capital asset" means property held by the taxpayer, but does not include:	Sec. 138-1-27(2). Sec. 15 (b). Property held by the taxpayer, but does not include:
	(1) Stock in trade or property properly included in the inventory, or property held primarily for sale to customers in the ordinary course of business.	(1) Stock in trade or property properly included in the inventory, or property held primarily for sale to customers in the ordinary course of business.
	(2) Property used in trade or business.	No such exclusion.
	(3) A copyright, a literary, musical, or artistic composition, or similar property.	No such exclusion.
	(4) Accounts or notes receivable acquired in the course of trade or business.	No such exclusion.
SPECIAL RULES PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS MG639	Sec. 1231(a). If the gains from the property used in the trade or business and involuntary conversions held for more than 6 months exceed the losses, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months.	Same as State for gains.
	If such gains do not exceed such losses, such gains and losses shall not be considered as gains or losses from sales or exchanges of capital assets.	No such special rule for losses.
	(1) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.	Art. 5(d) 3. If livestock has been purchased for any purpose, and afterwards dies from disease, exposure, or injury, or is killed by order of the authorities, the loss is allowable as a deduction.
	(b) includes: (1) Timber or coal.	
	(2) Livestock held for draft, breeding or dairy purposes, and held for 12 months or more (not including poultry).	No time limit necessary to be recognized as a capital asset.
	(3) Unharvested crop.	

	Federal	State
BONDS AND OTHER EVIDENCES OR INDEBTEDNESS	Sec. 1232. (2). If bonds or other evidences of indebtedness are issued at a discount, and are held for more than six months by the taxpayer, any gain on their sale, exchange or retirement that is due to the original issue discount is taxable as ordinary income. Any gain in excess of that amount is taxed as long-term capital gain.	Sec. 138-1-27 C R S - Rev. Sec. 15 Where bonds are capital assets, they are subject to capital gain and loss limitations.
SHORT SALES	Sec. 1233. Gains or losses from short sales of property are considered as gains or losses from the sales or exchanges of capital assets to the extent the property used to close the short sale is a capital asset, other than a hedging transaction.	No specific provision accepted as a matter of policy.
OPTIONS	Sec. 1234. Options are a capital gain or loss on sale, exchange or lapse if the optioned property would be, if acquired, a capital asset in the hands of the holder of the option.	Sec. 4(a) Sec. 6(a)(1). Treated as ordinary income or loss.
SALE OR EXCHANGE OF PATENTS	Sec. 1235. Long-term capital gains treatment has been made applicable to gain on the transfer (other than by gift, inheritance or devise) of all substantial rights to a patent or of an undivided interest.	Art 4(a)-8. Capital gain treatment not extended or available to full time inventors.
DEALERS IN SECURITIES	Sec. 1236. A dealer may treat a gain as a capital gain if: 1. The security is clearly identified in the dealer's records as a "security held for investment" within 30 days after the security was acquired. 2. At any time after such 30th day, the security must not be held primarily for sale in the ordinary course of his trade or business.	No specific provision.

	Federal	State
REAL PROPERTY SUBDIVIDED FOR SALE	Sec. 1237. In general, a non-corporate seller will get capital-gain treatment if these conditions are met: 1. He is not a dealer in other real estate in the year of sale. 2. He never held the subdivided tract as a dealer. 3. He had never made certain substantial improvements which increased the value of the lots sold.	Art. 4(a)-10 The gain or loss from sale of a tract of land subdivided into lots or parcels shall not be treated as a capital gain or loss.
	4. Unless the property was inherited, it must have been held for at least 5 years. Until the year in which the 6th lot is sold, all the gain is capital gain. In that and later years, gain up to 5% of the selling price is ordinary income and the balance capital gain. The taxpayer can start the count of 5 sales over again after 5 years elapse without a sale.	No such provision.
AMORTIZATION IN EXCESS OF DEPRECIATION	Sec. 1238 (117(g)(3). Gain realized from the sale of property which is amortized as an emergency facility is frequently treated as part ordinary income and part capital gain, rather than capital gain exclusively.	No special provision.
GAIN FROM SALE OF CERTAIN PROPERTY BETWEEN SPOUSES OR BETWEEN AN INDIVIDUAL AND A CONTROLLED CORPORATION	Sec. 1239 (117 (O). Capital gain benefits are denied where depreciable property is transferred, directly or indirectly, between husband and wife or between an individual and a corporation in which he, his spouse, and their minor children and minor grandchildren own more than 80% of the value of the outstanding stock.	No such provision-treated as a capital gain.

	Federal	State
TAXABILITY TO EMPLOYEE OF TERMINATION PAYMENTS	Sec. 1240 (117 (p)). Capital gain treatment is available for amounts received by an employee after termination of his employment, in exchange for an assignment or release of all rights to receive a percent of future profits or receipts. Limited to payments on contracts made before the 54 Code.	No such provision.

	Federal	State
TAXABILITY TO EMPLOYEE OF TERMINATION PAYMENTS	Sec. 1240 (117 (p)). Capital gain treatment is available for amounts received by an employee after termination of his employment, in exchange for an assignment or release of all rights to receive a percent of future profits or receipts. Limited to payments on contracts made before the 54 Code.	No such provision.

	Federal	State
COMPENSATION FROM AN EMPLOYMENT	Sec. 1301 In the case of compensation from an employment of an individual or a partnership covering a period of 36 calendar months or more from the beginning to the completion of the services, if at least 80% of the total compensation is received or accrued in any one year, the tax for the amount received or accrued in that year shall not be greater than the taxes which would have been paid if such amount had been included in gross income ratably over the period.	No such provision. The Income is taxable in year received.
INCOME FROM AN INVENTION OR ARTISTIC WORK	Sec. 1302 Income from inventions can be spread up to 60 months and up to 36 months for artistic works (the portion which is not taxable as a capital gain or loss), if - 1. The work covered a period of at least 24 months and at least 80% was received of the total compensation.	No such provision. The income is taxable in the year received.
INCOME FROM BACK PAY	Sec. 1303 If "back pay" received in one taxable year is more than 15% of the taxpayer's gross income for such year, the taxes on such "back pay" can be limited to such taxes as would be payable had it been received in those years for which it was paid.	No such provision. The income is taxable in the year received.

	Federal	State
JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE	Sec. 6013 If an individual has filed a separate return for a taxable year for which a joint return could have been made by him and his spouse and the time prescribed by law for filing the return has expired, such individual and his spouse may nevertheless make a joint return for such taxable year.	Art.19 (a) -6. When a return, has been filed on the basis selected, another return for the same taxable period on another basis is not permitted after the due date for filing such return has passed. The option must be exercised on or before the day prescribed for filing returns.
	Where the husband and wife have different taxable years because of the death of either spouse, the joint return shall be treated as if the taxable years of both spouses ended on the date of the closing of the surviving spouse's taxable year.	Sec. 19 (a) (1) A joint return may not be filed if husband or wife died during the year.

TOPIC IV

CONSTITUTIONAL PROBLEMS INVOLVED IN BASING COLORADO'S INCOME TAX LAW ON THE FEDERAL STATUTE AND RETURNS

Introduction

Recognizing the fundamental legal questions involved in correlating the Colorado and federal income tax statutes, the committee first examined the problem of making the Colorado income tax law follow the federal code in its entirety. The University of Colorado Law School was asked for a detailed brief on the subject. The brief, which follows, was prepared by Professor Al Menard of the Colorado University Law School. It points out very clearly that there are serious legal problems involved in making the Colorado statute follow the federal act on a mandatory basis. In view of these problems and the extensive degree to which the state is dependent upon the income tax for its general fund revenues, the committee would suggest that this alternative not be undertaken without a constitutional amendment giving the General Assembly unquestioned authority to act in this regard.

THE COLORADO CONSTITUTIONAL PROVISIONS AND SUPREME COURT CASES(1)

There are at least three provisions in the Colorado Constitution which call for some consideration. Each of these provisions will now be examined in detail.

A. The Colorado Constitution and Legislation by Reference.

The first provision directly concerns the matter of legislation by reference and is present if the Colorado General Assembly desires

(1) The remainder of this section was prepared by Professor Al Menard of the University of Colorado Law School.

to take any steps to coordinate our income tax with the federal tax, other than to copy verbatim provisions of the federal law. This provision of the Colorado Constitution reads as follows:

> "Article V, Section 24, Revival, Amendment or Extension of Laws. - No law shall be revived or amended or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revived, amended, extended or conferred, shall be re-enacted and published at length."

The part of the foregoing section of the Colorado Constitution which is particularly pertinent to the current problem is that which prevents a law from being extended by reference to its title only. The obvious purpose of the amendment is to require that the legislature have squarely before it for re-enactment the full-text of the statute which it is in effect passing. A secondary objective of the section is to make somewhat easier the job of search for the provisions of state law by insuring that the entire law on a point is set out at a single place.

This phase of Section 24 has not been construed by the Colorado Supreme Court on very many occasions. In People v. Friederich, 67 Colo. 69, 185 P. 657 (1919) a statute provided that any law of the State of Colorado defining delinquency should be considered to apply to and include all girls under 18 years of age. The Supreme Court held such a statute unconstitutional on the grounds that it extended the provisions of other statutes by reference instead of re-enacting at length so much of those laws which it purported to extand. The court found that the test of whether or not the act before it was complete in itself was whether it would apply to any offense of its own motion. The court found that it was not complete because it was necessary to refer to other acts to determine offenses against children under 18.

Perhaps the Colorado case which resembles most closely the present problem is that of Brannaman v. Richlow Company, 106 Colo. 317, 104 P.2d 897 (1940). In that case, an unemployment compensation contribution dispute was before the court. The issue involved the definition of employment. It was argued to the court that the Colorado statute incorporated by reference the definition of employment in the federal social security act, although it was admitted that the Colorado statute also contained a definition of employment. The court found that the Colorado statute did not seek to incorporate the federal definition by reference, so that it did not have to squarely face the constitutional problem with which we are concerned. However, in the course of the opinion the court commented as follows: "Even if it be assumed that a definition of the federal act can be incorporated in our law by reference, which in reality presents a serious constitutional question, the argument of the state officials still is fallacious." Later the court pointed to Section 24, Article V, as the section which raised this question.

On the other hand, the Supreme Court has held that the provisions of Article V, Section 24, do not prevent the adoption by reference of mere procedural provisions from another statute. In Terminal Drilling Co. v. Jones, 84 Colo. 279 269 P.894 (1928), the court had before it a statute which extended a lien to those who performed services in drilling a well. The statute further provided that the perfecting and enforcing of such a lien should be accomplished in the same manner as then was provided for mechanic's liens. The court held that a statute which incorporated by reference procedural matters only does not contravene Section 24, Article V of the Colorado Constitution.

Again, most recently, the matter was before the Supreme Court in connection with the adoption of the Colorado Revised Statutes of 1953. As the members of the income tax study committee no doubt recall, the Supreme Court was requested to render an advisory opinion on the adoption of the Colorado Revised Statutes of 1953. That opinion is reported under the title "In Re Interrogatories from the House of Representatives" 127 Colo. 160, 254 P2d. 853 (1953). It was suggested that Section 24, Article V, might render the adoption of the revised statutes unconstitutional as legislation by reference. The court disposed of the problem rather summarily by stating that the bill tendered by the commission, constituting the entire body of the statute, was before the legislature in full and was enacted in full. Thus the Constitution did not prevent a general revision of the statutes or a codification thereof.

In summary then, a survey of the Colorado decisions which are pertinent does not reveal an unequivocal answer to the question of adoption of the federal income tax code by reference. It does suggest that there are dangers inherent in such action. Undoubtedly, there are examples of adoption by reference now present in the Colorado Revised Statutes 1953. As a practical matter of statutory drafting, it is sometimes difficult to avoid this device. For example, the additional estate tax imposed by the State of Colorado in the event that the full 80% credit against the federal estate tax is not utilized by the Colorado inheritance tax may perhaps be an example of at least computation by reference. It has never been attacked in this state. The issue has been raised elsewhere and state estate taxes so phrased have been sustained against such argument. See e.g. Cook v. Taylor, 210 Ark. 803, 197 S. W. 2d 738 (1946). In any event, our supplemental estate does not go as far as a proposed adoption of the income tax code by reference. Despite the practical success of adoption by reference on a minor scale in a number of instances and the basic merit in the proposal, there is a real danger in an attempt to base such an important segment of the revenue as the income tax produces upon a device of questionable constitutionality. Alternate solutions involve either a constitutional amendment or the setting out in detail of a state statute modeled on the federal statute, as does California.

B. The Colorado Constitution and Delegated Legislation

A second possible constitutional objection to incorporation of the federal income tax code into Colorado law by statute lies in the attitude that our state Supreme Court has taken to the delegation of legislative power. Article V, Section 1, of the Colorado Constitution provides in part as follows: "The legislative power of the state shall be vested in the general assembly...

This language generally has been taken to prevent the delegation of legislative power. In Colorado, the doctrine has been principally utilized in connection with the giving of power to make substantive rules to administrative agencies. The attitude of our Supreme Court in this connection is fairly well summarized in the recent case of Prouty v. Heron, 127 Colo. 168, 255 P2d 755 (1953). In that case, involving certain actions of the Engineering Licensing Board, the Supreme Court reiterated an oft repeated statement to the effect that the general assembly may not delegate the power to make a law. While the precedents came chiefly from the administrative law field, the language is broad and lends itself to use in the instant type of problem.

A partial answer to this type of argument exists when the legislature simply refers to an existing federal statute as of a certain date and provides that computations of tax due should be based upon the provisions thereof both for the present and the future. In this case it can be maintained, perhaps with success, that the legislature has not delegated the power to make a law but has simply adopted provisionsof existing law and levied its own tax at its own rates on such a fixed basis. However, it may be contemplated that changes in the federal income tax code, which take place almost annually, should affect the basis for Colorado income tax computations. Indeed, this is the most practicable approach to the problem. If such be the case, though, there is some substance to the argument that the Colorado legislature has delegated to Congress the power todetermine the income tax law for the State of Colorado. This approach, which obviously may be anticipated, may be met by an argument to the effect that what the Colorado legislature is doing is accepting a method of computation, which may change, but is not adopting the details of the legislation so involved. The outcome of litigation, in which arguments such as those outlined would no doubt be advanced, cannot be predicted with absolute certainty. However, the wisdom of adopting legislation open to such question is definitely doubtful.

C. The Colorado Constitution and Retrospective Legislation

A final problem which may be encountered unless a carefully planned approach is used is that of the Colorado prohibition against retrospective legislation. Article II, Section 11 of the Colorado Constitution reads as follows:

> "No ex post facto law, nor law impairing the obligation of contracts, or retrospective in its operation, or making any irrevocable grant of special privileges, franchises or immunities, shall be passed by the general assembly."

It should be noted that no comparable limitation on retrospective or retroactive legislation is found in the United States Constitution.

This provision of our Colorado Constitution is involved in the instant problem in two ways. In the first place, if a tax statute making major changes is adopted by the 1956 General Assembly, for example, may it legally become effective as to calendar year returns covering a year from January 1, 1956 to December 31, 1956, since such year has already begun and some of the events affecting the tax due have already taken place? In other words, is such a statute retrospective legislation? The same question arises in applying tax changes to fiscal year taxpayers. Before speculating upon the answer to this problem, it may be noted that it arises with any change in tax law and not merely with one integrating a state and federal tax statute. In fact, it is applicable to all legislation, although of course tax legislation is peculiarly vulnerable to attack under the provision since it is most apt to involve previously completed events through its annual accounting feature.

There seem to be no decided cases squarely presenting the issue of retrospective legislation in all its aspects in a tax case before the Colorado Supreme Court. However, there are cases touching on some phases of the problem which illustrate the fact that the point is raised at times in tax cases. In American Refrigerator Transit Co. v. Adams 28 Colo. 119, 63 P. 410 (1900) the legislature had provided in an act passed in the 1897 General Assembly and approved by the governor on April 1, 1897, for the method of determining the tax for the year 1897 on railroad cars operating both within and without the state. It was argued that this constituted retrospective legislation as a part of the year 1897 had gone by prior to passage of the law. The Supreme Court x brushed this point aside on the grounds that the cars were already subject to taxation under existing statutes and the law in question merely made certain the method of computing the number of cars. From this case an argument may be made that certain details of a tax statute may be changed during the tax year, but certainly any broad generalization as to changes in rates or basic principles of tax is not warranted, since the case involved a rather narrow factual situation.

In People v. Estate of Waterman 108 Colo. 263, 116 P.2d 204 (1941) the legislature had removed certain inheritance tax exemptions between the date of death of the individual whose demise gave rise to the taxable transfer and the time when the property was actually transferred to the takers for their beneficial use. The court avoided a square holding on the problem here present by finding that the transfer upon which the tax rested had not taken place when the exemptions were removed and hence the statute had no retrospective operation as it applied in practice.

While the annotations to this section of the Colorado Constitution in the Colorado Revised Statutes indicate that this provision prohibiting retrospective laws is invoked without success far more frequently then it prevails, it is not completely toothless. In some cases it has served to invalidate the application of a statute. See for example Atkinson v. Colorado Wheat Growers Association, 77 Colo. 475, 222 P. 1116 (1924).

Examination of past legislative custom in regard to amending the Colorado income tax law does not reveal any consistency of practice. The original income tax act of 1937 (Ch. 175, Colo. Sess. Laws, 1937) was carefully drafted to become effective only upon passage and to tax no income received prior to such date. (See Sec. 38 thereof) When major rate increases were imposed and other significant changes were made in 1949 (Ch. 171, Colo. Sess. Laws 1949) careful provisions were again inserted to make the changes operative only after the passage of the statute. On the other hand, when exemptions were further cut in 1951 and other changes made, the statute became effective immediately although a part of the year had passed and though this had an effect on the amount due. (See Ch. 196, Colo. Sess. Laws 1951) The same was true when extensive changes were made in 1943, although most of these do not appear to have affected the amount of tax due (see Ch. 114, Colo. Sess. Laws 1943) Thus there is no settled legislative practice.

Finally, it should be pointed out that the problem is repeatedly raised if the method of integration adopted is to base the Colorado tax upon adjusted gross income, or some other figure on a federal tax return. The federal statute is subject to amendment almost annually and these amendments nearly always operate retroactively to the beginning of the tax year. There is no prohibition specifically against retrospective legislation in the United States Constitution and in a number of cases the United States Supreme Court has held that general principles of due process did not prevent some retroactivity. See for example, Stockdale v. Insurance Companies, 20 Wall. 323 (1873 - the Civil War period income tax); Brushaber v. Union Pacific Railroad 240 U.S. 1 (1916 - the present income tax).

In summary on this point, the problem of the retrospective limitation may be solved rather easily if the legislature simply desires to base the Colorado tax on federal law as of a given date. The practice in 1937 and 1949 points out a completely safe course, in making the adoption prospective only and applicable only to income received after the effective date of the statute. Possibly this is not necessary, as laws which were not this carefully phrased have not been attacked. But if the legislature wishes to automatically accept federal changes the problem is more serious for many of these federal changes will be retroactive if past experience is significant. For such a pattern, a constitutional amendment does seem indicated, although in the current trend most of these changes are such as would benefit the taxpayer and hence would not come under attack.

D. The Possibility of an Advisory Opinion

It is obvious from the discussion of these three constitutional provisions that constitutional doubts do exist surrounding any system of adoption of the federal code other than by detailed reiteration. While arguments favoring the legality of basing Colorado's tax on the reportable federal adjusted gross income, for example, can be made, absolute reliance thereon does involve some risk. In view of precedents noted in the discussion of experience in other states below, perhaps the odds favor decision of constitutionality. Still the element of risk cannot be eliminated in an opinion on this point as the foregoing summary of the Colorado Constitution and cases demonstrates.

One possibility should be noted. The Colorado Constitution, unlike that of most states, authorizes the Supreme Court to give an advisory opinion "upon important questions upon solemn occasions when requested by the governor, the senate or the house of representatives. . ." See Colorado Constitution Article VI, Sec. 3. The Court has been somewhat reluctant to exercise this authority unless a number of conditions are met, e.g. the statute must have been introduced but not passed by both houses if the interrogatories come from the Assembly. See in re Interrogatories by Governor 71 Colo.331, 206 P. 383 (1922); in re House Resolution, 88 Colo. 569, 298 P. 960 (1931). This obviously implies that a specific measure must be submitted to the Court and not merely general inquiries as to how an objective may be legally reached. Within appropriate limits, however, the Court has passed upon the Constitutionality of measures upon request. See, for example, In re Interrogatories Senate Bill 24, 127 Colo. 160, 254 P.2nd 853 (1953). If the committee of the Legislative Council desires, it might consider the submission of a bill involving incorporation by reference and the other matters discussed above and request an advisory opinion prior to final passage. If this were done early in the session, it might be possible to secure an opinion early enough to permit adequate consideration thereafter of alternative proposals involving either a constitutional amendment or enactment of a bill embodying federal language set out at length.

III

EXPERIENCE IN OTHER STATES

In the absence of specific precedent in Colorado which indicates definitely either the legality or illegality of basing the Colorado income tax upon the federal code, it is appropriate to turn to the experience in other jurisdictions. A good many states, including Colorado, have copied varying quantities of phraseology from the federal statute in the interests of simplicity. This, of course, poses no legal problems at all. A rather cursory survey indicates that approximately six states and one territory have experiemented in one form or another with true adoption by reference of federal income tax provisions. A brief discussion of the apparent legal experience in each of these states is in order.

From the materials available in the law library of the University of Colorado, it would appear that the state of South Carolina was the first to base its income tax statute upon the federal statute without setting forth in the South Carolina laws the full details of the tax system so adopted. This action was taken in the year 1922. The South Carolina statute imposed a state income tax fixed at 33 1/3% of the amount of the federal tax paid by the South Carolina tax payer. It did provide some adjustments for non-resident corporations and others in a comparable position. It did specifically adopt by reference all the provisions of the United States income tax statute of 1921.

The South Carolina statute was promptly challenged in the courts of that state. In the case of Santee Mills v. Query, 115 S. E. 202 (1922) the Supreme Court of South Carolina upheld the constitutionality of the statute. Against the contention that the act incorporated by reference in a fashion not permissable, the Supreme Court of South Carolina simply stated that incorporation by reference was permissable in that state. Itshould be noted that South Carolina has no constitutional provision comparable to Section 24, Article V, of the Colorado Constitution, the provision of our own constitution which was discussed at length in part IIA of this study above. The second point usually at issue in this type of case was also raised in the Santee Mills case, the party attacking the South Carolina statute asserting that it delegated legislative power. The South Carolina Constitution does contain a clause vesting legislative power in the general assembly of that state, see South Carolina Constitution, Section 1, Article III. The Supreme Court of South Carolina, however, found that the statute intended to adopt only the 1921 statute and not subsequent amendments thereto which might be passed by Congress from time to time. On this basis the court found no illegal delegation of power.

While the materials in the University of Colorado law library are not sufficiently adequate to permit an unequivocal statement, it appears that South Carolina abandoned the utilization of the federal income tax code in this fashion in 1927, and on that date began to utilize a method comparable to the present Colorado statute. In other words, at the present time South Carolina has enacted and utilizes an income tax statute of its own drafting. See Code of Laws of South Carolina 1952, Section 65-201 et seq.

The next state to utilize federal income tax law by reference appears to have been Georgia. In 1929, Georgia adopted an act very similar to that of South Carolina discussed above. While it prescribed somewhat more administrative machinery, in general, it turned upon assessing for the state a tax at a rate of 33 1/3% of the amount actually paid by the tax payer to the federal government. The constitutionality of this statute was attacked in the case of Featherstone v. Norman, 153 S.E. 58, 70 A.L.R. 449 (1930). Georgia does not have in its constitution a provision comparable to Section 24, Article V of the Colorado constitution. Consequently no issue of incorporation by reference was raised before the Georgia Supreme Court. However the Georgia Constitution then in effect (the Constitution of 1877) did provide in Article III, Section 1, that constitutional provision comparable to Section 24, Article V, of the Colorado Constitution, the provision of our own constitution which was discussed at length in part IIA of this study above. The second point usually at issue in this type of case was also raised in the Santee Mills case, the party attacking the South Carolina statute asserting that it delegated legislative power. The South Carolina Constitution does contain a clause vesting legislative power in the general assembly of that state, see South Carolina Constitution, Section 1, Article III. The Supreme Court of South Carolina, however, found that the statute intended to adopt only the 1921 statute and not subsequent amendments thereto which might be passed by Congress from time to time. On this basis the court found no illegal delegation of power.

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The next state, chronologically, to utilize the federal income tax provisions seems to have been Vermont. In 1947 Vermont adopted an income tax statute which provides for the computation of net income for purposes of state income taxation upon the basis of and in the same manner that net income is computed for purposes of federal tax returns. This naturally results in a considerable shortening of the Vermont income tax statute. In order to avoid argument that the Vermont legislature is delegating the power to Congress to legislate in the future for Vermont, the statute provides an alternative whereby the federal definition of net income, as it read on the date of adoption of the Vermont statute, is to be used. Then, for convenience, the tax payer is allowed at his election to use the present federal definition. Presumably any tax payer who utilizes the current definition is estopped to raise the question of delegation of power. See Chapter 43, Section 932, Vermont Statutes of 1947. An examination of the Vermont Constitution indicates no section comparable to Section 24, Article V of the Colorado Constitution and hence there is no problem of incorporation by reference in that jurisdiction. Apparently the Vermont statute has not challenged in the courts and is still in effect.

The fourth state to venture into this area was probably Utah. Borrowing somewhat from the alternative expressed in the Vermont statute noted above but utilizing it in a different fashion, in 1951 Utah provided that a taxpayer with adjusted gross income for federal tax purposes of less than $5,000, who elected to utilize the tax table provided in the federal statute, could pay, if he wished, 10% of the amount paid to the federal government in discharge of his Utah income tax liability. If the taxpayer did not so elect, he could compute his Utah tax on the regular basis using the full provisions of the statute. Obviously therefore, the Utah experiment extended to only a part of the total number of taxpayers within the state. The Utah statute, which had appeared as Section 59-14-73 of the Utah Code Annotated 1953, was repealed by the 1955 Utah Legislature. See Chapter 124, Section 3, Utah Laws of 1955. The validity of this statute was not tested before the appellate courts of Utah. Examination of the Utah Constitution indicates that the legislative power of the state is vested in the Legislature (Article 6, Section 1) but that there is no section of the constitution comparable to Article V, Section 24, of the Colorado Constitution, directly pertinent to adoption by reference.

The fifth state to be considered is New Mexico. In 1953, New Mexico enacted a statute patterned somewhat after that of Utah. It provided (see New Mexico Statutes 1953, Annotated, 72-15-21 (e)) that individuals having a gross income of $10,000 or less might, at their option, pay a New Mexico state income tax of 4% of the total income tax payable for the same year to the United States under the provisions of the Internal Revenue Code. When this matter was pending before the legislature, probably in a slightly different form, the attorney general of New Mexico rendered an opinion that it would be unconstitutional. This opinion was based upon three grounds. In the first place the statute was taken to delegate legislative authority because it contemplated that the percentage paid in New Mexico would be based solely on the amount paid to the United States, which would vary from year to year. In the second place, the New Mexico statute was thought to incorporate a United States Statute by reference and New Mexico does have a provision in its constitution (See New Mexico Constitution, Article 4, Section 18) very nearly identical with Article 5, Section 24, of the Colorado Constitution.

Finally the statute was thought to violate principles of proper classification of tax payers, contrary to due process. It does not appear that the New Mexico statute was challenged before the appellate courts of that state. It was repealed by Section 2 of Chapter 188 of the New Mexico Laws, 1955.

In Iowa, the 1955 legislature has adopted a statute which utilizes the figure reportable as federal adjusted gross income under the 1954 Internal Revenue Code as a point of departure in computing state income taxes. See Ch. 208, Iowa Laws of 1955. It specifically avoids problems of change in the federal law by operating on the figure as computed under the 1954 Code and contemplates amendment of the Iowa law to change this date as frequently as Congress changes the Code. See the discussion by Miller, The New Iowa Income Tax Law, 41 Iowa Law Review 85. (fall 1955). Mr. Miller, the author of the Iowa statute, is of the opinion that it avoids constitutional pitfalls at least somewhat comparable to those which exist in Colorado. His argument is that incorporation of definitions and the use of the federal figure merely pertain to computation and do not delegate legislative power. He is partially sustained, at least, by an earlier Iowa case, Ballard Hassett Co. v. Local Board of Review, 215 Iowa 556, 246 N. W. 277(1933). The current Iowa statute obviously has not been in existence long enough to produce definitive litigation.

In New Hampshire, the state supreme court gave an advisory opinion in 1949 approving, without discussion, a pending bill to base the state income tax on the federal definition of net income as of the date the statute became effective. See Opinion of the Justices 95 N. H. 540, 64 A2d 322 (1949). Apparently this measure was never adopted. In 1955 another bill was proposed which would base the New Hampshire tax upon a percentage of the federal tax. This was ruled to be unconstitutional in another advisory decision. Opinion of the Justices 113 A 2d 547 (1955). The grounds of the last decision were a rather stringent requirement of tax equality in the New Hampshire Constitution.

Finally the experience of Alaska should be noted. The territorial legislature passed an income tax based upon payment to the territory of a sum equal to ten per cent of the amount paid to the United States as income tax. In Alaska Steamship Co. v. Mullaney, 180 F 2d.805 (1950) this statute was upheld by the United States Court of Appeals for the Ninth Circuit. The language is persuasive, although the case came up so promptly that it did not involve any change in the federal law. It should be noted that the Alaskan legislature was not faced with certain limiting factors involving legislation by reference which are present in Colorado.

Results in other jurisdictions, on the basis of the discussion above, do not prove to be of great assistance to one who would seek to uphold a Colorado statute basing income tax within the state upon the federal code although they help somewhat. While there are three state cases upholding such an action, their weight is limited by the fact that none of the states involved have constitutional provisions comparable to that of Colorado. The same may be said of the case from Alaska. Of the states which have more recently ventured into this method of corrolating their own income tax with that of the federal government, only New Mexico has a constitutional problem comparable to that existent in Colorado, and in New Mexico an adverse opinion of the state attorney general was rendered on this particular legal problem.

IV

Conclusions

The conclusions which can be drawn from a survey of the Colorado Constitution and precedents and from a brief summary of legal experience with the same situation in other jurisdictions cannot be expressed absolute terms. There is no square authority on the matter in Colorado but decisions upon analogous issues indicate state constitutional doubts, despite the possible practical advantages in the proposal. While cases from other jurisdictions have upheld use of the Federal Internal Revenue Code by reference, in none of these cases were the same constitutional hurdles present as exist in Colorado. A recent trend has been to make the use of the federal code as a basis elective with the taxpayer, hoping thus to avoid constitutional litigation on the theory that only one who uses the elective method could question it and that he would be estopped in any event by his own free choice of such method. There have been no court tests which have reached an appellate court level of the effectiveness of this latter device but it might well be legally adequate. Balancing all of the factors discussed herein, it must be concluded that adoption of any of the provisionsof the Internal Revenue Code by reference, perhaps even an alternative elected at the option of the taxpayer, does involve some constitutional risks unless a constitutional amendment is proposed and adopted or unless an advisory opinion approves the measure in advance. Basing the Colorado law on the federal code by the utilization of identical language involves no constitutional problem but does lengthen our statutes.

TOPIC V

"TIEING-IN" COLORADO AND FEDERAL INCOME TAX LAWS ON AN OPTIONAL BASIS

In Topic IV are presented the major legal obstacles involved in adopting the federal personal income tax by reference in the Colorado statutes. The foregoing discussion is concerned principally with the legal questions which might arise if the federal law were adopted by reference as "the method" for the Colorado taxpayer. In Topic V, however, this report examines the possibility of allowing the taxpayer the option of using either the federal definitions for arriving at "net income" or the state of Colorado definitions for arriving at "net income."

Before discussing the mechanics of such a proposal, the committee desired to have some specific legal opinion on the matter, and accordingly, an inquiry was sent on June 14, 1955, to the Attorney General, posing three specific questions relative to adoption of an optional filing system.

The questions asked of the Attorney General at that time related to using the federal "adjusted gross income" rather than the federal "net income" as the option, but the principles involved would appear to be the same in either case. He expressed the opinion that an optional system would probably be valid in Colorado, if properly drawn. He quite properly indicated that the language of a specific bill would have to be examined before any final answer on the subject could be made. The complete text of his opinion is reproduced on the next two pages.

DUKE W. DUNBAR
ATTORNEY GENERAL

The State of Colorado

DEPARTMENT OF LAW

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ASSISTANT ATTORNEYS GENERAL

July 27, 1955

Mr. Harry S. Allen
Senior Research Analyst
Legislative Council
State Capitol
Denver 2, Colorado

Dear Sir:

Receipt is acknowledged of your letter of June 14, 1955, in which you request my opinion concerning the following:

FACTS: The Legislative Council, pursuant to House Joint Resolution 20, First Regular Session, Fortieth General Assembly, is engaged in the study of the Colorado Income Tax law. The chairman of the Income Tax Sub-committee of the Council is interested in the legality of tying the Colorado law to the Federal Internal Revenue Act. One of the plans considered has been for Colorado to adopt an optional short form return which an individual taxpayer could elect to file in lieu of the current long form return. Such short form would permit the taxpayer to enter the amount of the adjusted gross income reported to the federal government, deducting therefrom either the total amount of itemized deductions or the standard deduction, whichever he prefers, plus the amount paid in federal income taxes, thus arriving at the net income for computing the Colorado income tax.

Another plan considered has been for Colorado to adopt a return in which the taxpayer pay to the state a given percentage of his tax paid to the federal government.

QUESTIONS: 1. Would optional short form, indicated in facts above, be constitutional if adopted by the General Assembly?

2. Would that plan involve an unconstitutional delegation of authority inasmuch as it involves the use of federal statutes and administrative decisions?

3. Would the plan set forth in the second proposition contravene the Colorado Constitution?

CONCLUSION: Subject to the specific language that may appear in a given bill, my conclusion is:

(1) An optional short form could be adopted; (2) Such would not be an unconstitutional delegation of authority, and (3) The taxpayer might adopt a return in which he pays the state a given percentage of his federal income tax; provided that the imposing statute were carefully drawn so as not to violate Article 5, Sections 17 and 24, Colorado Constitution, and if provision were made for exclusion of income over which Colorado has no jurisdiction.

ANALYSIS: It is extremely difficult to adequately analyze and answer the propositions advanced in the questions without having before me for analysis a specific bill. This problem has been devoted considerable time and research. Any objections which appear on a theoretical examination might well be resolved by careful draftsmanship. I believe, generally, that the above questions can be embodied in a satisfactory statute with the admonition that Article 5, Sections 17 and 24, Colorado Constitution, must be observed. (Section 17 requires that no law shall be passed except by bill; Section 24 states that no law shall be revived, or amended, or the provisions thereof extended by reference to title only, but shall be re-enacted and published at length). It is impossible to render an opinion concerning those two sections of the Constitution without having specific language before me to analyze.

The adoption of an optional method of reporting income, if the taxpayer were given an opportunity to select his return, and to amend, if he later discovered another form were to his advantage, would probably be valid. The election given would eliminate a large class of persons who might be in a position to raise a constitutional question, as the election would minimize the possibility of the taxpayer being detrimentally affected by the adoption of the federal figures.

I shall be happy to examine any specific legislation that you may present to me. May I suggest that the Council examine the experience of New Mexico with its percentage of the Federal tax statute which was repealed in 1955.

If you desire a member of my staff to be present at the meeting on July 29 to discuss the research, please advise.

Very truly yours,

Duke W. Dunbar

DUKE W. DUNBAR
Attorney General

DWD:ml

Mechanics of an Optional Filing System

Topic III of this report lists the major differences between the definitions used in the federal income tax law and the Colorado income tax law. All these differences affect the calculation of "net income." This "net income" figure appears as line 3 in the tax computation section of page 3 on the 1954 federal income tax return (Form 1040). The net income on the state return is line 3 of Schedule N of the 1954 Colorado income tax return (Form 104). Since this "net income" is the one affected by the differences in definitions, the use of the same definition to arrive at "net income" for both state and federal purposes would result in great simplification for the taxpayer, since he would have to make only one set of calculations instead of two.

Under an optional filing system, the taxpayer would report as his "net income" to the state the same amount as shown on his return to the federal government. This also would give the taxpayer the advantage of the more liberal federal provisions, such as deduction for babysitting expense, charitable contributions, and so on.

Mandatory Adjustments to Net Income

Even if the state should allow the taxpayer to report as his "net income" for state tax purposes that figure which is so reported on the federal return, certain other minor adjustments must still be made to conform with constitutional (federal and state) provisions. For example, the amount of income derived from federal bonds must be deducted before the state tax can be applied, since states, by federal constitutional provisions, are not allowed to tax income derived from that source.

Optional Adjustments to Net Income

In addition to the mandatory adjustment to federal "net income" on the state return it is possible to allow other adjustments as state policy may dictate. One of the adjustments which would have the greatest effect, aside from allowing credit for federal income taxes paid, is that of adding back into income for state purposes the loss "carry-back" allowed in computing net income for federal purposes. Under the Federal Internal Revenue Law of 1954, a net operating loss may be offset against net income of other years by means of a 2 year carry-back, and a 5 year carry-forward. The Colorado law allows only an offset against net income for 4 succeeding years. Also the interest received from state and municipal bonds subject to taxation may be added to the state return inasmuch as this source of revenue is not included in net income for federal purposes.

Computation of Tax

In computing the tax on the basis of "net income," credit must be then allowed for the Colorado personal exemptions ($600 for each dependent at the present time). To illustrate the maximum information which would be needed to arrive at Colorado net taxable income under an optional system of filing and the present Colorado deductions, the following specific entries are given:

1.	Net income (report same figure as on line 3 of tax computation section, federal form 1040)		$ x,xxx
2.	Less income from federal bonds	$ xxx	
3.	Less federal income taxes paid	xxx	- xxx
4.	Total		$ x,xxx
5.	Add optional items as state policy dictates (see instructions)		xxx
6.	Total		$ x,xxx
7.	Less personal exemptions ($600 multiplied by number of exemptions claimed)		- x,xxx
8.	Colorado net taxable income		$ x,xxx

The above is the information which would be necessary on a state income tax return, in addition to the personal information listing the taxpayer's name, names of dependents, etc. There would also be required an additional small section for those taxpayers who are subject to the surtax on income derived from interest and dividends, plus space for the lines to compute the tax and to take the existing 20% credit. These latter two computations could be eliminated by statutory adoption of a tax table taking into consideration all factors to be used by those taxpayers electing to file under the optional form.

Special Considerations in Using an Option

The federal law allows a husband and wife to file a joint return and split income filing. Therefore, the use of the optional filing would have to be limited to the income prior to splitting, and a taxpayer must file a Colorado return on the same basis as his federal return unless the state wished to lose substantial amounts of revenue. In other words, if a joint return is filed for federal purposes, then a joint return must be filed for state purposes and the net income figure,* prior to applying the split, as reported on the federal tax return, used as the Colorado figure. If husband and wife file separate returns with the federal government, then they would have to file separate returns with the state and use the net income reported by each of them to the federal government as the net incomes reported to the state.

If the state is using the net income reported to the federal government as the base for state income tax, then it must also

* This figure appears on line 3 of the tax computation section on page 3 of Form 1040 (Federal), 1954.

provide the taxpayer with the same opportunity to amend his return, as is provided in the federal law. Since at the present time the state law is more liberal in this respect than the federal government, this presents no particular problem, but should the federal government extend the statute of limitations for filing an amended return, then the state would have to conform.

Use of Tax Table in Optional System

At the request of the committee, the State Revenue Department has developed a tax table that could be used with optional filing, and which takes into consideration all special features of the present Colorado income tax law except the surtax, and allows the taxpayer to arrive at the amount of state income tax due without the necessity for any computation. This table starts out with the net income,* as reported to the federal government, and computes the tax due to Colorado for all types of taxpayers. It includes the credit for federal income taxes paid as well as the present 20% credit allowed on Colorado state income tax.

If such a table were adopted in the statutes as part of the optional filing system, it would provide the greatest possible simplification to the taxpayer.

Arguments for Optional Filing

1. This makes the filing of a state income tax return as simple as possible, and thus serves to eliminate any reason for complaint on the part of the taxpayer that the computation of the Colorado income tax is complicated.

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* This figure appears on line 3 of the tax computation section on page 3 of Form 1040 (Federal), 1954.

2. Administration of the personal income tax by the State Department of Revenue would be simplified to a considerable extent. The audit program for personal income tax returns would be reduced to mathematical computations plus checks, as necessary, with the Federal Bureau of Internal Revenue. The cost of printing, processing, and mailing returns would also be reduced to some extent.

3. An <u>optional</u> filing system would apparently avoid the constitutional pitfalls which are inherent in tieing the state and federal laws together on a mandatory basis.

<u>Arguments Against Optional Filing</u>

1. The enactment of an optional filing system may result in a revenue loss to the state.

2. Even an optional filing system may pose some serious constitutional problems.

COMMITTEE CONCLUSION

A system of optional filing appears to offer a reasonable method of simplifying the Colorado personal income tax and it is therefore suggested that the General Assembly, if simplification is desired, give serious consideration to this plan. Prior to its final adoption it is advisable that the constitutional question be passed upon, either by submitting a bill to the Attorney General for his opinion, or by asking the Supreme Court for an interrogatory opinion. It is further suggested that if an optional filing system is adopted there also be enacted a tax table to be used in computing taxes under the optional filing which would maintain tax revenue from those using this simplified form at substantially the same level as existed at the time such plan was adopted.