



COLORADO
Department of Revenue
Taxation Division

Colorado Enterprise Zone Tax Guide



Enterprise zones are economically depressed areas designated by the Colorado Economic Development Commission based upon unemployment rate, population growth rate, and/or per capita income. Enterprise zones may include both urban and rural areas. There are sixteen designated enterprise zones in Colorado. Maps and additional information about designated enterprises zones can be found online at OEDIT.Colorado.gov/enterprise-zone-program.

Colorado has established several tax incentives for private enterprises to start new businesses and to expand existing businesses in enterprise zones. These incentives come primarily in the form of credits that can be applied toward a taxpayer's Colorado income tax liability. These credits are generally based on investments made or employees hired by the taxpayer in an enterprise zone. There are also sales and use tax exemptions allowed for certain machinery and machine tools used solely and exclusively in an enterprise zone.

This publication is designed to provide taxpayers with general information about tax incentives for business activity and investments in enterprise zones. Nothing in this publication modifies or is intended to modify the requirements of Colorado's statutes and regulations. Taxpayers are encouraged to consult their tax advisors for guidance regarding specific situations. Additionally, taxpayers can request a General Information Letter (GIL) or Private Letter Ruling (PLR) from the Department on issues related to enterprise zone tax credits and exemptions.

In addition to the tax incentives discussed in this publication, an enterprise zone contribution credit is allowed to taxpayers who make monetary or in-kind contributions for the purpose of implementing the economic development plan for an enterprise zone. Please see Department publication *Income Tax Topics: Enterprise Zone Contribution Credit* for additional information about the contribution credit.

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Taxpayers must satisfy certain certification and filing requirements to claim enterprise zone credits. Additionally, taxpayers who claim enterprise zone credits are generally required to file electronically. The pre-certification, certification, and mandatory electronic filing requirements described in this *Part 1* apply to all enterprise zone credits discussed in this publication.

Pre-certification requirements

Before a taxpayer engages in any activity for which the taxpayer intends to claim any enterprise zone credit discussed in this publication the taxpayer must apply for pre-certification online at OEDIT.Colorado.gov/enterprise-zone-program. As part of the application, the taxpayer must identify their business location within the enterprise zone and attest that:

- the taxpayer is aware of enterprise zone credits; and
- enterprise zone credits are a contributing factor to the start-up, expansion, or relocation of the taxpayer's business in the enterprise zone.

Furthermore, the taxpayer must acknowledge in the application that the pre-certification applies only to activities that commence after the date that pre-certification is issued by the enterprise zone administrator and before the end of the taxpayer's current income tax year.

The pre-certification applies only with respect to activities undertaken by the taxpayer at the business location identified in the pre-certification.

Certification requirements

Before filing an income tax return claiming any credit covered by pre-certification, the taxpayer must obtain final certification from the enterprise zone administrator. A taxpayer who has not satisfied the *pre-certification requirements*, discussed earlier in this publication, may not apply for any enterprise zone credits. Applications for final certification must be made online at OEDIT.Colorado.gov/enterprise-zone-program. OEDIT provides information to the Department of Revenue confirming that taxpayers have complied with pre-certification and certification requirements.

The final certification issued by the enterprise zone administrator affirms only that the taxpayer's business address is within the boundaries of the enterprise zone, the taxpayer satisfied the applicable pre-certification requirements, and, in the case of the vacant building rehabilitation credit, that the expenditures are of a qualified nature. The final certification does not establish the taxpayer's eligibility for the credit or the amount of the credit claimed. Any enterprise zone credits a taxpayer claims are subject to examination, audit, and adjustment by the Department of Revenue.

Claiming credits

Taxpayers must file a Colorado income tax return and *Enterprise Zone Credit and Carryforward Schedule (DR 1366)* to claim any enterprise zone income tax credits allowed to the taxpayer for the tax year. Credits must be claimed on the return filed for the tax year in which the taxpayer earned the credit, even if the taxpayer has no tax liability for that year to offset with the credit(s). Enterprise zone credits claimed, but not applied to offset tax in the year claimed can generally be carried forward to the following tax year. Credits cannot be carried forward and applied toward tax in subsequent tax years unless the taxpayer filed an income tax return and form DR 1366 to properly claim the credit for the tax year in which it was earned.

Mandatory electronic filing

Any taxpayer who claims one or more enterprise zone credits must file their Colorado income tax return electronically, unless filing electronically would cause undue hardship for the taxpayer. A taxpayer may claim enterprise zone credits on a paper return only if the taxpayer cannot file electronically because the taxpayer does not have:

- access to a computer;
- sufficient internet access;
- sufficient internet capability; or
- sufficient computer knowledge.

Any taxpayer who claims one or more enterprise zone credits must also include with their return a completed *Enterprise Zone Credit and Carryforward Schedule (DR 1366)*. Additionally, S corporations, partnerships, and any other entity treated as a partnership for tax purposes must file with their returns a completed *Pass-Through Entity Enterprise Zone Credit Distribution Report (DR 0078A)*.

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to pre-certification, certification, and filing requirements for enterprise zone credits. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- § 39-30-103, C.R.S. Zones established - review - termination - repeal.
- § 39-30-110, C.R.S. Electronic submissions.
- § 39-30-111, C.R.S. Department of revenue - enterprise zone data - electronic filing - submission of carryforward schedule.
- § 39-30-112, C.R.S. Data provided to department of revenue.

Forms and guidance

- [Tax.Colorado.gov](https://tax.colorado.gov)
- *Enterprise Zone Credit and Carryforward Schedule (DR 1366)*
- *Pass-Through Entity Enterprise Zone Credit Distribution Report (DR 0078A)*
- [OEDIT.Colorado.gov/enterprise-zone-program](https://oedit.colorado.gov/enterprise-zone-program)

Part 2: Investment Tax Credit

The enterprise zone investment tax credit is allowed for 3% of the taxpayer's qualified investment made during the tax year in qualified property used solely and exclusively in an enterprise zone for at least one year. This *Part 2* provides information about qualifications, calculations, and limitations applicable to the investment tax credit.

I.R.C. References in This Part 2

The enterprise zone investment tax credit is based upon provisions of the Internal Revenue Code ("I.R.C.") as it existed immediately prior to the enactment of the federal Revenue Reconciliation Act of 1990. All references in this Part 2 to sections of the I.R.C. are to those sections as they existed immediately prior to the enactment of the federal Revenue Reconciliation Act of 1990.

Qualified property

Qualified property is property defined as "section 38 property" in section 48 of the I.R.C. Section 38 property generally includes tangible personal property that is depreciable under section 168 of the I.R.C. Section 168 prescribes the method of depreciation for property either used in a trade or business or otherwise held for the production of income. Property that is neither used in a trade or business nor held for the production of income is not qualified property and does not qualify for the enterprise zone investment tax credit. Additionally, any property the taxpayer elects to expense pursuant to section 179 of the I.R.C. is not qualified property and does not qualify for the credit.

Several other types of property may also qualify as section 38 property if they are (1) depreciable under I.R.C. section 168 (without regard to useful life) or (2) otherwise eligible for depreciation (or amortization in lieu of depreciation) and have a useful life of 3 years or more. Please see I.R.C. section 48 and the associated federal regulations for information regarding specific rules for the following types of property:

- air conditioning and heating units;
- tangible property used as an integral part of manufacturing or extraction;
- tangible property used as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services;
- tangible property that constitutes a research facility or bulk storage facility;
- elevators and escalators;
- single-purpose agricultural or horticultural structures;
- qualified rehabilitation expenditures;
- qualified timber property;
- a storage facility used in connection with distribution of petroleum products;
- property used in lodging;
- livestock;
- boilers fueled by oil or gas;
- movie and television films;
- energy property; and
- sound recordings.

Pre-certification

Any taxpayer who intends to claim a credit must first pre-certify with the applicable enterprise zone administrator. No enterprise zone investment tax credit is allowed with respect to any property acquired by the taxpayer, or with respect to which the taxpayer paid or incurred any expense, prior to the taxpayer's pre-certification with the enterprise zone administrator for the tax year. Please see *Part 1* of this publication for additional information about pre-certification.

Qualified investment

The allowable credit is an amount equal to 3% of the taxpayer's qualified investment during the tax year in qualified property that is used solely and exclusively in an enterprise zone for at least one year. The qualified investment is a percentage of the basis or cost of qualified property placed into service by the taxpayer during the tax year. The applicable percentage may be based on various factors, including the type of property, the useful life of the property, whether the property is new or used when the taxpayer acquires it, and whether section 168 of the I.R.C. applies to the property. Section 168 of the I.R.C. provides generally for the accelerated cost recovery system for depreciable business assets.

The applicable percentage for property to which I.R.C. section 168 applies is:

- 60% for property classified as 3-year property in I.R.C. section 168(e); and
- 100% for property classified as anything other than 3-year property in I.R.C. section 168(e).

Please see I.R.C. section 46(c)(2) for the applicable percentage for section 38 property to which I.R.C. section 168 does not apply.

When property is placed in service

For the purpose of determining a taxpayer's qualified investment, qualified property is placed in service in the earlier of the following tax years:

- the tax year in which, under the taxpayer's depreciation practice, the period for depreciation with respect to such property begins; or
- the tax year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function.

Please see 26 CFR § 1.46-3(d), the section titled "Placed in Service" in Chapter 1 of *IRS Publication 946, How to Depreciate Property*, and the following examples for additional guidance in determining the tax year during which qualified property is placed in service.

Examples

The following are examples of cases where property shall be considered in a condition or state of readiness and availability for a specifically assigned function:

- Parts are acquired and set aside during the taxable year for use as replacements for a particular machine (or machines) in order to avoid operational time loss.
- Operational farm equipment is acquired during the taxable year and it is not practicable to use such equipment for its specifically assigned function in the taxpayer's business of farming until the following year.
- Equipment is acquired for a specifically assigned function and is operational but is undergoing testing to eliminate any defects.

Special rules

Special rules apply to various types of property and investments. The following sections provide information about special rules for:

- used property;
- property ultimately used solely and exclusively in an enterprise zone for less than one year;
- renewable energy investments;
- leased property; and
- the commercial vehicle investment tax credit for heavy trucks, tractors, and semitrailers.

Used property

In the case of used property, the qualified investment that may be considered in the calculation of the credit is limited to \$150,000.

One-year requirement

The credit is allowed only for qualified property that is used solely and exclusively within an enterprise zone for at least one year after the property is placed in service. However, a taxpayer may file a tax return claiming the credit before the full year has elapsed. For example, if a taxpayer places qualified property in service in November of 2018, the taxpayer can file a 2018 income tax return claiming the credit in April 2019, before the full one-year period has elapsed.

If a taxpayer claims a credit for qualified property that is not ultimately used solely and exclusively in an enterprise zone, the taxpayer must file an amended return to withdraw the credit claim for such property. For example, if a taxpayer places qualified property in service in November of 2018 and files a 2018 income tax return claiming the credit in April 2019, but uses the property outside of the enterprise zone in June 2019, the taxpayer must file an amended 2018 return to withdraw the claim for credit.

Renewable energy investments

In general, the credit can be used only to offset tax and cannot be used to claim a refund. However, any taxpayer who is allowed a credit for a new renewable energy investment may elect to receive a refund for a portion of the allowable credit if the new renewable energy investment was both:

- placed in service on or after January 1, 2015, but prior to January 1, 2021; and
- placed in service during a tax year commencing on or after January 1, 2015, but prior to January 1, 2021.

A new renewable energy investment is a qualified investment for a project that generates electricity from eligible energy resources. Eligible energy resources generally include solar, wind, geothermal, biomass, hydroelectricity, and recycled energy. Fossil fuels, nuclear fuels, and their derivatives are not eligible energy resources. Please see section 40-2-124(1)(a), C.R.S., for a complete definition of eligible energy resources.

A taxpayer who makes an election to receive a refund for a new renewable energy investment is allowed a refund for 80% of the credit. By making the election, the taxpayer agrees to forgo the remaining 20% of the credit. The taxpayer may make the election no later than the due date, including extensions, for filing the tax return for the tax year during which the renewable energy investment was placed into service.

If the refund the taxpayer elects to receive is greater than \$750,000, the taxpayer will receive a refund of \$750,000 for the tax year the election is made and a refund of \$750,000 for each subsequent tax year until the full amount of the allowable refunded has been refunded to the taxpayer. A taxpayer may make the election to receive a refund with respect to multiple renewable energy investments, but in no event may the taxpayer receive a refund, for any tax year, totaling more than \$750,000 for renewable energy investments.



Leased property

Under certain conditions, the lessor of qualified property can elect to treat the lessee as having acquired the property for the purpose of the credit. Please see I.R.C. section 48(d) and 26 CFR § 1.48-4 for additional information regarding leased property.

Commercial vehicle investment tax credit

Special rules apply for determining whether heavy trucks, tractors, and semitrailers qualify for a credit and for calculating the amount of that credit. These special rules apply to heavy trucks, tractors, and semitrailers that meet all of the following criteria:

- They have a gross vehicle weight rating (GVWR) of 54,000 pounds or greater.
- They are model year 2010 or newer.
- They are designated as Class A personal property for vehicle registration purposes.
- They are licensed and registered in Colorado.

Heavy trucks, tractors, and semitrailers, and any parts associated therewith, are deemed to satisfy the *one-year requirement* described earlier in this publication if they are predominantly housed and based at the taxpayer's business trucking facility within an enterprise zone for the 12-month period following purchase.

Subject to approval and certification by the Economic Development Commission, a commercial vehicle investment tax credit is allowed for heavy trucks, tractors, and semitrailers that satisfy all of the requirements for the enterprise zone investment tax credit. The allowable credit is equal to 1.5%, rather than 3%, of the qualifying investments.

For additional information regarding commercial vehicle investment tax credits allowed for heavy trucks, tractors, and semitrailers, please visit OEDIT.Colorado.gov/enterprise-zone-commercial-vehicle-investment-tax-credit.

Limits on use of the credit

Multiple limitations restrict the amount of credit a taxpayer can use for a given tax year. If the credit allowed to the taxpayer exceeds these limits, the taxpayer can generally carry forward the excess credit for application toward the tax due for subsequent tax years. The amount of credit a taxpayer can use in a given tax year is the lesser of:

- the taxpayer's net tax liability;
- the sum of \$5,000 plus 50% of the taxpayer's tax net liability in excess of \$5,000; or
- \$750,000.

The \$750,000 limit applies to any credit applied toward tax, any refund the taxpayer receives for a renewable energy investment, and to the combined total of credit applied and refund claimed by the taxpayer for the tax year. If a taxpayer claims a \$750,000 refund for a renewable energy investment, the taxpayer cannot apply any credit toward tax for the same tax year. The \$750,000 limit does not apply to any credit the taxpayer has carried forward from a tax year prior to 2014.

The limits on credit use apply to the investment tax credit and the job training investment tax credit discussed in *Part 4* of this publication. The combined amount of investment tax credit and job training investment tax credit a taxpayer applies to offset tax for a given tax year cannot exceed the limits on credit use.

Please see sections 39-30-104(2)(a) and (b) and 39-22-507.5(3), C.R.S., for limits applicable to tax years commencing prior to January 1, 2014.

Credit carryforwards

If the credit a taxpayer may use is limited as described above, the taxpayer can generally carry forward the excess credit to the next tax year. The number of years a taxpayer can carry forward excess credits beyond the tax year in which the investment was made depends on the tax year for which the credit was initially allowed. The credit carryforward periods reflected in *Table 2-1* do not apply to renewable energy investments for which the taxpayer has elected to receive a refund.

Table 2-1. Credit Carryforward Periods

<i>Tax Years</i>	2013 and prior	2014 through 2017	2018 and later
<i>Credit carryforward period</i>	12 years	14 years	14 years
<i>Carryforward period for renewable energy investments</i>	20 years	22 years	14 years

Any credit that has not been used within the carryforward period expires and is no longer available to the taxpayer.

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to the enterprise zone investment tax credit. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

State statutes and regulations

- § 39-30-104, C.R.S. Credit against tax - investment in certain property - definitions.
- Rule 39-30-104. Enterprise zone investment tax credit.

Federal law

The federal laws listed here, that apply to the enterprise zone investment tax credit, are those laws as they existed immediately prior to the enactment of the federal Revenue Reconciliation Act of 1990.

- I.R.C. § 38. General business credit.
- I.R.C. § 46. Amount of credit.
- I.R.C. § 47. Certain dispositions...of section 38 property.
- I.R.C. § 48. Definitions; special rules.
- I.R.C. § 167. Depreciation.
- I.R.C. § 168. Accelerated cost recovery system.

Any federal regulations promulgated under these sections may also apply to the enterprise zone investment tax credit.

Forms and guidance

- *Tax.Colorado.gov*
- *OEDIT.Colorado.gov/enterprise-zone-investment-tax-credit*
- *OEDIT.Colorado.gov/enterprise-zone-commercial-vehicle-investment-tax-credit*
- *Enterprise Zone Credit and Carryforward Schedule (DR 1366)*
- *IRS Publication 946, How to Depreciate Property*

A taxpayer who operates a business facility in an enterprise zone is allowed a credit for the net increase during the tax year in employees working at the facility. The taxpayer may claim additional employee credits if certain qualifying criteria are met. This *Part 3* provides information about business facility new employee credits, including discussion of the following subjects:

- *Qualifying criteria for business facilities and business facility employees*
- *Calculation of net new business facility employees for the tax year*
- *Additional credits for certain facilities and employees*
- *Examples for calculating the credit*

Business facilities

Enterprise zone business facility employee credits are allowed only to taxpayers who operate a business facility in an enterprise zone. The business facility must meet certain criteria, must be used by the taxpayer in a revenue-producing enterprise, and is subject to certain rules in the event the facility is leased. If a taxpayer operates a business without any business facility, the taxpayer may not claim the business facility new employee credit.

The taxpayer's business facility must be a factory, mill, plant, refinery, warehouse, feedlot, or any other building or complex of buildings within which individuals are customarily employed or that are customarily used to house machinery, equipment, or other property.

Temporary structures and mobile units do not qualify as business facilities, unless they are used in association with permanent structures that qualify as business facilities. If a temporary structure or mobile unit is not used in association with a permanent structure that qualifies as a business facility, any employees working in connection with that temporary structure or mobile unit are not business facility employees and do not qualify for the credit.

Revenue-producing enterprises

The taxpayer must operate the business facility in a revenue-producing enterprise that engages in one or more of the following activities:

- the production, assembly, fabrication, manufacturing, or processing of any agricultural, mineral, or manufactured product;
- the storage, warehousing, distribution, or sale of any products of agriculture, mining, or manufacturing;
- the feeding of livestock at a feedlot;
- the operation of laboratories or other facilities for scientific, agricultural, animal husbandry, or industrial research, development, or testing;
- the performance of services of any type; or
- the administrative management of any of the activities listed above.

Leased business facilities

If a taxpayer owns a business facility in an enterprise zone and leases the entire facility to another person or business, the taxpayer cannot claim any employee credits with respect to the facility. If the taxpayer leases part of that facility to another person or company and operates a revenue-producing enterprise in the remaining part, the taxpayer may claim employee credits only with respect to employees employed by the taxpayer in that revenue-producing enterprise.

Business facility employees

In general, a taxpayer may claim business facility employee credits only with respect to employees who satisfy the applicable business facility, work location, time, and withholding requirements. Special rules that apply specifically to *commercial drivers* are discussed later in this publication.

Business facility and work requirements

To qualify for the credit, an employee must work in or at the business facility, within the enterprise zone, including the land on which the facility is located and be employed by the taxpayer in connection with the operation of the taxpayer's business facility during the taxable year for which the credit is claimed. An employee's duties are performed in connection with the operation of a business facility only if such duties contribute materially to the operation of a revenue-producing enterprise conducted in or at the business facility.

An employee satisfies these requirements if they customarily perform duties in or at the business facility, in connection with the operation of the facility, for at least 20 hours per week throughout the taxable year, regardless of whether they also perform additional duties at another location either inside or outside of the zone. For example, if an employee customarily performs duties at the business facility in connection with the operation of the facility for at least 20 hours per week, the employee qualifies for the credit even if that employee also spends some additional time working from their home outside of the enterprise zone.

In general, an employee whose duties are not performed in connection with the operation of the business facility or are performed outside of the enterprise zone do not qualify as business facility employees. Examples of non-qualifying employees may include employees who perform landscaping, housecleaning, or construction duties at the customer's location.

Minimum time requirement

The employee must perform duties in connection with the operation of the business facility on:

- a regular, full-time basis;
- a part-time basis if the person is customarily performing his or her duties at least twenty hours per week throughout the taxable year; or
- a seasonal basis if the person performs his or her duties for substantially all of the season customary for the position in which the person is employed.

In order to qualify as a business facility employee, the employee must, throughout the taxable year, customarily perform duties for at least 20 hours per week in or at the business facility, in connection with the operation of the business facility. An employee who meets this requirement and all other applicable requirements is considered a business facility employee even if that employee also performs duties unconnected with the business facility or outside the enterprise zone.

Withholding requirement

The employee must receive compensation for duties performed in the operation of the business facility from which Social Security, Medicare, and income taxes are withheld by either:

- the taxpayer; or
- an employee leasing company acting as the employing unit for, or co-employer with, the taxpayer, if the taxpayer is a work-site employer. See section 8-70-114(2)(a)(V) and (VII), C.R.S.

The withholding requirement is not satisfied with respect to any "statutory employee" for whom the taxpayer withholds Social Security and Medicare taxes, pursuant to I.R.C. section 3121(d)(3), but not income taxes.

Commercial drivers

Special rules apply to any employee whose primary duties consist of operating a commercial motor vehicle with a commercial driver's license. These employees generally are not required to work at or in the business facility, provided they spend no more than 5% of their total time at any business of the employer other than the business within the zone. These employees must nonetheless customarily perform duties for at least 20 hours per week throughout the taxable year that contribute materially to the operation of a revenue-producing enterprise conducted in or at the business facility. They are also subject to the *withholding requirements* discussed earlier in this publication.

Employee credit calculation

The credit is based on the taxpayer's total number of business facility employees, averaged over the course of the tax year, as described later in this section. For the business facility's first year of operation, the taxpayer is allowed a credit of \$1,100 for each business facility employee working within the enterprise zone. For each subsequent tax year, the taxpayer is allowed a credit of \$1,100 for each additional business facility employee working within the enterprise zone in excess of the highest total number of business facility employees for any prior tax year. For any year subsequent to the facility's first year of operation, the credit is allowed only for the additional employees at the facility, even if the taxpayer did not operate the facility in the prior year(s) and/or acquired the facility from another taxpayer. An employer must satisfy all applicable per-certification requirements to qualify for any employee credits.

Averaging employees for the year

In determining the credit, the taxpayer must calculate the total number of business facility employees working in connection with the business facility for the current tax year and for each preceding tax year. In general, the number of business facility employees for any year is calculated by adding together the number of business facility employees on the last business day of each month of the tax year and dividing the total by 12. The taxpayer must use this formula even if the taxpayer's tax year is a short tax year consisting of fewer than 12 months, as may occur if the taxpayer is not in existence for the entire tax year or changes their annual accounting period (please see *IRS Publication 538, Accounting Periods and Methods* for additional information regarding short tax years).

However, the number of business facility employees is calculated differently if the taxpayer's business facility is in operation for less than the entire tax year, as might be the case if the facility operates seasonally or otherwise ceases all operation for some period of time during the year. If the taxpayer's business facility is in operation for less than the entire tax year, the number of business facility employees is calculated by adding together the number of business facility employees on the last business day of each full calendar month of the tax year during which the facility was in operation and dividing the total by the number of such full calendar months of operation. If the business facility's period of operation commences or ceases during a calendar month, and the business facility is therefore not in operation for the full calendar month, that partial month of operation is not considered in the calculation of business facility employees. A business facility is considered to be in operation for less than the entire taxable year only if all business activities conducted at the facility cease temporarily for a period of not less than one full calendar month during the taxable year. Business activities are not deemed to have ceased at a facility in any month during which any employee performs work at or in the facility or during which the generation of any gross revenue can be attributed to the facility.

Pre-certification

Before a taxpayer engages in any activity for which the taxpayer intends to claim any enterprise zone business facility new employee credit, the taxpayer must apply for pre-certification from the enterprise zone administrator. Please see *Part 1* of this publication for additional information regarding pre-certification requirements.

If a taxpayer does not pre-certify as required by law prior to the commencement of the tax year, the number of employees for any month that commences prior to pre-certification during such tax year is deemed not to exceed the highest number of business facility employees calculated for any prior tax year. In calculating the number of business facility employees for any prior year, in order to determine the increase in employees in the current tax year, the number of business facility employees employed by the taxpayer at the business facility on the last business day of each month of the prior year(s) shall be included in the calculation, regardless of whether the taxpayer pre-certified prior to or during such prior year(s).

Please see *Example 3-6*, later in this publication, for illustrations of credit calculations for taxpayers who have commenced operations prior to satisfying pre-certification requirements.

Changes to enterprise zone boundaries

In general, the continuing operations at an existing business facility initially located outside of an enterprise zone that is absorbed into an enterprise zone when the boundaries for the zone are redrawn will not qualify for any enterprise zone employee credits. Employee credits are allowed only to a taxpayer who, before engaging in any activity for which they intend to claim a credit, has certified that the credits are a contributing factor to the start-up, expansion, or relocation of a taxpayer's business in the enterprise zone. If this condition has not been met, the taxpayer may not claim any enterprise zone employee credits with respect to employees at the facility, even after the boundaries of the enterprise zone have been redrawn to include the facility. If an existing business facility is absorbed into an enterprise zone when the boundaries for the zone are redrawn, a subsequent expansion of the facility may qualify the enterprise zone credits.

Replacement business facilities

If the taxpayer's business facility is a replacement business facility, special rules apply for calculating the number of business facility employees. A replacement business facility is a business facility at which the taxpayer (or a related taxpayer) operates a revenue-producing enterprise substantially similar to a revenue-producing enterprise that was operated by the taxpayer (or a related taxpayer) at another business facility in this state that discontinued operating on or before the close of the first taxable year in which commercial operations commenced at the new business facility.

In calculating the credit for a replacement business facility, the average number of business facility employees for any given year must be reduced by the average number of employees at the old facility during the three taxable years preceding the first taxable year that the replacement business facility is first available for use by the taxpayer or capable of being used by the taxpayer in a revenue-producing enterprise.



Other employee credits

Taxpayers may be able to claim up to four additional credits for business facility employees. Qualifying criteria for these credits are detailed in *Table 3-1*, later in this publication. Some of these additional credits are allowed for employees who work in enhanced rural enterprise zones or in connection with business facilities that add value to agricultural commodities through manufacturing or processing, which are explained in greater detail in the following sections.

Enhanced rural enterprise zones

An enhanced rural enterprise zone is any portion of any county that is within the boundaries of an enterprise zone and that meets certain criteria established by law. Every two years, the Office of Economic Development and International Trade (“OEDIT”) determines which counties meet the qualifying criteria to be designated as enhanced rural enterprise zones. Please see OEDIT.Colorado.gov/enterprise-zone-program and section 39-30-103.2, C.R.S., for additional information regarding the designation of enhanced rural enterprise zones.

Agricultural processing

A business adds value to agricultural commodities through manufacturing or processing if it engages directly in an activity that substantially transforms an agricultural commodity into a form other than that which enters the normal agricultural commodity marketing channels. Harvesting, cleaning, packaging, storing, transporting, wholesaling, retailing, or otherwise distributing commodities without substantially changing the form of the commodity do not qualify.

Calculation for other employee credits

Except for the health insurance credit, the other employee credits shown in *Table 3-1*, later in this publication, are allowed only with respect to employees for whom the taxpayer claims the standard enterprise zone employee credit. The taxpayer must first calculate the number of business facility employees (for the first year of operation) or the number of additional business facility employees (for any subsequent year of operation) and then determine which of those employees meet the additional qualifying criteria detailed in *Table 3-1*. The credits allowed for enhanced rural enterprise zones and for processing agricultural commodities are in addition to the standard enterprise zone employee credit.

Employee health insurance credit

A taxpayer may claim the health insurance credit only for the first two full tax years the taxpayer is located in the enterprise zone. Any tax year of less than 12 months is not considered a full tax year. The health insurance credit is not allowed for any tax year subsequent to the first two full tax years that a taxpayer operates a business facility in an enterprise zone, regardless of whether the taxpayer qualified for or claimed any credit for the first two full tax years.

The taxpayer may claim the health insurance credit each of the first two full tax years for each employee that meets the qualifying criteria (please see *Table 3-1*, later in this publication). The credit is calculated by *averaging the qualifying employees for the tax year*, as described earlier in this publication, but, unlike other employee credits, the credit is allowed for all qualifying employees rather than just the increase in qualifying employees over the highest total number of qualifying employees in any prior tax year.



Part 3: Business Facility New Employee Credits

Table 3-1 outlines the qualifying criteria for each of the five different enterprise zone business facility employee credits, including both the standard enterprise zone employee credit and the four additional employee credits. If the applicable qualifying criteria are met, the four additional

employee credits are allowed in addition to, and not instead of, the standard enterprise zone employee credit. Please see *Employee credit calculation*, earlier in this publication, for information about calculating the number of qualifying employees for each credit.

Table 3-1. Business Facility New Employee Credits

<i>Credit</i>	<i>Qualifying criteria</i>	<i>Credit per employee</i>	<i>Carry-forward</i>
Enterprise zone employee credit	<ul style="list-style-type: none"> ➤ The employee must be a business facility employee who satisfies all applicable requirements. 	\$1,100	5 years
Enhanced rural enterprise zone employee credit	<ul style="list-style-type: none"> ➤ The employee must be a business facility employee who satisfies all applicable requirements. ➤ The employee must work during the tax year in an <i>enhanced rural enterprise zone</i>. 	\$2,000	7 years
Enterprise zone agricultural manufacturing or processing employee credit	<ul style="list-style-type: none"> ➤ The employee must be a business facility employee who satisfies all applicable requirements. ➤ The taxpayer must operate a business facility that <i>adds value to agricultural commodities through manufacturing or processing</i>. ➤ The employee does not need to work directly in agricultural manufacturing or processing, but must be employed in the operation of the facility that adds value to agricultural commodities through manufacturing or processing. 	\$500	5 years
Enhanced rural enterprise zone agricultural manufacturing or processing employee credit	<ul style="list-style-type: none"> ➤ The employee must be a business facility employee who satisfies all applicable requirements. ➤ The employee must work during the tax year in an <i>enhanced rural enterprise zone</i>. ➤ The taxpayer must operate a business facility that <i>adds value to agricultural commodities through manufacturing or processing</i>. ➤ The employee does not need to work directly in agricultural manufacturing or processing, but must be employed in the operation of the facility that adds value to agricultural commodities through manufacturing or processing. 	\$500	7 years
Enterprise zone employee health insurance credit	<ul style="list-style-type: none"> ➤ The employee must be a business facility employee who satisfies all applicable requirements. ➤ The employee must be insured under a health insurance plan or program provided by the taxpayer. ➤ The taxpayer must contribute 50% or more of the total cost of the health insurance plan or program. ➤ The plan or program must be a self-insurance program or comply with the provisions of Parts 1, 2, 3, or 4 of Article 16 of Title 10, C.R.S. ➤ The health insurance plan or program must include partial or complete coverage for hospital and physician services. 	\$1,000	5 years

Examples

The following examples illustrate the calculation of business facility employee credits.

Example 3-1. First tax year of operation

A taxpayer begins operation of its business facility on March 18th. The taxpayer’s tax year runs from March 18th through December 31st. The number of employees working at the facility on the last business day of each month is:

March:	6	August:	18
April:	8	September:	24
May:	9	October:	26
June:	12	November:	25
July:	15	December:	37

Under the general rules for calculating the credit, discussed in *Employee credit calculation*, earlier in this publication, the number of business facility employees for the year is calculated by adding together the number of business facility employees on the last business day of each month of the tax year and dividing the total (180) by 12. The result is a total of 15 business facility employees for the tax year. The taxpayer is allowed a credit of \$1,100 for each employee or \$16,500 total (\$1,100 x 15).

Example 3-2. Subsequent tax years

The taxpayer described in *Example 3-1* continues operation of its business facility in the next three tax years. Using the *Employee credit calculation*, described earlier in this publication and in *Example 3-1*, the taxpayer has 15 business facility employees in the 1st year, 22 in the 2nd year, 18 in the 3rd year, and 25 in the 4th year. The following table illustrates the increase in employees over the highest preceding year and the allowable credit for each year.

Tax Years	2nd year	3rd year	4th year
Employees for tax year	22	18	25
Highest total number of employees in any prior year	15	22	22
Increase over highest prior year	7	0	3
Allowable credit	\$7,700	\$0	\$3,300

Example 3-3. Health insurance credit

The taxpayer described in *Examples 3-1* and *3-2* provides health insurance each year to all employees. The insurance meets the requirements to qualify for the health insurance credit.

Unlike the other enterprise zone employee credits, the health insurance credit is allowed for all employees that meet the qualifying criteria, not just the increase in those employees over the highest number in any prior year, but it is allowed only for the first two full tax years that the business facility is located in the enterprise zone.

The taxpayer’s first tax year of operation was not a full tax year, so the taxpayer cannot claim the health insurance credit for that year. Instead, the taxpayer can claim the credit for the 2nd and 3rd years of operation, since those are the taxpayer’s first two full tax years located in the enterprise zone.

The taxpayer had 22 qualifying employees in the 2nd year and 18 qualifying employees in the 3rd year. The taxpayer can claim a credit of \$22,000 (\$1,000 x 22) for the 2nd year and \$18,000 (\$1,000 x 18) for the 3rd year.



Part 3: Business Facility New Employee Credits

Example 3-4. Other employee credits

The business facility of the taxpayer described in *Examples 3-1 and 3-2* was not in an enhanced rural enterprise zone in the year it began operations. However, beginning with the 3rd year of operation, the location of the facility was designated as an enhanced rural enterprise zone.

The taxpayer did not increase employees at the facility in the 3rd year (18 employees for the year compared with 22 in a prior year), so the taxpayer could not claim the standard employee credit or the enhanced rural employee credit for the 3rd year.

In the 4th year, the taxpayer's 25 employees represented an increase of three employees over the highest total number of employees in any prior year. The taxpayer can claim both a standard employee credit of \$3,300 (\$1,100 x 3) and the enhanced rural enterprise zone credit of \$6,000 (\$2,000 x 3) for these three additional employees.

Example 3-5. A facility operating for less than the entire tax year

Each tax year, a taxpayer operates the same business facility in an enterprise zone seasonally from mid-May through mid-October. At all other times, there is no activity and there are no employees working at the facility. The taxpayer's tax year runs from January 1st through December 31st.

Since all business activities conducted at the facility cease temporarily during the tax year and the business facility is therefore in operation for less than the entire tax year, as described earlier in this publication, the calculation of the number of business facility employees for the year includes only the full calendar months of operation. The number of employees working at the facility on the last business day of each full calendar month of operation is:

June:	9	August:	14
July:	12	September:	5

The number of business facility employees for the year is calculated by adding together the number of business facility employees on the last business day of each month of the tax year and dividing the total (40) by the number of full calendar months during which the facility was in operation (4). The result is a total of 10 business facility employees for the tax year, resulting in an increase of two business facility employees over the eight business facility employees, which was the highest number of business employees for any prior tax year. The taxpayer is allowed a credit of \$1,100 for each of the two additional employees or \$2,200 total (\$1,100 x 2).



Part 3: Business Facility New Employee Credits

Example 3-6. Pre-certification after commencing operations

A taxpayer commences operations at a business facility in an enterprise zone on January 1, 2018, and is a calendar year filer whose 2018 tax year runs from January 1, 2018, to December 31, 2018. The taxpayer employs eight business facility employees at the facility at the end of each month of the 2018 tax year. However, the taxpayer does not pre-certify, as described in *Part 1* of this publication, either prior to or at any time during the 2018 tax year. Consequently, for the purpose of calculating the credit allowed for the 2018 tax year, the taxpayer is deemed to have zero employees (the highest average number of employees in any prior tax year) at the end of each month during the 2018 tax year and is therefore not allowed any credit.

Beginning in January 2019, and throughout the entirety of tax year 2019, the taxpayer employs 11 business facility employees. On August 15, 2019, the taxpayer pre-certifies with the enterprise zone administrator. For the purpose of calculating the credit for tax year 2019, the number of business facility employees for any month in 2019 commencing prior to pre-certification is deemed not to exceed the highest average number of business facility employees for any prior year. Consequently, the number of business facility employees from January 2019 through August 2019 is deemed to be eight, rather than 11.

The credit for tax year 2019 is computed by subtracting the average number of business facility employees in 2019 by the highest average number of business facility employees for any prior year and multiplying the result by \$1,100. The average number of business facility employees for 2019 is calculated by adding together the number of employees at the end of each month during the tax year (eight for each month January through August and 11 for each month September through December) and dividing the sum (108) by 12, resulting in nine business facility employees for tax year 2019. The nine business facility employees for tax year 2019 is one more than the eight business facility employees that were the highest average from any prior year. Therefore, the taxpayer is allowed a credit of \$1,100 ($\$1,100 \times 1$).

The taxpayer continues operation of the business facility throughout tax year 2020, employing eleven business facility employees at all times during the tax year. The credit for tax year 2020 is calculated by subtracting the average number of business facility employees for tax year 2020 (11 employees) by the highest average number of business facility employees for any prior year (11 employees, for tax year 2019). Because the average number of business facility employees for tax year 2020 is no greater than the highest average number of business facility employees for any prior year, the allowable credit for tax year 2020 is \$0.



Credit carryforwards

The credit a taxpayer can use for any tax year is limited to the taxpayer's net tax liability. If the allowable credit exceeds the taxpayer's net tax liability, the taxpayer can carry forward the excess credit for application toward the tax due for subsequent tax years. Please see *Table 3-1*, earlier in this publication, for the allowable carryforward period applicable to the different enterprise zone employee credits. Any credit that has not been used within the carryforward period expires and is no longer available to the taxpayer.

Additional resources

The following is a list of statutes, regulations, forms, and guidance relevant to enterprise zone business facility employee credits. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- § 39-30-105.1, C.R.S. Credit for new enterprise zone business employees - definitions.
- Rule 39-30-105.1. Enterprise zone business facility employee credits.

Forms and guidance

- *Tax.Colorado.gov*
- *OEDIT.Colorado.gov/enterprise-zone-new-employee-tax-credit*
- *OEDIT.Colorado.gov/enterprise-zone-employer-sponsored-health-insurance-tax-credit*
- *Enterprise Zone Credit and Carryforward Schedule (DR 1366)*

A taxpayer who invests in a qualified job training program for employees who work predominantly within an enterprise zone may claim a credit equal to 12% of the qualified investment. This *Part 4* provides information about qualified job training programs, qualified investments, the credit calculation, and the allowable carryforward period for any excess credits.

Qualified job training programs

A qualified job training program is a structured training or basic education program to improve the job skills of the taxpayer's employees who work predominantly within an enterprise zone. The program may be conducted at the taxpayer's location or off-site. The training program may be conducted by the taxpayer or by another entity.

Qualified investment

For the purpose of calculating the credit, the qualified investment may include investments in real property and capital equipment, as well as other expenses that meet the following requirements.

Real property and capital equipment

The taxpayer's costs in purchasing, leasing, or improving real property or capital equipment may qualify for the credit. Eligible real property may include land, buildings, real property improvements, leasehold improvements, and leased space. The property or equipment must satisfy all of the following requirements:

- it must be used entirely within an enterprise zone;
- it must be used primarily for qualified job training program purposes or to make a training site accessible; and
- it must not be eligible for enterprise zone investment tax credit discussed in *Part 2* of this publication.

Other expenses

Other expenses incurred by the taxpayer either inside or outside of an enterprise zone may be qualified investments. Such expenses must be incurred for a qualified job training program for employees working predominantly within an enterprise zone. Examples of qualifying expenses may include:

- expensed equipment,
- supplies,
- training staff wages or fees,
- training contract costs,
- virtual and in-person training classes and courses,
- temporary space rental, and
- travel expenses.

Non-qualifying expenses

Non-qualifying expenses that do not qualify for the credit include, but are not limited to, expenses incurred for any of the following purposes:

- the regular operation of a business;
- on-the-job training that is not part of a qualified job training program;
- wages paid to employees being trained; or
- training employees who are or will be working primarily outside of the enterprise zone.

Pre-certification

Any taxpayer who intends to claim a credit must first pre-certify with the applicable enterprise zone administrator. No job training investment tax credit is allowed with respect to any property acquired or any expense paid or incurred prior to the taxpayer's pre-certification with the enterprise zone administrator for the tax year. If investments are made in multiple tax, the taxpayer must submit a separate pre-certification form for each year, prior to making any investments in that year. Please see *Part 1* of this publication for additional information about pre-certification.

Credit calculation and carryforward

The allowable credit is equal to 12% of the taxpayer's qualified investment during the tax year in a qualified job training program.

The limits on credit use discussed in *Part 2* of this publication apply to the investment tax credit and the job training investment tax credit. The combined amount of investment tax credit and job training investment tax credit a taxpayer applies to offset tax for a given tax year cannot exceed the limits on credit use. Any excess credit that cannot be used to offset tax can be carried forward to the following tax year as discussed in *Part 2* of this publication.

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to the enterprise zone job training investment tax credit. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- § 39-30-104, C.R.S. Credits against tax - investment in certain property - definitions.

Forms and guidance

- *Tax.Colorado.gov*
- *OEDIT.Colorado.gov/enterprise-zone-job-training-tax-credit*
- *Enterprise Zone Credit and Carryforward Schedule (DR 1366)*



An income tax credit is allowed to any taxpayer who makes expenditures in research and experimental activities conducted in an enterprise zone for the purpose of carrying out a trade or business. This *Part 5* provides information about qualifying expenditures and calculation of the credit.

Research and experimental expenditures

Research or experimental expenditures that qualify for the credit are any expenditures subject to the federal income tax treatment prescribed by section 174 of the Internal Revenue Code. Eligible expenditures must be incurred in connection with the taxpayer's trade or business and represent research and development costs in the experimental or laboratory sense. These expenditures generally include all costs incident to the development or improvement of a product.

A "product" for which research and experimental expenditures are made can be a pilot model, process, formula, invention, technique, patent, or similar property. The product can be used by the taxpayer in its trade or business or developed for sale, lease, or license.

Whether expenditures qualify as research or experimental expenditures depends on the nature of the activity to which the expenditures relate, not the nature of the product or improvement being developed or the level of technological advancement the product or improvement represents. The ultimate success, failure, sale, or use of the product is not relevant to a determination of eligibility of expenditures for the credit.

Research or experimental expenditures are those made for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. Uncertainty exists if the information available to the taxpayer does not establish the capability or method for developing or improving the product or the appropriate design of the product. Costs may qualify for the credit if paid or incurred after production begins, but before uncertainty concerning the development or improvement of the product is eliminated.

Qualifying expenditures

Qualifying expenditures generally include all costs incident to the development or improvement of a product. Examples of qualifying expenditures include:

- salaries for those engaged in research or experimentation efforts;
- amounts incurred to operate and maintain research facilities (e.g., utilities, depreciation, rent, etc.);
- expenditures for materials and supplies used and consumed in the course of research or experimentation (including amounts incurred in conducting trials);
- the costs of obtaining a patent, such as attorneys' fees expended in making and perfecting a patent application; and
- expenditures paid or incurred for research or experimentation conducted on the taxpayer's behalf by another person or organization (such as a research institute, foundation, engineering company, or similar contractor).

The credit is allowed only for the amount of research and experimental expenditures that is reasonable under the circumstances. In general, the amount of an expenditure for research or experimental activities is reasonable if the amount would ordinarily be paid for like activities by like enterprises under like circumstances. Amounts supposedly paid for research that are not reasonable under the circumstances may be characterized as disguised dividends, gifts, loans, or similar payments.

Please see section 174 of the Internal Revenue Code and 26 CFR § 1.174-2 for additional information about research and experimental expenditures.



Non-qualifying expenditures

The credit is not allowed for any expenditures for:

- the acquisition or improvement of land or depreciable property;
- the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas);
- the ordinary testing or inspection of materials or products for quality control (quality control testing);
- efficiency surveys;
- management studies;
- consumer surveys;
- advertising or promotions;
- the acquisition of another's patent, model, production, or process; or
- research in connection with literary, historical, or similar projects.

Pre-certification

Any taxpayer who intends to claim a credit must first pre-certify with the applicable enterprise zone administrator. No credit is allowed with respect to any activity undertaken by the taxpayer prior to the taxpayer's pre-certification with the enterprise zone administrator for the tax year. If expenditures are made in multiple tax years, the taxpayer must submit a separate pre-certification form for each year, prior to making any expenditures for that year. Please see *Part 1* of this publication for additional information about pre-certification.

Credit calculation

The allowable credit is based upon an increase in the taxpayer's research and experimental expenditures in an enterprise zone over the two prior years. The credit is equal to 3% of the amount by which the taxpayer's research and experimental expenditures in an enterprise zone exceed the average of the taxpayer's research and experimental expenditures in the same enterprise zone over the two preceding tax years.

The credit calculated as described above is not allowed entirely for the tax year in which the expenditures were made. Instead, the credit is divided evenly over four tax years. Twenty-five percent of the credit is allowed for the tax year in which the expenditures were made and 25% of the credit is allowed for each of the subsequent three tax years.

Credit carryforward

If the credit allowed exceeds the income tax the taxpayer otherwise owes for the tax year, the excess credit may be carried forward and applied toward the taxpayer's tax liability for the following tax year. Any excess credit after application toward tax for the subsequent year may be further carried forward until the full amount of the credit has been used.

Examples

The following examples illustrate the calculation of the credit and carryforwards.

Example 5-1

A taxpayer incurs \$140,000 in expenditures for research and experimental activities conducted in an enterprise zone in tax year 2017. The taxpayer's research and experimental expenditures in the same enterprise zone for tax years 2015 and 2016 were \$0 and \$100,000, respectively, for an average of \$50,000. The \$140,000 of expenditures in 2017 is \$90,000 more than the taxpayer's average expenditures in the same enterprise zone over the two preceding tax years.

The total allowable credit is \$2,700 (3% x \$90,000). The credit is divided evenly over the current tax year and the three following tax years. The taxpayer can claim a credit of \$675 (25% of the total credit) for tax year 2017 and for each of the three subsequent tax years.

Illustration of Example 5-1

2015 expenditures	\$ 0
2016 expenditures	\$ 100,000
2017 expenditures	\$ 140,000
Average of 2015 and 2016	\$ 50,000
2017 expenditures minus the average from the two prior years	\$ 90,000
Total credit (3% of increase)	\$ 2,700
Credit allowed for 2017 (25% of total)	\$ 675
Credit allowed for 2018 (25% of total)	\$ 675
Credit allowed for 2019 (25% of total)	\$ 675
Credit allowed for 2020 (25% of total)	\$ 675

Example 5-2

The taxpayer from *Example 5-1* incurs \$200,000 in expenditures for research and experimental activities conducted in the same enterprise zone in tax year 2018. The taxpayer's average expenditures in the same enterprise zone in the two prior tax years were \$120,000 (\$100,000 for tax year 2016 and \$140,000 for tax year 2017). The \$200,000 of expenditures in 2018 is \$80,000 more than the taxpayer's average expenditures in the same enterprise zone over the two preceding tax years.

The total allowable credit is \$2,400 (3% x \$80,000). The total allowable credit is divided evenly over the current tax year and the three following tax years. The taxpayer can claim a credit of \$600 (25% of the total credit) for tax year 2018 and for each of the three subsequent tax years.

Illustration of Example 5-2

2016 expenditures	\$ 100,000
2017 expenditures	\$ 140,000
2018 expenditures	\$ 200,000
Average of 2016 and 2017	\$ 120,000
2018 expenditures minus the average from the two prior years	\$ 80,000
Total credit (3% of increase)	\$ 2,400
Credit allowed for 2018 (25% of total)	\$ 600
Credit allowed for 2019 (25% of total)	\$ 600
Credit allowed for 2020 (25% of total)	\$ 600
Credit allowed for 2021 (25% of total)	\$ 600



Part 5: Research and Experimental Activities Credit

Example 5-3

The taxpayer from *Examples 5-1* and *5-2* had a tax liability of \$400 for tax year 2017. The taxpayer applied \$400 of the \$675 credit allowed for tax year 2017 to offset the entire tax amount due. The remaining \$275 of credit is carried forward to tax year 2018.

For tax year 2018, the taxpayer will have available credits totaling \$1,550, consisting of the following:

- \$675, equal to 25% of the total credit allowed for expenditures made during 2017;
- \$600, equal to 25% of the total credit allowed for expenditures made during 2018; and
- \$275 allowed in the prior year and carried forward to the 2018 tax year.

The taxpayer's 2018 tax liability is \$500. After applying \$500 of the available credit to offset the tax due, the taxpayer has \$1,050 credit remaining to carry forward to tax year 2019.

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to the enterprise zone research and experimental activities credit. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- § 39-30-105.5, C.R.S. Credit...for research and experimental activities.
- I.R.C. § 174. Research and experimental expenditures.
- 26 CFR § 1.174-2. Definition of research and experimental expenditures.

Forms and guidance

- *Tax.Colorado.gov*
- *OEDIT.Colorado.gov/enterprise-zone-research-and-development-tax-credit*
- *Enterprise Zone Credit and Carryforward Schedule (DR 1366)*



Any taxpayer who is the owner or tenant of a qualified building in an enterprise zone may claim an income tax credit for qualified expenditures for the purpose of rehabilitating the building. This *Part 6* provides information about qualifying expenditures and the credit calculation.

Qualified buildings

A qualified building is a building located in an enterprise zone that is at least 20 years old and has been unoccupied for at least two years. For the purpose of the credit, a “building” is defined to include the entire physically contiguous structure, regardless of whether it has been legally divided into separate units. To qualify for the credit, the entire physically contiguous structure must be unoccupied for at least two years.

A building is not considered to be unoccupied at any time during which the building is actively utilized by the owner, a lessor, or any other party in the operation of a trade or business including, but not limited to, any storage within the building of inventory, equipment, or other property for an operating business. However, the mere presence of tangible personal property in an otherwise unoccupied building does not disqualify the building for the credit. Additionally, transitory use of a building that is not related to the conduct of any trade or business does not disqualify the building for the credit.

The pre-certification described in *Part 1* of this publication must identify the location of the building.

Qualified expenditures

Qualified expenditures are expenditures necessary to rehabilitate a qualified building for commercial use that are associated with any of the following:

- exterior improvements,
- structural improvements,
- mechanical improvements, or
- electrical improvements.

A building is rehabilitated for commercial use only if both:

- the taxpayer’s primary use of the building is for commercial purposes; and
- the taxpayer does not use any part of the building as their residence, either full-time or part-time.

Examples of Qualified Expenditures

Qualified expenditures necessary to rehabilitate a qualified building may include expenditures associated with any of the following:

- demolition
- painting
- exterior repair
- carpentry
- ceilings
- tuckpointing
- sheetrock
- fixtures
- cleanup
- plaster
- doors
- roofing and flashing
- windows
- cleaning
- sprinkler systems for fire protection purposes



Part 6: Vacant Building Rehabilitation Credit

Non-qualified expenditures

A variety of costs that may be associated with rehabilitation do not qualify for the credit. Qualified expenditures do not include costs associated with:

- acquisition
- excavation
- grading
- paving
- interior furnishings
- landscaping
- repairs to outbuildings
- new additions, except as may be required to comply with building and safety codes

Additionally, “soft costs” do not qualify for the credit.

“Soft costs” include costs associated with:

- loan fees
- closing
- bids
- insurance
- copying
- rent loss during construction
- building permit, use, and inspection fees
- legal, accounting, and realtor fees
- architectural, engineering, and interior design fees
- bid bonds
- appraisals
- sales and marketing
- project signs and phones
- temporary power

Federal rehabilitation credit

Additionally, a taxpayer who is allowed a federal rehabilitation credit pursuant to sections 38, 46, and 47 of the Internal Revenue Code cannot claim the vacant building rehabilitation credit for the same rehabilitation expenditures.

However, a taxpayer who claims a commercial historic preservation tax credit on their Colorado income tax return is not precluded from claiming the enterprise zone vacant building rehabilitation credit for the same building.

Credit calculation

The allowable credit is generally equal to 25% of the taxpayer’s aggregate qualified expenditures during the tax year. However, the total credit allowed to each taxpayer with respect to any given building is limited to \$50,000. The limit applies to the aggregate amount of the credit, whether allowed in one or more tax years, and to the building as a whole, whether the taxpayer is the owner or tenant of the entire building or one or more separate units therein.

The limit applies to each individual, estate, trust, or C corporation who is the owner or tenant of a building, either directly or indirectly as the partner or shareholder in a partnership or S corporation, as well as to each partnership or S corporation that is the owner or tenant of a building or any separate unit or units therein.

Examples

The following examples illustrate the calculation of the credit and the limitations applicable thereto.

Example 6-1. Expenditures made over multiple years

A taxpayer who is the owner of a vacant building makes qualified expenditures for the purpose of rehabilitating the building in each of three consecutive years. In the first year, the taxpayer makes qualified expenditures totaling \$100,000 and is allowed a credit of \$25,000 (25% of the qualified expenditures). In the second year, the taxpayer makes qualified expenditures totaling \$80,000 and is allowed a credit of \$20,000 (25% of the qualified expenditures). Because the aggregate amount of the credit allowed is limited to \$50,000 and the taxpayer was allowed credits totaling \$45,000 in the two prior years, the amount of credit the taxpayer is allowed in the third year cannot exceed \$5,000. In the third year, the taxpayer makes qualified expenditures totaling \$60,000 and is allowed a credit of \$5,000, rather than \$15,000 (25% of the qualified expenditures).

Example 6-2. Single owner of multiple units

A taxpayer owns three units in the same vacant building and makes qualified expenditures for the purpose of rehabilitating each of the three units. The taxpayer makes qualified expenditures of \$100,000, \$200,000, and \$300,000 for the three units, respectively, for a total of \$600,000. The total credit the taxpayer is allowed for qualified expenditures for the three units is \$50,000, rather than \$150,000 (25% of the qualified expenditures).

Example 6-3. Different owners of separate units

Three unrelated taxpayers own three separate units in the same vacant building. The building is at least twenty years old, has been unoccupied for at least two years, and is therefore eligible for the credit. Each of the three taxpayers make qualified expenditures for the purpose of rehabilitating the unit they own. The three taxpayers make qualified expenditures of \$80,000, \$160,000, and \$240,000, respectively. The first taxpayer is allowed a credit of \$20,000 (25% of their \$80,000 in qualified expenditures). The second taxpayer is allowed a credit of \$40,000 (25% of their \$160,000 in qualified expenditures). The third taxpayer is allowed a credit of \$50,000, rather than \$60,000 (25% of their \$240,000 in qualified expenditures).

Example 6-4. Ownership by a partnership

A partnership consisting of five partners owns several units within a single building and makes \$400,000 in qualified expenditures. A credit of \$50,000 is allowed for the qualifying expenditures made by the partnership, rather than \$100,000 (25% of the \$400,000 in qualified expenditures). Each of the five partners is allowed their distributive share of the \$50,000 credit allowed for the qualifying expenditures made by the partnership.

Example 6-5. Partner in multiple partnerships

An individual is a partner in two different partnerships that separately own units in the same vacant building. Each partnership makes qualified expenditures for the purpose of rehabilitating the units. The two partnerships pass through credits of \$25,000 and \$40,000, respectively, to the individual partner. However, the total credit the partner is allowed for the rehabilitation of the building is limited to \$50,000.

Credit carryforwards

The credit a taxpayer can use for any tax year is limited to the taxpayer's net tax liability. If the allowable credit exceeds the taxpayer's net tax liability, the taxpayer can carry forward the excess credit for application toward the tax due for subsequent tax years. Credits may be carried forward up to five tax years. Any credit that has not been used within the carryforward period expires and is no longer available to the taxpayer.

Certification

Any taxpayer who intends to claim a credit must first pre-certify with the applicable enterprise zone administrator. No credit is allowed with respect to any expenditure either paid or incurred prior to the taxpayer's submission of a pre-certification form to the enterprise zone administrator. If expenditures are made in multiple tax years for the rehabilitation of the same building, the taxpayer must submit a separate pre-certification form for each year, prior to making any expenditures for that year. Please see *Part 1* of this publication for additional information about pre-certification.

Any taxpayer claiming the credit must obtain certification of the qualified nature of expenditures from the enterprise zone administrator. Please visit OEDIT.Colorado.gov/enterprise-zone-vacant-commercial-building-rehabilitation-tax-credit for additional information regarding certification.

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to the vacant building rehabilitation credit. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- § 39-30-105.6, C.R.S. Credit against tax - rehabilitation of vacant buildings.
- Rule 39-30-105.6. Credit for rehabilitation of vacant buildings.

Forms and guidance

- Tax.Colorado.gov
- OEDIT.Colorado.gov/enterprise-zone-vacant-commercial-building-rehabilitation-tax-credit
- [Enterprise Zone Credit and Carryforward Schedule \(DR 1366\)](#)

Machinery, machine tools, and parts thereof used solely and exclusively in an enterprise zone are exempt from state and state-administered local sales and use taxes if all four of the following conditions are met. This *Part 7* discusses the qualifying criteria and requirements for the exemption.

To qualify for exemption, machinery, machine tools, or parts thereof must:

- 1) be purchased for more than \$500;
- 2) be used solely and exclusively in an enterprise zone in Colorado;
- 3) satisfy certain requirements prescribed by federal law; and
- 4) be used directly and predominantly in the manufacturing of tangible personal property for sale or profit, as “manufacturing” is defined by law for the enterprise zone exemption.

The exemption also applies to materials for the construction or repair of machinery, machine tools, and parts thereof.

The enterprise zone exemption for machinery and machine tools applies to state sales and use taxes, as well as all state-administered local sales and use taxes.

Machinery, machine tools, and parts

Colorado law defines machinery, eligible for exemption, as any apparatus consisting of interrelated parts used to produce an article of tangible personal property. The exemption applies to both the basic unit and any adjunct or attachment necessary for the basic unit to accomplish its intended function.

Requirements prescribed by federal law

With one notable exception, machinery, machine tools, and parts thereof qualify for the enterprise zone exemption only if they are of such nature that they would have qualified for the federal investment tax credit under section 38 of the Internal Revenue Code of 1954, as amended. The Internal Revenue Code of 1954, as amended, was replaced by the Internal Revenue Code of 1986. Consequently, eligibility for the exemption cannot be determined based upon the Internal Revenue Code as it exists today, but rather is governed by the version of the Code in effect immediately prior to the 1986 change.

In defining “section 38 property” that was eligible for the credit, section 48 of the Internal Revenue Code of 1954, as amended, established many requirements and exceptions that also apply in determining eligibility for the exemption from Colorado sales and use taxes. For example, section 48 establishes special conditions for leased property and limits on used property, which are discussed below.

While section 48 establishes depreciability and useful life requirements, these requirements do not apply to the enterprise zone exemption for machinery and machine tools. Provided that all other requirements are met, machinery and machine tools qualify for the enterprise zone exemption regardless of whether they are capitalized or expensed.



Part 7: Machinery and Machine Tools Exemption

Limitations for used property

The federal investment tax credit allowed for used property was allowed only for the first \$150,000 of all used property purchased during a tax period. As the excess over \$150,000 could not qualify for credit, the excess also does not qualify for the sales tax exemption. Therefore, annually, only the first \$150,000 of all purchases of used machinery to be used directly and predominantly in manufacturing in Colorado can qualify for the exemption. All purchases of used property in excess of that amount are subject to sales or use tax.

Qualifying uses of machinery

For machinery or machine tools to qualify for exemption, they must be used directly and predominantly in manufacturing tangible personal property. Importantly, the term “manufacturing” is defined, for the purpose of the enterprise zone exemption, to include a number of activities.

The following four sections discuss the exemption requirements related to:

- 1) the definition of “manufacturing”;
- 2) the manufacture of “tangible personal property”;
- 3) the use of machinery “directly” in manufacturing; and
- 4) the use of machinery “predominantly” in manufacturing.

Manufacturing

Manufacturing is the operation of producing a new product, article, substance, or commodity different from and having a distinctive name, character, or use from raw or prepared materials. The manufacturing process for items normally manufactured from inventoried raw materials begins at the point that raw material is moved from plant inventory on a contiguous plant site and ends at the point at which manufacturing has altered the raw material to its completed form. Manufacturing includes the process of packaging the finished product, if applicable.

For the purpose of the enterprise zone exemption, “manufacturing” also includes refining, blasting, exploring, mining and mined land reclamation, quarrying for, processing and beneficiation, or otherwise extracting from the earth or from waste or stockpiles or from pits or banks any natural resource.

Manufacturing tangible personal property

To qualify for exemption, machinery, machine tools, or parts thereof must be used in the manufacturing of tangible personal property. Machinery, machine tools, and parts thereof do not qualify for exemption if they are used to produce something other than tangible personal property. For example, machinery used in the generation of electricity does not qualify for exemption because electricity does not constitute tangible personal property for the purpose of the exemption. However, please see Department publication *Sales & Use Tax Topics: Renewable Energy Components* for information about the exemption for components used to produce energy from renewable sources.

Direct use in manufacturing

To qualify for exemption, machinery, machine tools, or parts thereof must be used directly in manufacturing. Any individual component of a larger system is used directly in manufacturing if it is a constituent part of machinery that is used directly in manufacturing. Machinery used directly in manufacturing includes:

- machinery that cleans or prepares raw or prepared materials for production on the manufacturing line, after manufacturing has begun and before it has stopped;
- machinery that performs testing of a particular product during the manufacturing process or as a step in a continuous manufacturing line process;
- machinery that moves material from one direct production step to another in a continuous flow, such as loaders, forklifts, conveyor belts, and valves that are adjuncts or attachments to qualifying machinery; and
- pipelines and fittings used to gather and deliver natural gas from wells to a processing facility.

The following types of machinery *are not* used directly in manufacturing and *do not* qualify for exemption:

- machinery used to clean facilities or machinery;
- machinery used to repair or maintain facilities, machines, or other items; and
- machinery used in managerial, sales research and development, or other non-operational activities.

Predominant use in manufacturing

To qualify for exemption, machinery, machine tools, or parts thereof must be used predominantly in manufacturing. If a machine has other uses in addition to its manufacturing use, the manufacturing use must be greater than 50% of all use for the machine to qualify for the exemption. In determining predominant use, machinery is not considered to be in use if it is shut off, even if it is being repaired or maintained.

Claiming the exemption

Anyone seeking to claim the exemption for machinery or machine tools must complete the applicable form DR 1191 or DR 1192. A taxpayer who makes 100 or fewer exempt purchases during the year must complete a separate *Sales Tax Exemption on Purchases of Machinery and Machine Tools (DR 1191)* for each exempt transaction. If a taxpayer makes more than 100 exempt purchases each year, the taxpayer may complete a *Colorado Machinery and Machine Tools State Sales Tax Exemption Declaration (DR 1192)* instead of preparing a DR 1191 for each purchase. In either case, the purchaser must provide copies of the completed DR 1191 or DR 1192 to the seller and to the Department of Revenue. The exemption can only be claimed for purchases in excess of \$500.

If tax was paid on a purchase that qualifies for exemption, the purchaser may request a refund for the tax paid. See form *DR 0137B, Claim for Refund of Tax Paid to Vendors*, and the associated instructions for information regarding sales and use tax refund claims.



Part 7: Machinery and Machine Tools Exemption

Additional resources

The following is a list of statutes, regulations, forms, and guidance pertaining to sales and use tax exemptions allowed for machinery and machine tools used in enterprise zones. This list is not, and is not intended to be, an exhaustive list of authorities that govern the tax treatment of every situation. Individuals and businesses with specific questions should consult their tax advisors.

Statutes and regulations

- § 39-26-709, C.R.S. Machinery and machine tools - definitions.
- § 39-30-106, C.R.S. Sales and use tax - machinery and equipment exempted.
- 1 CCR 201-4, Rule 39-26-709.

Internal Revenue Code of 1954, as amended

- 26 U.S.C. § 38. General business credit
- 26 U.S.C. § 46. Amount of [investment] credit
- 26 U.S.C. § 48. Definitions; special rules [for the investment tax credit]
- 26 CFR § 1.48-1. Definition of section 38 property
- 26 CFR § 1.48-2. New section 38 property
- 26 CFR § 1.48-3. Used section 38 property
- 26 CFR § 1.48-4. Election of lessor of new section 38 property to treat lessee as purchaser

Forms and guidance

- *Tax.Colorado.gov*
- *Sales Tax Exemption on Purchases of Machinery and Machine Tools* (DR 1191)
- *Colorado Machinery and Machine Tools State Sales Tax Exemption Declaration* (DR 1192)
- *Claim for Refund of Tax Paid to Vendors* (DR 0137B)
- *OEDIT.Colorado.gov/enterprise-zone-sales-and-use-tax-exemption-for-manufacturing-and-mining*