



COLORADO
Department of Revenue

Taxation Division

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GIL 22-003

April 25, 2022

XXXXXXXXXX
XXXXXXXXXX

Via Electronic Mail: XXXXXXXXXXXX

Re: Sourcing nonresident partner's distributive share of partnership income

Dear XXXXXXXXXXXX:

You submitted a request for a general information letter regarding the sourcing of a nonresident partner's distributive share of partnership income. The Colorado Department of Revenue ("Department") issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues, but is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department, and requires payment of a fee. For more information about general information letters and private letter rulings, please see 1 CCR 201-1, Rule 24-35-103.5.

Issues

How is a nonresident partner's distributive share of ordinary business income¹ sourced under section 39-22-109, C.R.S.?

How is a nonresident partner's distributive share of other items of partnership income² sourced under section 39-22-109, C.R.S.?

How is a nonresident partner's distributive share of the gain from the sale of a disregarded entity by the partnership sourced under section 39-22-109, C.R.S.?

Discussion

Sourcing of the nonresident partner's distributive share of ordinary business income

For nonresident partners,³ Colorado-source income from partnership activity is determined pursuant to section 39-22-109, C.R.S., or, at the partnership's election, apportioned and

¹ As used within this general information letter, the term "ordinary business income" refers to a partner's distributive share of ordinary business income properly reported in box 1 of IRS Schedule K-1 (Form 1065).

² As discussed within this general information letter, other items of partnership income includes any income properly reported in any box of IRS Schedule K-1 (Form 1065) other than box 1.

³ A resident partner's distributive share of partnership income is not apportioned, regardless of whether any or all of that income is derived from sources outside of Colorado. Section 39-22-202, C.R.S.

allocated pursuant to section 39-22-303.6, C.R.S.⁴ Rule 39-22-109 provides considerable guidance regarding the determination of Colorado-source income under section 39-22-109, C.R.S. More specifically, Rule 39-22-109(3)(c) offers direction regarding the sourcing of a nonresident partner's distributive share of partnership income. However, the rule does not explicitly prescribe the method for sourcing a nonresident partner's distributive share of ordinary business income.

Under section 39-22-109(2)(a)(II), C.R.S., income derived from a business, trade, profession, or occupation carried on in Colorado is considered Colorado source income. Although Rule 39-22-109 does not explicitly address the sourcing of a nonresident partner's distributive share of ordinary business income, the rule does prescribe the method for sourcing the business income of an independent contractor derived from activities other than the performance of purely personal services.⁵ Under the rule, such business income is apportioned under the apportionment rules for corporations set forth in section 39-22-303.6, C.R.S., and the rules promulgated thereunder. The character of a nonresident partner's distributive share of any income item is determined as if the item was realized or incurred directly by partner.⁶ Therefore, under section 39-22-109, C.R.S., a nonresident partner's share of ordinary business income is apportioned pursuant to section 39-22-303.6, C.R.S. This apportionment method applies even if the partnership did not elect, under section 39-22-203(1)(a), C.R.S., to apportion or allocate the entirety of the partner's distributive share of the items of partnership income, gain, and loss pursuant to section 39-22-303.6, C.R.S.

Sourcing of the nonresident partner's distributive share of other items of partnership income

Other items of income, such as gain, loss, rents, and royalties, that may flow through from a partnership to its nonresident partners are sourced separately under section 39-22-109, C.R.S. (unless the partnership has made an election under section 39-22-203(1)(a), C.R.S., to apportion all items of income pursuant to section 39-22-303.6, C.R.S.). For example, any gain or loss realized from the sale of real or tangible personal property is Colorado-source income if the property is located in Colorado.⁷ Income, including gain and loss, earned from intangible property employed in a business, such as patents, trademarks, and copyrights, are Colorado-source income if the intangible property is employed in a business, trade, profession, or occupation carried on in Colorado.⁸

Sourcing of the nonresident partner's distributive share of the gain when the partnership sells its ownership interest in a single-member LLC that is a disregarded entity for federal tax purposes

In determining the source of income under section 39-22-109, C.R.S., each item of partnership income, gain, loss, deduction, or credit has the same character for the nonresident partner for Colorado income tax purposes as for federal income tax purposes.⁹ The Internal Revenue Service has provided guidance regarding the sale of all or a part of an ownership interest in a single member domestic limited liability company (LLC) that is disregarded for federal tax

⁴ Section 39-22-203, C.R.S.

⁵ 1 CCR 201-2, Rule 39-22-109(3)(b)(ii)(B)

⁶ 1 CCR 201-2, Rule 39-22-109(3)(c)(ii); sections 39-22-202(2) and -203(5)(a), C.R.S.; and 26 USC sec. 702(b).

⁷ Section 39-22-109(2)(a)(I), C.R.S., and 1 CCR 201-2, Rule 39-22-109(3)(a)(ii) and (iii).

⁸ Section 39-22-109(2)(a)(V), C.R.S., and 1 CCR 201-2, Rule 39-22-109(3)(e).

⁹ Sections 39-22-202(2) and 39-22-203(5)(b), C.R.S.

purposes as an entity separate from its owner under 26 CFR § 301.7701-3.¹⁰ The Internal Revenue Service treats this transaction as a sale of the LLC's assets, which are treated as held directly by the single member—here the partnership—for federal tax purposes. Any gain realized by a nonresident partner from such a sale, treated for federal income tax purposes as a sale of the LLC's assets held directly by the partnership that was the LLC's single member, will be sourced under section 39-22-109, C.R.S., as though such assets had been sold directly by the nonresident partner.¹¹

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination on any of the issues raised and the Department is not bound by this general information letter.

Thank you for your request.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue

¹⁰ IRS Rev. Rul. 99-5, 1999-1 CB 434.

¹¹ 26 U.S.C. sec. 702(b). Gain or loss from the sale of a pass-through entity (as defined in Rule 39-22-109(2)(e)) that is not disregarded for federal income tax purposes is sourced pursuant to Rule 39-22-109(3)(e)(ii).