



COLORADO

Department of Revenue

Taxation Division

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GIL-15-001

January 21, 2015

XXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXX

Re: Dividend and Capital Gain Distributions from Colorado and U.S. Obligations

Dear XXXXXXXXXXXX,

You ("Taxpayer") submitted a request for guidance to determine the whether dividends and capital gain distributions from the United States and Colorado obligations through ownership of shares of a mutual fund can be subtracted from federal taxable 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 and 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 but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department Rule 24-35-103.5 at www.colorado.gov/revenue/tax > Tax Library > Rulings.

The Department initially treats your request as one of a general information letter. If you would like the Department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with Department Rule 24-35-103.5. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction.

Issues

1. May dividend or capital gains distributions earned from United States and Colorado obligations due to the ownership of mutual funds be subtracted from federal taxable income?
2. If so, where is this reported on Form 104?

Background

Taxpayer owns shares in a mutual fund from which taxpayer receives dividend income and capital gains distribution income derived from obligations of the United States and of Colorado. Taxpayer represents that the Internal Revenue Service treats interest income, dividend income and capital gains distribution income derived from obligations of the United States as ordinary income subject to tax. Taxpayer also represents that the Internal Revenue Service treats dividend income and capital gains distribution income derived from obligations of Colorado as ordinary income subject to tax, but

treats interest income from a bond used to finance government operations of any state, the District of Columbia, a possession of the United States, or any of their political subdivisions generally as non-taxable.

Discussion

Colorado allows taxpayers to subtract from their federal taxable income “an amount equal to any interest income of obligations of the United States and its possessions to the extent included in federal taxable income.”¹ Similarly, interest income on obligations of the State of Colorado or its political subdivisions is not added back into federal taxable income when excluded from gross income for federal income tax purposes.²

The Department is unaware of any circumstance in which the United States or State of Colorado would pay dividends. It may be the case that what the mutual fund is characterizing as a dividend is really interest income. If the dividend paid by the mutual fund is indeed interest income from a United States obligation³, the interest income can be subtracted from federal taxable income to the extent the income is included in federal taxable income. The Department does not have sufficient information and is unable to make a determination in a general information letter about whether the dividends Taxpayer receives is interest income.

Interest income derived from an obligation issued by a state or local government is generally excluded from federal taxable income.⁴ The issuer of such interest income should be able to tell you whether the interest is subject to federal income tax. Colorado, on the other hand, taxes interest income from obligations of other states or their political subdivisions, but not the interest income derived from obligations of the State of Colorado and its political subdivisions.⁵ To implement this, Colorado law requires taxpayers to add to their Colorado taxable income the interest income derived from obligations of other states (but only if such income has been excluded from federal gross income), but not add back interest income derived from obligations of the State of Colorado or its subdivisions.⁶

Mutual funds may contain assets other than obligations of the United States. Taxpayer has the burden of demonstrating both that the income is derived from the obligations of the United States and that such income is interest income and not capital gain distribution income (which cannot be subtracted). Finally, interest on obligations of a private entity do not qualify for this subtraction, even if the obligation is backed or protected by federal programs.

We note that there was, for tax years 2000-2010, another subtraction for the aggregate of any interest income, dividend income, and net capital gains to the extent included in federal taxable income if financial reports certified that the amount of excess state tax revenues for the state fiscal year ending in that income tax year exceeded the limitation on state fiscal year spending.⁷ However, this subtraction was repealed by the Colorado General Assembly in 2010 and is no longer available.

Finally, your inquiry raises the question of whether capital gain earned on the sale of obligations of the United States and the State of Colorado can be subtracted from federal taxable income. Colorado allows a subtraction for certain Colorado-source capital gains.⁸ In prior years, the statute allowed a subtraction for capital gains arising from the sale of stock in a “Colorado company”. Capital gains arising from the sale of stock in a non-Colorado company were not eligible for the

¹ §39-22-104(4)(a), C.R.S.

² §39-22-104(3)(b), C.R.S.

³ See Department FYI Income 20 for a list of exempt sources of income.

⁴ §103 I.R.C.

⁵ See Department FYI Income 52 for a list of exempt sources of income.

⁶ §39-22-104(3)(b), C.R.S.

⁷ §39-22-104(4)(l) and (l.5), C.R.S.

⁸ §39-22-518, C.R.S.

subtraction. Neither the United States nor the State of Colorado qualify as a "Colorado company". Therefore, capital gains earned on such assets cannot be subtracted from Colorado taxable income. We also note that in 2010, the Colorado General Assembly amended this statute to eliminate the subtraction for capital gains arising on or after January 1, 2010 from the sale of stock in a Colorado company.

To subtract the United States government interest, report the income on line 6 of Colorado Individual Income Tax Form 104.

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 here on any of the issues raised and the Department is not bound by this general information letter.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue