COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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PLR-15-005

January 30, 2015

XXXXXXXXXXXXX
Attn: XXXXXXXXX
XXXXXXXXXXXXX
XXXXXXXXXXXXX

Re: Apportionment of Combined Report's Income

Dear XXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXXXXXXXX a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Department Rule 24-35-103.5. This letter is the Department's private letter ruling.

Issue

1. May all corporations in the Affiliated Group be included in a combined corporate income tax return?
2. May Affiliated Group calculate its combined income tax liability using the methodology outlined in Department Private Letter Ruling PLR-11-002?

Conclusion

1. All corporations (financial and non-financial) in the Affiliated Group must be included in the combined corporate income tax return.
2. Affiliated Group may calculate its combined income tax liability using the methodology outlined in Department Private Letter Ruling PLR-11-002 for tax years 2014 and prior; however, once adopted by the Department, Affiliated Group must calculate its combined income tax liability using the methodology that will be adopted by the Department in amended Department Regulation 1 CCR 201-2, 39-22-303(11)(c).

Background

XXXXXXXXXXXXXXXXX is the parent corporation of an affiliated group of corporations within the meaning of section 39-22-303(12), C.R.S. that includes XXXXXXXXXXXXXXXXXXX and XXXXXXXXXXXXXXXXXXXXX (collectively, "Affiliated Group"). Affiliated Group currently files separate Colorado corporate income tax returns. Following a review of their filing status in Colorado, Affiliated Group believes it should be filing a combined Colorado corporate income tax return;

however, because the group is comprised of corporations subject to different apportionment rules, it needs additional guidance on preparing such a return.

The Affiliated Group engages in the business of providing data-driven marketing and loyalty solutions. For example, members of the Affiliated Group offer a comprehensive portfolio of integrated outsourced marketing solutions including customer loyalty programs, database marketing services, marketing strategy consulting, analytic and creative services, and direct marketing services.

In addition, the Affiliated Group has a segment that assists retailers in extending their brand through private label and/or co-brand credit card accounts. This segment also provides receivables financing, risk management solutions, account origination and funding services, processing services, and service and maintenance for private label and co-brand credit card programs. Two corporations within the Affiliated Group provide these services [individually, ("Fin 1") and ("Fin 2"), collectively ("FI Corporations")].

Fin 1 was established as a credit card bank under the Competitive Equality Banking Act of 1987, but converted to a Delaware state bank in 2011. Fin 1 makes credit card loans to individuals primarily by offering proprietary credit cards to customers of third-party retail establishments. Initially, Fin 1 offered only private label credit cards that could only be used for purchases from the retailer authorizing the credit card. Now, however, Fin 1 also offers co-branded credit cards that carry MasterCard, Visa, or Discover logos. Fin 1 has also begun issuing certificates of deposit and brokered money market demand deposits to the general public.

In connection with its credit card operations, Fin 1 has entered into agreements with many third-party retailers governing the acceptance of cards, processing of credit transactions, and administration of the cash settlement process by which Fin 1 funds receivables generated by the retailers. To fund these receivables, Fin 1 generally bundles credit card receivables and sells them to investors through a securitization transaction involving a subsidiary and related trusts.

Fin 2 is an industrial loan corporation. Fin 2's operations are substantially similar to those of Fin 1. In addition to its private label/co-brand credit card services, Fin 2 has also begun issuing credit to consumers to finance medical procedures. Fin 2's initial business model was providing fleet credit cards (i.e., issuing a single master credit card account to a business under which employees would have access to individual credit cards linked to the master account).

The FI Corporations both have wholly-owned limited liability company subsidiaries that provide services to support the FI Corporations' operations ("FI Subs"). The FI Subs are disregarded for federal income tax purposes.

For purposes of this private letter ruling, assume (1) that all members of the Affiliated Group satisfy at least three-of-six tests provided in§ 39-22-303(11), C.R.S., (2) that the Affiliated Group meets the three-of-six test in the current tax year and two preceding tax years, (3) that the Affiliated Group's income is subject to apportionment, and (4) the FI Corporations are financial institutions within the meaning of 1 CCR 201-3, Special Regulation 7A.

Discussion

Any member of an affiliated group[1] that meets the conditions described in section 39-22-303(11)(a), C.R.S. must be included in a combined report with all other members of the affiliated group that meet these conditions. These conditions are: (1) satisfying three of the six tests described in section 39-22-303(11)(a)(I) - (VI), C.R.S. and (2) satisfying the three-of-six test in the current tax year and in the immediate prior two tax years.[2] The purpose of this provision is to treat the affiliated group as a single taxpayer because the affiliated group acts as a unitary enterprise.

Because Affiliated Group satisfies the three-of-six test described in section 39-22-303(11)(a)(I) - (VI), C.R.S. and satisfies the three-of-six test in the current tax year and in the immediate prior two tax years, all members of the Affiliated Group are required to be included in a combined report.

If members of an affiliated group have sources of income both from inside and outside Colorado, the income of the combined group must be apportioned among the relevant states. Affiliated Group represents that members have sources of income that come from inside and outside Colorado. Colorado generally requires taxpayers to apportion their business income using the single-sales factor apportionment methodology.3 Under the single-sales factor apportionment methodology, the affiliated group files one return, apportioning income under the provisions of section 39-22-303.5 C.R.S., and sum the numerators to derive a single apportionment factor for the combined group.[4] However, Colorado recognizes that the specific rules under section 39-22-303.5, C.R.S. governing the single-sales factor apportionment methodology may be ill-suited for certain types of business and, thus, the legislature allows the Department to promulgate regulations to determine the apportionment and allocation rules for certain industries where unusual factual situations produce inequitable results under the general apportionment and allocation rules.[5] The Department has created regulations for special industries, such as financial institutions.[6]

When an affiliated group engages in two or more distinctly different commercial activities, and each commercial activity requires the use of different apportionment or allocation rules, the question of how to apportion the combined group's income arises. In the case at hand, Affiliated Group engages in marketing and financial services, which are distinctly different commercial activities that require the use of two different apportionment methodologies. The Affiliated Group's members providing marketing and loyalty solutions must use the apportionment methodology outlined in section 39-22-303.5, C.R.S., while the FI Corporations must use the financial institutions apportionment methodology outlined in 1 CCR 201-3 Special Regulation 7A.

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1 An affiliated group is defined in §39-22-303(12), C.R.S.

2 §39-22-303(11), C.R.S.

3 §39-22-303.5, C.R.S.

4 Department Regulation 39-22-303.11(C)(2).

5 §39-22-303.S(?)(a), C.R.S.

6 1 CCR 201-3, Special Regulation 1A- 8A.

The Department acknowledges that little guidance exists on how to apply two different apportionment methodologies. In 2011, the Department issued a Private Letter Ruling PLR-11-002, describing how an affiliated group should apportion its income using two different apportionment methodologies. In the most general terms, the Department required the financial and non-financial members of the combined group to calculate their modified federal taxable income as separate subgroups, including the elimination of all intercompany transactions regardless of whether such transactions were between members of the financial or non-financial subgroups. The financial and non-financial subgroups were also required to separately allocate allocable income and loss and apportion any apportionable business income or loss using the respective apportionment methodology and factors for each subgroup. Next, all business income or loss allocated and apportioned to Colorado by the financial and non-financial subgroups were added together to produce an aggregated Colorado tax base to which the income tax rate applied. In addition, the ruling detailed which sub-group should include in its modified federal taxable income assets transferred between the financial and non-financial sub-groups. Lastly, the ruling states that the ruling is applicable until superseded by specific guidance from the Department withdrawing its approval or by a regulation that contradicts the ruling.[7]

Because so little guidance exists on how to apportion income when a combined report requires two or more different apportionment methodologies, the Department rules that Affiliated Group may use the allocation and apportionment methodology outlined in PLR-11-002. That being said, the Department is currently in the process of working with stakeholders to revise its current regulation to provide specific guidance outlining how to apportion income when a combined report requires two or more different apportionment methodologies. The Department may outline an approach that differs from the guidance outlined in PLR-11-002. If the Department does adopt a regulation whose methodology differs from PLR-11-002, then the Affiliated Group must prospectively follow the guidance adopted by the Department in regulation for the tax year in which the regulation becomes effective, or request an alternative apportionment methodology if Affiliated Group feels the apportionment and allocation outlined in the newly adopted regulation does not fairly represent the extent of the taxpayer's activities in Colorado.[8] The Department anticipates adopting an amended regulation sometime in 2015.

Miscellaneous

This ruling is premised on the assumption that Affiliated Group has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Affiliated Group's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation,

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[7] Department Private Letter Ruling PLR-11-002

[8] §39-22-303.5(7}(b}, C.R.S.

this redacted version of the ruling 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 version of the ruling.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue