



Tax Insights  
from State and Local Tax  
Services

# Colorado enacts worldwide combined reporting regime with water's-edge election, repeals 80/20 company treatment

June 19, 2026

## In brief

### What happened?

On June 4 Colorado enacted legislation providing for default worldwide unitary combined reporting with a 10-year water's-edge election. The legislation also repeals the 80/20 rule, under which a C corporation is excluded from the unitary combined return if 80% or more of its property and payroll are assigned to locations outside the United States. These changes are effective for tax years beginning on or after January 1, 2027.

[[H.B. 1289](#), enacted 6/3/26]

### Why is it relevant?

This legislation continues a significant shift in Colorado's unitary combined reporting regime. Under 2024 legislation, Colorado replaced its historic "3 of 6" unitary test with a statement of constitutional principles for determining if a unitary business exists, effective for tax years beginning on or after January 1, 2026, among other unitary combined reporting changes. ([Click here](#) for PwC's Insight on the changes.) Now, for the 2027 tax year and forward, Colorado unitary combined groups will need to determine whether to compute income and apportionment on a worldwide basis or make a water's-edge election that is binding for 10 years (unless otherwise allowed by the Department of Revenue).

## Actions to consider

Taxpayers filing on a unitary combined basis should model the potential impact of the legislation's worldwide and water's-edge reporting rules, incorporating changes to the unitary combined group test adopted in the prior legislation. Both the worldwide and water's-edge rules appear to be based on the Multistate Tax Commission (MTC) model statute, but with some significant divergences. Unitary combined groups will need to determine the impact of the unitary definition changes for 2026 tax year filings and apply these determinations in deciding whether to make a water's-edge election beginning with the 2027 tax year return filing.

## In detail

### Default worldwide unitary combination

Under existing law, all members of an affiliated group of C corporations, wherever incorporated or domiciled, that are members of a unitary business are required to file as a unitary combined group. However, the Colorado "80/20" company rule excludes from the unitary combined report any C corporation that conducts business outside the United States if 80% or more of its property and payroll is assigned to locations outside the United States. The legislation repeals this 80/20 company rule effective for tax years beginning on or after January 1, 2027.

Also effective for tax years beginning on or after January 1, 2027, for includable corporations that are not US-incorporated or included in a consolidated federal return, "federal taxable income" means the corporation's income and loss statement on a separate entity basis in the currency in which its books of account are regularly maintained, provided that this P&L statement is adjusted to conform to US GAAP and modified to take into account any book-tax adjustments necessary to reflect federal and state tax law. The computation includes all income wherever derived and is not limited to items of income from US sources or ECI. These computation rules for foreign corporations parallel the rules under existing Colorado law.

To the extent the net income of a member of a unitary combined group includes subpart F income or net CFC tested income (NCTI) with respect to another member of the unitary combined group of which the member is a US shareholder, the group will eliminate that subpart F or NCTI from the worldwide unitary combined report.

### Water's-edge election

The legislation enacts new C.R.S. Section 39-22-303(8.5) to provide that members of an affiliated group of C corporations required to file a unitary combined report may make a water's-edge election, effective for tax years beginning on or after January 1, 2027.

**Observation:** The legislation does not alter the existing ability to elect to file a nexus consolidated return. An election to file a nexus consolidated return can be made even if the return will include members of an affiliated group of corporations that are required to file a unitary combined report. However, the filing of a nexus consolidated return does not extinguish the requirement for mandatory unitary combined filings.

*Water's-edge group composition.* The unitary combined group will take into account the entire net income and apportionment factors of:

- *Domestic corporations.* Every member of the affiliated group incorporated in the United States or formed under the laws of any state, DC, or US territory or possession.
- *“Reverse 80/20” companies.* Every member regardless of place of incorporation if 20% or more of the member’s property and payroll is assigned to the US states and DC.
- *DISCs/export trade corps.*
- *Foreign incorporated member/tax avoidance.* Every member of the affiliated group incorporated in a foreign jurisdiction for the purpose of tax avoidance. (The existing inclusion for these corporations under C.R.S. Section 39-22-303(8)(b) is repealed.) As in current law, there is a rebuttable presumption that incorporation in a listed jurisdiction shows a purpose of tax avoidance, but the taxpayer may rebut this presumption by proving that the member is incorporated in a listed jurisdiction for reasons that meet the IRC Section 7701(o) economic substance doctrine.

*Water’s-edge income/factor inclusion.* To the extent not included in the income / apportionment of the group as reflected above, the group will also take into account:

- *ECI.* Income subject to federal income tax because it is effectively connected (or treated as effectively connected under the IRC) with the conduct of a US trade or business, and the related factors.
- *20% intercompany intangible/service income/no treaty.* For an affiliated group member that is resident of a country that does not have a comprehensive income tax treaty with the United States and earns more than 20% of its net income from intangible property or service-related activities that are deductible from the apportionable income of a unitary combined group member, “the related net income and the apportionment factors.”
- *Elimination for included NCTI/subpart F.* To the extent the net income of a unitary combined group member includes subpart F income or NCTI with respect to another member of the unitary combined group of which the member is a US shareholder, the group will eliminate that income from the unitary combined report.

*Water’s-edge election.*

- *Timely filed return.* The water’s-edge election must be made on a timely filed, original return.
- *Binding for 10 years.* The election is binding for 10 years (the year of the election and the nine succeeding years).
- *Automatic renewal.* In the year following the expiration of the water’s-edge election, the election is deemed renewed for another 10-year period unless the taxpayer makes a written withdrawal.
- *Withdrawal.* Withdrawal may be made on a timely filed, original tax return for the first income tax year after the above 10-year period, or “by other written withdrawal made in the time and manner prescribed by rules promulgated by the Executive Director.” That withdrawal is then binding for the year of the withdrawal and the succeeding nine years (10 years total).
- *Petition to change prior to expiration of 10-year period.* The unitary combined group may petition to withdraw a water’s-edge election or reinstate a withdrawn election by showing reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy. On granting a withdrawal, the DOR may impose reasonable conditions necessary to

prevent tax evasion or to clearly reflect net income for the election period prior to or after the withdrawal.

- *DOR discretion.* The legislation grants broad authority for the DOR to disregard a water's-edge election and adjust income and included factors if any group member knowingly fails to comply, has reckless disregard to the law, or a person not otherwise included is used for a substantial state income tax avoidance purpose.

The legislation amends the preexisting tax haven inclusion to remove Liechtenstein from the tax haven list, effective for tax years beginning on or after January 1, 2027. The legislation also provides a mechanism for the DOR to engage a contractor to examine whether a country identified as a listed jurisdiction should remain a listed jurisdiction and further provides criteria for the contractor to make recommendations on potential changes to the list.

## Tax credit changes

The legislation includes multiple credit changes. Regarding the existing credit for R&E expenditures as defined in Section 174 conducted in an enterprise zone, the legislation updates the statutory references from Section 174 to Section 174A and restricts the credit to taxpayers that make at least \$150,000 of qualifying expenditures, effective for tax years beginning on or after January 1, 2027.

## Let's talk

To discuss the potential impact of Colorado's unitary combined reporting changes on your business, please contact:

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