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HB 1210-Income Tax- Subtraction Modification- Expenses of Medical Cannabis Grower, Processor, Dispensary or Independent Testing Laboratory:

White Paper in Support of decouple modification from
Internal Revenue Code Section 280E when computing
Maryland Taxable Income

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Good afternoon. My name is Stephen Bishop and I am a resident of Bel Air, Maryland. I have been a practicing certified public accountant for over 25 years. I am currently a senior manager with SC&H Group in Sparks, Maryland. My firm and I have been consulting individuals and businesses in the medical Cannabis space since the summer of 2016. We have worked with growers and processors but mainly dispensaries. The primary focus of my practice is tax compliance and planning with a strong focus on Internal Revenue Code Section 280E.

280E was implemented in the early 80s. It was specifically created to penalize criminals involved in drug trafficking. I could talk about this more if I had more time because it really is a fascinating subject for tax nerds like myself. It is important to note that no where does the internal revenue code distinguish between illegal income or legal income. Citizens are expected to pay tax on their income regardless of source. You may remember that Al Capone was imprisoned not because of his illegal activities but because he did not report those activities and pay taxes on them. 280E simply states if you are selling cannabis you cannot deduct normal business expenses that you otherwise would be able to if you were selling any other item even if those items were illegal.

The calculation of Maryland taxable income begins with federal taxable income as its starting point. Without a specific modification like many other states have Maryland is effectively following federal guidelines and treating these businesses as criminal activities under a punitive tax regime. The modification which Senate Bill 146 seeks does not give Maryland Cannabisbusiness any special treatment. It merely says- We think you are a legitimate business and we are going to treat you like everyone else.

The net result of section 280E and Maryland's conformity with it is to create an effective tax rate that is unsustainable for most if not all businesses. A Cannabisbusiness already operates under very tight cash flow constraints, in part because they cannot typically go to a neighborhood bank and open a line of credit or get a loan. Their working capital cash flow comes from the owners or investors and their after-tax net profit. It is not unusual for an owner of one of these businesses to have a tax bill that exceeds the actual cash profit generated.

I have seen dispensary owners sell their businesses because they cannot afford to operate them under the current punitive tax structure. I believe the tax issue is the main reason for the mergers and acquisitions we have seen with large out of state players. I have seen dispensary owners go into a payment plan with the IRS because there is no cash available to pay the tax on the imaginary profit that section 280E creates. Ultimately, in order to generate an after-tax profit that is reasonable, dispensaries will be forced to raise prices on Cannabis to a point that is so high it would push patients to instead buy similar product off the black market which as we know will increase real criminal activity and avoid tax revenue to the state.

I was told that I would only have 3 minutes for my remarks, so I have tried to keep them short. I am happy to answer any questions which will help you understand the need for House Bill 1210.

Internal Revenue Code Section 280E
And
Operation of a Cannabis Business in Maryland

Support for House Bill 1210

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Internal Revenue Code

§ 280E Expenditures in connection with the illegal sale of drugs.

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

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Effects of Section 280E

| | Typical
Business | Cannabusiness
Under 280E |
|---|-----------------------------|-------------------------------------|
| Revenue | \$ 1,000,000 | \$ 1,000,000 |
| Cost of Goods Sold (COGS): | | |
| Costs to Purchase or Produce the Product | (550,000) | (550,000) |
| Gross Income | 450,000 | 450,000 |
| Business Expenses: | | |
| Rent | | |
| Heat, HVAC, Water, Electricity | | |
| Payroll | | |
| Employee Benefits | | |
| Business Insurance | | |
| Repairs and Maintenance | | All Disallowed |
| Licenses and other fees | | |
| Security | | |
| Internet Connection | | |
| Advertising | | |
| Accounting and legal | | |
| Other Miscellaneous Expenses | | |
| Total Business Expenses | (300,000) | 0 |
| Net Income - "Taxable Income" | 150,000 | 450,000 |
| Economic Profit | 150,000 | 150,000 |
| Taxes: | | |
| Federal Tax at Blended Rate of 25% | \$ 37,500 | \$ 112,500 |
| State & Local Tax at Blended Rate of 8% | \$ 12,000 | \$ 36,000 |
| Total Tax | \$ 49,500 | \$ 148,500 |
| Net Cash Generated from Operations After Taxes | \$ 100,500 | \$ 1,500 |
| Hypothetical Effective Tax Rate | 33% | 99% |

State Tax Chart Results

Tax Type: Corporate Income

Legend:

N/A - Not Applicable

State Follows IRC Section 280E

This chart shows whether each state conforms to IRC Section 280E dealing with expenses related to the sale of drugs.

| State | State Follows IRC Section 280E | Authority | Editorial Reference |
|-------|--|--|------------------------|
| AK | Yes.

Alaska conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Alaska Stat. § 43-20-021(a) ; Alaska Stat. § 43.20.300(a) ; Alaska Stat. § 43.20.340(5) | ¶11,059; ¶ 1063AK:1000 |
| AL | Yes.

Alabama conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Ala. Code § 40-18-33 ; Ala. Code § 40-18-1.1 ; Ala. Admin. Code § 810-3-1.1-.01 | ¶11,059; ¶ 1063AL:1000 |
| AR | No.

Arkansas does not conform to IRC 280E for corporate income tax purposes, unless otherwise provided. | Ark. Code Ann. § 26-51-423(a)(1) | ¶11,059; ¶ 1063AR:1000 |
| AZ | Yes.

Arizona conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit.
Note: nonprofit medical marijuana dispensaries are exempt from Arizona income tax. | Ariz. Rev. Stat. Ann. § 43-105(A) ; Ariz. Rev. Stat. Ann. § 43-102(A)(2) ; Ariz. Rev. Stat. Ann. § 43-102(A)(3) ; Ariz. Rev. Stat. Ann. § 43-1201(B) | ¶11,059; ¶ 1063AZ:1000 |
| CA | No.

California does not conform to IRC § 280E for corporate franchise (income) tax purposes. Taxpayers may deduct ordinary and necessary business expenses, without regard to the limitation in IRC § 280E. | Cal. Rev. & Tax. Cd. § 24436.1 ; Cal. Rev. & Tax. Cd. § 24341 | ¶11,059; ¶ 1063CA:1000 |
| CO | No.

Colorado permits Colorado-licensed marijuana businesses to deduct expenditures that were disallowed at the federal level by operation of IRC § 280E. | Colo. Rev. Stat. § 39-22-304(3)(m) ; Colo. Rev. Stat. § 39-22-304(3)(n) | ¶11,059; ¶ 1063CO:1000 |
| CT | Yes.

Connecticut conforms to IRC §280E to the extent of conformity to the underlying federal deduction or credit. | Conn. Gen. Stat. § 12-213(a)(23) | ¶11,059; ¶ 1063CT:1000 |
| DC | Yes, in part.

For District of Columbia corporate income tax purposes, some deductions are subject to federal limitations including IRC 280E. | D.C. Code Ann. § 47-1801.04(28) ; D.C. Code Ann. § 47-1803.03(a)(1) ; School Street Associates Ltd. Partnership v. District of Columbia (2001, D.C. Ct. App.), 764 A2d 798, Dkt. Nos. 97-TX-1442; 1-4-2001 | ¶11,059; ¶ 1063DC:1000 |
| DE | Yes.

Delaware conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Del. Code Ann. 30 § 1903(a) ; Del. Code Ann. 30 § 1901(10) | ¶11,059; ¶ 1063DE:1000 |
| FL | Yes.

Florida conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Fla. Stat. § 220.03(1)(n) ; Fla. Stat. § 220.03(4) ; Fla. Stat. § 220.13(1) | ¶11,059¶ 1063FL:1000 |
| GA | Yes.

Georgia conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Ga. Code Ann. § 48-1-2(14) ; Ga. Code Ann. § 48-7-21(a) ; Bourassa v. Commr., Ga. Dept. of Rev., Ga. Tax Tribunal, Dkt. No. TAX-IIT-1407354, 12/14/2015 | ¶11,059; ¶ 1063GA:1000 |
| HI | No.

Hawaii does not conform to IRC § 280E with | Haw. Rev. Stat. § 235-2.4(v) ; Hawaii Dept. of Taxation Announcements No. 2016-07, , 07/26/2016 | ¶11,059; ¶ 1063HI:1000 |

| | | | |
|----|--|---|------------------------|
| | respect to the production and sale of medical cannabis and manufactured cannabis products by Hawaii-licensed dispensaries and their subcontractors. | | |
| IA | Yes.

Iowa conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Iowa Code § 422.32(1)(h) | ¶11,059; ¶ 1063IA:1000 |
| ID | Yes.

Idaho conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Idaho Code § 63-3004 ; Idaho Admin. Rules § 35.01.01.291(03)(e) | ¶11,059; ¶ 1063ID:1000 |
| IL | Yes.

Illinois conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | ILCS Chapter 35 § 5/1501(a)(11) ; ILCS Chapter 35 § 5/203(b)(1) | ¶11,059; ¶ 1063IL:1000 |
| IN | Yes.

Indiana conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Ind. Code § 6-3-1-3.5(b) ; Ind. Code § 6-3-1-11(a) | ¶11,059; ¶ 1063IN:1000 |
| KS | Yes.

Kansas conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Kan. Stat. Ann. § 79-32,138(a) ; Kan. Stat. Ann. § 79-32,109(a)(1) | ¶11,059; ¶ 1063KS:1000 |
| KY | Yes.

Kentucky conforms to IRC §280E to the extent of conformity to the underlying federal deduction or credit. | Ky. Rev. Stat. Ann. § 141.010(15) | ¶11,059; ¶ 1063KY:1000 |
| LA | Yes.

Louisiana conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | La. Rev. Stat. Ann. § 47:287.63 ; La. Rev. Stat. Ann. § 47:287.73 | ¶11,059; ¶ 1063LA:1000 |
| MA | Yes.

Massachusetts conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Mass. Gen. L. Chapter 63 § 1 ; Mass. Gen. L. Chapter 63 § 30(3) ; Mass. Gen. L. Chapter 63 § 30(4) ; Massachusetts Department of Revenue Website, Marijuana Retail Taxes FAQs, 10/01/2018; Massachusetts DOR Directive No. 14-4, , 12/16/2014 | ¶11,059; ¶ 1063MA:1000 |
| MD | Yes.

Maryland conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Md. Code Ann. Tax-Gen. § 10-304(1) | ¶11,059; ¶ 1063MD:1000 |
| ME | No.

For tax years beginning on or after January 1, 2018, Maine allows a subtraction modification for business expenses related to carrying on a trade or business as a Maine-registered caregiver or a Maine-registered dispensary in an amount equal to the deduction that would otherwise be allowable if not for IRC § 280E. | Me. Rev. Stat. Ann. 36 § 111(1-A) ; Me. Rev. Stat. Ann. 36 § 5200-A(2)(BB) , eff. 12/13/2018 (retroactively applicable) | ¶11,059; ¶ 1063ME:1000 |
| MI | No.

Under the Michigan Regulation and Taxation of Marihuana Act, in computing net income for marihuana establishments, deductions from state taxes are allowed for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying out a trade or business. | Mich. Comp. Laws Ann. § 333.27962 ; Michigan Revenue Administrative Bulletin No. 2019-17, , 11/18/2019 | ¶11,059; ¶ 1063MI:1000 |
| MN | No.

Effective for taxable years beginning after December 31, 2018, taxpayers are allowed a subtraction from federal taxable income equal to the expenses of a medical cannabis manufacturer related to the business of medical cannabis, and not allowed for federal income tax purposes under IRC § 280E. | Minn. Stat. § 290.0134, Subd. 19 | ¶11,059; ¶ 1063MN:1000 |
| MO | Yes.

Missouri conforms to IRC § 280E to the extent | Mo. Rev. Stat. § 143.091 ; Mo. Rev. Stat. § 143.431 | ¶11,059; ¶ 1063MO:1000 |

| | | | |
|----|--|--|------------------------|
| | of conformity to the underlying federal deduction or credit. | | |
| MS | No.

Mississippi does not automatically incorporate the disallowance of deductions and credits under IRC § 280E. To the extent that a particular Mississippi deduction is limited by the amount actually claimed on the taxpayer's federal return, however, the disallowance of a deduction by reason of IRC § 280E would carry through to the Mississippi return unless otherwise provided. | Miss. Code Ann. § 27-7-13(1) ; Miss. Administrative Code § 35.III.5.01 | ¶11,059; ¶ 1063MS:1000 |
| MT | No.

Montana-licensed medical marijuana providers can subtract from gross income the same ordinary and necessary expenses incurred for the business that are allowed for other types of businesses operating in the state. | Mont. Code Ann. § 15-31-113(1) ; Mont. Code Ann. § 15-31-114(1)(a) ; Montana Tax News You Can Use, 12/14/2017 | ¶11,059¶ 1063MT:1000 |
| NC | Yes.

North Carolina conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | N.C. Gen. Stat. § 105-228.90(b)(1b) ; N.C. Gen. Stat. § 105-130.2(15) | ¶11,059; ¶ 1063NC:1000 |
| ND | Yes.

North Dakota conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | N.D. Cent. Code § 57-38-01(5) ; N.D. Cent. Code § 57-38-01(13) | ¶11,059; ¶ 1063ND:1000 |
| NE | Yes.

Nebraska conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Neb. Rev. Stat. § 77-2714 ; Neb. Rev. Stat. § 77-2734.04(24) | ¶11,059; ¶ 1063NE:1000 |
| NH | Yes.

New Hampshire conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | N.H. Rev. Stat. Ann. § 77-A:1, (XX)(n) ; N.H. Rev. Stat. Ann. § 77-A:1, III(a) | ¶11,059; ¶ 1063NH:1000 |
| NJ | Yes.

New Jersey conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | N.J. Rev. Stat. § 54:10A-4(k) ; N.J. Admin. Code § 18:7-5.1(b) | ¶11,059; ¶ 1063NJ:1000 |
| NM | Yes.

New Mexico conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | NMSA 1978 § 7-2A-2(H) ;NMSA 1978 § 7-2A-2(C) ;NMSA 1978 § 7-2A-2(I) ; | ¶11,058; ¶ 1063NM:1000 |
| NV | N/A | N/A | N/A |
| NY | Yes.

New York conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | N.Y. Tax Law § 208(9) ; NYCRR 20 § 3-2.2 | ¶11,059; ¶ 1063NY:1000 |
| OH | N/A | N/A | N/A |
| OK | Yes.

Oklahoma conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Okla. Stat. 68 § 2353(2) ; Okla. Stat. 68 § 2353 | ¶11,059;¶ 1063OK:1000 |
| OR | No.

Oregon taxpayers can deduct from federal taxable income any federal deduction that would have been allowed to the taxpayer for the production, processing, or sale of marijuana items authorized under Oregon law in the absence of IRC Sec. 280E. | Or. Rev. Stat. § 317.363 | ¶11,059; ¶ 1063OR:1000 |
| PA | Yes.

Pennsylvania conforms to IRC 280E for corporate income tax purposes, to the extent of conformity to the underlying federal deduction or credit. | Pa. Stat. Ann. 72 § 7401(3)(1)(a) ; Pennsylvania Department of Revenue, Medical Marijuana Fact Sheet, 07/10/2018 | ¶11,059; ¶ 1063AR:1000 |
| RI | Yes. | R.I. Gen. Laws § 44-11-11(a) | ¶11,059; ¶ 1063RI:1000 |

| | | | |
|----|---|---|------------------------|
| | Rhode Island conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | | |
| SC | Yes.

South Carolina conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | S.C. Code Ann. § 12-6-40(A)(1)(a) ; S.C. Code Ann. § 12-6-1110(A) ; S.C. Code Ann. § 12-6-1130(A) ; S.C. Code Ann. § 12-6-580 | ¶11,059; ¶ 1063SC:1000 |
| SD | N/A | N/A | N/A |
| TN | Yes.

Tennessee conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Tenn. Code Ann. § 67-4-2006(a)(1) ; Tenn. Code Ann. § 67-4-2006(b)(2) | ¶ 1063TN:1000; ¶11,059 |
| TX | No.

Texas does not conform to IRC § 280E. Texas uses federal gross income (as that term is defined in the IRC in effect on January 1, 2007), except for cost of goods sold, as the starting point for purposes of net taxable margin computation. For the purpose of computing its taxable margin, the total revenue of a corporation is an amount computed by adding the amount reportable as income on Line 1c of IRS Form 1120. | Tex. Tax Code Ann. § 171.0001(9) ; Tex. Tax Code Ann. § 171.1011(c) | ¶11,059; ¶ 1063TX:1000 |
| UT | Yes.

Utah conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Utah Code Ann. § 59-7-101(21) ; Utah Code Ann. § 59-7-101(30)(a) | ¶11,059; ¶ 1063UT:1000 |
| VA | Yes.

Virginia conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Va. Code Ann. § 58.1-301(B) ; Va. Code Ann. § 58.1-402 ; Virginia Public Document Ruling No. 88-214, , 07/27/1988 | ¶11,059; ¶ 1063VA:1000 |
| VT | Yes.

Vermont conforms to IRC 280E to the extent of conformity to the underlying federal deduction or credit. | Vt. Stat. Ann. 32 § 5811(18) ; Vt. Stat. Ann. 32 § 5820(a) ; Vt. Stat. Ann. 32 § 5824 | ¶11,059; ¶ 1063VT:1000 |
| WA | N/A | N/A | N/A |
| WI | Yes.

Wisconsin conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | Wis. Stat. § 71.22(4)(l) ; Wis. Stat. § 71.26(3) | ¶11,059 |
| WV | Yes.

West Virginia conforms to IRC § 280E to the extent of conformity to the underlying federal deduction or credit. | W. Va. Code § 11-24-3(a) ; W. Va. Code § 11-24-6 ; Code of State Rules § 110-24-2 | ¶11,059; ¶ 1063WV:1000 |
| WY | N/A | N/A | N/A |

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Income Tax Subtractions

These subtractions will change your Colorado Taxable Income from the amount of Federal Taxable Income. See instructions in the income tax booklet for additional guidance on completing the schedule. Do not enter negative amounts. To ensure faster processing of your paper return, the amount entered in the Subtractions line of the income tax return must exactly match the subtotal amount at the end of the subtractions schedule or form.

Visit the [Credits & Subtractions Forms](#) page to download the forms and/or schedules needed to file for the subtractions listed below.

Reminder: Save time and file online! You may use the Department's free e-file service [Revenue Online](#) to file your state income tax. **You do not need to login to Revenue Online to File a Return.** After you file, you have the option of setting up a Login ID and Password to view your income tax account in Revenue Online. Or, you may opt to e-file through a paid tax professional or purchase tax software to complete and file returns.

- **Agricultural Asset Lease Deduction**
 - Enter the certificate number (YY-###) for the deduction certificate that was provided by the Colorado Agricultural Development Authority (CADA). If you received more than one certificate, then you must file electronically. Enter the amount of the deduction on this line. The amount of deduction allowed to a qualified taxpayer may not exceed \$25,000. You must submit a copy of each certificate with your return.
- [Catastrophic Health Insurance](#)
- [Charitable Contributions](#)
- [Colorado Source Capital Gain](#)
- **Exonerated Persons Deduction**
 - For tax years 2013 and thereafter, certain exonerated persons (or the immediate family members of an exonerated person) who are found to be actually innocent may deduct from their individual income tax return any compensation received pursuant to §13-65-103, C.R.S. that was received on or after January 1, 2014. However, attorney fees that are awarded as part of the compensation shall not be deducted. [§39-22-104(4)(q), C.R.S.] The deduction shall be subtracted from the individual income tax return on the line designated. Write "Exonerated Persons Income" as the explanation for the deduction.
- [First-time Home Buyer Savings Account Interest Deduction](#)
- **Marijuana Business Deduction**
 - To claim this deduction, Colorado-licensed marijuana businesses must list any expenditure that is eligible to be claimed as a federal income tax deduction but is disallowed by section 280E of the Internal Revenue Code because marijuana is a controlled substance under federal law.
- [Medical Savings Account](#)
- [Olympic Gold Medal](#)
- [Reacquisition of Residence During Active Military Service \(Formerly the Military Income Tax Exemption\)](#)
- **Military Family Relief Fund Grants Deduction**
 - For tax years 2014 and thereafter, military families receiving a grant from the Military Family Relief Fund may deduct the amount of the grant from their individual income tax return to the extent that it is included in federal taxable income. [§39-22-104(4)(p), C.R.S.] The deduction shall be subtracted from the individual income tax return. Write "Military Family Relief Fund Grant" as the explanation for the deduction where designated. If you deducted the income on your federal return rather than claiming the grant (you did not include it in federal taxable income), no Colorado subtraction is allowed since the income is not included in your federal taxable income.
- **Non-resident Disaster Relief Worker Subtraction**
 - For nonresident individuals, enter the amount of income (compensation earned) while working in Colorado during a declared state disaster emergency on disaster-related work. Disaster-related work includes repairing, renovating, installing, building, or rendering services that relate to infrastructure that has been damaged, impaired, or destroyed by a declared state disaster emergency or providing emergency medical, firefighting, law enforcement, hazardous material, search and rescue, or other

emergency service related to a state declared disaster emergency. This subtraction is only available to nonresident individuals. If you are a full-year resident of Colorado, you are not eligible for this subtraction.

- [Pension Annuity](#)
- [Railroad Pension](#)
- **Reservation Income**
 - List any amount of income that was derived wholly from reservation sources by a recognized tribal member, which was included as taxable income on the federal income tax form. Submit proof of tribal membership, residence, and source of income. This must be submitted only every three years by taxpayers claiming this subtraction.
- [State Income Tax Refund](#)
- [Tuition Program Contribution/Distribution](#)
- [United States Government Interest](#)
- **Wildfire Mitigation Measures**
 - Enter the amount of qualified expenses incurred in performing wildfire mitigation on your land, up to \$2,500. Reference [FYI Income 65](#) for information on how to accurately calculate this subtraction.