



Connecticut's New Pass-Through Entity Tax

November 8, 2018

6:00 p.m. – 8:00 p.m.

Polish National Home

Hartford, CT

CT Bar Institute, Inc.

CT: 1.0 CLE Credit (General)

NY: 1.0 CLE Credit (AOP)

Lawyers' Principles of Professionalism

As a lawyer I must strive to make our system of justice work fairly and efficiently. In order to carry out that responsibility, not only will I comply with the letter and spirit of the disciplinary standards applicable to all lawyers, but I will also conduct myself in accordance with the following Principles of Professionalism when dealing with my client, opposing parties, their counsel, the courts and the general public.

Civility and courtesy are the hallmarks of professionalism and should not be equated with weakness;

I will endeavor to be courteous and civil, both in oral and in written communications;

I will not knowingly make statements of fact or of law that are untrue;

I will agree to reasonable requests for extensions of time or for waiver of procedural formalities when the legitimate interests of my client will not be adversely affected;

I will refrain from causing unreasonable delays;

I will endeavor to consult with opposing counsel before scheduling depositions and meetings and before rescheduling hearings, and I will cooperate with opposing counsel when scheduling changes are requested;

When scheduled hearings or depositions have to be canceled, I will notify opposing counsel, and if appropriate, the court (or other tribunal) as early as possible;

Before dates for hearings or trials are set, or if that is not feasible, immediately after such dates have been set, I will attempt to verify the availability of key participants and witnesses so that I can promptly notify the court (or other tribunal) and opposing counsel of any likely problem in that regard;

I will refrain from utilizing litigation or any other course of conduct to harass the opposing party;

I will refrain from engaging in excessive and abusive discovery, and I will comply with all reasonable discovery requests;

In depositions and other proceedings, and in negotiations, I will conduct myself with dignity, avoid making groundless objections and refrain from engaging in acts of rudeness or disrespect;

I will not serve motions and pleadings on the other party or counsel at such time or in such manner as will unfairly limit the other party's opportunity to respond;

In business transactions I will not quarrel over matters of form or style, but will concentrate on matters of substance and content;

I will be a vigorous and zealous advocate on behalf of my client, while recognizing, as an officer of the court, that excessive zeal may be detrimental to my client's interests as well as to the proper functioning of our system of justice;

While I must consider my client's decision concerning the objectives of the representation, I nevertheless will counsel my client that a willingness to initiate or engage in settlement discussions is consistent with zealous and effective representation;

Where consistent with my client's interests, I will communicate with opposing counsel in an effort to avoid litigation and to resolve litigation that has actually commenced;

I will withdraw voluntarily claims or defense when it becomes apparent that they do not have merit or are superfluous;

I will not file frivolous motions;

I will make every effort to agree with other counsel, as early as possible, on a voluntary exchange of information and on a plan for discovery;

I will attempt to resolve, by agreement, my objections to matters contained in my opponent's pleadings and discovery requests;

In civil matters, I will stipulate to facts as to which there is no genuine dispute;

I will endeavor to be punctual in attending court hearings, conferences, meetings and depositions;

I will at all times be candid with the court and its personnel;

I will remember that, in addition to commitment to my client's cause, my responsibilities as a lawyer include a devotion to the public good;

I will endeavor to keep myself current in the areas in which I practice and when necessary, will associate with, or refer my client to, counsel knowledgeable in another field of practice;

I will be mindful of the fact that, as a member of a self-regulating profession, it is incumbent on me to report violations by fellow lawyers as required by the Rules of Professional Conduct;

I will be mindful of the need to protect the image of the legal profession in the eyes of the public and will be so guided when considering methods and content of advertising;

I will be mindful that the law is a learned profession and that among its desirable goals are devotion to public service, improvement of administration of justice, and the contribution of uncompensated time and civic influence on behalf of those persons who cannot afford adequate legal assistance;

I will endeavor to ensure that all persons, regardless of race, age, gender, disability, national origin, religion, sexual orientation, color, or creed receive fair and equal treatment under the law, and will always conduct myself in such a way as to promote equality and justice for all.

It is understood that nothing in these Principles shall be deemed to supersede, supplement or in any way amend the Rules of Professional Conduct, alter existing standards of conduct against which lawyer conduct might be judged or become a basis for the imposition of civil liability of any kind.

--Adopted by the Connecticut Bar Association House of Delegates on June 6, 1994

Update on the Pass-Through Entity Tax (“PET”)

Program Agenda

Time	Topic	Speaker
6:00 p.m. – 6:30 p.m.	Registration and Dinner	
6:30 p.m. – 6:45 p.m.	Introduction to/Background on the PET	Matt Dayton
6:45 p.m. – 7:05 p.m.	Mechanics of the PET	Matt Dayton
7:05 p.m. – 7:30 p.m.	PET Issues to date	Matt Dayton
7:30 p.m. – 7:40 p.m.	Questions & Answers	Matt Dayton

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Matthew Dayton is a tax attorney with the Connecticut Department of Revenue Services. At the Department, Matt is responsible for legal matters relating to a variety of tax types, including the Corporation Business Tax and the recently-enacted Pass-Through Entity Tax. Matt had extensive involvement in the Department's implementation of the combined unitary reporting regime and market-based sourcing rules.

Prior to joining the Department, Matt was a state and local tax consultant at Ernst & Young LLP. Matt received a B.S. in management from Boston College and received a J.D. from the University of Connecticut School of Law.

Connecticut Bar Association Meeting Materials

Tax and Estates & Probate Sections

November 8, 2018

Update on the Pass-Through Entity Tax (“PET”)

Presentation by:

Matthew Dayton, Connecticut Department of Revenue
Services

Contents:

- SN 2018(4) - Guidance on 2018 Estimated Payments for the Newly Enacted Pass-Through Entity Tax
- OCG-6 Regarding the Calculation of the Pass-Through Entity Tax
- OCG-7 Regarding the Pass-Through Entity Tax Credit
- CT-1065/CT-1120SI ES
- CT-1065/CT-1120SI RR
- CT-1065/CT-1120SI RRS



Guidance on 2018 Estimated Payments for the Newly Enacted Pass-Through Entity Tax

Introduction: On May 31, 2018, Governor Malloy signed Public Act 18-49, which fundamentally changes how Connecticut taxes income earned by partnerships and S corporations, including limited liability companies treated as partnerships and S corporations for federal income tax purposes (referred to collectively as “pass-through entities”). This change is applicable to taxable years beginning on or after January 1, 2018. The legislation does not impact the taxation of publicly-traded partnerships, sole proprietorships, or single-member limited liability companies that are disregarded entities.

Prior to enactment of this legislation, pass-through entities were not subject to tax on their income. Instead, the partners, members or shareholders (referred to collectively as “partners”) were required to pay tax on their distributive shares of the pass-through entity’s income. As a general rule, partners were responsible for paying tax on their distributive share of income from a pass-through entity and typically made estimated payments for that liability.

For taxable years beginning on or after January 1, 2018, a pass-through entity is now subject to tax on its own income (the “Pass-Through Entity Tax”). To account for the fact that the pass-through entity must pay tax on its own income, Public Act 18-49 provides a tax credit that partners may claim on their Connecticut income tax returns and corporation business tax returns. The credit is intended to ensure the pass-through entity’s income is not taxed twice.

2018 Estimated Payments Required from Pass-Through Entities

Beginning with the 2018 taxable year, a pass-through entity is required to make estimated payments against its Pass-Through Entity Tax liability. Estimated payments for calendar year filers are due on April 15,

2018, June 15, 2018, September 15, 2018, and January 15, 2019. The law generally requires that each estimated payment equal 22.5% of the pass-through entity’s tax liability.

Recognizing that the Pass-Through Entity Tax was not enacted until after the April 15th due date of the first estimated payment, pass-through entities may comply with their 2018 estimated payment requirements by:

- Making a “catch-up” payment with the June 15, 2018, estimated payment that satisfies both the first and second estimated payment requirements;
- Making three estimated payments (by June 15, 2018, September 15, 2018, and January 15, 2019), each equal to 22.5% of the tax liability (the full amount of tax remains due by the return due date); or
- Annualizing their estimated payments for the taxable year.

In addition, DRS will allow pass-through entities to re-characterize all or a portion of any April 15, 2018, June 15, 2018, or September 15, 2018, income tax estimated payments made by any of their individual partners, with such partner’s consent, so that the payments are applied against the pass-through entity’s 2018 estimated payment requirements. The re-characterization of these 2018 income tax estimated payments must be completed by December 31, 2018. The re-characterized amount will be deemed to have been made by the pass-through entity on the date that the individual partner remitted the estimated payment to DRS. DRS will provide information by September 30, 2018, about the mechanism to re-characterize these estimated payments.

A pass-through entity may make its June 15, 2018, estimated payment by completing an estimated tax payment coupon and mailing the coupon with a check to DRS. The estimated tax payment coupon is

available on the DRS website. For the September 15, 2018, estimated payment, a pass-through entity may also make its estimated payments electronically by visiting the TSC at www.ct.gov/tsc.

Impact on Estimated Payments Made by Partners

Resident Partners

Because individual partners will get a credit for the Pass-Through Entity Tax paid by their pass-through entity, many resident individual and trust partners will no longer need to make estimated income tax payments to cover their Connecticut income tax liability arising from their pass-through entity income. A partner may still be required to make estimated income tax payments depending upon the method the pass-through entity uses to calculate the Pass-Through Entity Tax, if the partner has income from other sources, or if the individual partner is an employee who will not have enough income tax withheld from their wages. Partners should consult with their pass-through entities to determine how they will be affected.

DRS is aware that some individual partners have already remitted the first-quarter estimated income tax payment, and may have scheduled the automatic payment of the second, third and fourth quarter estimated income tax payments. If an individual partner determines that he or she no longer needs to make estimated income tax payments, the partner may cancel any pending scheduled payments.

If the automatic estimated income tax payments were scheduled through a third-party software, the individual partners should **first** try to cancel the scheduled payments through the third-party software. If the individual partners are unable to do so, then the individual partners must either contact DRS by phone at 860-297-4973 or by e-mail at ct.efile@po.state.ct.us to cancel payments. The request must be made at least two days before the scheduled payment date.

If the estimated income tax payments were scheduled through the TSC, the individual partners can log on to the TSC and cancel the scheduled payment.

For estimated income tax payments that have already been made, the individual partners will have two options:

- 1) The individual partners will receive a refund when the partners file their 2018 Connecticut income tax return; or
- 2) The individual partners may have all or a portion of their 2018 income tax estimated payments re-characterized so that the payments are applied against their pass-through entity's 2018 estimated payment requirements. This must be done by December 31, 2018. DRS will provide information by September 30, 2018, about the mechanism to re-characterize these estimated payments.

Non-Resident Partners

Under prior law, pass-through entities paid composite tax on behalf of nonresident individual and trust partners at the end of the taxable year. Under the new law, the pass-through entity is required to make estimated payments during the taxable year. If the nonresident does not have any other income from Connecticut sources and the pass-through entity pays its tax due, the nonresident generally is not required to file a Connecticut income tax return or make estimated income tax payments. Partners should consult with their pass-through entities to determine how they will be affected.

Corporations

DRS anticipates that most pass-through entities controlled by corporate partners will elect the alternate method of calculating the tax, which means that the corporation will continue to pay tax on its distributive share of income from the pass-through entity. If the pass-through entity is making the election, the corporation should continue to make estimated payments as it did previously.

Underpayment of Estimated Tax Due to the Enactment of the Pass-Through Entity Tax

Due to the timing of the legislation, DRS recognizes that pass-through entities may inadvertently underpay their 2018 estimated payments. If a pass-through entity receives a notice from DRS that the entity may have underpaid its estimated tax for 2018, the pass-through entity may contact DRS with a written explanation describing why it failed to comply along with all supporting documentation. All documents must be submitted to DRS at the following address:

Department of Revenue Services
450 Columbus Boulevard, 11th Floor
Hartford, Connecticut 06103
Attn: Legal Division/PE Tax Estimates

Special Note for Partners of Fiscal-Year Pass-Through Entities

Partners in a pass-through entity that files on a fiscal year basis will likely need to continue to make 2018 estimated income tax payments. The Pass-Through Entity Tax applies to taxable years beginning on or after January 1, 2018. If a pass-through entity is a fiscal year filer, the distributive share of the partner's pass-through entity's income from the pass-through entity's 2018 return will be included in such partner's 2019 income tax return. Therefore, the credit associated with the pass-through entity's 2018 return will not be claimed until the partner's 2019 Connecticut income tax return.

Effective Date: Upon issuance.

Statutory Authority: 2018 Conn. Pub. Acts 18-49.

Effect on Other Documents: None.

Effect of This Document: A Special Notice announces a new policy or practice in response to changes in state or federal laws or regulations or to judicial decisions. A Special Notice indicates an informal interpretation of Connecticut tax law by the Department of Revenue Services (DRS).

SN 2018(4)
Pass-Through Entity Tax
Issued: 6/6/2018

For Further Information: Call DRS during business hours, Monday through Friday:

- **1-800-382-9463** (Connecticut calls outside the Greater Hartford calling area only); **or**
- **860-297-5962** (from anywhere).

TTY, TDD, and Text Telephone users only may transmit inquiries anytime by calling 860-297-4911.

Forms and Publications: Visit the DRS website at www.ct.gov/DRS to download and print Connecticut tax forms and publications.

Paperless Filing/Payment Methods (fast, easy, free, and confidential): Business and individual taxpayers can use the **Taxpayer Service Center (TSC)** at www.ct.gov/TSC to file a variety of tax returns, update account information, and make payments online.

File Electronically: You can choose first-time filer information and filing assistance or log directly into the *TSC* to file returns and pay taxes.

Pay Electronically: You can pay taxes for tax returns that cannot be filed through the *TSC*. Log in and select the *Make Payment Only* option. Choose a payment date up to the due date of the tax and mail a paper return to complete the filing process.

DRS E-alerts Email Service: Get connected to the latest DRS news including new legislation, policies, press releases, and more. Visit the DRS website at www.ct.gov/DRS and select *Sign up for e-alerts* under *How Do I?* on the gold navigation bar.



OCG-6

OFFICE OF THE COMMISSIONER GUIDANCE Regarding the Calculation of the Pass-Through Entity Tax

This preliminary guidance is intended to assist taxpayers in calculating their Pass-Through Entity Tax (“PE Tax”) for purposes of making estimated payments. This guidance may be updated as needed to answer additional questions.

Separate guidance will be issued about how partners will be able to claim the PE credit. This credit may be used to offset a partner’s Connecticut income tax (under chapter 229) or corporation business tax liability (under chapter 208). If the PE credit exceeds a taxpayer’s Connecticut income tax liability, the excess credit can be refunded. Corporations will be allowed to carry an excess credit forward until fully used.

1. Who is subject to the PE Tax?

The PE Tax is imposed on the following entities that do business in Connecticut or have income derived from or connected with Connecticut sources:

- Partnerships, including limited liability companies that are treated as partnerships for federal income tax purposes, but excluding publicly-traded partnerships; and
- S corporations, including limited liability companies that are treated as S corporations for federal income tax purposes.

Sole proprietorships and single-member limited liability companies that are disregarded for federal income tax purposes are not subject to the PE Tax.

Entities subject to the PE Tax are collectively referred to as “PEs” in this publication.

2. How is the PE Tax calculated?

There are two methods that PEs may use to calculate their PE Tax. The “Standard Base” is the default method and must be utilized unless the PE elects to use the “Alternative Base” method. PEs will be able to decide each year whether to use the Alternative Base method and must elect to do so on or before the due date, or extended due date, of the PE Tax return. The PE Tax rate of 6.99% is applied to the applicable base to determine the amount of PE Tax due.

3. How is the Standard Base calculated?

The Standard Base is equal to the PE’s Connecticut source income,¹ determined under Connecticut income tax rules, less any distributive share of Connecticut source income that the PE received

¹ A PE’s Connecticut source income is equal to its separately and nonseparately computed items described in I.R.C. §§ 702(a) or 1366, to the extent derived from or connected with sources within this state, as determined under Connecticut income tax sourcing rules and as modified by the items described in Conn. Gen. Stat. § 12-701. The federal limitations on deductions for charitable contributions and capital losses do not apply.

from a subsidiary PE that filed a Connecticut PE Tax return. A PE that does not make an election to use the Alternative Base method is subject to tax on the entire amount of its Standard Base; no adjustments are made to account for the types of partners² (e.g., corporations or individuals) that own interests in the PE.

Standard Base	=	CT Source Income of PE	-	CT Source Income from Subsidiary PEs
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Example 1: PE has \$1,000 of ordinary income and has no other income. PE carries on business both within and without Connecticut and determines, based upon facts not stated in this example, that its apportionment fraction is 10%. In this situation, the PE has \$100 of Connecticut source income (\$1,000 * 10%) and has a PE Tax liability of \$6.99 (\$100 * 6.99%).

Example 2: PE has \$500 of Connecticut source income, including a distributive share of \$200 of Connecticut source income that it received from Sub PE. PE is a partner in Sub PE. Sub PE filed a PE Tax Return and paid the PE Tax due. PE is subject to tax on \$300 (\$500-\$200) of its Connecticut source income and has a PE Tax liability of \$20.97 (\$300 * 6.99%).

4. How is the Alternative Base calculated?

The Alternative Base is equal to *modified Connecticut source income* plus the *resident portion of un sourced income*. In general, the amount of tax due under the Alternative Base method depends upon the types of partners (e.g., individuals or corporations) that own interests in the PE.

Alternative Base	=	Modified CT Source Income	+	Resident Portion of Un sourced Income
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Modified Connecticut Source Income. Modified Connecticut Source Income equals the Standard Base multiplied by the percentage of “ownership interests” that are directly or indirectly³ held by partners subject to tax under chapter 229 (income tax).⁴ For purposes of this calculation, a partner’s “ownership percentage” is based upon the partner’s direct or indirect distributive share of the PE’s income.

Modified CT Source Income	=	Standard Base	x	Percentage of PE's Income Directly or Indirectly Allocated to Partners Subject to Tax Under Chapter 229 (Income Tax)
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² For purposes of this publication, the term “partner” is used to refer to partners in a partnership, members in a limited liability company treated as a partnership for federal income tax purposes, and shareholders in an S corporation.

³ A shareholder in a C corporation, which C corporation is a partner in a PE, is not an indirect partner.

⁴ If a PE (“Parent PE”) is a partner in another PE (“Sub PE”) and Sub PE does not have information on Parent PE’s partners, Sub PE must assume that all of Parent PE’s partners are subject to tax under chapter 229.

Example 3: PE has a Standard Base of \$10,000. The PE is owned by a resident individual, a nonresident individual, a corporation subject to the corporation business tax, and a tax-exempt entity. Each of these four partners receive distributive shares equal to 25% of PE’s income. Under these facts, 50% of the PE’s income is distributed to partners subject to tax under chapter 229 (the resident and nonresident individuals). Therefore, the PE’s modified Connecticut source income is \$5,000 (\$10,000 * 50%).

Example 4: PE is owned by two corporations subject to the corporation business tax. Each corporate partner receives a distributive share equal to 50% of PE’s income. Under these facts, 0% of the PE’s income is distributed to partners subject to tax under chapter 229. Therefore, the PE’s modified Connecticut source income is \$0.

Example 5: PE has a Standard Base of \$20,000. PE is owned by two other PEs (“Parent PE”). Each Parent PE is owned by either resident or nonresident individuals. Under these facts, 100% of the PE’s income is indirectly distributed to partners subject to tax under chapter 229. Therefore, the PE’s modified Connecticut source income is \$20,000 (\$20,000 * 100%).

Example 6: PE has a Standard Base of \$20,000. PE is owned by two other PEs (“Parent PE”). Each Parent PE is owned by either C corporations, insurance companies, or tax-exempt entities. Under these facts, none of the PE’s income is indirectly distributed to partners subject to tax under chapter 229. Therefore, the PE’s modified Connecticut source income is \$0.

Example 7: PE has a Standard Base of \$2,000,000. PE is owned by a resident individual and by a corporation subject to the corporation business tax. The resident individual receives an income allocation of \$30,000,000, \$3,000,000 of which is Connecticut source income. The corporation receives a loss allocation of (\$10,000,000), (\$1,000,000) of which is Connecticut source loss. Because the individual is allocated an amount of Connecticut source income that exceeds the amount of the Standard Base, 100% of the Standard Base is subject to tax. Therefore, the PE’s modified Connecticut source income is \$2,000,000.

Resident Portion of Unsourced Income. *Unsourced income* is a PE’s income that is not sourced to Connecticut or to another state with which the PE has nexus, regardless of whether the other state actually subjects the PE to tax. Unlike the Standard Base, unsourced income includes the distributive share of income a PE receives from a subsidiary PE. Whether income is sourced to Connecticut or to another state, or whether a PE has nexus in another state, is determined under Connecticut nexus and income tax sourcing and apportionment rules.

Unsourced Income	=	Total Income ⁵ of PE	-	CT Source Income	-	Income Sourced to Other States Where PE has Nexus
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⁵ A PE’s total income is equal to its separately and nonseparately computed items, as described in I.R.C. §§ 702(a) or 1366, regardless of where derived or connected, as modified by the items described in Conn. Gen. Stat. § 12-701. The federal limitations on deductions for charitable contributions and capital losses do not apply.

The resident portion of unsourced income equals unsourced income multiplied by the percentage of “ownership interests” that are **directly** held by Connecticut resident partners. For purposes of this calculation, a resident partner’s “ownership percentage” is based upon the partner’s **direct** distributive share of the PE’s income.

Resident Portion of Unsourced Income	=	Unsourced Income	x	Percentage of PE's Income Allocated Directly to CT Resident Individual Partners
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Example 3A (continuation of Example 3): PE has \$100,000 of total income. The PE is owned by a resident individual, a nonresident individual, a corporation subject to the corporation business tax, and a tax-exempt entity. Each of these four partners receive distributive shares equal to 25% of PE’s income. PE has nexus with Connecticut, Massachusetts and Rhode Island. Under Connecticut rules, PE has \$10,000 of Connecticut source income, \$20,000 of Massachusetts source income, and \$30,000 of Rhode Island Source Income. PE has \$40,000 of unsourced income (\$100,000 - \$60,000). A resident individual receives 25% of the PE’s distributive shares of income. Therefore, the resident portion of PE’s unsourced income is \$10,000 (\$40,000 * 25%).

Under the facts of Examples 3 and 3A, PE is subject to tax on \$15,000 (its \$5,000 of modified Connecticut source income plus \$10,000) and has a PE Tax liability of \$1,049 (\$15,000 * 6.99%).

Example 4A (continuation of Example 4): Because PE is owned by two corporations subject to the corporation business tax, none of the PE’s income is directly distributed to a resident individual. Therefore, the resident portion of PE’s unsourced income is \$0.

Under the facts of Examples 4 and 4A, PE is subject to tax on \$0 and, therefore, has no PE Tax liability.

Example 5A (continuation of Example 5): Because PE is owned by other PEs, none of the PE’s income is directly distributed to a resident individual. Therefore, the resident portion of PE’s unsourced income is \$0.

Under the facts of Examples 5 and 5A, PE is subject to tax on \$20,000 (its \$20,000 of modified Connecticut source income plus \$0) and has a PE Tax liability of \$1,398 (\$20,000 * 6.99%).

Example 6A (continuation of Example 6): Because PE is owned by other PEs, none of the PE’s income is directly distributed to a resident individual. Therefore, the resident portion of PE’s unsourced income is \$0.

Under the facts of Examples 6 and 6A, PE is subject to tax on \$0 and, therefore, has no PE Tax liability.

Example 7A (continuation of Example 7): PE is owned by a resident individual and a corporation subject to the corporation business tax. PE has nexus in Connecticut, New York and New Jersey. PE has \$20,000,000 of total income of which \$2,000,000 is Connecticut source income, \$4,000,000 is New York source income, and \$4,000,000 is New Jersey source income. Therefore, PE has \$10,000,000 of unsourced income.

The resident individual receives an income allocation of \$30,000,000 of the PE's total income. The corporation receives a loss allocation of (\$10,000,000) of the PE's total income. Because the resident individual is allocated an amount of the PE's income that exceeds the total amount of the PE's income, 100% of the unsourced income is subject to tax. Therefore, the resident portion of the unsourced income is \$10,000,000.

Under the facts of Examples 7 and 7A, PE is subject to tax on \$12,000,000 (its \$2,000,000 of modified Connecticut source income plus \$10,000,000) and has a PE Tax liability of \$838,800 ($\$12,000,000 * 6.99\%$).

5. Are guaranteed payments included in a PE's income subject to tax under the Standard Base or the Alternative Base method?

No, guaranteed payments are not included in a PE's income subject to tax under either the Standard Base or the Alternative Base method. Under federal law, guaranteed payments are deducted on Line 10 of Form 1065 when determining a PE's ordinary income. Therefore, for Connecticut PE Tax purposes, guaranteed payments are not included when determining the amount of a PE's income subject to PE Tax.

Nonresident individual partners who receive guaranteed payments are required to file Form CT-1040NR/PY to report all of their Connecticut source income, including the Connecticut source portion of their guaranteed payments.⁶ The Connecticut source portion of a guaranteed payment is determined at the PE level. The Connecticut portion is generally calculated by multiplying the amount of the partner's guaranteed payments by the PE's apportionment fraction.

6. Can a PE deduct the PE Tax when calculating income under the Standard Base or the Alternative Base?

No. When determining a PE's income subject to tax, no deduction should be taken for any PE Tax paid. In determining a partner's income subject to Connecticut income tax or corporation business tax, however, the partner is not required to add back any PE Tax paid by the PE.

7. Can PEs file combined returns to offset gain and loss between PEs?

PEs that are commonly-owned may elect to file a combined return. Commonly-owned means that more than 80% of the voting control of the PE is either directly or indirectly owned by a common owner or owners. The election must be made on an annual basis with the filing of the return by the

⁶ The provisions of Public Act 18-49, § 1(e), that excuse certain nonresident partners from filing Connecticut income tax returns do not apply to nonresident partners who receive guaranteed payments.

due date or extended due date. DRS will provide forms to make the election and to calculate the tax on a combined basis.

PEs electing to file a combined return must first separately calculate their tax base. All electing PEs must use the same method (either the Standard Base or Alternative Base). After calculating the separate base, each PE's tax base is then combined. This combined base is multiplied by the tax rate of 6.99% to determine the group's PE Tax.

8. Are PEs required to make estimated payments for 2018?

Yes. PEs are required to make estimated payments for 2018. Information on estimated payments is provided in **Special Notice 2018(4)**, *Guidance on 2018 Estimated Payments for the Newly Enacted Pass-Through Entity Tax*.

Due to the timing of the legislation, DRS recognizes that PEs may inadvertently underpay their 2018 estimated payments. If a PE receives a notice from DRS that the entity may have underpaid its estimated tax for 2018, the PE may contact DRS with a written explanation describing why it failed to comply along with all supporting documentation. These documents must be submitted to DRS by December 31, 2019,⁷ at the following address:

Department of Revenue Services
450 Columbus Boulevard, 11th Floor
Hartford, Connecticut 06103
Attn: Legal Division/PE Tax Estimate

Additionally, if the enactment of the PE Tax has created other issues relating to the calculation or payment of 2018 estimated payments of a PE or partner, the PE or partner should contact DRS at 860-297-5776 for assistance.

Additional Questions: Send an e-mail to the DRS Legal Division at legal.division@po.state.ct.us

TTY, TDD, and Text Telephone users only may transmit inquiries by calling 860-297-4911.

For Forms and Publications: Visit the DRS website at www.ct.gov/DRS

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Pass-Through Entity Tax
Issue Date: 6/19/2018

⁷ DRS will also consider requests after this date if documents are sent within sixty days of receipt of a notice of underpayment of estimated payments.



OCG-7

OFFICE OF THE COMMISSIONER GUIDANCE Regarding the Pass-Through Entity Tax Credit

This preliminary guidance is intended to provide information to partners¹ about the credit available under the Pass-Through Entity Tax (“PE Tax”). This guidance may be updated as needed to answer additional questions.

1. What is the Pass-Through Entity Tax Credit?

For taxable years that begin on or after January 1, 2018, pass-through entities (“PEs”) are subject to an entity-level tax on their own income.² Partners in PEs that are subject to the PE Tax are entitled to a credit (the “PE Tax Credit”) equal to 93.01% of the partner’s direct and indirect share of a PE’s tax liability, provided the PE has paid such liability prior to the partner claiming the PE Tax Credit. A partner may claim the PE Tax Credit against taxes imposed on the partner under chapter 208 (corporation business tax) or chapter 229 (income tax).³

2. How will a partner know the amount of PE Tax Credit to claim?

A PE must report the amount of PE Tax Credit allocated to each of its partners on Schedule CT K-1.

3. In what year may a partner claim the PE Tax Credit?

A partner may claim the PE Tax Credit against the partner’s tax due for the year the distributive share of the PE’s income that creates the PE Tax liability is included the partner’s income.

Example 1: PE is a calendar year filer. All of PE’s partners are individuals. PE’s tax liability for taxable year 2018 is \$100,000. PE makes estimated payments of \$90,000 during 2018 and pays the \$10,000 balance due on March 15, 2019. Partners in PE may claim the PE Tax Credit, calculated based upon PE’s \$100,000 tax liability, on their 2018 Connecticut income tax returns.

4. What happens if the PE Tax Credit exceeds a partner’s tax liability?

If the PE Tax Credit is claimed against the tax imposed under chapter 229 (income tax), any excess credit is treated as an overpayment and, provided the taxpayer does not have other tax liabilities or other debts or obligations to the state, will be refunded, without interest, to the taxpayer

¹ For purposes of this publication, the term “partner” is used to refer to partners in a partnership, members in a limited liability company treated as a partnership for federal income tax purposes, and shareholders in an S corporation.

² Information on the calculation of the PE Tax is found in **OCG-6**, *Office of the Commissioner Guidance Regarding the Calculation of the Pass-Through Entity Tax*.

³ The PE Tax Credit may be claimed against all taxes imposed under chapter 229 of the Connecticut General Statutes, other than income tax withholding imposed under Conn. Gen. Stat. § 12-707.

claiming the credit. If the PE Tax Credit is claimed against the tax imposed under chapter 208 (corporation business tax), any excess credit may be carried forward until used.

5. How is the PE Tax Credit allocation calculated generally?⁴

A partner is entitled to a PE Tax Credit equal to 93.01% of the partner's share of the PE Tax liability. A partner's share of the PE Tax liability is determined based upon the percentage of the partner's distributive share of income that is included in the PE's income subject to the PE Tax.

If a partner is allocated a net loss, such partner's share of the PE Tax is zero and, therefore, the partner is not entitled to any PE Tax Credit. The PE Tax should be prorated between the remaining partners based upon their relative distributive shares of income included in the PE's income subject to PE Tax.

Standard Base Examples

Example 2: PE has a PE Tax liability of \$1,000, which it has paid. Tom, an individual partner, receives 10% of the PE's distributive share of income. Tom's share of the PE's tax liability is \$100 ($\$1,000 * 10\%$). Tom is entitled to a credit of \$93.01 ($\$100 * 93.01\%$) against his Connecticut income tax liability.

Example 3: PE has income of \$2,000,000 subject to tax under the standard base. This results in a PE Tax liability of \$139,800 ($\$2,000,000 * 6.99\%$), which the PE has paid. PE has three individual partners: Abby, Betty, and Charlie. Collectively, these partners will be allowed to claim PE Tax Credits of \$130,028 ($\$139,800 * 93.01\%$), which are allocated as follows:

- Abby is allocated \$7,000,000 of income from PE. Abby's share of the PE Tax is \$97,860 (70% of the PE Tax) and, therefore, she is entitled to a PE Tax Credit of \$91,020.
- Betty is allocated \$3,000,000 of income from PE. Betty's share of the PE Tax is \$41,940 (30% of the PE Tax) and, therefore, she is entitled a PE Tax Credit of \$39,008.
- Charlie is allocated a loss of (\$8,000,000). Charlie's share of the PE Tax is zero and, therefore, he is not entitled to any PE Tax Credit.

Alternative Base Examples

Example 4: PE has income of \$1,000,000 subject to tax under the alternative base, which is comprised of \$100,000 of modified source income and \$900,000 as the resident portion of unsourced income. This results in a PE Tax liability of \$69,900 ($\$1,000,000 * 6.99\%$), which the PE has paid. PE has two individual partners: Adam and Bob. The PE Tax Credits of \$65,014 ($\$69,900 * 93.01\%$) are allocated as follows:

⁴ The allocation of the PE Tax Credit may be different for partners of a PE that files a combined return. See question 8.

- Adam, a resident individual, received 90% of the PE's distributive share of income. Adam's portion of the modified source income is \$90,000 ($\$100,000 * 90\%$). Adam, as the only resident individual partner, is attributed all of the PE's resident portion of unsourced income. Of PE's \$1,000,000 of income subject to tax, \$990,000 (99%) is attributable to Adam's distributive share of income. Therefore, Adam's share of the PE Tax liability is \$69,201 (99% of the PE Tax liability), and he will be entitled to a PE Tax Credit of \$64,364 ($\$69,201 * 93.01\%$).
- Bob, a nonresident individual, receives 10% of the PE's distributive share of income. Bob's portion of the modified source income is \$10,000 ($\$100,000 * 10\%$). Because Bob is a nonresident, he is attributed none of the PE's resident portion of unsourced income. Of PE's \$1,000,000 of income subject to tax, \$10,000 (1%) is attributable to Bob's distributive share of income. Therefore, Bob's share of the PE Tax liability is \$699 (1% of the PE Tax liability), and he will be entitled to a PE Tax Credit of \$650 ($\$699 * 93.01\%$). If Bob's distributive share of PE's income is Bob's **only** source of Connecticut income, then, as a nonresident, Bob would not be required to file a Connecticut income tax return.

Example 5: PE's income subject to tax under the standard base is \$2,000,000. PE has four partners:

1. Carl, a resident individual, received a 25% distributive share;
2. David, a resident individual, received a 12.5% distributive share;
3. Elliott, a nonresident individual, received a 12.5% distributive share; and
4. Corporation, a C corporation subject to the Connecticut Corporation Business Tax, received a 50% distributive share.

Because partners subject to the income tax under chapter 229 (Carl, David and Elliott) receive 50% of the PE's distributive shares of income, the PE's modified source income is 50% of the standard base, which is \$1,000,000 ($\$2,000,000 * 50\%$).

PE's unsourced income is \$8,000,000. Because resident individuals (Carl and David) receive 37.5% of the PE's distributive shares of income, the PE's resident portion of unsourced income is \$3,000,000 ($\$8,000,000 * 37.5\%$).

Accordingly, PE's income subject to tax under the alternative base is \$4,000,000 ($\$1,000,000 + \$3,000,000$), which results in a PE Tax liability of \$279,600 ($\$4,000,000 * 6.99\%$). PE's partners will, collectively, be allowed to claim PE Tax Credits of \$260,055 ($\$279,600 * 93.01\%$).

The chart below shows the calculation of each partner's share of the PE's tax and the associated PE Tax Credit:

Member	Modified Source Income	Resident Portion of Unsourced Income	Total Alternative Base	Partner's Share of the PE Tax	PE Tax Credit
Carl (RI)	\$500,000	\$2,000,000	\$2,500,000	62.50%	\$162,535
David (RI)	\$250,000	\$1,000,000	\$1,250,000	31.25%	\$81,267
Elliott (NR)	\$250,000	N/A	\$250,000	6.25%	\$16,253
Corporation	N/A	N/A	N/A	N/A	N/A
Total	\$1,000,000	\$3,000,000	\$4,000,000	100.00%	\$260,055

6. What happens if a PE (“parent PE”) is a partner in another PE (“subsidiary PE”)?

A subsidiary PE will report to a parent PE the amount of PE Tax Credit that the parent PE is allocated. The parent PE cannot claim this credit against the PE Tax reported on its own return because the parent PE is not subject to tax under the Connecticut corporation business tax or individual income tax. Instead, the parent PE must flow-through the PE Tax Credit to its partners. PE Tax Credits that flow through a parent PE are called “indirect PE Tax Credits.”

7. How are indirect PE Tax Credits allocated and reported?

Indirect credits will be reported on the parent PE’s tax return and the parent PE will allocate the indirect credits to its partners. Each partner’s portion of the indirect credit will be reported on the partner’s Schedule CT K-1. Indirect credits should be allocated to each partner in a ratio that reflects the portion that the partner’s share of the distributive share of income contributes to the PE’s standard base (for standard base filers) or modified source income (for alternative base filers).

Example 6 (Standard Base): Parent PE is a partner in Sub PE. Sub PE filed PE Tax Return and paid the PE Tax due. Sub PE issued a Schedule CT K-1 to PE reporting that the PE Tax Credit available to Parent PE was \$1,200.

Parent PE calculates its PE Tax using the standard base. Therefore, Parent PE should allocate the \$1,200 of indirect PE Tax Credit consistent with the standard base methodology.⁵

Parent PE has four partners that each receive 25% of Parent PE’s distributive share of income: 1) a resident individual (RI), 2) a nonresident individual (NR), 3) a C corporation, and 4) and a tax-exempt entity. Each partner will be allocated \$300 of indirect PE Tax Credit (25% of \$1,200).

Example 7 (Alternative Base): Same facts as Example 6, except that Parent PE elects to file using the alternative base. Parent PE should allocate the \$1,200 of indirect PE Tax Credit based upon the portion that the each partner’s distributive share of the PE’s income

⁵ Each partner should be allocated a portion of the credit in the same proportion that the partner’s distributive share of the PE’s income compares to the total distributive shares of the PE’s income.

was included in modified source income. Only the distributive shares of income attributable to RI and NR are included in the modified source income.

Because the distributive shares of income received by the C Corporation and tax-exempt entity are not included in modified source income, no indirect PE Tax Credit is allocated to those partners. RI and NR should each be allocated \$600 of indirect PE Tax Credit (50% of \$1,200) because each of their distributive shares of income compromises half of Parent PE's modified source income.

8. How is the PE Tax Credit allocation calculated for combined filers?

A combined group may allocate the PE Tax Credit to the partners of the group's members in the manner it deems appropriate. This allocation is irrevocable and must be made when the original group return is filed.

Nonresident individuals who are partners of a PE included in a combined return, and who otherwise would be excused from filing a Connecticut income tax return, are required to file a Connecticut income tax return if the credit provided to such partner would not fully offset his or her Connecticut income tax liability. Administratively, DRS will presume that the PE Tax Credit is sufficient to cover the Connecticut income tax liability of a nonresident individual partner if the PE Tax Credit is equal to or exceeds the partner's portion of the combined group's Connecticut source income multiplied by 6.99%.

Example 8: PE1 and PE2 are commonly-owned and elect to file a combined return. PE1 and PE2 both use the standard base to calculate their income. PE1 has a standard base of \$2,000,000 and PE2 has a standard base of (\$1,500,000). After combining the \$2,000,000 of income with the loss of \$1,500,000, tax is due on the combined group's base of \$500,000. The group's PE Tax is \$34,950 ($\$500,000 \times 6.99\%$). The group has a total PE Tax Credit of \$32,507 ($\$34,950 \times 93.01\%$), which the group may allocate to the partners of PE1 and PE2 in a manner the group deems appropriate. This allocation must be reported on the combined PE Tax return and the partners' Schedule CT K-1s issued by the Designated Combined Reporting PE.

If the group does not allocate sufficient PE Tax Credit to completely satisfy the Connecticut income tax of any nonresident individual partner on their distributive share of the PE's Connecticut source income, such individuals are required to file Connecticut income tax returns.

9. Can a partner claim the PE Tax Credit before the partner receives a Schedule CT K-1 from the PE?

No. The partner must wait until the PE issues the Schedule CT K-1 before claiming the PE Tax Credit. If the PE does not issue the Schedule CT K-1 until after the due date of the partner's return, the partner should request an extension of time to file. The partner should estimate the partner's tax due and PE Tax Credit and ensure that sufficient payments are made prior to the due date.

10. Can a partner that is a trust claim the PE Tax Credit on Form CT-1041?

A trust that is a partner of a PE and receives a Schedule CT K-1 reporting a PE Tax Credit may allocate all or a portion of such credit between the trust and its beneficiaries. Any PE Tax Credit allocated to the beneficiaries should be reported on Schedule CT-1041 K-1. Beneficiaries may claim their allocation of PE Tax Credit against tax liabilities under the Connecticut corporation business tax or individual income tax.

11. If a nonresident individual's only source of Connecticut income is a distributive share of income from one or more PEs that file PE Tax returns and pays the PE Tax, is the nonresident individual required to file a Connecticut income tax return?

No, unless the nonresident individual:

- Receives Connecticut-source guaranteed payments from one or more PEs;
- Is a member of a PE that files a combined PE Tax return and the PE Tax Credit allocated by the combined group to the nonresident individual does not fully offset his or her Connecticut income tax liability (see question 8 above); **or**
- Receives a Schedule CT K-1 reporting Connecticut source income and does not report a PE Tax Credit.

Nonresident individuals who receive Connecticut-source guaranteed payments or who have other sources of Connecticut income must file **Form CT-1040NR/PY** to report all of their Connecticut-source income. These nonresident individuals may claim the PE Tax Credit against their tax due.

A nonresident individual, who is excused from filing a Connecticut income tax return, may choose to file a **Form CT-1040NR/PY** to report his or her Connecticut-source income and claim the PE Tax Credit.

Additional Questions: Send an e-mail to the DRS Legal Division at legal.division@po.state.ct.us

TTY, TDD, and Text Telephone users only may transmit inquiries by calling 860-297-4911.

For Forms and Publications: Visit the DRS website at www.ct.gov/DRS



For Taxable Year Ending ▶	<input type="text"/> <small>M M - D D - Y Y Y Y</small>	Connecticut Tax Registration Number (if any) ▶	<input type="text"/>	Federal Employer ID Number (FEIN) ▶	<input type="text"/>
Pass-through entity name <input type="text"/>					
Address (number and street) <input type="text"/>		PO Box <input type="text"/>			
City, town, or post office <input type="text"/>		State <input type="text"/>	ZIP code <input type="text"/>	Payment amount due <input type="text"/> .00	

CT-1065/CT-1120SI ES - Tax Payment Coupon Instructions

- Complete payment coupon in blue or black ink only.
- Print all information. Include your FEIN.
- Cut along dotted line and mail coupon and payment to the address below.
- Make your check payable to **Commissioner of Revenue Services**.
- DRS may submit your check to your bank electronically.
- To ensure proper posting, write your FEIN and "2018 CT-1065/CT-1120SI ES" on your check.

Send completed coupon and payment to:

Department of Revenue Services
PO Box 2965
Hartford CT 06104-2965

**Form CT-1065/CT-1120SI RR
Pass-Through Entity Tax 2018
Income Tax Estimated Payment
Recharacterization Request**

2018

Complete this form in blue or black ink only. Type or print.

General Instructions

Partners/Members/Shareholders who wish to recharacterize all or a portion of their 2018 income tax estimated payments (including any 2017 overpayments credited to 2018) must complete this form and return it to their pass-through entities (PEs). The PEs must gather all Recharacterization Request forms from their partners/members/shareholders and send all of these forms to DRS along with **Form CT-1065/CT-1120SI RRS, Pass-Through Entity Tax 2018 Income Tax Estimated Payment Recharacterization Request Summary Sheet**. The PE must submit all recharacterization requests by December 31, 2018.

Pass-through entity's taxable year beginning - - 2018 and ending - -
M M - D D - Y Y Y Y M M - D D - Y Y Y Y

Name of pass-through entity (PE) Federal Employer ID Number (FEIN) of PE

Number and street PO Box Connecticut Tax Registration Number (if applicable) of PE

City, town, or post office State ZIP code

Name of individual or trust/estate (Member)

Number and street PO Box

City, town, or post office State ZIP code

Social Security Number (SSN) Spouse's SSN (if married filing jointly) FEIN (trust/estate)

Amount of Member's 2018 estimated income tax payments to recharacterize to PE: .00

Member agrees to recharacterize the above payments to Member's PE. Member understands that this recharacterization is irrevocable. Member acknowledges that the amount recharacterized cannot be claimed on Member's Connecticut tax return and that the amount of Member's PE Tax Credit may be less than the amount of estimated income tax payments that were recharacterized. Member further understands that recharacterizing Member's estimated payments may subject Member to underpayment interest (CT-2210 interest) on Member's Connecticut tax return.

Member's estimated payments will be recharacterized in reverse chronological order of when Member made such payments and any 2017 overpayment will be recharacterized only after all of Member's estimated payments are recharacterized.

PE agrees to accept the recharacterization of the above payments from Member. The recharacterized payments will be applied to PE's taxable year listed above. If Member did not make 2018 estimated payments prior to the date of this request that are equal to or greater than the requested recharacterization amount, the recharacterization request from Member will be denied in its entirety and PE will not be allowed to claim the requested recharacterized estimated payments on its return. PE and Member acknowledge that notice of a denial will be sent to the addresses listed above for PE and Member and that such denial is not subject to protest or appeal.

Signature of Member/trustee Date (MMDDYYYY)

Signature of Member's spouse (if married filing jointly) Date (MMDDYYYY)

Signature on behalf of PE Date (MMDDYYYY)

MEMBERS: SEND THIS FORM TO YOUR PE. DO NOT SEND DIRECTLY TO DRS.

Form CT-1065/CT-1120SI RRS
Pass-Through Entity Tax
2018 Income Tax Estimated Payment
Recharacterization Request Summary Sheet

2018

Complete this form in blue or black ink only. Type or print.

Pass-through entity's taxable year beginning		- - 2018	and ending		- -
		<small>M M - D D - Y Y Y Y</small>			<small>M M - D D - Y Y Y Y</small>
Name of pass-through entity (PE)				Federal Employer ID Number (FEIN)	
Number and street		PO Box		Connecticut Tax Registration Number (if applicable)	
City, town, or post office			State	ZIP code	

General Instructions

A pass-through entity (PE) must obtain a completed **Form CT-1065/CT-1120SI RR, Pass-Through Entity Tax 2018 Income Tax Estimated Payment Recharacterization Request** from each of its partners/members/shareholders who wish to recharacterize their estimated payments. If additional lines are required, complete and attach supplemental schedules as needed.

This Summary Sheet, along with a Form CT-1065/CT-1120SI RR for each recharacterization request, must be sent to DRS by December 31, 2018, at the following address:

Department of Revenue Services
 State of Connecticut
 P.O. Box 2973
 Hartford, CT 06104-2973

Name of Partner/Member/Shareholder	Social Security Number (individual)/ FEIN (trust/estate)	2018 Estimated Payments to be Recharacterized	For DRS Use Only Request denied
1.			.00
2.			.00
3.			.00
4.			.00
5.			.00
6.			.00
7.			.00
8.			.00
9.			.00
10.			.00
11.			.00
12.			.00
13.			.00
14.			.00
15.			.00
16.			.00
17.			.00
18.			.00
19.			.00
20.			.00
21.			.00
22.			.00
23.			.00
24. Subtotal(s) from supplemental schedule(s).			.00
25. Total: Add Line 1 through Line 24.			.00

**2018 Income Tax Estimated Payment Recharacterization Request Summary Sheet
Supplemental Schedule (if needed)**

Pass-through entity's Federal Employer ID Number (FEIN)

Name of Partner/Member/Shareholder	Social Security Number (individual)/ FEIN (trust/estate)	2018 Estimated Payments to be Recharacterized	For DRS Use Only Request denied
1.			.00
2.			.00
3.			.00
4.			.00
5.			.00
6.			.00
7.			.00
8.			.00
9.			.00
10.			.00
11.			.00
12.			.00
13.			.00
14.			.00
15.			.00
16.			.00
17.			.00
18.			.00
19.			.00
20.			.00
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22.			.00
23.			.00
24.			.00
25.			.00
26.			.00
27.			.00
28.			.00
29.			.00
30.			.00
31.			.00
32.			.00
33.			.00
34.			.00
35.			.00
36.			.00
37. Subtotal for this page: Add Line 1 through Line 36. Enter the total of all supplemental schedules on Page 1, Line 24.		37.	.00