



INFORMATIONAL PUBLICATION

**Q & A on Connecticut Income Tax Changes Affecting
S Corporations with Nonresident Shareholders**

Purpose: This Informational Publication is intended to answer frequently-asked questions concerning new legislation that requires each S corporation doing business in Connecticut or having income derived from or connected with sources within Connecticut to pay Connecticut income tax on behalf of its nonresident shareholders.

For purposes of this publication:

- *Pass-through entity* means and includes an S corporation, general partnership, limited partnership, limited liability partnership, or limited liability company treated as a partnership for federal income tax purposes.

Effective Date: May 6, 2004, and applicable to taxable years of S corporations beginning on or after January 1, 2004.

Statutory Authority: Conn. Gen. Stat. §§12-719(b) and (c) and 12-726, as amended by 2004 Conn. Pub. Acts 216, §§54 and 55.

1. What form is an S corporation required to file under the new legislation? For taxable years beginning on or after January 1, 2004, an S corporation is required to file **Form CT-1065/CT-1120SI**, where it:

- Is required to file federal Form 1120S, U. S. Income Tax Return for an S Corporation; **and**
- Has any income, gain, loss, or deduction derived from or connected with sources within Connecticut.

Form CT-1065/CT-1120SI is used by all S corporations to provide information on the S corporation and is also used by S corporations with nonresident shareholders to make composite payments on behalf of those nonresident shareholders. Previously, all S corporations were required to file **Form CT-1120SI**, *Connecticut S Corporation Information and Composite Income Tax Return*.

2. When is Form CT-1065/CT-1120SI due?

Form CT-1065/CT-1120SI is due on or before the fifteenth day of the fourth month following the close of the S corporation's taxable year (April 15 for an S corporation whose taxable year for federal income tax purposes is the calendar year). If the due date falls on a Saturday, Sunday, or legal holiday, the next business day is the due date.

3. Under what circumstances is an S corporation required to make a Connecticut composite income tax payment?

An S corporation is required to make a Connecticut composite income tax payment on behalf of a shareholder where:

- The shareholder's pro rata share of the S corporation income derived from or connected with Connecticut sources is \$1,000 or more;
- An election to be included on a group return (**Form CT-G**, *Connecticut Group Income Tax Return*), has not been made by the shareholder (see Question 14); **and**
- The shareholder is a nonresident individual, nonresident trust, nonresident estate, or a pass-through entity.

In accordance with the above criteria, an S corporation may be required to make Connecticut composite income tax payments on behalf of all of its shareholders, some of its shareholders, or none of its shareholders.

Previously, an S corporation was not required to make a composite Connecticut income tax payment on behalf of any nonresident shareholder who elected to pay Connecticut income tax by filing **Form CT-INA, *Nonresident Income Tax Agreement***, with the S corporation. 2004 Conn. Pub. Acts 216, §54 precludes that election, and, if the election was previously made, nullifies that election for taxable years of S corporations beginning on or after January 1, 2004.

4. Under what circumstances is an S corporation not required to make a Connecticut composite income tax payment?

An S corporation is not required to make a Connecticut composite income tax payment on behalf of a nonresident shareholder where:

- The shareholder's pro rata share of the S corporation income derived from or connected with Connecticut sources is less than \$1,000; **or**
- An election to be included on a group return (**Form CT-G**) has been made by the shareholder (see Question 14).

In addition, an S corporation is not required to make a Connecticut composite income tax payment where the shareholder is a resident individual, resident trust, resident estate, real estate investment trust, real estate mortgage investment conduit, regulated investment company, C corporation, or LLC that has elected to be taxed as a corporation for federal income tax purposes.

5. If an S corporation makes a Connecticut composite income tax payment on behalf of a nonresident shareholder, is the shareholder required to file a Connecticut income tax return?

The shareholder is **not required** to file a Connecticut income tax return if the composite income tax payment made by the S corporation on the shareholder's behalf (and any other composite income tax payment made by any other pass-through entity on the shareholder's behalf) satisfies the shareholder's Connecticut income tax liability. The shareholder is **required** to file a

Connecticut income tax return if the composite income tax payment made by the S corporation on the shareholder's behalf (and any other composite income tax payment made by any other pass-through entity on the shareholder's behalf) does not satisfy the shareholder's Connecticut income tax liability, or if the shareholder has Connecticut source income other than from one or more pass-through entities.

6. How are Connecticut composite income tax payments calculated?

The Connecticut composite income tax payment for a shareholder for whom a payment must be made is calculated by multiplying the shareholder's pro rata share of the S corporation's separately and nonseparately computed income derived from or connected with Connecticut sources by 5%. The S corporation must calculate the Connecticut composite income tax payment based only on the shareholder's pro rata share of income from that S corporation derived from or connected with Connecticut sources. The S corporation may not take into account any losses that the shareholder may realize from other sources or Connecticut income tax withholding related to Connecticut employment.

7. When is an S corporation required to make estimated Connecticut composite income tax payments for a shareholder?

Beginning with estimated Connecticut composite income tax payments due on or after June 15, 2004, an S corporation is required to make *estimated* Connecticut composite income tax payments for a shareholder where:

- The S corporation is required to make a Connecticut composite income tax payment on behalf of the shareholder (see Question 3); **and**
- The shareholder's Connecticut income tax liability on the shareholder's pro rata share of the S corporation's income derived from or connected with Connecticut sources is expected to equal or exceed \$1,000. Therefore, estimated Connecticut composite income tax payments will be required if a shareholder's share of income derived from or connected with Connecticut sources from the S corporation is expected to be \$20,000 or more for the taxable year.

In accordance with the above criteria, an S corporation may be required to make estimated Connecticut composite income tax payments on behalf of all of its shareholders, some of its shareholders, or none of its shareholders.

For each installment, the S corporation must aggregate the estimated Connecticut composite income tax payments made on behalf of nonresident shareholders and file one **Form CT-1065/CT-1120SI ES**, *Estimated Connecticut Composite Income Tax Payment*.

8. How are estimated Connecticut composite income tax payments calculated?

Estimated Connecticut composite income tax payments for a shareholder for whom an estimated payment must be made are calculated as follows:

- On or before the fifteenth day of the fourth month of the S corporation's taxable year (**April 15** for a calendar year S corporation), **25%** of the Connecticut income tax liability of the shareholder must be paid;
- On or before the fifteenth day of the sixth month of the S corporation's taxable year (**June 15** for a calendar year S corporation), a total of **50%** of the Connecticut income tax liability of the shareholder must be paid;
- On or before the fifteenth day of the ninth month of the S corporation's taxable year (**September 15** for a calendar year S corporation), a total of **75%** of the Connecticut income tax liability of the shareholder must be paid; **and**
- On or before the fifteenth day of the first month of the S corporation's next succeeding taxable year (**January 15** for a calendar year S corporation), a total of **100%** of the Connecticut income tax liability of the shareholder must be paid.

9. Will DRS accept the required estimated composite Connecticut income tax payments using the 2004 Form CT-1120SI ES, Estimated Connecticut Composite Income Tax Payment? Yes. DRS will accept payments for 2004 made with **Form CT-1120SI ES**.

10. What are the "safe harbor" provisions for an S corporation making estimated Connecticut composite income tax payments?

Estimated Connecticut composite income tax payments for a shareholder for whom estimated composite income tax payments must be made (see Question 7) are to be made in accordance with Conn. Gen. Stat. §12-722. The required annual payment for the taxable year beginning on or after January 1, 2004, and prior to January 1, 2005, is 90% of the tax shown for the shareholder on the **2004 Form CT-1065/CT-1120SI**.

The required annual payment for taxable years beginning on or after January 1, 2005, is the lesser of:

- 90% of the tax shown for the shareholder on the current year **Form CT-1065/CT-1120SI**; or
- 100% of the tax shown for the shareholder on the prior year **Form CT-1065/CT-1120SI**.

Each required installment is 25% of the required annual payment. In the case of any required installment, if the shareholder establishes, in accordance with 26 C.F.R. §1.6654-2(d)(2), that the annualized income installment is less than 25% of the required annual payment, the amount of the required installment is the annualized income installment, as described in Conn. Gen. Stat. §12-722(d)(2).

If the required annual payment is not made for a shareholder, interest at 1% (.01) per month or fraction of a month will be added to the tax due until the earlier of the fifteenth day of the fourth month

following the close of the S corporation's taxable year, or the date on which the underpayment is paid. The interest may be collected by DRS from either the S corporation or the shareholder.

11. If a shareholder previously made an estimated Connecticut income tax payment for the 2004 taxable year, may the S corporation net that payment against an estimated Connecticut composite income tax payment required to be made on behalf of the shareholder and pay only the difference to DRS? Yes. The S corporation may take into account any estimated Connecticut income tax payment for the 2004 taxable year made by the shareholder prior to May 6, 2004.

12. Is an S corporation subject to interest and penalty for late payment of the Connecticut composite income tax? Yes. If a Connecticut composite income tax payment reported for a shareholder on **Form CT-1065/CT-1120SI** is not timely paid, interest will be assessed at 1% (.01) per month or fraction of a month until the tax is paid in full. The penalty for paying all or a portion of the tax late is 10% (.10) of the tax paid late. The late payment penalty may be avoided if the S corporation:

- Files **Form CT-1065/CT-1120SI EXT**, *Application for Extension of Time to File Connecticut Composite Income Tax Return*, on or before the original due date of the return;
- Pays at least 90% of the tax shown to be due on the return on or before the original due date; **and**
- Pays the balance due with the return on or before the extended due date.

If the S corporation does not file its return and the Commissioner of Revenue Services files a return on its behalf, the penalty for failure to file is 10% (.10) of the balance due or \$50, whichever is greater.

The interest and penalty may be collected by DRS from either the S corporation or the shareholder.

If no tax is due, the Commissioner of Revenue Services may impose a \$50 penalty for the late filing of any return or report that is required by law to be filed.

13. How is an S corporation required to notify a shareholder of the amount of Connecticut composite income tax payments, including estimated Connecticut composite income tax payments, made on behalf of the shareholder? An S corporation will be required to furnish written information, on or before the fifteenth day of the third month following the close of the S corporation's taxable year (March 15 for a calendar year S corporation), to each shareholder for whom Connecticut composite income tax payments, including estimated Connecticut composite income tax payments, were made by the S corporation during the taxable year.

14. Who may elect to be included in a group return? An S corporation doing business in Connecticut, or having income, gain, loss, or deduction derived from or connected with sources within Connecticut, may file **Form CT-G** on behalf of two or more of its qualified electing nonresident shareholders. All qualified electing nonresident shareholders must have the same taxable year. Previously, a group return could only be filed by an S corporation which had 10 or more qualified electing nonresident shareholders in a taxable year.

15. Who is a qualified electing nonresident shareholder for purposes of filing Form CT-G? A *qualified electing nonresident shareholder* is one who meets all of the following conditions:

- The shareholder was a nonresident individual for the entire taxable year;
- The shareholder did not maintain a permanent place of abode in Connecticut at any time during the taxable year;

- The shareholder (or his or her spouse, if a joint federal income tax return is or will be filed) did not have any income derived from or connected with Connecticut sources other than from one or more pass-through entities;
- The shareholder waives the right to claim any Connecticut personal exemption under Conn. Gen. Stat. §12-702 and any Connecticut personal credit under Conn. Gen. Stat. §12-703;
- The shareholder does not have a Connecticut alternative minimum tax liability for the taxable year;
- The shareholder has the same taxable year as the other qualified electing nonresident shareholders; **and**
- The shareholder elects to be included on **Form CT-G**, by completing and delivering to the S corporation **Form CT-2NA**, *Connecticut Nonresident Income Tax Agreement/Election to be Included in a Group Return*, prior to the filing of **Form CT-G** by the S corporation.

The filing of a group return will be considered to be a group of separate returns meeting the filing requirements otherwise separately imposed on each qualified electing nonresident shareholder in the group by DRS. Qualified electing nonresident shareholders who are included on **Form(s) CT-G** are not required to file **Form CT-1040NR/PY**. DRS retains the right to require the filing of an individual Connecticut income tax return by any of the shareholders. A nonresident shareholder may not revoke an election to be included in a group return, or elect to be included in a group return, after the fifteenth day of the fourth month following the close of the entity's taxable year.

16. When is Form CT-G due? **Form CT-G** is due on or before the fifteenth day of the fourth month following the close of the taxable year of the qualified electing nonresident shareholders (April 15 for calendar year taxpayers). If the due date falls on a Saturday, Sunday, or legal holiday, the next business day is the due date.

17. Are estimated Connecticut group income tax payments required for shareholders included on Form CT-G? Yes. Estimated Connecticut group income tax payments are required for a shareholder included on **Form CT-G** if the shareholder's Connecticut income tax liability on the shareholder's pro rata share of the S corporation's income derived from or connected with Connecticut sources is expected to equal or exceed \$1,000. For each installment, the entity must aggregate the estimated Connecticut group income tax payments made on behalf of nonresident shareholders and file one **Form CT-G ES**, *Estimated Connecticut Group Income Tax Payment*.

18. How does the new legislation affect single member LLCs (SMLLCs)?

- **SMLLC owned by a corporation.** An SMLLC that, for federal income tax purposes, is disregarded as an entity separate from the corporation which is its owner is treated as a C corporation for purposes of the new legislation. Therefore, if the SMLLC is a shareholder of an S corporation, the S corporation is not required to make Connecticut composite income tax payments for the SMLLC. Also, the SMLLC is not a pass-through entity, so it is not required to make Connecticut composite income tax payments for its owner.
- **SMLLC owned by an individual.** An SMLLC that, for federal income tax purposes, is disregarded as an entity separate from the individual who is its owner is treated as an individual for purposes of the new legislation. Therefore, if the SMLLC is a shareholder of an S corporation, the S corporation is required to make Connecticut composite income tax payments for the SMLLC, if the criteria of Question 3 are met. Also, the SMLLC is not a pass-through entity, so it is not required to make Connecticut composite income tax payments for its owner.

- **SMLLC that elects to be taxed as a corporation.** An SMLLC that elects, for federal income tax purposes, to be taxed as a corporation is treated as a C corporation for purposes of the new legislation. Therefore, if the SMLLC is a shareholder of an S corporation, the S corporation is not required to make Connecticut composite income tax payments for the SMLLC. Also, the SMLLC is not a pass-through entity, so it is not required to make Connecticut composite income tax payments for its owner.

19. Does the new legislation require an S corporation (“upper-tier S corporation”) to make a Connecticut composite income tax payment on behalf of a shareholder that is itself a pass-through entity (“lower-tier S corporation”)?

Yes. An upper-tier S corporation is required to make a Connecticut composite income tax payment on behalf of a lower-tier S corporation where the lower-tier S corporation’s share of the upper-tier S corporation’s income derived from or connected with Connecticut sources is \$1,000 or more. The upper-tier S corporation is also required to make *estimated* Connecticut composite income tax payments on behalf of the lower-tier S corporation where the lower-tier S corporation’s share of the upper-tier S corporation’s income derived from or connected with Connecticut sources would be expected to equal or exceed \$20,000.

However, if both of the following conditions are met, an upper-tier S corporation is not required to make a Connecticut composite income tax payment on behalf of a shareholder of a lower-tier S corporation:

- The lower-tier S corporation provides sufficient evidence to the upper-tier S corporation that the shareholder of the lower-tier S corporation is a person for whom a Connecticut composite income tax payment is not otherwise required to be made (see Questions 3 and 4), for example, the shareholder is a C corporation or a resident individual; **and**
- Information about the pro rata share of the lower-tier S corporation owned by the shareholder is provided to the upper-tier S corporation.

Example 1: *L*, an S corporation, is a shareholder of *U*, an S corporation. Therefore, *L* is a lower-tier S corporation and *U* is an upper-tier S corporation. *L*’s pro rata share of *U*’s income derived from or connected with Connecticut sources is \$1,000, or more. Each shareholder of *L* is a C corporation. *L* provides sufficient evidence of this to *U*. *U* is not required to make a Connecticut composite income tax payment on behalf of *L*.

Example 2: The facts are the same as in Example 1 except for the following: *L*’s pro rata share of *U*’s income derived from or connected with Connecticut sources is expected to equal or exceed \$20,000, and the shareholders of *L* are four individuals, each with a 25% pro rata share of *L*’s income. Three of the individuals (*A*, *B*, and *C*) are resident individuals, and one (*D*) is a nonresident individual. *L* provides sufficient evidence of this to *U*. *U* is not required to make a Connecticut composite income tax payment on behalf of *L* with respect to *A*, *B*, or *C*’s pro rata share of *L*’s income. *U* is required to make a Connecticut composite income tax payment on behalf of *L*, but only with respect to *D*’s pro rata share of *L*’s income. *U* is not required to make estimated Connecticut composite income tax payments on behalf of *L* with respect to *D*’s pro rata share of *L*’s income unless it is expected to equal or exceed \$20,000.

Effect on Other Documents: None affected.

Effect of This Document: An Informational Publication addresses frequently asked questions about a current position, policy, or practice, usually in a less technical question and answer format.

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

- **1-800-382-9463** (in-state), 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: Forms and publications are available anytime:

- **Internet:** Preview and download forms and publications from the DRS Web site at www.ct.gov/DRS
- **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu. (Only forms (not publications) are available on TAX-FAX.)
- **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (in-state) and select **Option 2** from a touch-tone phone.

Paperless Filing Methods (fast, easy, free, and confidential):

- **For business returns:** Use *Fast-File* to file sales and use taxes, business use tax, room occupancy tax, or withholding tax returns over the internet or telephone. Visit the DRS Web site at www.ct.gov/DRS and click on *File Returns On-Line*.
- **For resident income tax returns:** Use *WebFile* to file personal income tax returns over the Internet. Visit the DRS Web site at www.ct.gov/DRS and click on *File Returns On-Line*.

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