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Multi-State Tax News

ISSUE:

CONNECTICUT PROPOSED LEGISLATION WOULD MAKE CHANGES TO PASS-THROUGH ENTITY FILING REQUIREMENTS AND WITHHOLDING

DATE:

For tax years beginning on or after January 1, 2005

DETAILS:

Connecticut proposed legislation, Senate Bill 421 (“the Bill”) would require pass-through entities to file a group return or pay the tax on behalf of their nonresident partners, shareholders, or members at the highest applicable rate and impose withholding remittance dates for nonresident partners, members or shareholders of pass-through entities such as partnerships, limited liability companies, and S corporations.

For tax years beginning on or after January 1, 2005, the Bill would decouple the dates for the payment of withholding tax from those dates required under the Internal Revenue Code and establish separate remitting dates for Connecticut withholding tax. These amounts would be based on the amounts required to be deducted and withheld during the 12-month period that ended on the June 30th preceding the calendar year (“12-month look-back period”).

If the amounts required to be deducted and withheld exceed \$10,000 during the look-back period, taxes must be remitted to the State weekly. Taxes must be remitted monthly if the stated amounts are \$2,000 or more but not more than \$10,000 during the look-back period. If the amounts during the look-back period are less than \$2,000 the taxes must be remitted quarterly. Note that different rules apply for household and seasonal employees. The state currently follows the federal withholding tax schedule. Connecticut Revenue Officials indicated that by establishing its own schedule under which the frequency of payments is based on the size of the payroll, the agency would be better able to determine when payments are due and whether or not payments are late and/or missed.

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DETAILS:

A further provision of the Bill would impact the income taxes of nonresident members of pass-through entities. The Bill would require partnerships doing business in the State or having income from in-state sources to a) file a group return and pay the income tax; or b) pay the income tax at the highest applicable rate on behalf of their nonresident partners. Connecticut Revenue Officials stated that, "despite provisions in the personal income tax to require partnerships and similar pass-through entities to file informational returns, it is our experience, as well as that of other states, that many nonresidents are not paying their tax obligations to the state where they earn their income." The measure would insure compliance by nonresidents by requiring the pass-through entity to either make payment of the tax on behalf of the nonresident or file and pay the tax on a group basis.

Finally, the Bill would subject each pass-through entity ("lower-tier pass-through entity") that is itself a member of a pass-through entity ("upper-tier pass-through entity") to the same payment requirements on behalf of its members. However, to prevent double taxation of the same income, the Department would apply the income tax paid by the upper-tier pass-through entity, on behalf of the lower-tier pass-through entity, to the income tax required to be paid by the lower-tier pass-through entity, on behalf of its members.

RECOMMENDED ACTION:

Join our *Connecticut-Watch Group* and we will alert you to any changes in this cutting-edge legislation. This is a free service we are offering our clients and friends with material nexus in Connecticut, through which we will keep you apprised of significant developments in this legislation.

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