**State Update: Connecticut Legislature Passes Changes to Apportionment and Sourcing Methodologies Impacting Pass-through Entities

June 27, 2016**

In a special session, the Connecticut General Assembly passed Senate Bill No. 502 on May 13, 2016. The bill enacts tax reform changes for both the corporate income tax and personal income tax, although with varying effective dates. Most significantly, the bill adopts a market-based sourcing methodology in computing apportionment for both corporate and personal income tax as well as enacts a single sales apportionment factor for personal income tax.[[1]](#footnote-1) Under current law, only sales of tangible personal property are sourced based on market for both corporate and personal income tax. The enactment of this bill, plus the passage of mandatory unitary reporting and single sales factor apportionment for corporate income tax, completes what the Connecticut Department of Revenue Services Commissioner Kevin Sullivan calls “the trifecta of business tax reform.”[[2]](#footnote-2) It is anticipated that the Governor will sign this bill in the next couple of weeks.

 The market-based sourcing rulings for corporate income tax purposes are effective for taxable years beginning on or after January 1, 2016. The personal income tax changes for market-based sourcing and single sales factor apportionment are effective for tax years beginning on or after January 1, 2017. As such, pass-through entities subject to a filing requirement in Connecticut are still subject to the current three-factor apportionment formula and sourcing rules for the 2016 tax year. Once effective, the bill essentially applies the same apportionment rules to both corporate and pass-through entity filers.

Below is a synopsis of the market sourcing and single sales factor apportionment rules for personal income tax purposes.

* Subsection (c) of section 12-711 of the 2016 supplement to the general statutes is repealed and the following is substituted in lieu thereof:

(c)(1) If a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under rules or regulations of the commissioner, the items of income, gain, loss and deduction derived from or connected with sources within this state shall be determined by apportionment under such rules or regulations and the provisions of this subsection.

(c)(2) The proportion of the net amount of the items of income, gain, loss and deduction attributable to the activities of the business, trade, profession or occupation carried on in this state shall be determined by multiplying the net amount of the items of income, gain, loss and deduction of the business, trade, profession or occupation by the gross income percentage. The gross income percentage shall be computed by dividing the gross receipts from sales earned within this state by the total gross receipts from sales, whether earned within or without this state. For the purposes of this subdivision:

(c)(2)(A) Gross receipts from sales of tangible personal property are considered to be earned within this state when the property is delivered or shipped to a purchaser within this state, regardless of the F.O.B. point or other conditions of the sale.

(c)(2)(B) Gross receipts from sales of services are considered to be earned within this state if the market for the services is in this state. The taxpayer's market for services is in this state if and to the extent the service is used at a location in this state.

(c)(2)(C) Gross receipts from the rental, lease or license of tangible personal property are considered to be earned within this state if and to the extent such property is situated in this state.

(c)(2)(D) Gross receipts from the rental, lease or license of intangible property are considered to be earned within this state if and to the extent such property is used in this state. Intangible property utilized in marketing a good or service to a consumer is used in this state if that good or service is purchased by a consumer in this state.

(c)(2)(E) Gross receipts from the sale or other disposition of tangible personal property or intangible property are excluded from the gross income percentage if such property is not held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business.

(c)(2)(F) Gross receipts from the sale, rental, lease or license of real property are excluded from the gross income percentage.

(c)(2)(G) Gross receipts, other than those receipts described in subparagraphs (A) to (F), inclusive, of this subdivision, are considered to be earned within this state to the extent the taxpayer's market for the sales is in this state.

(c)(2)(H) If a taxpayer concludes that it cannot reasonably determine where its gross receipts are earned in accordance with subparagraphs (A) to (G), inclusive, of this subdivision, such taxpayer may petition the commissioner for approval to use a methodology that reasonably approximates the method for determining where such receipts are earned provided for in this subdivision. Any such petition shall be submitted not later than sixty days prior to the due date of the return for the first taxable year to which the petition applies, determined with regard to any extension of time for filing such return. The commissioner shall grant or deny such petition before such due date.

* Subsection (a) of section 12-712 of the general statutes is repealed and the following is substituted in lieu thereof:

(a)(1) The portion of a nonresident partner's distributive share of partnership income that is derived from or connected with sources within this state shall be determined in accordance with the provisions of section 12-711, as amended by this act.

(a)(2) The portion of a nonresident shareholder's pro rata share of S corporation income that is derived from or connected with sources within this state shall be determined in accordance with the provisions of section 12-711, as amended by this act.

(a)(3) The portion of a nonresident beneficiary's share of trust or estate income that is derived from or connected with sources within this state shall be determined in accordance with the provisions of section 12-711, as amended by this act.

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1. Please refer to Sections 199, 200, and 201 of Senate Bill No. 502 (May Special Session, Public Act No. 16-3) [↑](#footnote-ref-1)
2. “DRS Commissioner Welcomes ‘Trifecta of Business Tax Reform’.” *State of Connecticut Department of Revenue Services.* 23 May 2016. Web. 25 May 2016. <http://www.ct.gov/drs/cwp/view.asp?Q=580978&A=1436> [↑](#footnote-ref-2)