

June 14, 2018 - Tax Group News: Connecticut Department of Revenue Services Issues Further Guidance on Connecticut Pass-Through Entity Tax



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Thursday, June 14, 2018

This Client Alert updates a previous Murtha Cullina LLP Client Alert titled "[Legislative Changes to Connecticut Income Tax](#)" (from May 16, 2018). The previous Client Alert explained that the Connecticut general assembly passed legislation that imposes a new 6.99% Connecticut income tax on most pass-through entities (namely, partnerships, S corporations and LLCs treated as partnerships). The legislation also provides for an offsetting Connecticut income tax credit to each owner of a pass-through entity (namely, partners, S corporation shareholders and LLC members) equal to 93.01% of the owner's allocable share of the tax ("PET Tax") paid by the entity. The purpose of the PET Tax is to mitigate the impact of the \$5,000 (single filer)/\$10,000 (joint filer) cap on the state and local income, property and sales tax ("SALT") deduction under the Tax Cuts and Jobs Act of 2017. Governor Dannel Malloy signed the legislation into law on May 31, 2018 with retroactive effect to the taxable year beginning January 1, 2018.

On June 6, 2018, the Connecticut Department of Revenue Services (the "DRS") issued Special Notice 2018(4) titled "[Guidance on 2018 Estimated Payments for Newly Enacted Pass-Through Entity Tax](#)" (the "Notice"). The Notice provides guidance regarding the estimated PET Tax payment requirements under the new law.

Specifically, since the legislation was enacted after the April 15, 2018 deadline for the first estimated payment, the DRS guidance gives a pass-through entity the following three options for complying with its year 2018 estimated payment requirements:

- Make a “catch-up” payment by June 15th to satisfy the first and second quarter estimated payment requirements;
- Make three estimated payments by June 15, 2018, September 15, 2018 and January 15, 2019, each equal to 22.5% of the PET
- Tax liability (with the full amount of PET Tax due by the return due date); or
- Annualize the estimated payments for the year.

Individual partners may consent to applying their personal estimated payments against the pass-through entity’s 2018 estimated payment requirements. The PET Tax estimated payment coupon is available [here](#).

Because owners will get a credit for the PET Tax paid by their pass-through entity, many Connecticut resident owners will no longer need to make estimated income tax payments. The Notice cautions, however, that owners of passthrough entities may still be required to make estimated income tax payments to cover their Connecticut income tax liability if they have income from other Connecticut sources or if they are an employee who will not have enough Connecticut income tax withheld from wages. In addition, passthrough entities may elect to calculate the PET Tax using an alternative basis which has the effect of causing the pass-through entity to pay the PET Tax only with respect to income allocable to individual owners. For pass-through entities that elect the alternative basis for calculating the PET Tax, a corporate owner will continue to owe Connecticut income tax on its distributive share of income from the pass-through entity and should continue to make estimated payments as it previously did.

Even with the issuance of additional guidance in the Notice, a number of questions and difficulties regarding the application of the PET Tax remain such as:

1. Does the PET Tax apply to guaranteed payments received from a partnership?
2. Will nonresidents be permitted to take a credit against their individual income tax liability in their home state for the PET Tax paid to Connecticut?
3. Should single member LLCs consider the addition of one or more new members to cause the entity to be treated as a pass-through entity for income tax purposes?
4. Will the IRS take regulatory action to prevent this workaround of the limited SALT deduction?

Due to the timing of the enactment of the PET Tax, impacted pass-through entities are encouraged to consider the impact of new law and the DRS guidance as soon as possible.

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