STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES

OCG-3

OFFICE OF THE COMMISSIONER GUIDANCE

Regarding the Calculation of the Corporation Business Tax on a Combined Unitary Basis

For income years beginning on or after January 1, 2016, commonly owned companies engaged in a unitary business are required to calculate their Corporation Business Tax on a combined unitary basis. On March 2, 2016, the Department of Revenue Services (DRS) issued general guidance on how to identify those companies that are required to file on a combined unitary basis and how to calculate their Corporation Business Tax liability. This general guidance is found in **Special Notice 2016(1)**, *Combined Unitary Legislation.*

Following the issuance of **Special Notice 2016(1)**, DRS has received questions on specific combined unitary issues. This publication provides answers to these questions and is intended to supplement the general guidance provided in **Special Notice 2016(1)**.

Taxpayers are encouraged to email additional questions to DRS at legal.division@po.state.ct.us. DRS will update this publication as it receives these questions. Any information added after initial publication will include the date on which the information was added.

Question 1: If a combined group member's sales are made only to other members of the combined group, are all of its sales eliminated for net income apportionment purposes?

Answer: Yes. Conn. Gen. Stat. § 12-218e(b)(4) provides that transactions between members of a combined group are eliminated for net income apportionment purposes. If a combined group believes that the statutory apportionment method unfairly attributes an undue portion of net income to Connecticut, such group may petition for an alternate method of apportionment pursuant to Conn. Gen. Stat. § 12-221a.

Question 2: May a combined group petition to exclude a member that otherwise, pursuant to statute, is required to be included in the group?

Answer: Yes. Conn. Gen. Stat. § 12-221a allows taxpayers to petition for permission to use an alternate method of apportionment when the statutory method results in the attribution of an undue portion of net income or capital base to Connecticut. For combined unitary purposes, such a petition may include a request to exclude from the combined group an affiliate that otherwise is statutorily required to be included in the combined group. A petition to request the exclusion of a member should, at a minimum, set forth the reasons why failure to grant the petition would result in the attribution of an undue portion of net income or capital to Connecticut and why electing to file on a worldwide or affiliated group basis would not adequately resolve such issue.

Similarly, a combined group may also petition to include an affiliate that otherwise, pursuant to statute, is not included in the group.

Question 3: If a taxable member is a broadcaster, as defined in Conn. Gen. Stat. § 12-218(k), must the combined group apportion the broadcaster's net income derived from broadcasting activities separately from the remainder of the combined group's net income?

Answer: Yes. Certain provisions of Conn. Gen. Stat. § 12-218 provide that net income derived from specific activities must be separately apportioned from other net income. Conn. Gen. Stat. § 12-218(k) provides that broadcasters must apportion net income from broadcasting separately from other net income. The following provisions provide for the separate apportionment of net income derived from specific activities:

- Carrying of passengers for hire – Conn. Gen. Stat. § 12-218(c)
- Carrying of property for hire – Conn. Gen. Stat. § 12-218(d)
- Services to regulated investment companies – Conn. Gen. Stat. § 12-218(e)
- Securities brokerage services – Conn. Gen. Stat. § 12-218(f)
- Credit card activities by financial service companies – Conn. Gen. Stat. § 12-218(i)
- Broadcasting and programming production services – Conn. Gen. Stat. § 12-218(k)

Net income that is subject to these separate apportionment rules should be removed from the combined group's net income and separately apportioned according to the applicable provisions. Similarly, receipts from the activities whose net income is subject to separate apportionment should be removed from the standard apportionment calculation.

Example 3A: A combined group contains two taxable members, Broadcaster and Non-Broadcaster. Broadcaster's net income derived from broadcasting activities is subject to separate apportionment. None of Non-Broadcaster's net income is subject to separate apportionment. The group has $120 of net income. Of the $120 of net income, $20 is from broadcasting. Broadcaster has $205 of Connecticut receipts, $125 of which are from broadcasting, and $1,000 of everywhere receipts, $250 of which are from broadcasting. Non-Broadcaster has $400 of Connecticut receipts and $1,250 of everywhere receipts.

Apportionment of Broadcasting Net Income	Broadcaster	Non-Broadcaster
1. CT Broadcasting Receipts	$125	N/A
2. Total Broadcasting Receipts	$250	N/A
3. Broadcasting Apportionment Percentage (Line 1 divided by Line 2)	50%	N/A
4. Broadcasting Net Income	$20	N/A
5. Broadcasting Apportioned Net Income (Line 3 multiplied by Line 4)	$10	N/A

Apportionment of Non-Broadcasting Net Income	Broadcaster	Non-Broadcaster
1. CT Non-Broadcasting Receipts	$80	$400
2. Total Non-Broadcasting Receipts	$750	$1,250
3. Non-Broadcasting Apportionment Percentage (Line 1 of each company divided by the total of Line 2 for both companies)	4%	20%
4. Non-Broadcasting Combined Group Net Income	$100	$100
5. Non-Broadcasting Apportioned Net Income (Line 3 multiplied by Line 4)	$4	$20

Total Apportioned Net Income	Broadcaster	Non-Broadcaster
1. Broadcasting Apportioned Net Income	$10	N/A
2. Non-Broadcasting Apportioned Net Income	$4	$20
3. Total Apportioned Net Income (Line 1 plus Line 2)	$14	$20

Example 3B (example added July 14, 2017): A combined group contains three taxable members: Broadcaster 1, Broadcaster 2, and Non-Broadcaster. The net income derived from broadcasting activities by Broadcaster 1 and Broadcaster 2 is required to be apportioned separately from the group's net income derived from other activities. None of Non-Broadcaster's net income is subject to separate apportionment. The group has $450 of net income, which is comprised of a net loss of $50 from the broadcasting activities of Broadcaster 1 and Broadcaster 2 and net income of $500 from the group's other activities.

Apportionment of Broadcasting Net Income	Broadcaster 1	Broadcaster 2	Non-Broadcaster
1. CT Broadcasting Receipts	$200	$50	N/A
2. Total Broadcasting Receipts	$400	$100	N/A
3. Broadcasting Apportionment Percentage (Line 1 of each broadcaster divided by the total of Line 2 for both broadcasters)	40%	10%	N/A
4. Broadcasting Combined Group Net Income/(Loss)	$(50)	$(50)	N/A
5. Broadcasting Apportioned Net Income/(Loss) (Line 3 multiplied by Line 4)	$(20)	$(5)	N/A

Apportionment of Non-Broadcasting Net Income	Broadcaster 1	Broadcaster 2	Non-Broadcaster
1. CT Non-Broadcasting Receipts	$300	$500	$1,000
2. Total Non-Broadcasting Receipts	$500	$750	$8,750
3. Non-Broadcasting Apportionment Percentage (Line 1 of each company divided by the total of Line 2 for all companies)	3%	5%	10%
4. Non-Broadcasting Combined Group Net Income/(Loss)	$500	$500	$500
5. Non-Broadcasting Apportioned Net Income/(Loss) (Line 3 multiplied by Line 4)	$15	$25	$50

Total Apportioned Net Income	Broadcaster 1	Broadcaster 2	Non-Broadcaster
1. Broadcasting Apportioned Net Income/(Loss)	$(20)	$(5)	N/A
2. Non-Broadcasting Apportioned Net Income/(Loss)	$15	$25	$50
3. Total Apportioned Net Income/(Loss)	$(5)*	$20	$50

* This apportioned net loss may be used to offset the apportioned net income of the other two members. The other members using such loss should report the loss as a negative number on Line 7 of **Form CT-1120CU-NI**, Part III. Similarly, Broadcaster 1 should report the loss utilized by the other members as a positive number on Line 7. If not fully utilized by the other members, Broadcaster 1 may carry forward its remaining loss as a net operating loss.

Question 4: Should a taxable member that is a manufacturer apportion its net income derived from manufacturing separately from the remainder of the combined group's net income?

Answer: No. The Connecticut General Statutes only require net income derived from the activities described in Question 3 to be separately apportioned.

Question 5: Can an air carrier, as defined in Conn. Gen. Stat. § 12-243(a), be included in a combined group?

Answer: Yes. If the air carrier satisfies the criteria to be a combined group member, the air carrier is required to be included in the combined group. If the air carrier is a taxable member, it should apportion the combined group's net income under Conn. Gen. Stat. § 12-244, using its separate activities to calculate the numerator and the group's activities to calculate the denominator.

Question 6: Can a non-captive real estate investment trust ("REIT") be included in a combined group?

Answer: Yes. If a non-captive REIT satisfies the criteria to be a combined group member, the non-captive REIT is required to be included in the combined group.

Question 7: Are dividends paid by a non-captive REIT to a fellow combined group member eliminated for purposes of calculating the combined group's net income?

Answer: Yes. Dividends between members of a combined group are eliminated. Moreover, because the dividends are eliminated, the non-captive REIT is not entitled to a dividends paid deduction for such dividends paid to fellow combined group members. The non-captive REIT, however, is entitled to a dividends paid deduction for dividends paid to recipients that are not part of the combined group.

A captive REIT combined group member is not entitled to any dividends paid deduction, regardless of whether the dividends are paid to a fellow member or to a third party.

Question 8: Should real estate investment trusts ("REITs") or regulated investment companies ("RICs") be included in the calculation of a combined group's capital base?

Answer: Conn. Gen. Stat. § 12-219(c) exempts REITs and RICs from the provisions of the capital base tax. As such, the capital of REITs and RICs should be excluded for purposes of calculating the combined group's capital base.

REIT and RIC combined group members should report a capital base tax of zero on the combined unitary return, unless they are also a financial service company, as defined in Conn. Gen. Stat. § 12-218b, in which case they should report a capital base tax of $250.

Question 9: When is a company that is included in a combined group considered to have "no tax liability" for purposes of the eligibility requirements under Conn. Gen. Stat. § 12-217ee ("R&D Exchange")?

Answer: Among other requirements, a company must have no Corporation Business Tax liability in order to be eligible to exchange credits under the R&D Exchange in a particular income year. Payment of the capital base tax (sometimes referred to as the "minimum base tax"), in a year in which a company reports no net income, or payment of a capital base tax of $250 is not considered to be a tax liability for eligibility purposes.

Conn. Gen. Stat. § 12-218e(j)(1) provides that a company included in a combined group must separately determine whether it is eligible for the R&D Exchange. This includes a separate determination as to whether it has a tax liability.

In the calculation of a combined group's tax, each member's income and capital is aggregated and then apportioned to the taxable members. Tax is calculated individually by each taxable member on its apportioned amount of the combined group's net income and capital. This separately calculated tax is the basis for determining whether a company has a "tax liability" for purposes of the eligibility requirements under the R&D Exchange.

Assuming the other requirements are satisfied, a company that files as part of a combined group is eligible for the R&D Exchange if the group pays tax on the capital base and:

- The company's apportioned amount of the combined group's net income is zero or negative, regardless of its portion of the capital base tax; or
- The company's portion of the capital base tax is equal to $250.

Question 10: Are companies that are included in a combined group required to add back any intercompany intangible or interest expenses under Conn. Gen. Stat. §§ 12-218c or 12-218d?

Answer: Yes. However, transactions between members of a combined group are eliminated for combined unitary purposes. As such, companies are only required to add back intangible and interest expenses if such expenses are paid to a related party that is not included in the combined group and none of the exceptions to the add back requirements apply.

Example: Company A, a combined group member, incurred intangible expenses associated with a transaction with Company Z, a related party that is not included in Company A's combined group. Because Company A and Company Z are not part of the same combined group, the transaction is not eliminated. Therefore, Company A must add back the intangible expenses, unless one of the exceptions applies.

Question 11: Under the water's-edge filing method, must a foreign company that has no property or payroll be included in a combined group with other commonly owned companies with which it conducts a unitary business?

Answer: No. Under the water's-edge filing method, companies incorporated in a foreign country are not included in the combined group unless 20% or more of the company's payroll and 20% or more of the company's property are located in the United States. In this situation, the foreign company should not be included in the combined group because it has no property or payroll and, therefore, does not qualify for the inclusion exception (i.e., $0 divided by $0 is not 20% or more).

Note: A foreign company that is not included in a combined group, but individually has nexus in Connecticut, must file a **Form CT-1120**, *Corporation Business Tax Return*, on a separate company basis.

Question 12: Under the water's-edge filing method, must a domestic company that has no property or payroll be included in a combined group with other commonly owned companies with which it conducts a unitary business?

Answer: Yes. Under the water's-edge filing method, companies incorporated under the laws of a state of the United States are included in the combined group unless 80% or more of its payroll and 80% or more of its property are located outside of the United States. In this situation, the domestic company should be included in the combined group because it has no property or payroll and, therefore, does not qualify for the exclusion exception (i.e., $0 divided by $0 is not 80% or more).

Note: A domestic company that is not included in a combined group, but individually has nexus in Connecticut, must file a **Form CT-1120**, *Corporation Business Tax Return*, on a separate company basis.

Question 13: Under the water's-edge filing method, a company engaged in a unitary business with other commonly owned companies may be excluded or included from the combined group depending upon the amount of its property and payroll that is located in the United States. A company incorporated within the United States is excluded from the group if 80% or more of its property and 80% or more of its payroll are located outside of the United States. A company incorporated outside of the United States is included in the group if 20% or more of its property and 20% or more of its payroll are located in the United States. For purposes of the 80% and 20% thresholds, what do the terms "property" and "payroll" include and how is their "location" determined?

Answer: The property of a company includes all of its assets, both tangible and intangible. The location of an asset should be determined in a manner consistent with the provisions of Conn. Gen. Stat. § 12-219a:

- Tangible assets are located where they are held.
- Intangible assets are located at the company's principal place of business unless it can be clearly established that some or all of the assets are held in connection with business conducted at a location other than the company's principal place of business.

The payroll of a company includes those items included in the calculation of the payroll factor under Conn. Gen. Stat. § 12-218(j)(3)(B)(ii). Such items include the total wages, salaries and other compensation to employees paid by the company. The location of such payroll should be determined in a manner consistent with Conn. Gen. Stat. § 12-218(j)(3)(B)(ii).

Question 14: Through income year 2015, taxpayers could elect to file their Corporation Business Tax returns on a unitary basis on **Form CT-1120U**, *Unitary Corporation Business Tax Return*. Under this now obsolete filing methodology, taxpayers were prohibited from claiming on their

elective unitary returns net operating losses or credits (collectively, "tax attributes") that were earned in years prior to making the unitary election.

My company carried tax attributes forward from a 2014 return that it filed on a separate company basis. The company could not use the tax attributes on its 2015 return because it elected to file a unitary return for such year. May my company use its 2014 tax attributes on its 2016 combined unitary return?

Answer: Yes, so long as such tax attributes are used in accordance with the combined unitary rules pertaining to the utilization of tax attributes from prior income years. See **Special Notice 2016(1)**, *Combined Unitary Legislation*.

Question 15: For income year 2015, Companies A, B and C filed a joint 2015 **Form CT-1120CR,** *Combined Corporation Business Tax Return*, which reported a combined net operating loss. For income year 2016, Companies A and B (but not C) will file together as members of a combined unitary return. After the 2015 combined net operating loss is divided between Companies A, B and C, may A and B share their portions of such net operating loss on their 2016 combined unitary return?

Answer: Yes. As indicated in **Special Notice 2016(1)**, *Combined Unitary Legislation*, the 2015 combined net operating loss should be divided between A, B and C in accordance with Conn. Agencies Regs. § 12-223a-2. Because A and B filed together as part of the 2015 **Form CT-1120CR** and both A and B are members of the 2016 combined unitary return, A and B are allowed to share their portions of the 2015 combined net operating loss on their 2016 combined unitary return. See Conn. Gen. Stat. § 12-218e(d)(3).

Question 16: Conn. Gen. Stat. § 12-218e(k) provides that a combined group's tax on a combined unitary basis cannot exceed its tax on a nexus combined basis by more than $2.5 million (the "Aggregate Maximum Tax"). Is a combined group required to file the Aggregate Maximum Tax calculation with its return if such calculation does not impact the amount of tax due? Also, if a combined group fails to file the Aggregate Maximum Tax calculation with its original return, has the group waived its ability to claim that its tax is limited to the Aggregate Maximum Tax at a later date?

Answer: The Aggregate Maximum Tax calculation is reported on **Form CT-1120CU-NCB**. If the combined group determines that the calculations on **Form CT-1120CU-NCB** do not affect the tax due, the group does not need to file such return. If the combined group later determines that the calculations do impact the tax due, it may file **Form CT-1120CU-NCB** with an amended return or provide **Form CT-1120CU-NCB** to DRS during the course of an audit examination.

Question 17 ***(question added July 14, 2017)*****:** How many companies are needed to file a **Form CT-1120CU?**

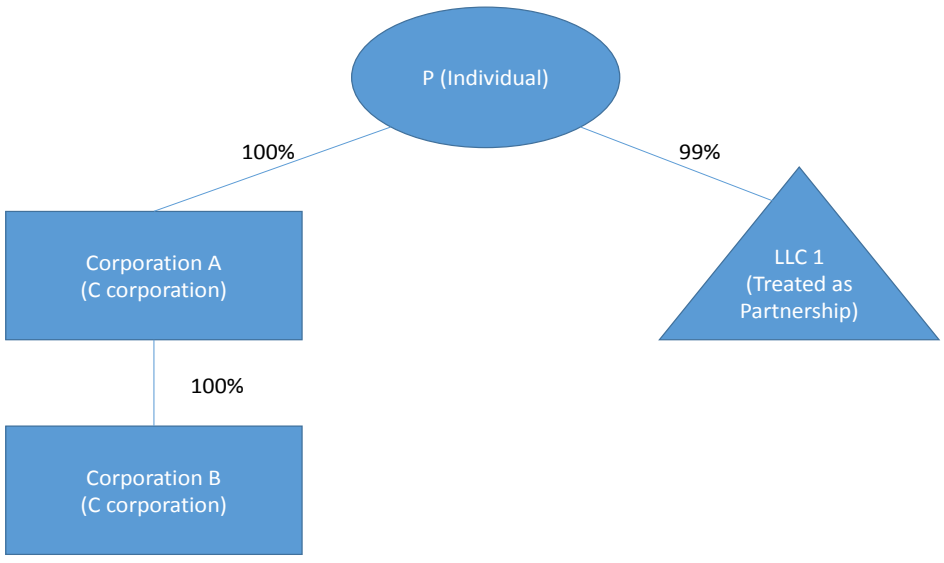
Answer: Two or more companies are needed to file a **Form CT-1120CU**. The term "company" generally means an entity taxed as a C corporation for federal income tax purposes. See Conn. Gen. Stat. § 12-213(a)(1).

For more information about combined group members, see the step process described in Section II, Determination of Combined Group, of **Special Notice 2016(1)**, *Combined Unitary Legislation*. If two or more companies remain after Step 4, such companies must file **Form CT-1120CU** together as a combined group.

Question 18 ***(question and examples added July 14, 2017)*****:** In the following examples, must **Form CT-1120CU** be filed and, if so, which entities are included as members of each combined group?

Note: All examples are based upon the water's-edge filing basis. For purposes of the examples, all corporations are incorporated in the United States and all entities only conduct business within the United States. Additionally, at least one of the corporations in each example conducts business within Connecticut.

Example 18A: P, an individual, owns 100% of the stock in Corporation A and a 99% interest in LLC 1, a limited liability company treated as a partnership for federal income tax purposes. Corporation A owns 100% of the stock of Corporation B. Corporation A and Corporation B are both treated as C corporations for federal income tax purposes. Corporation A, Corporation B, and LLC 1 are engaged in a unitary business.



Special Notice 2016(1), *Combined Unitary Legislation*, provides that "groups of companies with common ownership that are engaged in a unitary business, where at least one member of the group

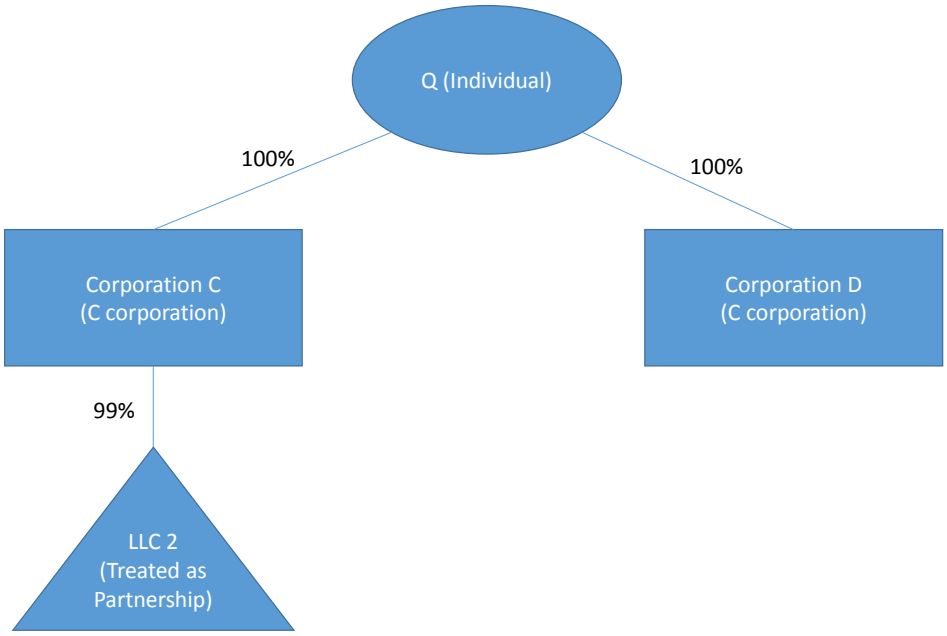
is subject to the Corporation Business Tax, are required to calculate their tax liability on a combined unitary basis."

Under the scenario presented, Corporation A and Corporation B are "companies" as defined in Conn. Gen. Stat. § 12-213(a)(1), have common ownership, and are engaged in a unitary business. As such, Corporation A and Corporation B must file a **Form CT-1120CU** as members of a combined group.

LLC 1, however, is not included in the combined group. Combined groups may only contain "companies." In general, companies are entities that are taxed as C corporations for federal income tax purposes. Because LLC 1 is treated as a partnership for federal income tax purposes, it is not a company for Corporation Business Tax purposes. As such, LLC 1 cannot be a member of the combined group.

LLC 1 must file **Form CT-1065/CT-1120SI**, *Connecticut Composite Income Tax Return*. If P is a non-resident, he or she is subject to tax on his or her distributive share of LLC 1's Connecticut source income. If P is a resident of Connecticut, he or she is subject to tax on the entire distributive share of LLC 1's income (less any credits for taxes paid to other jurisdictions).

Example 18B: Q, an individual, owns 100% of the stock of Corporation C and 100% of the stock of Corporation D. Corporation C owns a 99% interest in LLC 2, a limited liability company treated as a partnership for federal income tax purposes. Corporation C and Corporation D are both treated as C corporations for federal income tax purposes. Corporation C, Corporation D, and LLC 2 are engaged in a unitary business.

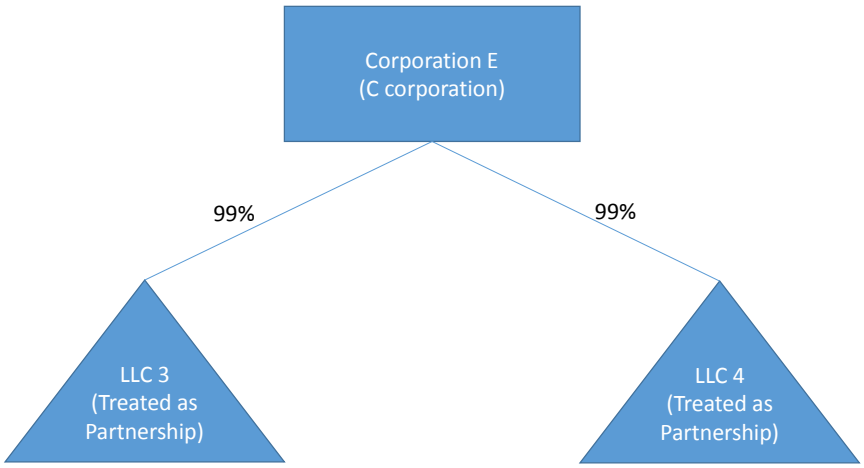


Under this scenario, Corporation C and Corporation D are "companies," have common ownership, and are engaged in a unitary business. As such, Corporation C and Corporation D must file a **Form CT-1120CU** as members of a combined group.

As in Example 18A, LLC 2 is not a company and, therefore, is not a member of the combined group. However, in this scenario, Corporation C owns an interest in LLC 2. While LLC 2 is not a member of the combined group, Corporation C must include its distributive share of LLC 2's activities when calculating the combined group's tax. For **Form CT-1120CU** purposes, Corporation C should combine its activities with its distributive share of LLC 2's activities and report such aggregated amounts in Corporation C's column on each respective form.

In this scenario, LLC 2 must also file **Form CT-1065/CT-1120SI**. No composite tax will be due from LLC 2 on behalf of Corporation C's distributive share of income from LLC 2.

Example 18C: Corporation E owns a 99% interest in LLC 3 and a 99% interest in LLC 4. Corporation E is treated as a C corporation for federal income tax purposes. LLC 3 and LLC 4 are treated as partnerships for federal income tax purposes. Corporation E, LLC 3, and LLC 4 are engaged in a unitary business.



Under this scenario, Corporation E is the only "company." Because there is only one "company," a combined unitary return is not required. Instead, Corporation E should file a separate company return on **Form CT-1120**.

On Corporation E's **Form CT-1120**, *Corporation Business Tax Return*, Corporation E should include its distributive share of the activities of LLC 3 and LLC 4.

LLC 3 and LLC 4 both must also file **Form CT-1065/CT-1120SI**. No composite tax will be due from LLC 3 or LLC 4 on behalf of Corporation E's distributive shares of income from LLC 3 and LLC 4.

Question 19 ***(question added October 17, 2017)*****:** For net income apportionment purposes, nontaxable members are required to assign their Connecticut receipts to taxable members. The amount assigned to each taxable member is based upon the relative portion of the taxable member's Connecticut receipts compared to the Connecticut receipts of all taxable members. In a situation where no taxable member has any Connecticut receipts (resulting in an equation of zero divided by zero, which is undefined), how are the Connecticut receipts of nontaxable members assigned?

Answer: If there is only one taxable member, that taxable member will be assigned all of the nontaxable members' Connecticut receipts. If there is more than one taxable member, a reasonable method should be used to assign the nontaxable members' Connecticut receipts to the taxable members. In total, all of the nontaxable members' Connecticut receipts must be assigned to the taxable members.

Question 20 ***(question added October 17, 2017)*****:** On federal Form 4797, gain or loss is calculated using the federal cost basis. Because Connecticut decouples from federal bonus depreciation, an adjustment is required to determine the gain or loss based on the Connecticut cost basis. On which line should this adjustment be reported?

Answer: The adjustment to arrive at the gain or loss based upon the Connecticut cost basis should be reported in the "Adjustments" column on Form CT-1120CU-NI, Part I, Line 9.

Additional Questions Regarding the Corporation Business Tax: 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 anytime by calling 860-297-4911.

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