

Enacted Connecticut bill targets deferred income received from off-shore hedge funds and the sale of certain real estate entities by nonresidents

June 18, 2014

In brief

On June 11, 2014, Connecticut Governor Dannel Malloy signed H. 5466 ([Act 14-155](#)), which requires certain deferred federal offshore hedge fund income that is attributed to services performed in-state to be sourced to Connecticut for purposes of calculating the income for nonresident individuals. The bill is intended to bolster the state impact of Internal Revenue Code section 457A and its subsequent rules enacted by the Internal Revenue Service in 2009 that limited the deferral of certain types of foreign income by the hedge fund partners. This provision is effective on enactment.

Additionally, the bill requires nonresidents to include in their Connecticut taxable income the gain or loss from the sale of their interests in certain entities if those entities hold real estate in Connecticut and 50% or more of its assets are real property located in Connecticut, and meet other requirements. This provision applies to taxable years commencing on or after January 1, 2014.

Note. Originally, these provisions were part of Senate Bill 369 and were added to H.B. 5466 on amendment.

In detail

Deferred compensation from hedge funds would be included in nonresident Connecticut income

H.B. 5466 amends Conn. Gen. Stat. section 12-711, which addresses the determination of income, gain, loss, and deductions derived from or connected with sources within the state. Specifically, the bill

provides that the income of a nonresident natural person derived from or connected to sources within this state to include 'his or her compensation from nonqualified deferred compensation plans attributable to services performed within the state, including, but not limited to, compensation required to be included in federal gross income under Section 457A of the

Internal Revenue Code.' I.R.C. Section 457A, enacted in 2008 as part of the Emergency Economic Stabilization Act of 2009, imposes restrictions on nonqualified deferred compensation arrangements sponsored by off-shore entities. Under Section 457A, any compensation deferred under a nonqualified deferred compensation plan of a nonqualified entity must be

included in federal gross income when there is no substantial risk of forfeiture.

In written testimony provided at a public hearing on March 13, 2014 Commissioner Kevin Sullivan of the Department of Revenue Services stated that this “strengthens our position in dealing with off-shore hedge fund income that should be sourced to Connecticut for non-residents performing services properly attributable to performance in the state. Even with federal repatriation of certain off-shore income, this and other forms of transfer payments are an area where Connecticut needs to step up its game in combating tax evasion.”

Nonresidents’ Connecticut taxable income would be expanded to include the sale of interest in certain entities that own real estate in Connecticut

H.B. 5466 also requires a nonresident to include in their Connecticut taxable income the gain or loss from the sale

of an interest in a partnership, limited liability company (LLC) or an s corporation if the entity whose interest is sold owns real property located in Connecticut and the real property has a fair market value that equals or exceeds 50% of all the assets of the entity on the date of sale or disposition. Only the assets that the entity owned for at least the last two years prior to the date of the sale or disposition of the person’s interest will be used to determine the fair market value of all the assets of the entity on the date of the sale or disposition. Additionally, the portion of the Connecticut gain or loss equals the total gain or loss for federal income tax purposes multiplied by a fraction, the numerator of which is the fair market value of all real property located in Connecticut owned by the entity, and the denominator is the fair market value of all the assets of the entity, as determined on the date of the sale or disposition.

The takeaway

H.B. 5466 may substantially affect the taxable income sourced to Connecticut for many nonresidents who had previously provided services in Connecticut to hedge funds in return for certain types of deferred compensation. The remarks of the Commissioner indicate that this type of deferred income may be a focus in the future.

Additionally, the inclusion of the gain or loss of an interest in certain entities that holds real property in Connecticut provides another example of how the State is seeking out ways to expand its tax base. Similar to New York’s “FIRPTA” provision that was enacted a few years ago, Connecticut is seeking to eliminate a non-resident’s planning strategy of selling an interest in real property to mitigate Connecticut taxation. The provisions are almost identical to New York’s rule except Connecticut is not including sales of corporate shares with less than 100 shareholders as an eligible entity.

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