

MEMO# 16408

August 6, 2003

INSTITUTE LETTER TO CONNECTICUT'S GOVERNOR REGARDING MANDATORY COMBINED REPORTING

[16408] August 6, 2003 TO: ADVISER DISTRIBUTOR TAX ISSUES TASK FORCE No. 15-03 TAX MEMBERS No. 43-03 RE: INSTITUTE LETTER TO CONNECTICUT'S GOVERNOR REGARDING MANDATORY COMBINED REPORTING Attached is a letter sent to the Governor of Connecticut (with identical copies sent to legislative leaders and state tax and budget officials), regarding the Institute's views on mandatory combined reporting, as required under Section 91 the recent budget legislation in Connecticut. The state budget for Connecticut for fiscal years 2004-2005 was introduced in, and passed by, the legislature last week. Section 91 of the budget bill requires a taxpayer who satisfies any one factor identified in the legislation to file an "alternate combined report," treating the taxpayer and any affiliated corporation satisfying the factor as a single corporation for Connecticut state tax purposes. The list of factors triggering combined reporting includes: (1) 50 percent or more of the taxpayer's gross income is derived from business conducted with affiliated corporations, or 50% of an affiliated corporation's gross income is derived from business conducted with a taxpayer and other related entities; (2) three or more of a specified list of services (including advertising, accounting, distribution, sales, and legal services) are provided between the taxpayer and related entities; and (3) 20% of the debt owed by or to the taxpayer is debt owed by or to related entities. In addition to the mandatory combined reporting under the legislation, the state Commissioner of Revenue has the discretion to include (or exclude) any other affiliated corporation in the alternate combined report. The taxpayer is required to pay the higher of the tax that would be imposed under the alternate combined report, or the taxpayer's usual return (whether a separate return or a combined return). For example, if a fund's distributor files a Connecticut tax return, then any fund affiliate that satisfies one of the above factors could be subject to tax in Connecticut on its income. Connecticut uses a single sales factor for mutual fund service providers, so any affiliates would be taxed based on the residence of the underlying mutual fund shareholder, without regard to the affiliate's lack of payroll or property in Connecticut. 2 The Institute's letter outlines the problems raised by the application of mandatory combined reporting to the mutual fund industry and proposes three possible changes to the budget legislation: (1) allow investment management service companies to use standard apportionment factors (sourcing income to the location where services are performed) in place of shareholder-based sourcing when filing on a combined basis; (2) eliminate mandatory combined reporting where inter-company services are provided in an arm's length transaction; and (3) eliminate the provision that mandates combined reporting when affiliates provide a certain number of specified inter-company services. David Orlin Assistant Counsel Attachment (in .pdf format)

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.