

Sec. 12-701(a)(10)-3. Modifications comprising the Connecticut fiduciary adjustment: subtractions

(a) The following items are to be subtracted in computing the Connecticut fiduciary adjustment of a trust or estate:

(1) Any income with respect to which taxation by any state is prohibited by federal law, to the extent properly includible in gross income for federal income tax purposes. The provisions of § 12-701(a)(20)-3(a)(1) of Part I are incorporated by reference herein.

(2)

(A) Exempt dividends paid by a qualified regulated investment company. As provided in Section 12-718 of the general statutes, a regulated investment company is a qualified regulated investment company if, at the close of each quarter of its taxable year, at least 50% of the value of its total assets (as defined in section 851(c)(4) of the Internal Revenue Code) is invested in obligations the taxation of which by any state is prohibited by federal law.

(B) The portion of the dividends received by a shareholder of a qualified regulated investment company that may be subtracted in computing the Connecticut fiduciary adjustment is based upon the portion of income received by such company that is derived from obligations which states are prohibited from taxing by federal law. Where all of the income of the company is derived from interest on obligations that states are prohibited from taxing by federal law, the full amount of the dividends received by the shareholders may be subtracted. Where less than the full amount is derived from such interest, the amount to be subtracted is determined as follows:

$$\frac{\begin{array}{l} \text{Interest income on obligations} \\ \text{which states are prohibited from} \\ \text{taxing by federal law less} \\ \text{expenses attributable to such income} \end{array}}{\begin{array}{l} \text{Regulated investment} \\ \text{company's taxable income} \end{array}} = \frac{\begin{array}{l} \text{Percent of dividends} \\ \text{received by shareholders} \\ \text{that qualifies as exempt} \\ \text{dividends} \end{array}}$$

(C) In the case of a series fund, the portion of the dividends paid that is exempt from Connecticut income tax shall be determined on a fund-by-fund basis.

(D) Dividends attributable to obligations which states are prohibited from taxing by federal law that are distributed by nonqualified regulated investment companies are fully taxable for Connecticut purposes and may not be subtracted under this section.

(E) *Example:*

(i) Computation for regulated investment company. A qualified regulated investment company receives income from the following sources:

Capital gains from the sale of stock	\$ 20,000
Interest income from federal obligations	70,000

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Dividends from a corporation	+ 10,000
Total:	\$100,000
Expenses (\$10,000 of which are directly related to interest income on federal obligations)	- 20,000
Taxable income:	\$ 80,000

The regulated investment company distributed the entire \$80,000 to its shareholders. The percentage of this distribution that may be subtracted from federal taxable income under this section is computed as follows:

$$\frac{\$70,000 - \$10,000}{\$80,000} = 75\% \text{ (percentage of dividends that qualifies as exempt dividends)}$$

(ii) Computation for shareholder. A shareholder receives dividend distributions of \$2,000 in 1992 from the above regulated investment company. The amount of these dividends qualifying as exempt dividends is 75% of \$2,000, or \$1,500.

(3) Interest income on Connecticut obligations, to the extent properly included in gross income for federal tax purposes.

(4)

(A) To the extent properly includible in determining the net gain or loss from sales or other dispositions of capital assets for federal income tax purposes, any gain (or amount that is properly treated as a capital gain dividend, as defined in section 852(b)(3) of the Internal Revenue Code) from the sale or exchange of Connecticut obligations, in the taxable year such gain was recognized, whether or not, for federal income tax purposes, gains from sales or other dispositions of capital assets exceed losses therefrom.

(B) *Example:* A resident trust has, for federal income tax purposes, a long-term capital gain of \$3,000 arising from the sale of Connecticut obligations and a long-term capital loss of \$2,000 arising from the sale of bonds issued by or on behalf of the Commonwealth of Massachusetts. Such trust's federal gross income shall be reduced by \$3,000, the amount of the gain derived from the sale of the Connecticut obligations.

(5)

(A) Interest expenses on indebtedness incurred or continued to purchase or carry obligations or securities, the interest income from which is subject to Connecticut income tax but exempt from federal income tax, to the extent such expenses would be deductible in determining federal taxable income prior to deductions relating to distributions to beneficiaries if the interest income were subject to federal income tax.

(B) *Example:* A trust borrows \$100,000 from a bank to purchase bonds issued by or on behalf of the State of California. In computing the trust's federal taxable income, income from these bonds is not includible in federal gross income, and the borrowing expense is not deductible. However, income received from these bonds is subject to Connecticut income tax and is therefore added to federal taxable income in computing the trust's Connecticut taxable income under § 12-701(a)(10)-2 of this Part. In addition, the borrowing expense shall be subtracted from the trust's federal taxable income prior to deductions

relating to distributions to beneficiaries to the extent such expenses would have been deductible if the interest income were subject to federal income tax.

(6)

(A) Ordinary and necessary expenses paid or incurred during the taxable year for (i) the production or collection of income which is subject to Connecticut income tax but exempt from federal income tax or (ii) the management, conservation or maintenance of property held for the production of income which is subject to Connecticut income tax but exempt from federal income tax or (iii) the amortizable bond premium on any bond, the interest income from which is subject to Connecticut income tax but exempt from federal income tax, but only to the extent that such expenses and premiums would be deductible in determining federal taxable income prior to deductions relating to distributions to beneficiaries if such income were subject to federal income tax.

If the sum of the trust or estate's miscellaneous itemized deductions, as defined in section 67(b) of the Internal Revenue Code, plus the expenses and premiums described herein, exceed 2% of the sum of its federal adjusted gross income, as computed under section 67(e) of the Internal Revenue Code, plus the income described herein which is subject to Connecticut income tax but exempt from federal income tax, the portion of the excess that such expenses and premiums described herein bear to the sum of the trust or estate's miscellaneous itemized deductions, as defined in section 67(b) of the Internal Revenue Code, plus the expenses and premiums described herein shall be subtracted from federal taxable income under this section.

If the expenses and premiums described herein would be deductible in determining federal taxable income prior to deductions relating to distributions to beneficiaries under section 67(e)(1) of the Internal Revenue Code, were such income described herein subject to federal income tax, then such expenses and premiums shall be subtracted from federal taxable income under this section.

(B) *Example:* If a trust pays or incurs \$150 of ordinary and necessary expenses in connection with the production of income from its California bonds and amortizes \$50 of a premium paid on such bonds, the amount of such expenses and premiums which are not deductible for federal income tax purposes shall be subtracted from the federal taxable income of the trust under this section, to the extent such expenses and premiums would have been deductible if such income were subject to federal income tax. The trust has adjusted gross income of \$19,000. The amount of its miscellaneous itemized deductions is \$800. The California bond expenses and premiums (\$200) plus the miscellaneous itemized deductions (\$800) exceed 2% of (i) the trust or estate's federal adjusted gross income (\$19,000) plus (ii) the interest income on California bonds (\$1,000). The portion of the excess (\$600) that such expenses and premiums (\$200) bears to the sum of miscellaneous itemized deductions (\$800) plus such expenses and premiums (\$200) is to be subtracted from federal taxable income in computing the trust's Connecticut taxable income under this section. Therefore, \$120 is subtracted from federal taxable income. If such expenses and premiums plus the miscellaneous itemized deductions had not exceeded 2% of (i) federal adjusted gross income plus (ii) the interest income on California bonds, no portion of the \$200 would have been subtracted from federal taxable income under this section.

(7) With respect to a trust or estate that is a shareholder of an S corporation carrying on

business in Connecticut (as the term is used in Section 12-214 of the general statutes, and as defined in Conn. Agencies Regs. § 12-214-1), the amount of such trust or estate's pro rata share of the corporation's nonseparately computed income (as defined in § 12-701(b)-1 of Part XIV), multiplied by the corporation's apportionment fraction, if any, as determined under Section 12-218 of the general statutes (irrespective of whether the S corporation shall pay the additional tax under Section 12-219 of the general statutes).

(b) While this section pertains to Section 12-701(a)(10) of the general statutes, for purposes of supplementary interpretation, as the phrase is used in Section 12-2 of the general statutes, the adoption of this section is authorized by Section 12-740(a) of the general statutes.

(Effective November 18, 1994)