

Sweeping Connecticut tax reforms enacted

July 2, 2015

Overview

On June 3, 2015, the Connecticut General Assembly passed in concurrence House Bill 7061 (HB 7061),¹ the Connecticut state budget bill for the biennium spanning July 1, 2015 through June 30, 2017. On June 29, 2015, the Connecticut General Assembly passed in concurrence Senate Bill 1502 (SB 1502),² an act implementing the state budget for the biennium spanning July 1, 2015 through June 30, 2017. SB 1502 makes some significant changes to HB 7061 and adds some additional provisions. Governor Dannel Malloy signed both bills into law on June 30, 2015.

On June 5, 2015, we issued a Tax Alert summarizing the proposed changes contained in HB 7061, which, at the time, was awaiting Governor Malloy's signature. In this updated Tax Alert we summarize the law changes enacted in HB 7061 as modified by SB 1502, including mandatory unitary taxation applicable to income years commencing on or after January 1, 2016.

Changes to the Connecticut Corporation Business Tax

HB 7061 and SB 1502 make the following changes to the corporation business tax:

- Extend the 20 percent surtax on both the 7.5 percent tax rate on the income base and the 0.31 percent tax rate on the capital base for income years beginning prior to January 1, 2018. The surtax is reduced to 10 percent for income years beginning on or after January 1, 2018, and before January 1, 2019.
 - The surtax applies to all companies with gross income of \$100,000,000 or more, all companies filing combined or elective unitary returns for income years commencing prior to January 1, 2016, and all companies filing unitary returns for income years commencing on or after January 1, 2016, and prior to January 1, 2019.
- Extend the current film production tax credit limitations through June 30, 2017. For vouchers issued on or after July 1, 2015, the period in which the film production tax credit can be claimed is extended to the year when the expenses were incurred and the next five years.
- Limit the deduction of net operating losses (NOLs) to 50 percent of Connecticut income effective for income years commencing on or after January 1, 2015.
 - An alternate elective operating loss carryforward rule is available for combined groups with unused operating losses in excess of \$6 billion dollars from years beginning prior to January 1, 2013.
- Limit the application of tax credits to 50.01 percent of the amount of tax due. This change is effective for income years commencing on or after January 1, 2015.
- Impose mandatory unitary taxation applicable to income years commencing on or after January 1, 2016. This effective date was specified in SB 1502, thus amending HB 7601, which had provided that this change was to apply to income years commencing on or after January 1, 2015.
 - The Connecticut combined group (referred to in this Tax Alert as the “CT unitary group”) is composed of all entities with common ownership (more than 50 percent, direct or indirect) that are engaged in a unitary business. CT unitary group members with nexus in Connecticut are taxable members. CT unitary group members without nexus in Connecticut are nontaxable members.
 - The “designated taxable member” is either the parent of the CT unitary group or, if the parent of the CT unitary group is not a taxable member, the taxable member as selected by the CT unitary group.

¹ Conn. Pub. Act No. 15-244; HB 7061, 2015 Gen. Assemb., Reg. Sess. (Conn., Jun. 30, 2015); available [here](#).

² SB 1502, 2015 Gen. Assemb., Spec. Sess. (Conn., Jun. 30, 2015).

- The CT unitary group's income is the aggregate income of every taxable and nontaxable member of the CT unitary group as reported on a federal return as if each member was filing a separate federal return or an adjusted profit and loss statement of a unitary foreign company that does not file a federal return.
- The CT unitary group's income includes its distributive share from a passthrough entity.
- All intergroup dividends are eliminated.
- Intercompany gains are deferred in a manner consistent with Treas. Reg. §1.1502-13.
- Charitable contributions are first deducted from the CT unitary group's income subject to Internal Revenue Code (IRC) §170 limitations.
- Gains or losses under IRC §1231(a)(3) are combined at the CT unitary group level and then apportioned to each member.
- Expenses related to income that Connecticut is prohibited from taxing under the US Constitution are not allowed as a deduction.
- Each taxable member determines its separate apportionment percentage based on the otherwise-applicable apportionment formula under Connecticut law.
- Taxable members use the CT unitary group's denominator.
- Sourcing rules depend on the apportionment formula applicable to the separate taxable or nontaxable entity.
- Receipts sourced to Connecticut for nontaxable members are allocated to the numerators of the taxable members.
- Transactions between members are eliminated for apportionment purposes.
- Every taxable member has the right to apportion if any member is taxable outside Connecticut (*Finnigan* rule).
- CT unitary group NOL carryforwards from income years beginning on or after January 1, 2016, can be shared with other taxable members of the CT unitary group, if such other members were members during the year the NOL was incurred.
- Combined group NOL carryforwards from an income year beginning prior to January 1, 2016, can be shared with other members of the CT unitary group that were included in the same combined group in the year the NOL was incurred.
- NOL carryforwards from income years beginning prior to January 1, 2016, which were earned by a separate company, are available to that separate company on a Separate Return Limitation Year basis.
- The CT unitary group's capital base tax is the aggregate capital bases of all taxable and non-taxable members. Intercorporate stockholdings are eliminated.
- Financial services companies are subject to the capital base tax at the \$250 minimum amount, are not included in the CT unitary group's capital base calculation, and are not included when calculating the capital base apportionment.
- The capital base apportionment denominator is the aggregate denominator for all CT unitary group members.
- The aggregate capital base cap is \$1 million on the CT unitary group. If the CT unitary group's tax exceeds \$1 million, then each member prorates its separate capital base tax.
- The CT unitary group compares its income tax liability on an aggregate basis to its capital base tax on an aggregate basis and pays the higher of the two.
- The tax credit ordering rules and tax credit limitation rules apply separately to each taxable member.
- Tax credits earned in an income year beginning on or after January 1, 2016, may be shared with other members of the CT unitary group, if such other members were members during the year the tax credits were earned.
- Tax credits carried forward from an income year beginning prior to January 1, 2016, may be shared with other entities that were included in the same combined return in the year the tax credit was earned.
- The default CT unitary group uses a water's-edge basis. Optional elections are available for filing on a federal affiliated group basis or a worldwide unitary basis. The affiliated election and worldwide unitary election are only available if made on an originally filed return and are then effective for the next 10 years.

- The water’s-edge CT unitary group: (a) excludes US-incorporated 80-20 companies; (b) includes foreign incorporated companies with 20 percent or more of property and payroll in the US; (c) includes any member that earns more than 20 percent of its gross income from intangible property or from providing services when the costs are deducted for federal income tax purposes against the income of other members of the group, but only to the extent of the income and related apportionment factors; and (d) includes any companies incorporated in a tax haven as the Commissioner, Department of Revenue Services (Commissioner) specifies, in his discretion, on a list published by September 30, 2016, unless it is proven to the satisfaction of the Commissioner that the member is incorporated in the tax haven for a legitimate business purpose.
- A CT unitary group lacking nexus in Connecticut, other than as a limited partner in a limited partnership, is not entitled to calculate its capital base apportionment using only the apportionment factors flowing through the limited partnership. Instead, the CT unitary group shall apportion its capital base by including the proportionate part of the numerator and the denominator flowing through the partnership.
- Publicly traded companies are entitled to the following deduction as stated in SB 1502:
For the seven-year period beginning with the combined group’s first income year that begins in 2018, a combined group shall be entitled to a deduction from combined group net income equal to one-seventh of the amount necessary to offset the increase in the net deferred tax liability or decrease in the net deferred tax asset, or the aggregate change thereof from a net deferred tax asset to a net deferred tax liability, as computed in accordance with generally accepted accounting principles, that would result from the imposition of the unitary reporting requirements under . . . this act, but for the deduction provided under this section.³
- The former rules providing for an election to file a nexus combined return in Connecticut do not apply to income years commencing on or after January 1, 2016.
- Require the Commissioner to review the impact of alternative methods of apportionment and provide recommendations in a report delivered to the Finance, Revenue, and Bonding Committee of the General Assembly on or before February 1, 2016.
- Extend the First Five Plus program through June 30, 2016, allowing the Department of Economic and Community Development to provide flexible financial assistance in exchange for job creation and other investments in Connecticut.
- Raise the cap on the Neighborhood Assistance Act tax credit from \$5 million to \$10 million per fiscal year. This change is effective July 1, 2017.
- Raise the cap on the Urban and Industrial Site Reinvestment tax credit from \$800 million to \$950 million. This change is effective July 1, 2015.

Changes to the Connecticut Personal Income Tax

HB 7061 and SB 1502 make the following changes to the personal income tax:

- Exempt US military retirement income from the Connecticut income tax effective for income years beginning on or after January 1, 2015.
- Increase the top two marginal rates to 6.9 percent and 6.99 percent effective January 1, 2015. The 6.9 percent rate applies to Connecticut taxable income over:
 - \$250,000, if filing Single or Married Filing Separately
 - \$400,000, if filing Head of Household
 - \$500,000, if filing Married Filing Jointly

The top 6.99 percent marginal rate applies to Connecticut taxable income over:

- \$500,000, if filing Single or Married Filing Separately
- \$800,000, if filing Head of Household
- \$1,000,000, if filing Married Filing Jointly

The 6.99 percent rate also applies to trusts and estates.

- Delay by one year a scheduled \$500 increase in the personal exemption. The personal exemption for the income year beginning on January 1, 2016, is \$14,500, increasing to \$15,000 for income years beginning on or after January 1, 2017.

³ SB 1502, §146(d), 2015 Gen. Assemb., Spec. Sess. (Conn., Jun. 30, 2015).

- Delay by one year a scheduled increase in the threshold for the credit for adjusted gross income. The various increases in the Connecticut gross income thresholds that were to occur for the income year beginning on January 1, 2015, will now occur for the income year beginning on January 1, 2016.
- Delay the increase of the earned income tax percentage to 30 percent. The percentage will remain at 27.5 percent for the 2015 and 2016 income years.
- Decrease the amount of the 2016 credit for taxes paid on a primary residence or motor vehicle from \$300 to \$200 and reduce the income levels for the phase-out of the credit.
- Reduce the restrictions for equitable innocent spouse relief effective from passage.
- Require employers to file with the Commissioner the report that they are required to provide to their employees showing wages, amounts withheld, and any other information proscribed by the Commissioner.
- SB 1502 provides that interest shall not accrue on the underpayment of estimated tax to the extent the underpayment was created by the changes in HB 7061.

Changes to the Connecticut Sales and Use Tax

HB 7061 and SB 1502 make the following changes to the sales and use tax:

- Limit the sales tax holiday in the 3rd week of August to clothing and footwear under \$100 (previously \$300). This change is effective July 1, 2015.
- Raise the luxury sales and use tax rate from 7 percent to 7.75 percent on: (a) motor vehicles over \$50,000, (b) jewelry over \$5,000, and (c) clothing and footwear over \$1,000. This change is effective July 1, 2015.
- Extend the definition of computer and data processing to include services rendered in connection with the creation, development, hosting, and maintenance of an Internet website, effective October 1, 2015. HB 7061 had included a phased-in increase in the tax rate on computer and data processing services from 1 percent to 3 percent, but SB 1502 repealed that increase and, therefore, the tax rate remains at 1 percent. HB 7061 had also included an exemption from sales and use tax for sales of computer and data processing services between affiliates, but SB 1502 repealed that exemption.
- Expand the sales tax to some parking services sold by certain government or tax exempt entities effective July 1, 2015. HB 7061 had extended the sales tax to some parking services sold by an employer to its employees, but SB 1502 repealed that extension.
- Extend the sales and use tax to car wash services. This change is effective July 1, 2015.
- Clarify that the nursing home exemption does not include taxable sales of parking. This change is effective July 1, 2015.
- Change the date when the sales tax is due and payable to the Commissioner from the 20th day of the succeeding month to the last day of the succeeding month effective for periods ending on or after December 31, 2015.

Changes to the Connecticut Insurance Premium Tax

HB 7061 and SB 1502 make the following changes to the insurance premium tax:

- Extend the current limitation for tax credits through 2016. Tax credits are limited to 30 percent, 55 percent, or 70 percent of the amount of tax due, depending on the type of tax credit.
- Rename the Insurance Reinvestment Fund tax credit as the "Invest CT Fund" tax credit and expand the credit to apply to investments in cybersecurity businesses and businesses located in municipalities with a population greater than 80,000. The aggregate amount of tax credits available is increased to \$350 million. These changes are effective July 15, 2015.

Changes to the Connecticut Hospital Gross Receipts Tax

HB 7061 and SB 1502 make the following changes to the hospital gross receipts tax:

- Limit the application of tax credits to 50.01 percent of the amount of tax due for quarters on or after July 1, 2015.
- Apply a new gross receipts tax to ambulatory surgical centers effective October 1, 2015. This new tax will be imposed quarterly with exemptions for the first \$1 million in gross receipts per fiscal year and for amounts that are otherwise already subject to the hospital gross receipts tax.

Changes to the Connecticut Estate and Gift Tax

HB 7061 and SB 1502 make the following changes to the estate and gift tax:

- Limit the amount of Connecticut estate tax for both residents and nonresidents to \$20 million after allowing for a credit for Connecticut gift taxes paid by the decedent or the decedent's spouse for deaths occurring on or after January 1, 2016.
- Limit the aggregate amount of gift tax to \$20 million for all years after January 1, 2016.

Changes to the Connecticut Cigarette Tax

HB 7061 and SB 1502 make the following changes to the cigarette tax:

- Increase the cigarette tax to 182.5 mills per cigarette effective October 1, 2015.
- Increase the cigarette tax to 195 mills per cigarette effective July 1, 2016.
- Impose a cigarette excise floor tax at 12.5 mills per cigarette on distributors and dealers on September 30, 2015 at 11:59 p.m., and then again on June 30, 2016 at 11:59 p.m.

Changes to the Connecticut Admission Tax

HB 7061 and SB 1502 exempt from tax admission charges to athletic events presented by a member of the Atlantic Professional Baseball League at Harbor Yard in Bridgeport from July 1, 2015 to June 30, 2017.

Administrative changes

HB 7061 and SB 1502 make the following changes to Connecticut's administrative tax laws:

- Require the Commissioner to post on the Department of Revenue Services' website—by February 15, 2017, and biennially thereafter—a tax incidence report covering personal income tax, sales and use tax, corporation business tax, and property tax.
- Allow the Commissioner to release administrative pronouncements without prior presentation to the legislative regulation review committee. This change is effective from passage.

ASC 740

The income tax law changes discussed in this Tax Alert were enacted on June 30, 2015. Accordingly, any impact of these law changes should be treated as a second-quarter event for financial statement purposes for calendar year taxpayers.

Considerations

Taxpayers subject to the Connecticut corporation business tax should consider these significant changes to the Connecticut tax law.

The increase in the highest marginal personal income tax rate also applies for purposes of the Connecticut composite tax on passthrough entities. In addition, employers may be required to adjust the personal income tax withheld from high-income employees.

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