

Connecticut Enacts Broad Tax Changes During 2019 Legislative Session

Overview

On June 26, 2019, Governor Ned Lamont signed House Bill 7424 (H.B. 7424),¹ which makes certain modifications to Connecticut's tax laws including:

- Phases out the capital base tax over four years and extends the corporate income tax surcharge (10%) for two additional years.
- Reduces the annual utilization limits for certain credits against the corporation business tax.
- Reduces the value of a member's refundable income tax credit for its share of pass-through entity taxes paid.
- Repeals the \$250 biennial business entity tax.
- Increases the sales tax rate on certain electronically delivered products and provides a "business use" exemption for certain software purchases. Lowers the sales tax economic nexus threshold.

The governor also signed House Bill 7373 (H.B. 7373) and Senate Bill 72 (S.B. 72), which include:

- Changes to the pass-through entity tax, including expanding the tax base to include guaranteed payments and updating the language controlling a nonresident partner's obligation to file an individual return.²
- A new corporate tax credit for payments made by businesses for student loans issued to employees.³

This Tax Alert provides a high-level summary of these Bills. The tax law changes are effective for various periods as discussed in the Alert.

Changes in Corporate Provisions

H.B. 7424 implements a number of changes in tax laws relating to corporations for tax years beginning on or after January 1, 2019, unless otherwise noted. These changes include:

- **Capital base tax phase out**—Beginning in 2021, H.B. 7424 phases-out the alternative minimum tax on capital over four years.⁴
- **Extends the corporate tax surcharge**—H.B. 7424 extends the 10% corporation business tax surcharge through tax years beginning prior to January 1, 2021.⁵ The capital base tax surcharge is similarly extended.⁶ No estimated payments are required for the surcharge amount due for tax years commencing on or before H.B. 7424's date of passage.⁷
- **Reduced tax credit cap**—H.B. 7424 reduces, from 70% to 50.01%, the amount by which a company may reduce its tax liability using R&D and Urban Reinvestment Act (URA) credits.⁸

¹ 2019 Conn. Pub. Act No. 19-117; H.B. 7424, 2019 Gen. Assemb., Reg. Sess. (Conn., June 26, 2019); available [here](#).

² 2019 Conn. Pub. Act No. 19-186; H.B. 7373, 2019 Gen. Assemb., Reg. Sess. (Conn., July 8, 2019); available [here](#).

³ 2019 Conn. Pub. Act No. 19-86; S.B. 72, 2019 Gen. Assemb., Reg. Sess. (Conn., June 28, 2019); available [here](#).

⁴ H.B. 7424, Sec. 340, amending Conn. Gen. Stat. § 12-219(a)(1). The capital base tax rate is 0.31% for income years commencing prior to January 1, 2021. The rate decreases to 0.26% in 2021, 0.21% in 2022, 0.11% in 2023, and zero beginning in 2024.

⁵ H.B. 7424, Sec. 341, amending Conn. Gen. Stat. § 12-214(b)(8)(A). The nominal corporation business tax rate is 7.5%, resulting in an effective tax rate of 8.25%.

⁶ H.B. 7424, Sec. 342, amending Conn. Gen. Stat. § 12-219(b)(8)(A).

⁷ H.B. 7424, Sec. 343.

⁸ H.B. 7424, Sec. 349, eliminating Conn. Gen. Stat. § 12-217zz(a)(3)(D).

Changes in Pass-through Entities Provisions

H.B. 7424 and H.B. 7373 provide certain changes to the pass-through entity tax (PET), which are generally applicable for tax years beginning on or after January 1, 2019, unless otherwise noted:

- **Reduces tax credit for PET payments**— H.B. 7424 reduces the PET tax credit from 93.01% to 87.5% that passes through to members based upon such member's share of taxes paid by the pass-through entity.⁹ For income tax years commencing on or before June 26, 2019, the bill waives penalties and interest on additional taxes owed as a result of the passage of this provision.¹⁰
- **Other changes to the PET**— H.B. 7373 makes these additional changes to the PET:
 - Exempts nonresident, individual members from filing a Connecticut individual income tax return provided such member's individual tax liability would be satisfied by the PET tax credit allowed to such member.¹¹
 - Expands the PET base to include guaranteed payments.¹²
 - Excludes from the PET base any item treated as an itemized deduction for federal income tax purposes.¹³
 - Exempts entities with less than \$1,000 in annual PET liabilities from the requirement to make estimated payments.¹⁴
- For tax years commencing on or after January 1, 2020, H.B. 7424 repeals the \$250 business entity tax.¹⁵ Beginning July 1, 2020, the bill increases, from \$20 to \$80, the fee that foreign and domestic limited partnerships, LLCs, and LLPs pay for filing an annual report with the Secretary of State.¹⁶

Changes in Individual Angel Investor Credit

For tax years commencing on or after January 1, 2019, H.B. 7424 increases the maximum total tax credit allowed to any angel investor in a single year from \$250,000 to \$500,000.¹⁷ The bill also extends the credit program to July 1, 2024.¹⁸

Changes to Connecticut Sales and Use Tax

The legislation also contains a number of changes that impact sales and use tax, generally applicable for sales occurring on or after October 1, 2019 (unless otherwise noted), including the following:

- **Expanded sales tax economic nexus**—Effective July 1, 2019, H.B. 7424 imposes the following changes on out-of-state retailers:
 - Lowers the economic nexus threshold to 200 transactions and \$100,000 of annual gross receipts.¹⁹
 - Eliminates the condition that out-of-state retailers be "regularly or systematically" soliciting sales.²⁰
- **Increases tax rate on certain electronically delivered products**—H.B. 7424 increases, from 1% to 6.35%,²¹ the sales and use tax rate on:
 - "Digital goods,"²² which are defined as "audio works, visual works, audio-visual works, reading materials or ring tones, which are electronically accessed or transferred."²³

⁹ H.B. 7424, Sec. 333, amending Conn. Gen. Stat. § 12-699(g)(1).

¹⁰ H.B. 7424, Sec. 334.

¹¹ H.B. 7373, Sec. 1, amending Conn. Gen. Stat. § 12-699(e). The previous statutory language exempted such members from filing provided the pass-through entity filed and paid the PET. The state has not provided guidance on whether the 2019 changes to the PET will result in additional tax liability and filing obligations for nonresident, individual members.

¹² H.B. 7373, Sec. 1, amending Conn. Gen. Stat. § 12-699(c). Applies to both the standard and alternative base methods.

¹³ *Id.*

¹⁴ H.B. 7373, Sec. 2, amending Conn. Gen. Stat. § 12-699a(b)(1).

¹⁵ H.B. 7424, Sec. 338, amending Conn. Gen. Stat. § 12-284b(b).

¹⁶ H.B. 7424, Sec. 344, amending Conn. Gen. Stat. § 34-38n(a).

¹⁷ H.B. 7424, Sec. 347, amending Conn. Gen. Stat. § 12-704d(b).

¹⁸ *Id.*, amending Conn. Gen. Stat. § 12-704d(e)(1).

¹⁹ H.B. 7424, Sec. 327, amending Conn. Gen. Stat. § 12-408(a)(12)(G), (L); H.B. 7424, Sec. 328, amending Conn. Gen. Stat. § 12-407(a)(15)(A)(v), (x).

²⁰ H.B. 7424, Sec. 327, amending Conn. Gen. Stat. § 12-408(a)(12)(G); H.B. 7424, Sec. 328, amending Conn. Gen. Stat. § 12-407(a)(15)(A)(v).

²¹ H.B. 7424, Sec. 318, amending Conn. Gen. Stat. § 12-411(1)(A).

²² H.B. 7424, Sec. 319, amending Conn. Gen. Stat. § 12-407(a)(13). See also H.B. 7424, Sec. 322, amending Conn. Gen. Stat. § 12-407(a)(37)(A), excluding "digital goods" from computer and data processing services.

²³ H.B. 7424, Sec. 320, adding Conn. Gen. Stat. § 12-407(a)(43).

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- Canned or prewritten software that is electronically accessed or transferred and any additional content related to such software.²⁴ The bill excludes from the definition of “tangible personal property” such software purchased by a business for use by such business.²⁵
- **Establishes resale exemptions for certain transactions**—H.B. 7424 establishes conditions under which certain sales of canned or prewritten software, digital goods, and taxable services are considered exempt “sales for resale.”²⁶

Changes to Real Property Tax and Related Conveyance Taxes

Applicable to conveyances of residential properties occurring on or after July 1, 2020, H.B. 7424 increases, from 1.25% to 2.25%, the real estate conveyance tax rate on the portion of the sales price that exceeds \$2.5 million.²⁷ For tax years beginning on or after January 2021, taxpayers who paid conveyance tax at the new rate may calculate their property tax credit against the income tax based on the amount paid in conveyance tax over a three-year period, beginning in the third year after the conveyance tax was paid.²⁸

New Corporate Tax Credit for Student Loan Payments

Applicable for tax years commencing on or after January 1, 2022, S.B. 72 authorizes a 50% tax credit for payments made by businesses for student loans issued to certain employees of their business.²⁹ The credit can be used to offset taxes on corporate income, insurance premiums, and hospitals.

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²⁴ H.B. 7424, Sec. 319, amending Conn. Gen. Stat. § 12-407(a)(13). H.B. 7424 does not alter Connecticut’s historical treatment of physically purchased canned or prewritten software as tangible personal property subject to the 6.35% sales and use tax rate. See Connecticut State Department of Revenue Services, *Policy Statement 2006(8) Sales and Use Taxes on Computer-Related Services and Sales of Tangible Personal Property* (Mar. 23, 2007).

²⁵ *Id.*

²⁶ H.B. 7424, Sec. 321, adding Conn. Gen. Stat. § 12-410(5)(C), (D), (E).

²⁷ H.B. 7424, Sec. 337, adding Conn. Gen. Stat. § 12-494(b)(2)(C).

²⁸ H.B. 7424, Sec. 335, amending Conn. Gen. Stat. § 12-704c(d).

²⁹ S.B. 72, Sec. 1.

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