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CONNECTICUT TAX DEVELOPMENTS

December 15, 2015
Updated December 29, 2015

in this issue

State and Local
Tax Practice Group

Alan E. Lieberman
alieberman@goodwin.com
(860) 251-5801

Louis B. Schatz
lschatz@goodwin.com
(860) 251-5838

Raymond J. Casella
rcasella@goodwin.com
(860) 251-5808

Ryan V. Leichsenring
rleichsenring@goodwin.com
(860) 251-5101

David O. Bigger
dbigger@goodwin.com
(860) 251-5203

Robert L. Day III
rday@goodwin.com
(860) 251-5602

www.shipmangoodwin.com

Connecticut Deficit Mitigation Package Contains Limited Tax Relief

On December 8, 2015, the Connecticut General Assembly adopted December Special Session, Public Act No. 15-1 (Senate Bill No. 1601) (the "Act"), which was signed into law by Governor Malloy on December 29, 2015. The Act reflects an attempt to address a projected budgetary shortfall for the current fiscal year and provide limited tax relief for the business community, which bore the brunt of the second largest tax increase in Connecticut history enacted earlier this year. This Tax Alert provides a brief summary of the tax law changes contained in the Act. Unless otherwise stated, the following tax law changes, should the Act become law, are effective for tax periods beginning on or after January 1, 2016. For a summary of the most significant 2015 Connecticut tax developments, including legislation, administrative pronouncements and case decisions, click here [http://www.shipmangoodwin.com/files/33679_CT_Tax_Developments_2015.pdf].

I. Corporation Business Tax

A. **Combined Unitary Reporting.** The Act makes numerous substantive and clarifying changes to the statutory provisions enacted earlier this year that impose mandatory combined unitary reporting for tax years commencing on or after January 1, 2016.

- **New Aggregate Maximum Tax Liability.** The Act provides that the tax calculated for a combined group on a combined unitary basis, prior to the surtax and the application of credits, may not exceed its "nexus combined base tax" by more than $2.5 million. The "nexus combined base tax" is the tax measured on the sum of the separate net income or loss (or the minimum tax base) of each taxable member of the combined group as if such members were not required to file a combined unitary tax return (with intercorporate dividends and stockholdings eliminated and certain other adjustments). [Ed. note. While the purported cap on the potential increase that large taxpayers will incur under the new combined reporting regime is welcome relief: (i) these taxpayers will be required to prepare essentially two tax return calculations; and (ii) the cap is *prior* to the application of the current 20% surtax and the application of credits.]

- **Tax Havens.** The Act retains the definition of what constitutes a "tax haven" for purposes of determining whether a foreign member incorporated in a tax haven must be included in a combined unitary return, but repeals the requirement that the Commissioner publish a list of tax havens. Rather, the Act adopts the rule that a "tax haven" does not include a jurisdiction that has entered into a comprehensive tax treaty with the United States that the Secretary of the Treasury has determined is satisfactory for purposes of I.R.C. § 1(h)(11)(C)(i)(II). [Ed. note. A list of these jurisdictions can be found in IRS Publication 17.]

- **Principles of Consolidated Return Regulations**. The Act clarifies that the principles of the federal consolidated return regulations promulgated under Section 1502 of the Internal Revenue Code of 1986, as amended, including those relating to deferrals, eliminations and exclusions, are to apply "to the extent consistent" with the Connecticut combined group membership and combined unitary reporting principles.

- **Combined Group Membership**. The Act repeals the requirement that a combined group filing on a "water's-edge basis" must include any member that earns more than 20% of its gross income, directly or indirectly, from intangible property or service-related activities, the costs of which generally are deductible for federal income tax purposes against the income of other members of the group.

- **Financial Service Companies**. The Act makes several clarifications consistent with the current Connecticut tax treatment of financial service companies, including the rules governing when these taxpayers may apportion their income and how these taxpayers are to calculate their additional tax liability under the capital base tax provisions.

- **Investment Partnerships**. The Act clarifies that the rules governing the application of the Connecticut Corporation Business Tax to income derived by a limited partner from an investment partnership remains the same under the combined unitary reporting rules unless the limited partner and the general partner of the investment partnership have common ownership.

B. Single-Factor Apportionment. Effective for income years commencing on or after January 1, 2016, the general formula for the apportionment of the net income of a corporate taxpayer taxable in Connecticut and elsewhere has been changed from a three-factor formula (property, payroll and double-weighted gross receipts) to a single-factor formula based solely on the taxpayer's gross receipts from sales or other sources. Manufacturers which derive a minimum of 75% of their gross receipts from the direct or indirect sale of tangible personal property to the United States government may continue to elect to use the old three-factor formula. The existing special apportionment formulae for manufacturers, financial service companies, broadcasters and other taxpayers remain unchanged.

C. Limitation on Tax Credits. As part of the biennial budget legislation enacted earlier this year, the General Assembly further limited the amount of tax credit or credits otherwise allowable against the Connecticut Corporation Business Tax due for an income year to not more than 50.01% (formerly 70%) of the amount of tax due for such income year prior to the application of such tax credits. The Act allows taxpayers to exceed this 50.01% limit according to the following schedule, but only by utilizing "excess credits" (i.e., research and experimental expenditure tax credits, rolling research and development expense tax credits, and urban and industrial site reinvestment program tax credits) that remain available after the application of the 50.01% limitation:

- For tax years beginning on or after January 1, 2015, but prior to January 1, 2016, tax credits and excess tax credits may offset no more than 50.01% of the tax due for the income year.

- For tax years beginning on or after January 1, 2016, but prior to January 1, 2017, tax credits and excess tax credits may offset no more than 55% of the tax due for the income year.

- For tax years beginning on or after January 1, 2017, but prior to January 1, 2018, tax credits and excess tax credits may offset no more than 60% of the tax due for the income year.

- For tax years beginning on or after January 1, 2018, but prior to January 1, 2019, tax credits and excess tax credits may offset no more than 65% of the tax due for the income year.

- For tax years beginning on or after January 1, 2019, tax credits and excess tax credits may offset no more than 70% of the tax due for the income year.

D. **Enterprise Zone Tax Credit.** Currently, there is a credit for a “qualifying corporation” that is created in an enterprise zone and that employs a required number of Workforce Investment Act (WIA)-eligible residents of the enterprise zone. Effective for taxable years commencing on or after January 1, 2017, the Act lowers the number of WIA-eligible residents of the enterprise zone that need to be employed by a “qualifying corporation” that is primarily engaged in bioscience, clean technology or cybersecurity technology and that is created on or after July 1, 2015 in an enterprise zone.

E. **Net Operating Loss (NOL) Carry-Overs.** As part of the budget legislation enacted earlier this year, effective for tax years beginning on or after January 1, 2015, a corporation generally is now limited in its utilization of NOL carry-overs to 50% of its net income in any taxable year. An exception to this rule was adopted, however, if a combined group has greater than $6 billion in Connecticut NOL carry-overs from tax years beginning before January 1, 2013, and the combined group, or any member thereof on behalf of the combined group, elects to relinquish 50% of its unused NOLs from tax years prior to the tax year commencing on or after January 1, 2015, and before January 1, 2016. If such an election is made, the combined group may use the remaining NOL carry-over to reduce the combined group’s tax, prior to surtax and prior to the application of credits, to $2.5 million. Such an election must be made on the tax return for the tax year which begins on or after January 1, 2015, and before January 1, 2016. NOLs generated in tax years beginning on or after January 1, 2015 are subject to the general limitation that they may only be used to offset up to 50% of the taxable income of a taxpayer.

II. Personal Income Tax

A. **Nonresident Personal Services.** In general, compensation for personal services provided in Connecticut by a nonresident employee is subject to tax in Connecticut. The Act adopts a new exclusion for nonresident income for personal services rendered in Connecticut when the nonresident employee spends no more than 15 full or partial days in Connecticut during a calendar year. If, however, the nonresident employee is in Connecticut for more than 15 days during a calendar year, then the nonresident employee must pay Connecticut income taxes on the total compensation received for rendering services in the state (and the employer must withhold and remit Connecticut tax). The new limited exclusion does not apply to other sources of income the taxpayer may have from a business, trade, profession or occupation carried on in Connecticut, or to sources of income derived by an athlete, entertainer or performing artist.

III. Sales and Use Tax

A. **Weatherization Products/Fluorescent Light Bulbs.** The Act repeals the sales and use tax exemption for residential weatherization products and compact fluorescent light bulbs. Residential weatherization products are currently defined as: (i) programmable thermostats; (ii) window film, caulking, and window and door weather strips; (iii) insulation; (iv) water heaters and water heater blankets; (v) natural gas and propane furnaces and boilers that meet the federal Energy Star standard; (vi) windows and doors that meet the federal Energy Star standard; (vii) oil furnaces and boilers that are at least 84% energy efficient; and (viii) ground-source heat pumps that meet the minimum federal energy efficiency rating.

One Constitution Plaza
Hartford, CT 06103-1919
860-251-5000

300 Atlantic Street
Stamford, CT 06901-3522
203-324-8100

265 Church Street - Suite 1207
New Haven, CT 06510-7013
203-836-2801

289 Greenwich Avenue
Greenwich, CT 06830-6595
203-869-5600

1875 K St., NW - Suite 600
Washington, DC 20006-1251
202-469-7750

www.shipmangoodwin.com

IV. Property Tax

A. Enterprise Zone Optional Tax Relief Program. The Act authorizes any of the 17 Connecticut municipalities with a state-designated enterprise zone to establish a local property tax relief program for qualifying commercial and industrial property owners. The relief program potentially would both (i) reduce the assessment of an improvement to commercial or industrial property that would otherwise result in a minimum of a $10,000 increased assessment from the October 1, 2014 assessment year, and (ii) allow for any increase in tax revenue attributable to the improvement to be allocated to reduce the assessments and total tax imposed on commercial and industrial properties located within the municipality.

V. Miscellaneous Taxes

A. Hospitals Tax and Ambulatory Surgical Centers Tax - Tax Credits.

- Under legislation enacted earlier this year, the General Assembly limited the amount of tax credits that a hospital can utilize to not more than 50.01% of the amount of Hospitals Tax due for any calendar quarter. The Act raises this cap to 55% in 2016, and then an additional 5% per year for each year thereafter until the cap reaches 70% in 2019.

- The Act also allows ambulatory surgical centers to offset the Ambulatory Surgical Center Tax with tax credits in the same manner, and subject to the same limitation, as a hospital subject to the Hospitals Tax.

B. Sale of Petroleum Products Gross Earnings Tax. The Act broadens an existing exemption from the Petroleum Products Gross Earnings Tax for propane used *exclusively* for heating purposes to cover propane used *primarily* for heating purposes. The revised exemption is effective for first sales made on or after December 1, 2015.

C. Manufacturing Apprenticeship Tax Credits. Under current law, the tax credit for apprenticeship training in the manufacturing, construction and plastics-related trades is available to corporations and pass-through entities (such as S corporations and partnerships); however, pass-through entities generally cannot realize any benefit from such tax credits unless they are sold as they currently are only applicable against the Corporation Business Tax. Effective January 1, 2016, the Act allows these manufacturing apprenticeship tax credits to be used to offset taxes additionally under Chapter 212 and Chapter 227, the Utility Company Tax and the Sale of Petroleum Products Gross Earnings Tax, respectively.

Please contact any member of our State and Local Tax Practice Group if you have any questions regarding the new tax law changes or how they may affect you and your business.