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Connecticut Tax Alert

in this issue

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Governor’s Budget Provides for More Taxes for Everyone

Faced with a projected state budget deficit of approximately $3.7 billion for each of the next two fiscal years, Governor Dannel Malloy has submitted to the Connecticut General Assembly a biennial budget that is projected to increase state tax revenues by more than $1.5 billion for the 2012 fiscal year and by more than $1.3 billion for the 2013 fiscal year.

The tax law changes are significant and likely will affect every Connecticut taxpayer. This bulletin summarizes the principal tax law provisions as currently drafted. We recommend caution when planning for these changes, however, as they are part of a budget plan that relies upon the State’s ability to secure significant savings attributable to concessions from state employee unions. If these savings are not realized, further budget cuts and/or tax increases may be forthcoming. In addition, the Connecticut General Assembly may add to, reject or modify certain of the Governor’s proposals. Please contact a member of our State and Local Tax Practice Group listed to the left of this page if you have any questions regarding the Governor’s tax proposals or how they will affect you or your business.

INDIVIDUAL INCOME TAX

New and Increased Marginal Tax Rates. The current schedule of three marginal tax rates of 3.0%, 5.0% and 6.5% would be replaced, retroactively to January 1, 2011, with a schedule of eight marginal tax rates, including a top rate of 6.7%. The new rates for single taxpayers (including married individuals filing separately), joint filers and heads of households, and the income levels after which each rate would begin to apply, are as follows:

	3.0%	5.0%	5.5%	5.75%	6.0%	6.25%	6.5%	6.7%
Single	$0	$10,000	$50,000	$100,000	$200,000	$300,000	$400,000	$500,000
Joint	$0	$20,000	$100,000	$200,000	$400,000	$600,000	$800,000	$1,000,000
HOH	$0	$16,000	$80,000	$160,000	$320,000	$480,000	$640,000	$800,000

Phase Out of Lowest Marginal Tax Rate. The amount of a taxpayer's Connecticut taxable income that will be subject to the 3.0% tax rate will begin to phase out when the Connecticut adjusted gross income of the taxpayer exceeds $56,500 in the case of a single filer, $100,500 in the case of a joint filer, $78,500 in the case of a head of household filer, and $50,250 in the case of a married individual filing separately. Any amount of income subject to the phase-out, instead, will be subject to tax at the 5.0% rate.

Repeal of Property Tax Credit. The tax credit for property taxes paid with respect to a primary residence or motor vehicle, that currently can be up to $500, would be repealed.

Trusts and Estates. The tax rate applicable to the Connecticut taxable income of trusts and estates would be increased from 6.5% to 6.7% as of January 1, 2011.

Estimated Tax Payments. Taxpayers would be permitted to make a catch-up estimated tax payment in June to account for any change in the rate of tax applicable to their 2011 Connecticut taxable income.

Income Tax Withholding. The Department of Revenue Services would issue new withholding tables for 2011 Connecticut income tax withholding to account for the new and increased marginal tax rates.

Nonresident Partner/Member/Shareholder Withholding. Since the required rate of withholding on the Connecticut source income of nonresident partners of a partnership, members of a limited liability company and shareholders of a Subchapter S corporation is the highest income tax rate, the new marginal tax rate schedule would increase the rate of withholding from 6.5% to 6.7%.

Earned Income Tax Credit. Effective January 1, 2011, a Connecticut resident subject to the Connecticut personal income tax generally would be entitled to claim a tax credit against the taxpayer's Connecticut tax equal to 30% of the amount of the taxpayer's federal earned income credit. The credit would be refundable to the extent that the credit exceeds the taxpayer's liability for Connecticut income tax.

CORPORATION BUSINESS TAX

Surcharge Continued for Two Years. The current 10% surcharge on the corporation business tax, that currently is applicable to income years commencing prior to January 1, 2012, would be extended for two additional years, through income years commencing prior to January 1, 2014. The surcharge is calculated based upon the tax liability of the Subchapter C corporation, excluding any credits, whether calculated based upon the corporation's net income or capital base, and is imposed on the corporation unless either (i) the tax liability of the corporation is equal to $250 (i.e. the minimum tax) or (ii) the gross income of the corporation is less than $100 million. The $100 million gross income exemption is not available to a corporation that files a combined or unitary return.

Throwback Rule. Applicable to income years commencing on or after January 1, 2011, a corporation that sells tangible personal property outside of Connecticut and apportions its multi-state income employing the standard three-factor apportionment formula or the special single-factor apportionment formula for manufacturers would have to include, as Connecticut source receipts, receipts from sales to the federal government or from sales to customers in states in which the taxpayer is not taxable. [Ed. note. By apportioning to Connecticut out-of-state sales without accounting for out-of-state personnel or facilities, this statutory change would effectively place many Connecticut manufacturers in a worse position than before the single-factor apportionment formula was adopted. As a result, the proposed tax law change could act as a significant disincentive for manufacturers to remain in, or relocate to, Connecticut.]

TAX CREDITS

Seventy Percent Cap Relief. Under current law, the amount of tax credit or credits allowable against the corporation business tax or the insurance premium/subscriber charge tax generally cannot exceed 70% of the amount of tax due. The Governor's proposed legislation would permit a taxpayer to exceed the 70% cap by an amount equal to $6,000 multiplied by the taxpayer's "average monthly net employee gain" for the year. In the case of a taxpayer subject to the corporation business tax, the cap relief would be available for an income year commencing on or after January 1, 2011, and prior to January 1, 2013, and would be based upon the average monthly net employee gain for the income year. In the case of a taxpayer subject to the insurance premium/subscriber charge tax, the 70% cap limit would be applied on a calendar year basis, and the cap relief would be available during, and based upon the average monthly net employee gain for, the 2011 and 2012 calendar years. Please note that the total credits allowed may not exceed the total tax liability of the taxpayer. In addition, only employees who work more than 35 hours and who were not employed in Connecticut by a related party will be counted to determine whether there has been a "net employee gain."

Film Production Tax Credit. The ability of a taxpayer to transfer film production tax credits will be limited if the transferring taxpayer is neither subject to the corporation business tax nor to the insurance premium/subscriber charge tax (e.g., a partnership that is subject to neither tax). The limitation would prevent such a taxpayer from transferring more than 50% of its film production tax credits in any one year in the case of credits allowed for the 2011 income year, and more than 25% of any such credits in any one year in the case of a credit allowed for any subsequent year.

Job Creation Tax Credit Programs. Effective July 1, 2011, the aggregate limit on tax credits granted under the jobs creation tax credit program, the qualified small business job creation tax program and the vocational rehabilitation job creation tax credit program would be increased from $11 million to $20 million in any one fiscal year.

Urban and Industrial Site Reinvestment Program. Effective July 1, 2011, the sum of all tax credits granted pursuant to the program would be increased from $500 million to $750 million.

SALES AND USE TAX

Rate Increases. The Governor's budget proposal would increase the base sales tax rates and add a new "municipal" sales and use tax on top of these increases:

- General Sales and Use Tax Rate. The general sales and use tax rate would be increased from 6.0% to 6.25% for sales occurring on or after July 1, 2011.

- Room Occupancy Tax Rate. The room occupancy tax rate would be increased from 12% to 14% as of July 1, 2011.

- Motor Vehicle Rental Tax Rate. As of July 1, 2011, the sales and use tax rate for the rental or leasing of a passenger motor vehicle for a period of 30 days or less would be increased from 6.0% to 8.25%.

- Luxury Item Sales and Use Tax Rate. Commencing July 1, 2011, the sale of the following "luxury" items would be subject to a two-tier tax: 6.25% on the portion of the sales price up to a statutory threshold, and 9.25% on the portion of the sales price in excess of the statutory threshold. The "luxury" items and the statutory threshold for each are as follows: a passenger vehicle or truck with a sales price exceeding $50,000; a vessel with a sales price exceeding $100,000; jewelry with a sales price exceeding $5,000; and an article of clothing or footwear, a handbag, luggage, umbrella, wallet or watch for a sales price exceeding $1,000.

- "Municipal" Sales and Use Tax. The Governor's budget plan would create an additional tax that would be collected by the State and then disbursed by the State to the municipality where the sale giving rise to the taxes occurred. The additional tax would be as follows:

  - Sales of tangible personal property or services by a "described retailer" would be subject to an additional tax of 0.10% (thereby increasing the effective sales and use tax rate to 6.35%, or 9.35% in the case of luxury items to the extent over the statutory threshold). A "described retailer" is a retailer who is primarily engaged in activities included in Sector 44 or 45 of the North American Industrial Classification System (i.e., general retailers, such as automobiles and parts dealers, furniture and home furnishings stores, electronics and appliance stores, building material and garden equipment stores, food and beverage stores, gasoline stations, clothing stores, sporting goods stores, general merchandise stores, etc.).

  - The room occupancy tax would be subject to an additional tax of 1.0% (thereby increasing the effective room occupancy tax to 15%).

  - The rental or leasing of a passenger motor vehicle for a period of 30 consecutive days or less would be subject to an additional tax of 1.0% (thereby increasing the effective tax rate to 9.25%).

Repeal of Credit for Trade-Ins. The ability of a retailer to exclude from the reported sales price of tangible personal property (such as a motor vehicle or construction equipment or machines) the amount of credit given for a trade-in of similar property is repealed effective for sales occurring on or after July 1, 2011, such that the purchaser will be required to pay sales tax on the gross purchase price. Similarly, the sales price of any new or manufactured part will not be reduced by the trade-in of a core component or core part of such property.

Repeal of Credit for Coupons. Effective July 1, 2011, when calculating sales tax on the sale of an item of tangible personal property, a retailer will no longer be able to deduct from the amount of the reported sales price the amount of any coupon accepted by the retailer, even though the coupon is accepted and applied against the sales price.

Numerous Sales Tax Exemptions Repealed. The following exemptions from the Connecticut sales and use tax would be repealed, thereby rendering sales or use of these services or property subject to sales tax effective for sales occurring on or after July 1, 2011:

- Dry or wet storage or mooring of any noncommercial vessel
- Voluntary evaluation, prevention, treatment, containment or removal of hazardous waste or other contaminants of air, water or soil when rendered to industrial, commercial or income-producing property
- Valet parking provided at any airport
- Yoga instruction provided at a yoga studio
- Aircraft repair services on aircraft having a maximum certificated takeoff weight of less than 6,000 pounds
- Articles of clothing or footwear costing under $50 (thereby rendering clothing and footwear generally subject to tax)
- Nonprescription drugs and medicines
- Cloth or fabric purchased for noncommercial sewing
- Services or tangible personal property used or consumed in operating solid waste-to-energy facilities
- Yarn for noncommercial use
- Products that aid in the cessation of smoking

New Taxable Services. The following new services would be subject to the sales and use tax effective July 1, 2011:

- Motor vehicle storage services (including motor homes, campers and camp trailers)
- Packing and crating services

- Motor vehicle washing, waxing and detailing services
- Motor vehicle towing and road services
- Intrastate transportation services provided by livery services (but not including transportation by taxicab, motorbus, ambulance or ambulette, scheduled public transportation or services provided in connection with funerals)
- Barber and beauty shop services
- Noncommercial vessel repair, maintenance and cleaning services
- Pet grooming and pet boarding services, except when such services are provided as an integral part of professional veterinary services, and pet obedience services
- Services in connection with a cosmetic medical procedure (N.B. Reconstructive surgery is expressly excluded from the definition of "cosmetic medical procedures.")
- Manicure and pedicure services

Sales Tax Free Week Repealed. The sales tax holiday for one week in August, when taxpayers can purchase clothing and footwear worth less than $300 without paying tax, would be repealed.

MUNICIPAL PROPERTY TAX

Aircraft and Vessels. Aircraft registered as required by the Department of Transportation would now be subject to property taxation, and the Commissioner of Transportation would be required to publish and distribute a list of values of aircraft set in the list of each municipality. Similarly, vessels required to be registered with the Department of Motor Vehicles (watercraft, other than seaplanes) would now be subject to property taxation and the Commissioner of Motor Vehicles would be required to publish and distribute a list of values of vessels set in the list of each municipality. The exemptions for aircraft and vessels (other than certain commercial fishing vessels) would be repealed and the PILOT program for vessels would be discontinued. The mill rate for aircraft and vessels would be set at 20 mills; accordingly, the amount of property tax due would be 70% of the value of the aircraft or vessel multiplied by 2%.

Manufacturing Machinery and Equipment. The State would cease to make PILOT payments related to the property tax exemption for manufacturing machinery and equipment and, accordingly, the State's involvement in the exemption process and setting of depreciation schedules would cease.

Certain Vehicles Used to Transport Freight for Hire. The limited exemption for these vehicles would be repealed, permitting municipalities to tax these vehicles.

ESTATE AND GIFT TAXES

Taxable Estate Threshold. Effective for the estates of decedents dying on or after January 1, 2011, the taxable estate threshold would be lowered from $3.5 million to $2.0 million, thereby increasing the tax on all estates in excess of that threshhold.

Taxable Gift Threshold. Effective for Connecticut taxable gifts made by a donor commencing on or after January 1, 2011, including the aggregate amounts of all Connecticut taxable gifts made by the donor during all calendar years commencing on or after January 1, 2005, the taxable threshold would be lowered from $3.5 million to $2.0 million.

MISCELLANEOUS TAXES

Hospital Provider Tax. Effective July 1, 2011, each hospital in Connecticut will be required to pay a tax on its net patient revenue each calendar quarter at the maximum rate allowed under federal law. "Net patient revenue" is defined as the hospital's gross revenue excluding the amount received by the hospital from the federal government for Medicare patients. According to the State, the hospital provider tax rate would be 5.5% from July 1, 2011 until September 30, 2011, and 5.71% thereafter. In the case of a delinquency, the Commissioner of Social Services can deduct and withhold the delinquent amount from amounts otherwise payable by the Department of Social Services to the hospital. [Please note that the nursing home user fee also would be increased to the maximum allowed under federal law, which is to be 6.0% effective October 1, 2011.]

Real Estate Conveyance Tax. The "temporary" increase in the municipal portion of the real estate conveyance tax from 0.11% to 0.25% would be made permanent. In addition, the right of a municipality to elect to increase the municipal portion of the real estate conveyance tax by an additional 0.25%, which is currently available to only certain targeted investment communities, would be made available to all municipalities.

Insurance Premium/Subscriber Charge Tax. The tax on total net direct premiums or net direct subscriber charges would be increased from 1.75% to 1.95% effective January 1, 2011.

Cigarette and Tobacco Products Tax. The tax on each cigarette is increased from 150 mills to 170 mills (representing an increase from $3.00 to $3.40 per pack) effective July 1, 2011, with a floor tax of 20 mills per cigarette on a dealer's inventory as of the close of business on June 30, 2011. Also effective July 1, 2011, the tax on snuff is increased from 55 cents to one dollar per ounce. The tax on all other tobacco products, as of the same date, is increased from 27.5% to 50% of the wholesale sales price of such products.

Alcoholic Beverages Tax. Effective for sales occurring on or after July 1, 2011, the tax on alcoholic beverages is increased as follows: (i) beer, and cider containing not more than 7% of absolute alcohol: from $6.00 to $7.20 for each barrel; $3.00 to $3.60 for each half barrel; $1.50 to $1.80 for each quarter barrel; $0.20 to $0.24 for each wine gallon or fraction thereof; (ii) liquor: from $4.50 to $5.40 per wine gallon; (iii) still wines of not more than 21% absolute alcohol: from 60 cents to 72 cents per wine gallon; (iv) other still wines and sparkling wines: from $1.50 to $1.80 per wine gallon; (v) alcohol in excess of 100 proof: from $4.50 to $5.40 per proof gallon; (vi) liquor coolers containing not more than 7% alcohol: from $2.05 to $2.46 per wine gallon; and (vii) certain still wine produced by small producers: from 15 cents to 18 cents per wine gallon. A floor tax is imposed on alcohol inventories as of the effective date of the new tax rates.

Motor Vehicles Fuels Tax. Effective July 1, 2011, the rate of the motor vehicles fuels tax is increased to 28 cents per gallon for gasoline, gasohol and diesel fuel, and the tax is applied to liquefied natural gas, liquefied petroleum gas and compressed natural gas. A floor tax is imposed on inventories of gasoline, gasohol and diesel fuel as of the close of business on June 30, 2011.

Electric Generation Tax. Commencing July 1, 2011, a new tax would be imposed on any person providing electric generation services and uploading electricity generated at such person's electric generation facility in this state to the regional bulk power grid. The tax is the product of 0.20% multiplied by the net kilowatt hours of electricity generated by such person and uploaded to the regional bulk power grid. The tax does not apply to any net kilowatt hours of electricity generated exclusively through the use of fuel cells or an alternative energy system.

Admissions Tax Exemptions Repealed. Effective July 1, 2011, the exemption from the admissions tax would be repealed for any event held at a number of venues, including the Hartford Civic Center, New Britain Veterans Memorial Stadium, Bridgeport Harbor Yard Stadium, and Lime Rock Park.

Cabaret Tax. Effective July 1, 2011, a tax equal to 3% would be imposed on all amounts charged for admissions, food and drink, service or merchandise at any cabaret or similar place furnishing music (other than mechanical music alone or music by a single live performer), dancing privileges or any other entertainment for profit in connection with the serving of alcohol. The taxes collected by the State are to be disbursed to the municipality where the transactions occurred.

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Our State and Local Tax Practice

The attorneys in the **State and Local Taxation Practice** at Shipman & Goodwin LLP are regularly called upon to advise businesses, executives and individual clients on all aspects of state and local tax matters. Additionally, our tax lawyers represent clients in connection with state and local tax audits, refund requests and appeals from state or local assessments.

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