taxstringer
NYSSCPA'S ONLINE TAX PUBLICATION

Connecticut's Response to the Tax Cuts and Jobs Act of 2017 (Part II)

By: Louis B. Schatz, Esq.

Published Date: Mar 1, 2019

This article is the second in a two-part series about Connecticut's Response to the Tax Cuts and Jobs Act of 2017 (the "New Federal Tax Act"). To read the first part published in the February 2019 *TaxStringer*, which summarized the provisions of Connecticut's new pass-through entity tax, please click here. This second part of the series summarizes the remaining significant provisions of the new Connecticut legislation that was adopted in response to the New Federal Tax Act.

Federal Bonus Depreciation Decoupled.

The adoption of 100% bonus depreciation was one of the signature provisions of the New Federal Tax Act. However, the benefit of bonus depreciation in Connecticut has been muted. For Connecticut tax purposes, an individual subject to the Connecticut personal income tax is required to "add back" any additional allowance for federal bonus depreciation for property placed in service after September 27, 2017, when calculating Connecticut adjusted gross income.[1] However, 25% of the disallowed deduction may be deducted by the taxpayer on his or her Connecticut return for each of the four succeeding taxable years. It is interesting to note that Connecticut's decoupling provision is silent with regards to whether the taxpayer's basis in the asset for Connecticut tax purposes should be different than the basis for federal tax purposes to account for the delay in the depreciation deduction, an issue that will arise if that asset is sold prior to the end of the four years in which the depreciation deduction will be taken. Without a state basis adjustment, in the event of an asset sale, any gain recognized by the taxpayer for federal tax purposes will not be adjusted downward for Connecticut tax purposes to account for the depreciation deduction that has yet to be deducted by the taxpayer. Although the statute does not provide for a basis adjustment, under the statute, the taxpayer should apparently be able to continue to deduct the additional depreciation allowance until fully utilized.

The additional allowance for federal bonus depreciation continues to be disallowed for Connecticut corporation business tax purposes.

Example:

Assume sole proprietor A, a Connecticut resident, has a bonus depreciation deduction of $5,000 on his 2018 federal income tax return. A is required to report a bonus depreciation addition modification of $5,000 on Schedule 1, line 37 of his 2018 CT-1040. On his Connection returns for taxable years 2019, 2020, 2021 and 2022, A will report a subtraction modification of $1,250 for each of those years (25% of the $5,000 federal bonus deprecation deduction reported in 2018).

Federal Asset Expensing Under Internal Revenue Code §179 Decoupled

Another significant change adopted by the New Federal Tax Act was the increased benefits available for Internal Revenue Code Section 179 expensing. In Connecticut, for taxable years commencing on or after January 1, 2018, an individual subject to the Connecticut personal income tax is required, when calculating his or her Connecticut adjusted gross income, to "add back" 80% of any deduction that is claimed under the federal asset expensing rules of Internal Revenue Code §179 [2]. The taxpayer may, however, take 25% of the disallowed portion of the deduction over each of the next four succeeding income years (i.e., the taxpayer must take the deduction over five years at the rate of 20% each year).

Similarly, corporate taxpayers are also required to add back 80% of any asset expensing deduction claimed under Internal Revenue Code §179, effective for income years commencing on or after January 1, 2018. The corporate taxpayer may claim 25% of the disallowed portion of the deduction in each of the four succeeding income years (i.e., the corporate taxpayer must take the deduction over five years at the rate of 20% each year). [3]

New Federal 20% Deduction for Qualified Business Income

One of the more significant provisions of the New Federal Tax Act was the adoption of a 20% deduction for individuals receiving "qualified business income." Since this new federal deduction is a deduction that reduces taxable income, and not federal adjusted gross income, the deduction will have no impact on a taxpayer's Connecticut personal income tax liability, since the starting point for the Connecticut personal income tax is an individual's federal adjusted gross income.

Business Interest Expense

As part of the New Federal Tax Act, Code §163(j) was amended to limit the deductibility of business interest expenses. In general, the interest deduction is limited for a taxable year to an amount equal to 30% of the taxpayer's adjusted taxable income and business interest income. Connecticut has decoupled from these new federal interest deduction limitations for purposes of determining net income under the Connecticut corporation business tax. [4] Specifically, in determining net income for Connecticut corporation business tax purposes for income years commencing on or after January 1, 2018, the deduction allowed for business interest paid or accrued shall be determined as provided under the Internal Revenue Code, e xcept that in making such determination, the new interest deduction limitation provisions of Code §163(j) shall not apply.

State Contribution Deduction

The New Federal Tax Act amended Internal Revenue Code §118(b)(2) to generally require a corporation include in its gross income any capital contribution to the corporation made by a governmental entity or civic group (other than a contribution made by a shareholder as such). Connecticut has decoupled from this federal change [5]. Accordingly, in arriving at net income for corporate business tax purposes, there shall be deducted from net income the amount of any contribution made to the corporation, on or after December 23, 2017, by the State of Connecticut or a political subdivision thereof to the extent that such contribution was included in the taxpayer's gross income under Internal Revenue Code §118(b)(2).

Estate and Gift Tax Exemption

In 2017, Connecticut adopted legislation that would have phased in the threshold for the state estate and gift tax to meet the federal threshold over three years: $2.6 million in 2018, to $3.6 million in 2019, and equal to the federal basic exclusion amount in 2020 and thereafter. The New Federal Tax Act subsequently doubled the federal threshold (to $11.18 million in 2018, after adjusting for inflation). In response, Connecticut extended the period for the phase-in of the increase in the estate and gift tax threshold by setting the gift and estate tax threshold at $5.1 million for 2020, $7.1 million for 2021, $9.1 million for 2022, and the federal exclusion amount for 2023 and thereafter. Consistent with this approach, the threshold for filing an estate tax return only with the probate court, rather than with the Department of Revenue Services, is set at $5.1 million for deaths occurring during 2020, $7.1 million for deaths occurring during 2021, $9.1 million for deaths occurring during 2022, and the federal threshold for deaths occurring on or after January 1, 2023 [6].

Credit for Donations to Community Supporting Organizations

Effective July 1, 2018, Connecticut municipalities can provide a residential property tax credit for the following fiscal year in an amount not to exceed the lesser of (i) the amount of property tax owed, or (ii) 85% of the amount of voluntary, unrestricted and irrevocable cash donations made by or on behalf of the owner of a residential property located in the municipality to a "community supporting organization" during the calendar year preceding the year in which an application for the tax credit is filed [7].

If a municipality desires to provide such a credit against the municipal property tax, the municipality must designate a single community supporting organization to receive the cash donations that will qualify for the tax credit and then enter into an agreement with that organization that requires the organization to (i) accept only voluntary, unrestricted and irrevocable cash donations; (ii) provide, on or after July 1 but not later than July 31 of each fiscal year for which the tax credit has been approved, a grant to the municipality in an amount equal to all cash donations received during the prior fiscal year and a written statement setting forth certain information about each donor and donation; and (iii) provide a contemporaneous written receipt to the donor of the donation. The agreement also must compel the municipality to provide to the community supporting organization a written statement of the municipal programs and services supported by the grant, and to act as the administrative and fiscal agent for the organization. A taxpayer who has made a donation to the community supporting organization may file an application for the tax credit with the municipal tax collector on or after January 1 and prior to April 2 prior to the fiscal year for which the tax credit is claimed.

The creation of a credit against the municipal property tax represents an additional attempt to provide a work-around to the new federal income tax limitations on the deductibility of state and local taxes. However, in Notice 2018-54, the IRS cautioned taxpayers that federal law controls the proper characterization of payments, such as purported charitable contributions, for federal income tax purposes. The Treasury Department subsequently issued proposed regulations (REG-112176-18) in August, 2018 governing the availability of a charitable contribution deduction under Internal Revenue Code §170 when a taxpayer receives or expects to receive a corresponding state or local tax credit. As a result of the IRS's position on this issue, taxpayers should consult with their tax advisors before taking a deduction for any contribution to a community supporting organization on their federal income tax returns.

Qualified Opportunity Zones

The New Federal Tax Act allows states to nominate one or more low-income communities to be designated by the Secretary of the Treasury to be a "qualified opportunity zone." Taxpayers who invest in a qualified opportunity fund that makes investments in a qualified opportunity zone can qualify for certain federal tax benefits related to those investments. On May 18, 2018, then Governor Malloy announced that 72 opportunity zones, located in 27 municipalities across Connecticut, have received the required federal designation [8]. A link to a map showing Connecticut's Opportunity Zones can be found here.

State Tax Credit

Under current law, a resident or part-year resident is generally allowed a credit against the Connecticut income tax for taxes imposed on the taxpayer by another state or a political subdivision thereof, or the District of Columbia, on income derived from sources located in that jurisdiction. Effective for taxable years beginning on or after January 1, 2019, the law has been amended to provide that a comparable credit shall be allowed for any tax on wages that is paid to another taxing jurisdiction by the employer on behalf of the employee and that other taxing jurisdiction grants a credit for such tax [9]. This provision will provide Connecticut taxpayers a tax credit to the extent they are impacted by the optional new payroll tax in New York which is intended to provide a work-around to the new limitation on the federal deductibility of state and local taxes.

International Provisions of the New Federal Tax Act

Section 965 Repatriation Transition Tax

Pursuant to Internal Revenue Code §965, certain taxpayers with untaxed foreign earnings and profits were required to include their accumulated post-1986 deferred foreign income ("Section 965 income") in their Subpart F income (income from controlled foreign corporations) for the 2017 taxable year. Although federal law allows certain taxpayers to elect to defer payment of their federal repatriation transition tax, the election does not defer the timing for the recognition of the income, and Connecticut does not defer the payment of state tax on that income.

For federal income tax purposes, an individual is required to report the net Section 965 amount (the Section 965(a) amount reduced by the Section 965(c) deduction) as "Other Income" on Form 1040, page 1. Since the net Section 965 amount will be included in a taxpayer's federal adjusted gross income, and that is the starting point in determining the taxpayer's Connecticut income tax liability, a resident taxpayer is not required to report separately his or her Section 965 income on the Form CT-1040. A nonresident individual, however, who receives a Schedule CT K-1 from a pass-through entity or other information or documentation relating to Connecticut-sourced Section 965 income, must report the associated income and deductions on the appropriate lines on Schedule CT-SI, Nonresident or Part-Year Resident Schedule of Income from Connecticut Sources, and on Form CT-1040NR/PY. Individuals who were unable to timely pay their 2017 tax liability were given the opportunity to request a payment plan agreement [10].

The Section 965 income must be included on a taxpayer's Connecticut corporation business tax return for its last taxable year beginning before January 1, 2018. Since Section 965 income is treated as Subpart F income for federal tax purposes, and Connecticut treats Subpart F income as dividend income, Section 965 income is treated as dividend income for Connecticut tax purposes. Connecticut provides a dividend received deduction that fully offsets the dividend income that a corporation received from foreign corporations to the extent such income is not otherwise deducted. However, Connecticut does require a corporation to add back its expenses that are related to dividend income subject to the dividend received deduction. Pursuant to new legislation summarized below, the expenses related to dividends is deemed to be 5% of the dividend income.

Dividends Received Deduction

Under prior law, a corporate taxpayer was not allowed to deduct, for Connecticut corporation business tax purposes, expenses related to dividends that are allowable as a deduction or credit under the Internal Revenue Code. To resolve disputes regarding the amount of such expenses, effective for years beginning on or after January 1, 2017, expenses related to dividends shall be deemed to be equal to 5% of all dividends received by a company during an income year. The net income associated with the disallowance of expenses related to dividends shall be apportioned if the taxpayer conducts business within and outside Connecticut, or is otherwise required to apportion its income [11].

Global Intangible Low-Taxed Income

Under the New Federal Tax Act, certain United States taxpayers will be subject to tax on their global, intangible low-taxed income ("GILTI") for income years beginning on or after January 1, 2018. In Special Notice 2018(7), the Connecticut Department of Revenue Services (DRS) announced that Connecticut will treat GILTI as dividend income because "GILTI is treated in a manner similar to Subpart F income for federal tax purposes...." Since Connecticut provides a dividend received deduction that fully offsets the dividend income that a corporation receives from foreign corporations to the extent that income is not otherwise deducted, a corporation that is required to now include GILTI on its Connecticut corporation business tax return will be entitled to claim a deduction to fully offset that income. The Special Notice notes, and as discussed above, that the corporation will be required to add back 5% of the gross amount of the GILTI as attributable to non-deductible expenses that relate to this deemed dividend income.

There remain many unanswered questions regarding the new Connecticut provisions that have been described in this two- part series. Hopefully, additional guidance will be forthcoming from the DRS to address these issues. In addition, with a new Governor in place in Connecticut, and an estimated budget deficit of $1.7 billion, it is likely that there will be significant new Connecticut tax legislation in the state this year. As a result, taxpayers and their advisors are urged to continue to monitor the latest legislative and administrative tax changes in Connecticut.

---

[1] Conn. Gen. Stat. §12-701(a)(20), as amended by Conn. Pub. Act No. 18-49, §11 (effective May 31, 2018, and applicable to taxable years commencing on or after January 1, 2017). See Office of Commissioner Guidance (OCG)-5, Regarding the Treatment of Bonus Depreciation for Connecticut Income Tax Purposes. Any taxpayer required to add back any additional allowance for federal bonus depreciation for 2017 was required both to file an amended return and to seek a waiver of any assessment of interest or penalty due to the underpayment on or prior to December 31, 2018.
[2] Conn. Gen. Stat. §12-701(a)(20), as amended by Conn. Pub. Act No. 18-49, §11 *(effective May 31, 2018, and applicable to taxable years commencing on or after January 1, 2017)*
[3] Conn. Gen. Stat. §12-217(b), as amended by Conn. Pub. Act No. 18-49, §12 (effective May 31, 2018)
[4] Conn. Gen. Stat. §12-217(a)(6), as added by Conn. Pub. Act No. 18-169, §41 *(effective June 14, 2018, and applicable to income years commencing on or after January 1, 2017)*, and Conn. Pub. Act No. 18-49, §13 *(effective May 31, 2018, and applicable to income years commencing on or after January 1, 2017)*. Interestingly, there is no similar decoupling provision for purposes of the Personal Income Tax.
[5] *Conn. Gen. Stat. §12-217(a), as amended by Conn. Pub. Act No. 18-169, §41* (effective June 14, 2018, and applicable to income years commencing on or after January 1, 2017), *and Conn. Pub. Act No. 18-49, §13* (effective May 31, 2018, and applicable to income years commencing on or after January 1, 2017).

[6] Conn. Gen. Stat. §§12-391(g), 12-642(a), 12-392(b)(3), 12-391(c) and 12-643, as amended by Conn. Pub. Act No. 18-49, §§14-18 *(effective May 31, 2018)*, as further amended by Conn. Pub. Act No. 18-81, §§66-68 *(effective May 15, 2018)*.
[7] Conn. Pub. Act No. 18-49, §10 *(effective July 1, 2018)*.
[8] Pub. Act No. 18-49, §21 *(effective May 31, 2018)*.
[9] Conn. Gen. Stat. §12-704(a)(5), as added by Conn. Pub. Act No. 18-169, §42 *(effective June 14, 2018, and applicable to taxable years commencing on or after January 1, 2019),* and Conn. Pub. Act No. 18-49, §19 *(effective May 31, 2018, and applicable to taxable years commencing on or after January 1, 2019)*.
[10] Office of Commissioner Guidance (OCG)-4, Regarding the Connecticut Treatment of the Federal Repatriation Transition Tax Under IRC §965.
[11] Conn. Gen. Stat. §12-217(a)(2), as amended by Conn. Pub. Act No. 18-169, §41 *(effective June 14, 2018, and applicable to income years commencing on or after January 1, 2017)*, and Conn. Pub. Act No. 18-49, §13 *(effective May 31, 2018, and applicable to income years commencing on or after January 1, 2017.*

This article originally appeared in the March 2019 *TaxStringer* and is reprinted with permission from the New York State Society of Certified Public Accountants.

Louis B. Schatz, Esq., *is an attorney as well as a partner at the Connecticut-based law firm of Shipman & Goodwin LLP, where he serves as Chair of the Tax and Employee Benefits Practice Group. He is a frequent lecturer on State of Connecticut tax topics.*