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Tax Increases...Again

Four years after enacting the largest tax increase in Connecticut history, the Connecticut General Assembly has adopted a new \$40.3 billion biennial state budget that contains \$1.5 billion in tax and fee increases.

Few taxpayers will be able to avoid the impact of the tax increases. Corporations will face a new combined unitary reporting requirement, an extension of the 20% surcharge, a limit on the use of net operating losses and a further limitation on the use of tax credits. High income individuals face two higher marginal tax rates, middle income taxpayers may realize a reduction in, or loss of, the property tax credit, and lower income individuals will suffer a delay in the planned increase in the earned income tax credit. Changes to the sales tax include a potential increase in the tax rate on computer and data processing services, which will impact small and large businesses, as well as an increase in the luxury sales tax rate and a limitation on the clothing and footwear that can be purchased tax free during the third week in August. The ability of hospitals to claim tax credits against the hospitals tax has been limited, and a new gross receipts tax is imposed upon ambulatory surgical centers.

The response of the business community to the budget was quick and filled with acrimony. In the ensuing days, Governor Malloy announced a proposal to rollback approximately \$223.7 million of the tax increases, including a delay in the implementation of the combined unitary reporting requirement until 2016, and a repeal of the increase in the sales and use tax rate for computer and data processing services. The dust is unlikely to settle until a special session of the Connecticut General Assembly is convened at the end of this month (and the situation may not be resolved even then).

Although the situation is in flux, we are publishing this Alert now as a number of the tax changes adopted as part of the budget may be effective July 1st. (As of publication, the budget bill, Public Act No. 15-244, still had not been signed by the Governor.) The Alert summarizes Connecticut tax legislation enacted, court decisions rendered and administrative guidance published by the Connecticut Department of Revenue Services ("DRS") during the first months of 2015. 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 affect you and your business. We will, of course, amend and supplement this publication on our website in response to future developments.

CORPORATION BUSINESS TAX

I. Legislation

Surcharge Extended. The surcharge on the corporation business tax has been extended for an additional three years. The current 20% surcharge on the corporation business tax, that was to be applicable only to income years commencing prior to January 1, 2016, is extended for two additional years, through income years commencing prior to January 1, 2018. For the income year commencing on or after January 1, 2018, the surcharge will be 10%. As under current law, 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 annual gross income of the corporation is less than \$100 million. The \$100 million annual gross income exemption is not available to a corporation that files a combined return or a unitary return (with respect to income years commencing prior to January 1, 2015), or a combined unitary tax return (for income years commencing on or after January 1, 2015). Conn. Gen. Stat. §§12-214(b) and 12-219(b), as amended by Conn. Pub. Act No. 15-244, §§83-84 (*effective from passage, and applicable to income years commencing on or after January 1, 2015*).

Combined Unitary Tax Reporting. Effective for income years commencing on or after January 1, 2015, a "combined group" with a member subject to the Connecticut corporation business tax must file a combined unitary tax return. A "combined group" is a group of companies that have "common ownership" and are engaged in a "unitary business." "Common ownership" means that more than 50% of the voting control of each member of the combined group is directly or indirectly owned by a common owner or owners, either corporate or noncorporate, whether or not the owner or owners are members of the combined group. A "unitary business" means a single economic enterprise that is made up either of separate parts of a single business entity or of a group of business entities under common ownership, "which enterprise is sufficiently interdependent, integrated or interrelated through its activities so as to provide mutual benefit and produce a significant sharing or exchange of value among such entities, or a significant flow of value among the separate parts." The combined group has the option of determining its members' net income, capital base and apportionment factors on a world-wide basis or an affiliated group basis, but an election of either reporting method is binding for the income year in which it is made and the following ten years. If the combined group does not elect to report on a world-wide basis or an affiliated group basis, it must determine the net income, capital base and the apportionment factors of each of its taxable members on a "water's-edge basis." Under the legislation, the use of the water's-edge basis may require the inclusion of the net income, capital base and apportionment factors of the nontaxable members of the combined group under certain circumstances, including if they are incorporated in a jurisdiction that is determined by the Commissioner of Revenue Services to be a "tax haven" as defined under the law. Special rules are provided for the calculation of the combined group's net income or loss, capital base and apportionment factors, the use of net operating losses, the application of tax credits and the ability of certain publicly-traded companies to offset any increase in their members' net deferred tax liability or decrease in their net deferred tax assets resulting from the newly imposed unitary reporting requirements (but only over a seven-year period commencing in the 2018 income year and only if they file a required statement with the DRS claiming the deduction by July 1, 2016). Affected taxpayers should note that limited relief has been provided to afford combined groups to make estimated tax payments for the 2015 income year. In the ordinary course, corporate taxpayers with calendar year tax years are to pay the following percentages of their annual taxes by the following dates: 30% by March 15, 40% by June 15, 10% by September 15, and 20% by December 15. The new legislation extends the due dates for the first and second estimated tax payments for combined groups whose 2015 group income years start in: (i) January or February 2015 to July 15, 2015; and (ii) March 2015 to August 15, 2015. Taxable members of combined groups required to file unitary returns are not subject to interest and penalties for underpaying estimated tax in 2015 if: (i) they pay estimated taxes equal to at least 90% of that shown on their unitary tax filing for the 2015 group income year; or (ii) if the 2014 income year was a 12-month year, the taxable members of the combined group pay estimated taxes

of 100% of the tax liability, before credits, shown on either their individual separate 2014 returns or their optional 2014 combined return, as applicable. Conn. Gen. Stat. §§12-213(a), 12-214, 12-217, 12-217n(b), 12-217t(e), 12-217u(l), 12-217gg(c), 12-217gg(h), 12-218, 12-218b, 12-218c(c), 12-218d(d), 12-219, 12-219a, 12-221a, 12-222, 12-223a, 12-223b, 12-223c, 12-223e, 12-223f, 12-242d and 38a-88a, as amended and supplemented by Conn. Pub. Act No. 15-244, §§138-163 (*effective from passage, and applicable to income years commencing on or after January 1, 2015*). [Ed. note. On June 12, 2015, Governor Malloy announced a proposal to delay the implementation date of the new combined unitary tax reporting requirement to income years commencing on or after January 1, 2016.]

Limitation on Net Operating Losses. Under current law, a corporation that incurs a net operating loss (“NOL”) for an income year (i.e., an excess of allowable deductions over gross income for the income year) may carry forward the NOL for up to 20 years and thereby reduce its tax liability in those years until the NOL is used in its entirety. Under new legislation, for income years commencing on or after January 1, 2015, the portion of the NOL for an income year (the “Loss Year”) which may be deducted in any future income year is limited to the lesser of (i) 50% of the net income of such year (or 50% of the net income apportioned to Connecticut if the corporation apportions its income to multiple states) or (ii) the excess, if any, of such NOL over the NOL being carried forward from income years prior to such Loss Year. Conn. Gen. Stat. §12-217(a)(14), as amended by Conn. Pub. Act No. 15-244, §87 (*effective from passage*).

Tax Credit Limitation. For any income year commencing on or after January 1, 2002, and prior to January 1, 2015, current law limits the amount of tax credit or credits otherwise allowable against the Connecticut corporation business tax due for an income year to not more than 70% of the amount of tax due for that income year prior to the application of such credit or credits. New legislation further limits the use of tax credits for any income year on or after January 1, 2015, such that their use may not exceed 50.01% of the tax due for the income year, prior to the application of such credit or credits. Conn. Gen. Stat. §12-217zz, as amended by Conn. Pub. Act No. 15-244, §88 (*effective from passage*). [Ed. note. On June 12, 2015, Governor Malloy announced a proposal to increase the tax credit cap from 50.01% to 55%.]

Apportionment and Sourcing Review. The Commissioner of Revenue Services has been charged with the review of the impact of alternative methods of apportionment and sourcing of income for purposes of the corporation business tax on businesses within the state of Connecticut. On or before February 1, 2016, the Commissioner is to file a report with recommendations, if any, to the Finance, Revenue and Bonding Committee of the Connecticut General Assembly. Conn. Pub. Act No. 15-244, §219 (*effective from passage*).

II. Administrative Pronouncements

Financial Service Income. In DRS Ruling No. 2015-1, the DRS ruled that a corporation is a “financial services company” under Conn. Gen. Stat. §12-218b(a)(6)(J)(i) if it derives all of its income from its distributive shares of the gross income from partnerships that, in turn, derive all of their gross income from financial service activities.

PERSONAL INCOME TAX

I. Legislation

Individual Marginal Tax Rates. The marginal tax rates have been increased for taxpayers whose taxable income is over certain thresholds. For married people filing jointly, the highest marginal tax rate is increased from 6.7% to (i) 6.9% on taxable income in excess of \$500,000, and (ii) 6.99% on taxable income in excess of \$1 million. For single and married filing separately taxpayers, the highest marginal tax rate is increased from 6.7% to (i) 6.9% on taxable income in excess

of \$250,000, and (ii) 6.99% on taxable income in excess of \$500,000. For heads of household filers, the highest marginal tax rate is increased from 6.7% to (i) 6.9% on taxable income in excess of \$400,000, and (ii) 6.99% on taxable income in excess of \$800,000. The provisions that phase out the tax benefit of the lower marginal rates, through a recapture of the tax benefit as adjusted gross income increases over certain thresholds, are adjusted to reflect the new marginal tax rates of 6.9% and 6.99%. Conn. Gen. Stat. §12-700(a), as amended by Conn. Pub. Act No. 15-244, §66 (*effective from passage, and applicable to taxable years commencing on or after January 1, 2015*). [Ed. note. We are hopeful that the Connecticut General Assembly or the DRS will adopt transition relief related to withholding and estimated tax payments since the change in the marginal tax rates is retroactive to January 1, 2015.]

Tax Rate for Trusts and Estates. The flat Connecticut income tax rate for trusts and estates is increased from 6.7% to 6.99%. Conn. Gen. Stat. §12-700(a), as amended by Conn. Pub. Act No. 15-244, §66 (*effective from passage, and applicable to taxable years commencing on or after January 1, 2015*).

Nonresident Partner/Member/Shareholder Withholding. Under current law, 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 marginal income tax rate. Accordingly, the adoption of a new highest marginal tax rate of 6.99% results in the increase in the rate of withholding on Connecticut source income from 6.7% to 6.99%.

Property Tax Credit. The amount and the availability of the property tax credit against the personal income tax have been limited. First, effective with the 2016 tax year, the maximum credit available has been reduced from \$300 to \$200. Second, the adjusted gross income thresholds at which the maximum property tax credit starts to phase out are reduced: (i) for single filers from \$64,500 to \$47,500 in 2015, and \$49,500 in 2016 and thereafter; (ii) for married taxpayers filing separately from \$50,250 to \$35,250 in 2015 and thereafter; (iii) for heads of household from \$78,500 to \$54,500 in 2015 and thereafter; and (iv) for married taxpayers filing jointly from \$100,500 to \$70,500 in 2015 and thereafter. Conn. Gen. Stat. §12-704c, as amended by Conn. Pub. Act No. 15-244, §70 (*effective July 1, 2015, and applicable to income years commencing on or after January 1, 2015*).

Delay in Single Filer Tax Relief. The following income tax relief provisions for single filers that were to have gone into effect for the 2015 tax year will now go into effect for the 2016 tax year: (i) the increase in the maximum personal exemption from \$14,500 to \$15,000 (and the increase in the threshold at which the personal exemption begins to gradually phase out from \$29,000 to \$30,000); and (ii) the increase in income ranges that allow single filers to qualify for personal credits against their income tax (from a range of \$14,500 to \$62,500, to a range of \$15,000 to \$65,000). Conn. Gen. Stat. §§12-702(a)(2)(H) and (I), and 12-703(a)(2)(H) and (I), as amended by Conn. Pub. Act No. 15-244, §§67-68 (*effective from passage, and applicable to taxable years commencing on or after January 1, 2015*).

Military Retirement Pay. The exemption from the Connecticut personal income tax for retirement pay for a retired member of the Armed Forces of the United States (i.e., Army, Navy, Marine Corps, Air Force and Coast Guard) or the Army or Air National Guard is increased from 50% to 100%, commencing with the 2015 tax year. Conn. Gen. Stat. §12-701(a)(20)(B)(xvii), as amended by Conn. Pub. Act No. 15-244, §65 (*effective July 1, 2015, and applicable to taxable years commencing on or after January 1, 2015*).

Earned Income Tax Credit. The increase in the earned income tax credit from 27.5% to 30%, which was to go into effect for the 2015 tax year, has been delayed two years so that the increase will go into effect for the 2017 tax year. Conn. Gen. Stat. §12-704e(e), as amended by Conn. Pub. Act No. 15-244, §69 (*effective from passage, and applicable to taxable years commencing on or after January 1, 2015*).

II. Case Law

Nonqualified Stock Options and Statutory Limitations on Refunds Claims. In *Allen v. Sullivan*, 2015 Conn. Super. LEXIS 953 (Super. Ct. Apr. 29, 2015), the plaintiff-taxpayers sought a refund of income taxes for the taxable years of 2002, 2006 and 2007, in each case based upon the asserted erroneous reporting of income from the exercise of nonqualified stock options as Connecticut source income. The Tax Session of the Superior Court held that the refund claim for the 2002 tax year was barred by the applicable statute of limitations because it had been filed after April 15, 2006 (the three-year anniversary of the due date for the 2002 tax year). The Court also rejected the taxpayers' argument that the income from the exercise of the nonqualified stock options in 2006 and 2007 should not be considered Connecticut source income because the taxpayers were not residents of Connecticut at the time of the exercise of the options. Rather, the Court found that the options had been granted as compensation to the taxpayer when the taxpayer was employed in, and a resident of, Connecticut, and held that any compensation earned thereby is Connecticut source income even if recognized for income tax purposes later upon exercise when the taxpayer is no longer a Connecticut resident.

SALES AND USE TAX

I. Legislation

Computer and Data Processing Services. The sales tax on computer and data processing services is extended to include services rendered in connection with the creation, development hosting or maintenance of all or part of a website which is part of the graphical, hypertext portion of the Internet (i.e., the World Wide Web). Conn. Gen. Stat. §12-407(a) (37)(A), as amended by Conn. Pub. Act No. 15-244, §75 (*effective July 1, 2015, and applicable to sales occurring on or after said date, and to sales of services that are billed to customers for a period that includes July 1, 2015*). In addition, the sales and use tax rate for computer and data processing services is increased from 1% to: (i) 2% effective on or after October 1, 2015 and prior to July 1, 2016; and (ii) 3% effective on or after July 1, 2016. Effective for sales of computer and data processing services occurring on or after October 15, 2015, however, those services will be exempt from tax when performed by an entity for an affiliate of such entity. (An "affiliate" is defined as a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person, and "owns", "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of 50% or more.) Conn. Gen. Stat. §§12-408(1)(D) and 12-411(1)(E), as amended by Conn. Pub. Act No. 15-244, §§74 and 76 (*§74 effective from passage and §76 effective October 1, 2015, with both applicable to sales occurring on or after October 1, 2015, and to sales of services that are billed to customers for a period that includes October 1, 2015*). [Ed. note. On June 12, 2015, Governor Malloy announced a proposal to repeal the increase in the sales and use tax rate for computer and data processing services. We understand that some consideration also is being given to the repeal or limitation of the new exemption for sales between "affiliates". Section 76 of the bill appears to erroneously provide that Internet access services shall no longer be exempt from use tax on or after October 1, 2015. Federal law bars the repeal of this exemption, and will likely require a technical correction as part of the legislative special session.]

Luxury Tax Rate. The special sales and use tax rate on specified "luxury" items is increased from 7% to 7.75%. The specified "luxury" items are: (i) certain motor vehicles with a sales price exceeding \$50,000; (ii) jewelry with a sales price exceeding \$5,000; and (iii) an article of clothing or footwear, a handbag, luggage, umbrella, wallet or watch with a sales price exceeding \$1,000. Conn. Gen. Stat. §§12-408(1)(H) and 12-411(1)(H), as amended by Conn. Pub. Act No. 15-244, §§72-73 (*effective July 1, 2015, and applicable to sales occurring on or after that date*).

Sales Tax Free Week. The scope of the sales-tax-free week that occurs annually commencing with the third Sunday in August has been limited. Under prior law, the exemption was limited to the sale of any article of clothing or footwear that

is intended to be worn on or about the human body, the cost of which is less than \$300. Effective for 2015, the cost of the article of clothing must be less than \$100, and the exemption is expressly not available for: (i) any special clothing or footwear primarily designed for athletic activity or protective use and which is not normally worn except for such an activity or use; and (ii) jewelry, handbags, luggage, wallets, watches and similar items carried on or about the human body but not worn on the body in the manner characteristic of clothing. Conn. Gen. Stat. §12-407e, as amended by Conn. Pub. Act No. 15-244, §71 (effective July 1, 2015).

Car Wash Services. Effective July 1, 2015, car wash services, excluding coin-operated car washes, once again are subject to the Connecticut sales and use tax. Car washing services previously were taxable during the period from July 1, 1989 through December 31, 1993. Conn. Gen. Stat. §§12-407(a)(37)(OO), as added by Conn. Pub. Act No. 15-244, §75 (effective July 1, 2015, and applicable to sales occurring on or after said date, and to sales of services that are billed to customers for a period that includes July 1, 2015). [Ed. note. On June 12, 2015, Governor Malloy announced a proposal to repeal the application of the sales and use tax to car wash services.]

Exemptions Repealed. The following exemptions from the Connecticut sales and use tax have been repealed: (i) sales of clothing and footwear costing less than \$50 (which exemption was to go into effective July 1, 2015); (ii) sales of non-metered parking in seasonal lots with 30 or more spaces provided by the United States, the state of Connecticut or any of the political subdivisions thereof, or its or their respective agencies, a nonprofit charitable hospital, nursing home, rest home, residential care home, certain acute care for-profit hospitals, other tax-exempt organizations and any employer who provides parking for the exclusive use of its employees in a lot owned by the employer or leased under the terms of a lease of not less than ten years' duration; and (iii) sales of goods or services purchased by a water company in maintaining, operating, managing, or controlling a pond, lake, reservoir, stream, well, or distributing plant or system to supply water to at least 50 customers. Conn. Gen. Stat. §12-412(119), as repealed by Conn. Pub. Act No. 15-244, §222 (effective July 1, 2015); Conn. Gen. Stat. §12-407(a)(37)(N), as amended by Conn. Pub. Act No. 15-244, §75 (effective July 1, 2015, and applicable to sales occurring on or after said date, and to sales of services that are billed to customers for a period that includes July 1, 2015); Conn. Gen. Stat. §12-412(5), as amended by Conn. Pub. Act No. 15-244, §77 (effective July 1, 2015); Conn. Gen. Stat. §12-412(90), as repealed by Conn. Pub. Act No. 15-244, §222 (effective July 1, 2015).

Sales Tax Revenue Diversion. New legislation requires the Commissioner of Revenue Services to direct a percentage of the revenue derived from sales subject to the 6.35% tax rate to the Special Transportation Fund (the "Fund") and to the Municipal Revenue Sharing Account (the "Account") commencing with calendar quarters ending on or after December 31, 2015. The percentage of revenue diverted to each of the Fund and the Account is initially 4.7%, and then increases to 6.3% for calendar quarters ending on or after July 1, 2016, and then increases again to 7.9% for calendar quarters on or after July 1, 2017. Conn. Gen. Stat. §12-408(1), as amended by Conn. Pub. Act No. 15-244, §74 (effective from passage, and applicable to sales occurring on or after October 1, 2015, and to sales of services that are billed to customers for a period that includes October 1, 2015).

Commercial Fishing Vessels, Machinery or Equipment. New legislation repeals the statutory requirement that the Commissioner of Revenue Services adopt regulations requiring periodic registration for purposes of the issuance of the fisherman tax exemption permits. Conn. Gen. Stat. §12-412(40), as amended by Conn. Pub. Act No. 15-179, §5 (effective from passage).

Commercial Motor Vehicles. Under current law, the sale of, and storage, use or other consumption of certain commercial motor vehicles (large buses) that operate under the laws governing interstate buses is exempt from the sales or use tax for one year from purchase if 75% of the vehicle's revenue is derived from trips out of state or crossing state lines. Effective July 1, 2015, the exemption is expanded to cover these same vehicles if they are transporting hazardous

materials for which federal law requires that they carry placards or federally listed agents or toxins. Conn. Gen. Stat. §12-412(82), as amended by Conn. Pub. Act No. 15-46, §10 (*effective July 1, 2015*). [Ed. note. The expansion of the exemption may have been made in error as part of an attempt to update a statutory reference.]

II. Administrative Pronouncements

Nonprescription Drugs and Medicines. The DRS has published guidance concerning the exemption from the sales and use tax for certain nonprescription drugs and medicines that went into effect as of April 1, 2015. DRS Special Notice 2015(1), *Sales and Use Tax Exemption for Nonprescription Drugs and Medicines*.

Board and Employee Search, Assessment, Compensation and Other Services. In DRS Ruling 2015-2, the DRS evaluates the application of the Connecticut sales and use tax to a wide variety of services provided by a consulting firm and rules that: (i) executive search services and middle-management search services are subject to the sales and use tax as services by employment agencies under Conn. Gen. Stat. §12-407(a)(37)(C), but not Board search services because there is no intention to create an employer-employee relationship; (ii) executive assessment services, Board effectiveness assessments, assignment study services, CEO succession services, post-merger integration services, compensation study services, cultural assessment services, organization design services and team effectiveness services are subject to the sales and use tax as business analysis or business management consulting services relating to human resource management under Conn. Gen. Stat. §12-407(a)(37)(J); (iii) coaching services are subject to sales and use tax only if the coaching directly pertains to the employee's job skills, such as coaching to complete a specific job-required presentation, as opposed to training services that are indirectly related to an employee's job skills; and (iv) convening services, involving the facilitating and hosting of meetings for executives, are not taxable because they do not include any analysis, recommendations, advice or assistance to clients.

TAX CREDITS

Insurance Premium Tax Credit Limit. As part of 2013 legislation, the Connecticut General Assembly enacted a temporary limitation on the use of tax credits to reduce a taxpayer's liability for the insurance premium tax or subscriber charge tax. The structure of the limitation is such that: (i) each of the tax credits available to a taxpayer is classified as one of three types; (ii) it specifies the order in which a taxpayer must apply the credits to offset its tax liability; and (iii) it establishes the maximum liability that a taxpayer can offset by claiming one or more of these types of credits. The "temporary" limitation, which was to be effective only for the 2013 and 2014 calendar years, is made effective additionally for the 2015 and 2016 calendar years. Conn. Gen. Stat. §12-211a(a), as amended by Conn. Pub. Act No. 15-244, §85 (*effective from passage, and applicable to calendar years commencing on or after January 1, 2015*).

Film and Digital Media Production Tax Credit Moratorium. As part of the 2013 legislative session, the General Assembly imposed a moratorium for the state fiscal years ending on June 30, 2014 and June 30, 2015, on the issuance of any tax credit for a motion picture that was not a designated state-certified production prior to July 1, 2013. An exemption from the moratorium was established for any motion picture for which 25% or more of the principal shooting days are in Connecticut at a facility that receives not less than \$25 million in private investment and opens for business on or after July 1, 2013. During the 2015 legislative session, the General Assembly extended the moratorium, subject to the same exemption, for the state fiscal years ending June 30, 2016, and June 30, 2017. Conn. Gen. Stat. §12-217jj(a)(3)(A), as amended by Conn. Pub. Act No. 15-244, §86 (*effective from passage*).

Tax Credit Limitation. For any income year commencing on or after January 1, 2002, and prior to January 1, 2015, current law limits the amount of tax credit or credits otherwise allowable against the Connecticut corporation business tax due for an income year to not more than 70% of the amount of tax due for that income year prior to the application of such

credit or credits. New legislation further limits the use of tax credits for any income year on or after January 1, 2015, such that their use may not exceed 50.01% of the tax due for the income year prior to the application of such credit or credits. Conn. Gen. Stat. §12-217zz, as amended by Conn. Pub. Act No. 15-244, §88 (*effective from passage*). [Ed. note. On June 12, 2015, Governor Malloy announced a proposal to increase the tax credit cap from 50.01% to 55%.]

Hospitals Tax Credit Limitation. New legislation limits the amount of tax credit or credits otherwise allowable against the hospitals tax due for a calendar quarter commencing on or after July 1, 2015, to an amount that does not exceed 50.01% of the amount of tax due for such calendar quarter prior to the application of such credit or credits. Conn. Gen. Stat. §12-263b, as amended by Conn. Pub. Act No. 15-244, §89 (*effective July 1, 2015*).

Connecticut Insurance Reinvestment Fund Credit. Under current law, a non-transferrable credit is available against the insurance premiums tax for taxpayers who make cash investments in a state-approved insurance reinvestment fund that fully funds the purchase price of (i) an equity interest in the fund, or (ii) an eligible debt instrument issued by the fund for at least par value that has a maturity date of at least five years. The insurance reinvestment tax credit provisions are amended to change the name of insurance reinvestment funds to invest CT funds and to: (i) increase the aggregate gap on credits available under the program (for application against the premium tax) from \$200 million to \$350 million (but does not change the annual cap of \$40 million); (ii) increase the amount of investments that a fund must obtain from sources other than insurers from 5% to 10% of the insurers' total investment; (iii) increase from 3% to 7% the amount a fund must invest in pre seed businesses; (iv) expand the investment targets of funds to include the requirements that 25% of the funds must be invested in businesses located in municipalities with over 80,000 people, and at least 3% in cybersecurity businesses; (v) delay the ability of an insurer to claim the credit from the fourth year to the sixth year; (vi) delay from the fourth year to the sixth year when a fund must have invested at least 60% of its credit-eligible capital in eligible businesses; (vii) add conditions a fund must meet before it can distribute returns; and (viii) extend the period when the state may decertify a fund and cause it to forfeit future unclaimed credits. Conn. Gen. Stat. §38a-88a, as amended by Conn. Pub. Act No. 15-244, §171 (*effective July 1, 2015*).

ESTATE AND GIFT TAX

I. Legislation

Cap on Estate and Gift Taxes. The combined estate and gift taxes payable by decedents dying on or after January 1, 2016, and gift taxes paid with respect to gifts made on or after January 1, 2015, is now limited to \$20 million. In addition, the \$20 million cap is reduced by gift taxes paid on post January 1, 2016 gifts made by a decedent, a decedent's estate or a decedent's spouse, with respect to gifts made by the decedent which are included in the decedent's taxable estate. Conn. Gen. Stat. §§12-391(d) and (e), as amended by Conn. Pub. Act No. 15-244, §174 (*effective from passage, and applicable to estates of decedents dying on or after January 1, 2016*); Conn. Gen. Stat. §12-642(c), as added by Conn. Pub. Act No. 15-244, §175 (*effective from passage, and applicable to gifts made during calendar years commencing on or after January 1, 2015*).

II. Case Law

Estate Taxation of QTIP Trusts. In two cases involving different decedent's estates but similar Connecticut estate tax issues, the Tax Session of the Superior Court rejected executor arguments that the value of qualified terminable interest in property ("QTIP") marital trusts should not be included in the taxable estates of the surviving spouses for whom the trusts were created. Consequently, the Court granted the Commissioner's motion for summary judgment in both cases. Specifically, the plaintiff executors, in *Estate of Helen Brooks vs. Sullivan*, 2015 Conn. Super. LEXIS 950 (Super. Ct. April

29, 2015), argued that the value of a trust created for the benefit of Mrs. Brooks by her late husband, for which her late husband's executor made a federal QTIP (qualified terminable interest in property) election so as to qualify the trust for the federal estate tax marital deduction, should not be included in the Connecticut taxable estate of Mrs. Brooks as she did not "own" the property at her death. The executors argued that prior to a 2013 amendment, Connecticut General Statutes §12-391(d)(3) provided that Connecticut had the jurisdiction to tax only intangible personal property "owned by" a Connecticut resident decedent. The executors further contended that, because Mrs. Brooks did not "own" the assets of the marital trust, Connecticut did not have the jurisdiction to impose Connecticut estate tax on those assets. The Court rejected that argument, finding that the plaintiff's reliance on the 2013 statutory change which now refers to assets "included in the gross estate of the decedent" was clarifying in nature, not a substantive change in the law and, therefore, should be applied retroactively. The Court also noted that Conn. Gen. Stat. §12-391(c)(1) defines the Connecticut taxable estate by reference to the federal gross estate which includes the marital trust. Similarly, in Alfred Terrell vs. Sullivan, 2015 Conn. Super. LEXIS 978 (Super. Ct. April 29, 2015), the Court rejected the executor's argument that the assets of a marital trust for the benefit of the surviving spouse decedent should not be included in the decedent's Connecticut taxable estate because the succession tax previously had been imposed on the value of the remainder of the trust, and the decedent surviving spouse did not "own" those assets for purposes of Conn. Gen. Stat. §12-391(d)(3).

PROPERTY TAX

I. Legislation

Motor Vehicles. Commencing with the October 1, 2015 assessment year, any municipality or district may establish a mill rate for motor vehicles that is different from the mill rate for real property, but the mill rate cannot exceed (i) 32 mills for the October 1, 2015 assessment year; and (ii) 29.36 mills for each assessment year thereafter. The legislation further limits the motor vehicle mill rate special taxing districts and boroughs may impose by barring them from setting a rate that, if combined with the motor vehicle mill rate of the municipality in which it is located, would exceed the forgiving mill rate caps. Conn. Gen. Stat. §12-122a, as amended and supplemented by Conn. Pub. Act No. 15-244, §§206 and 208 (*effective October 1, 2015, and applicable to assessment years commencing on or after October 1, 2015*).

Municipal Tax Collection. The statutes governing the collection of municipal taxes are amended in a number of ways, including: (i) requiring a municipality to follow the written instructions of a taxpayer who is liable for taxes on more than one property as to which property or properties a specific payment shall be applied; (ii) eliminating the requirement that a municipality apply payments on a priority basis to outstanding recording fees; (iii) specifying that tax payments made through a municipal electronic payment service within the time allowed by statute are timely and not subject to interest charges; (iv) authorizing a municipality or any district health department to withhold or revoke any license or permit issued by it to operate a business enterprise if any taxes or water, sewer or sanitation charges are delinquent for a period of one year or more; and (v) permitting the enforcement by levy and sale any tax warrant upon real estate for any unpaid tax. Conn. Gen. Stat. §§12-144b, 12-146, 12-146a and 12-155(b), as amended by Conn. Pub. Act No. 15-156, §§1-4 (*effective October 1, 2015*). In addition, the laws governing tax sales are amended to: (i) clarify in a pre-sale tax notice that additional taxes, interest, fees and other charges "are owed in addition to", as opposed to "have been added to", the amount indicated as due and owing in the notice; (ii) require that the post-sale notice that the municipality must cause to be published in a newspaper and mailed to the owner, mortgagee, lienholder and other interested persons state that if the property is not redeemed, all parties notified will lose their respective titles, mortgage liens and other interests in it including, now, restraints on alienation; (iii) require municipalities to retain any interest that accrues on excess tax sale proceeds; (iv) specify that state and municipal tax liens against a delinquent taxpayer have precedence or priority over any claim against the taxpayer by a party who redeems a property following a tax sale; (v) extend the redemption

period when a delinquent taxpayer or another interested party can redeem a property to cover the period from the tax sale notice's publication through the sale date; (vi) limit the priority of a claim by a redeeming party who paid delinquent taxes on a property against the delinquent taxpayer such that the claim will not have precedence or priority over any state or municipal tax liens (including a lien for a tax that was not yet due and payable when notice of the tax levy was first published); (vii) require that a tax collector's deed specify that the redeemer's claim is subject to other liens in favor of the municipality; and (viii) provide that a purchaser need not be a party to an action filed by a delinquent taxpayer to claim excess sales proceeds from a tax sale. Conn. Gen. Stat. §§ 12-157, 12-158(a) and 12-159(b), as amended by Conn. Pub. Act No. 15-156, §§5-7 (*effective October 1, 2015*).

Property Tax Base Revenue Sharing Program. New legislation authorizes a regional council of governments to establish a property tax base revenue sharing program under which the municipalities in the region (i) tax commercial and industrial property at a composite mill rate, and (ii) share up to 20% of the property tax revenue generated by the growth in their commercial and industrial property tax bases since 2013 (the base year). Conn. Pub. Act No. 15-244, §§211-215 (*effective October 1, 2015, and applicable to assessment years commencing on or after October 1, 2015*).

Land Value Taxation Program. New legislation amends the statute authorizing the Secretary of the Office of Policy and Management to conduct a pilot program in up to three municipalities whereby the selected municipalities can classify real estate as (i) land or land exclusive of buildings or (ii) buildings or land, and then establish a higher mill rate for land or land exclusive of buildings. The legislation (a) extends from December 31, 2014 to December 31, 2015, the deadline by when a participating municipality must submit a plan for implementation of land value taxation to the Connecticut General Assembly, and (b) prohibits any municipality that previously applied for and participated in the pilot program from again participating in the pilot program (for example, to designate additional areas to be subject to land value taxation). Conn. Gen. Stat. §12-63h, as amended by Conn. Pub. Act No. 15-184, §7 (*effective from passage*).

Tax Increment Financing Districts. New legislation authorizes a municipality's legislative body to establish a tax increment district (also known as a tax increment financing (TIF) district) to finance economic development priorities in an eligible area. The municipality may finance the economic development property by (i) designating all or a part of the new or incremental real property tax revenue generated in the district to pay the costs incurred to fund the projects, (ii) imposing assessments on real property in the district benefitting from certain public improvements (i.e., benefit assessments), and (iii) issuing bonds backed by these revenue streams to pay projects costs. Conn. Pub. Act No. 15-57, §§1-9 (*effective October 1, 2015*).

II. Case Law

Receiver of Rents Authority. Pursuant to Conn. Gen. Stat. §12-163a, a municipality may petition the Superior Court for the appointment of a receiver of rents or for use and occupancy payments for any property for which the owner is delinquent in the payment of real property taxes. In Canton v. Cadle Properties of Connecticut, Inc., 316 Conn. 851 (2015), the Connecticut Supreme Court held that a receiver of rent can be authorized to collect new and back taxes, but that section 12-163a cannot be the basis to authorize the receiver to evict a tenant from the property in the event of default and to lease the property to a new tenant.

Statute of Limitations. In Cornelius v. Arnold, 2015 Conn. Super. LEXIS 164 (Super. Ct. Jan. 30, 2015), the taxpayer argued that the one-year statute of limitations for filing an appeal pursuant to Conn. Gen. Stat. §12-119 from a property tax assessment does not commence until the assessment list for the relevant assessment year is sent by the assessor to the Secretary of the Office of Policy and Management. The Superior Court disagreed and granted summary judgment in favor of the municipality finding that an appeal of an assessment for the assessment year commencing October 1, 2011 must be filed within one year of that date pursuant to section 12-119.

MISCELLANEOUS TAXES

I. Legislation

Rental Surcharge Tax. Under current law, a surcharge is imposed on any business entity that is a “rental company” on the short-term rental (i.e., 30 days or less) of cars, trucks and heavy machinery (without an operator) that may be used for construction, mining or forestry. The applicable surcharge is 3% for car and truck rentals and 1.5% for machinery rentals. In general, a business entity is a “rental company” if it has five or more passenger motor vehicles, rental trucks or pieces of machinery for rent in Connecticut (excluding certain new and used car dealers and those required to be licensed for selling or repairing motor vehicles). Under new legislation, effective July 1, 2015, the statute imposing the surcharge is amended to: (i) provide that a business entity will be deemed to be a “rental company” only if it has total rental income, excluding retail or wholesale sales of rental equipment, that is 51% or more of the total revenue of the business entity in a given taxable year; and (ii) expands the application of the surcharge on machinery to all rental equipment (not just heavy machinery) owned by the rental company and for rentals of 364 days or less or under an open-ended contract for an undefined period of time. By law, the surcharge reimburses the rental company for Connecticut property taxes and Department of Motor Vehicles (DMV) licensing and titling fees. The rental company must annually report to the DRS on (i) the aggregate amount of personal property taxes paid to towns and registration and titling fees paid to the DMV, and (ii) the aggregate amount of rental surcharges collected in the previous year on rentals. The new legislation now requires this report to be filed on a consolidated basis. Conn. Gen. Stat. §12-692, as amended by Conn. Pub. Act No. 15-244, §107 (*effective from July 1, 2015*).

Ambulatory Surgical Center Tax. For each calendar quarter commencing on or after October 1, 2015, a new tax is imposed on each ambulatory surgical center in Connecticut at the rate of 6% of the gross receipts of the center. For purposes of the tax, an “ambulatory surgical center” is defined as an entity included within the definition of “ambulatory surgical center” that is set forth in 42 CFR 416.2 and that is licensed by the Department of Public Health as an outpatient surgical facility, and any other ambulatory surgical center that is Medicare certified. The return for the tax must be filed electronically on or before the last day of the first month after each calendar quarter. The audit, refund, penalty, appeal and other miscellaneous rules applicable to the Admissions and Dues Tax are made applicable to this tax. Conn. Pub. Act No. 15-244, §172 (*effective October 1, 2015*). [Ed. note. Our office has expressed concern that there may be an overlap of the hospitals tax and the new ambulatory surgical center tax when a hospital operates a surgical center as a division of a hospital, or where the revenue of such a center passes through to a hospital by virtue of its ownership of an interest in a pass-through entity.]

Cigarette Taxes. The cigarette tax is increased in two steps, from (i) \$3.40 to \$3.65 per pack on October 1, 2015, and (ii) \$3.65 to \$3.90 per pack on July 1, 2016. Similar to prior tax rate increases, a “floor tax” of 25 cents is imposed on each pack of cigarettes that a dealer or distributor has in inventory at the earlier of close of business or 11:59 p.m. on each of September 30, 2015 and June 30, 2016. Conn. Gen. Stat. §§12-296 and 12-316, as amended by Conn. Pub. Act No. 15-244, §§176-177 (*effective October 1, 2015, and applicable to sales occurring on or after said date*), 178 (*effective from passage*) and 179-180 (*effective July 1, 2016, and applicable to sales occurring on or after said date*).

Admissions Tax. An exemption from the admissions tax was enacted with respect to any admission charge, from July 1, 2015 to June 30, 2017, to any athletic event presented by a member team of the Atlantic League of Professional Baseball at the Ballpark at Harbor Yard in Bridgeport. Conn. Gen. Stat. §12-541, as amended by Conn. Pub. Act No. 15-244, §216 (*effective July 1, 2015*). A similar exemption was enacted as part of Conn. Pub. Act No. 15-184, §11 (*effective July 1, 2015*).

Power of Attorney. Effective July 1, 2016, the Connecticut Uniform Power of Attorney Act has been adopted. The Act provides that a power of attorney grants, unless expressly stated to the contrary, general authority with respect to taxes, including authority for the agent to: (i) prepare, sign and file tax returns, refund claims, extensions for time, waivers, offers, consents, petitions and other tax documents; (ii) pay taxes due, collect refunds, receive confidential information and contest delinquencies; (iii) exercise any tax election; and (iv) act for the principal in all tax matters before a taxing authority. Conn. Pub. Act No. 15-240, §39 (*effective July 1, 2016*).

Insurance Company Tax Allocation Agreements. The statute that requires notice to and the approval of the Commissioner of Insurance of certain transactions involving a domestic insurance company and any person in its holding company system, including amendments to or modifications of previously filed agreements, is amended to include tax allocation agreements. Conn. Gen. Stat. §38a-136(b)(1), as amended by Conn. Pub. Act No. 15-144, §8 (*effective July 1, 2015*).

II. Administrative Pronouncements

Motor Vehicle Fuels Tax on Diesel Fuel. The DRS has announced that the motor vehicle fuels tax rate per gallon for diesel fuel that is to go into effect for the 12-month period commencing July 1, 2015 has been reduced to 50.3 cents. DRS Announcement 2015(4), *Motor Vehicle Fuels Tax Rate on Diesel Fuel Decreased Effective July 1, 2015*.

Conversion Factors on Motor Vehicle Fuels. The DRS has announced the conversion factors for motor vehicle fuels occurring in gaseous form applicable for the 12-month period commencing July 1, 2015. DRS Special Notice 2015(2), *Conversion Factors on Motor Vehicles Occurring in Gaseous Form Applicable Beginning July 1, 2015*.

ADMINISTRATIVE PRONOUNCEMENTS

Announcements

- AN 2015(1), Refunded by the Connecticut Insurance Guaranty Association
- AN 2015(2), Annual List of Distributors for Motor Vehicle Fuels Tax Purposes
- AN 2015(2.1), Quarterly List of Distributors for Motor Vehicle Fuels Tax Purposes
- AN 2015(3), Annual Revision of Forms TPM-1, TPM-2, and TPM-3
- AN 2015(4), Motor Vehicle Fuels Tax Rate on Diesel Fuel Decreased Effective July 1, 2015

Informational Publications

- IP 2015(1), Connecticut Circular CT Employer's Tax Guide
- IP 2015(2.1), Topical Index to Rulings and Administrative Pronouncements Covering Income Tax
- IP 2015(3.1), Topical Index to Rulings and Administrative Pronouncements Covering Corporation Business Tax
- IP 2015(4) Numerical Index to Rulings and Administrative Pronouncements as Affected, If at All, by Later-Issued Rulings and Pronouncements
- IP 2015(5.1), Topical Index to Rulings and Administrative Pronouncements Covering Sales and Use Taxes
- IP 2015(6.1), Topical Index to Rulings and Administrative Pronouncements Covering Miscellaneous Taxes and Administrative Topics



- IP 2015(7), Is My Connecticut Withholding Correct?
- IP 2015(8), Connecticut Tax Guide for Payers of Nonpayroll Amounts
- IP 2015(11), Q&A on the Business Entity Tax
- IP 2015(12), Getting Started in Business
- IP 2015(13), The Connecticut Neighborhood Assistance Tax Credit Program
- IP 2015(14), Q&A on Estimated Corporation Business Tax and Worksheet CT-1120AE

Policy Statements

- PS 2015(1), Sales and Use Tax Exemptions for Foreign Missions and Mission Personnel

Special Notices

- SN 2015(1), Sales and Use Tax Exemption for Nonprescription Drugs and Medicines
- SN 2015(2), Conversion Factors on Motor Vehicle Fuels Occurring in Gaseous Form
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