

Keeping you up-to-date on state and local tax matters.



Connecticut Enacts Tax Legislation

After many months of deliberation in a special legislative session, the Connecticut legislature recently enacted a budget bill that provides broad tax legislative changes. The bill became law as of September 8, 2009. Following is a brief summary of the significant Connecticut tax law changes contained in the two-year budget, *An Act Concerning Expenditures and Revenue for the Biennium Ending June 30, 2011* (H6802). In addition, a link to a detailed analysis of the tax law changes is provided afterward.

Nexus:

Economic Nexus Standard Applied to "Out-of-State" Businesses: For tax years beginning on or after January 1, 2010, any "corporation, S corporation, or partnership" that has a substantial "economic presence" within Connecticut (regardless of whether the entity has any "physical presence" within Connecticut) will subject an out-of-state corporation or the non-resident owners of S corporations and partnerships to Connecticut income taxation. Although a "limited liability company" is not specifically enumerated as a type of legal entity that is subject to the economic nexus standard, it is anticipated that during a special legislative session to be held at the end of September, legislation will be added to include limited liability companies. Economic nexus has been broadly defined to mean purposefully directing business towards Connecticut viewing the economic contact taken as a whole. Although this standard is most often applied to the financial service industry or intangible holding companies (e.g., licensing of trademarks and trade names), it can be extended to other businesses that derive significant revenue from Connecticut sources. (See our August 2009 State and Local Tax E-mail Newsletter for a more detailed explanation of nexus, including economic nexus.)

Tax Settlement Initiative Program:

TSI Program: For the period October 1, 2009 through December 31, 2009, a "tax settlement initiative program" has been established. The legislation authorizes the Commissioner of Revenue Services to send written statements of eligibility to participate in the program to taxpayers who owe certain previously imposed taxes, interest or penalties. Upon written notification from the Commissioner, if a taxpayer pays the tax that is owed in full, civil penalties will be waived as well as 50% of the interest due.

Corporation Business Taxation:

Federal DPAD: Effective for tax years beginning on or after January 1, 2009, Connecticut will not allow corporations the ability to deduct the federal domestic production activities deduction ("DPAD"), pursuant to IRC §199, when computing Connecticut taxable income. This deduction will also not be allowed for personal income tax purposes.

Three-year Corporation Business Tax Surcharge: For tax years beginning on or after January 1, 2009 and prior to January 1, 2012 (i.e., 2009, 2010 and 2011), an additional 10% corporation tax surcharge will be imposed (effectively increasing the corporate income tax rate to 8.25% from 7.5% and the capital base tax rate to .0034 from .0031). However, corporations with "gross income" less than \$100 million, other than corporations filing combined or unitary returns, are not subject to the surcharge. In addition, corporations whose tax liability does not exceed the \$250 minimum tax are not subject to the surcharge.

Preference Tax: The maximum preference tax for corporations filing Connecticut combined corporation business tax returns is increased from \$250,000 to \$500,000 (*effective upon passage*). As of the date of this newsletter, it is unclear whether the preference tax will be effective for tax years beginning on or after January 1, 2009 or a subsequent date – it is anticipated that this will be clarified in a special legislation session to be held at the end of September.

Tax Credits:

Donation of Open Space Land Credit: For tax years beginning on or after January 1, 2009, the carry forward period for the donation of open space land credit is extended from 15 to 25 years.

Film and Digital Animation Production and Infrastructure Investment Tax Credits: For tax years beginning on or after January 1, 2010, significant and numerous changes have been made to the film production, film production infrastructure and digital animation production tax credits. Please refer to the OLR analysis, below, for further detail.

Estimated Tax Payments: The legislative changes did not address whether Connecticut corporation business estimated tax payments for the 2009 tax year need to be adjusted to avoid underpayment of estimated tax penalties as a result of the tax law changes to the corporation business tax. Although we believe that no penalties will be assessed due to underpayments resulting from the legislation, there is no definitive guidance. It is our understanding that this will be addressed in the upcoming special legislation session.

Personal Income Taxation:

Income Tax Rate Increase: For 2009 and subsequent tax years, the highest marginal Connecticut personal income tax rate increases to 6.5% (currently 5%) for individuals with Connecticut taxable income over \$500,000 (single and married filing separately filers), \$800,000 (heads of household filers) and \$1,000,000 (joint filers). The 3% and 5% marginal tax rates remain in effect for Connecticut taxable income below these thresholds.

Estimated Income Tax Payments: The legislative changes did not address whether Connecticut estimated income tax payments and income tax withholding for the 2009 tax year needs to be adjusted to avoid underpayment of estimated income tax penalties as a result of the increase in the income tax rate (or the DPAD disallowance). Although we believe that no penalties will be assessed, at this time there is no definitive guidance regarding whether 2009 underpayment penalties will be imposed or whether a "catch-up" payment will be required before the end of 2009. It is our understanding that this will be addressed in the upcoming special legislation session.

Estates, Trusts and Gift Taxation:

Estate and Trust Income Tax Rate Increase: For 2009 and subsequent tax years, the Connecticut income tax rate imposed on trusts and estates increases to 6.5% from 5% on all taxable income.

Estate and Gift Tax: Effective for deaths and gifts occurring on or after January 1, 2010, estate and gift taxes will apply to estates and gifts over \$3.5 million (currently \$2 million). In addition, the so-called "cliff tax" is eliminated and the marginal tax rates have been reduced by 25%. As a result, the amount of

estates/gifts over \$3.5 million will begin to be subject to a tax rate of 7.2% (formerly 9.6%), gradually increasing to 12% (formerly 16%) for estates/gifts greater than \$10.1 million.

Sales and Use Taxation:

Potential Reduction in Tax Rate: Effective January 1, 2010, the sales and use tax general rate could potentially be reduced to 5.5% from 6%. This reduction is contingent upon the State meeting certain revenue targets.

Miscellaneous Taxes:

Real Estate Conveyance Tax: Applicable to conveyances on or after January 1, 2010, the real estate conveyance tax will apply to property that is "foreclosed by sale" due to a court order.

Cigarette and Tobacco Products Taxes: Applicable to sales occurring on or after October 1, 2009, the cigarette tax increases to \$3 per pack (of 20) from \$2 per pack (of 20). A \$1 inventory floor tax will also be imposed on each pack of cigarettes in a dealer's or distributor's inventory as of September 30, 2009. In addition, effective October 1, 2009, the tobacco products tax increases to 27.5% from 20% of the wholesale price and the tax on snuff tobacco increases to 55 cents per ounce (currently 40 cents).

House Bill 6802 Office of Legislative Research Analysis:

For a more detailed explanation of the above Connecticut tax law changes, please click on the link below:

OLR Analysis: <http://www.cga.ct.gov/2009/BA/2009HB-06802-R01SS1-BA.htm>

Other Noteworthy State and Local Tax Developments:

Offshore Accounts:

Under a current IRS amnesty program, U.S. taxpayers with undeclared offshore bank accounts *have until September 23, 2009* to report those assets and income to the Internal Revenue Service under specific voluntary disclosure guidelines. Those who come forward will be subject to federal income taxes, interest and specific penalties for a limited 6-year look-back period. Taxpayers amending their federal income tax returns under the IRS amnesty program are likewise required to amend their Connecticut personal income tax returns.

Recently, Connecticut's Attorney General Richard Blumenthal announced that he will begin investigating whether Connecticut residents are among those who have evaded Connecticut income taxes through offshore accounts (specifically those held at Swiss Bank, UBS). He indicated that "we will vigorously pursue [tax evaders] for unpaid taxes, including anyone who comes forward under the federal amnesty program . . ."

With the federal amnesty period soon ending and the heightened level of Connecticut's awareness and scrutiny of offshore accounts, Connecticut residents (or former residents) holding offshore accounts should seek immediate tax advice.

Massachusetts Sales and Use Tax Judicial Decision:

In *Town Fair Tire Centers, Inc. v. Commissioner of Revenue*, Massachusetts Supreme Judicial Court (8/2/09), it was held that a New Hampshire tire seller is not required to collect Massachusetts use tax on sales of tires to Massachusetts residents where the customers purchased and took delivery of the tires outside Massachusetts. The Massachusetts Department of Taxation asserted that even though the Massachusetts residents purchased and took possession of the tires at the Town Fair Tire Centers located in New Hampshire (a state that does not impose a sales tax), the retailer was required to collect

Massachusetts use tax on the tire purchases since the retailer had the requisite nexus in Massachusetts (i.e., the company had physical presence, i.e., retail outlets in Massachusetts). The retailer also presumably knew that the tires would ultimately be used in Massachusetts since they were placed on Massachusetts registered vehicles. However, the court held that since there is no Massachusetts statutory presumption of use in Massachusetts nor evidence of actual use of the tires in Massachusetts, the out-of-state retailer is not required to impose the Massachusetts tax. (*Note*: If an out-of-state retailer is not required to collect a customer's resident state's sales or use tax, the customer nevertheless must self-assess and remit the tax to the state).

To discuss how the above Connecticut tax legislative changes or the other state tax developments discussed in this newsletter may affect you or your business, please contact one of the below listed state and local tax professionals:

- Doug Joseph, Partner: (860) 561-6829
- Tony Switajewski, Principal: (860) 561-6810

Look for future BlumShapiro State and Local Tax E-mail Newsletters.

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