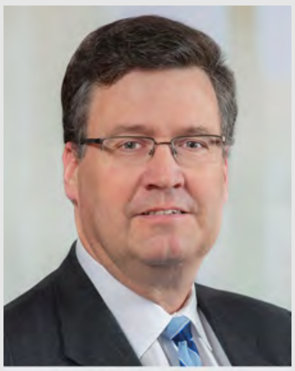
Connecticut's New Budget Is Packed With New and Expanded Taxes

by Glenn G. Rybacki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In this installment of ConnTax, Rybacki reviews the tax changes in Connecticut's fiscal 2020-2021 biennial budget.

With the adjournment of the 2019 regular session, the Connecticut General Assembly approved the fiscal 2020-2021 biennial budget. H.B. 7424, which Gov. Ned Lamont (D) signed on June 26, will make numerous changes to existing tax laws while adding several new taxes.[1] By some estimates, the budget legislation will raise over $300 million in each year by repealing past tax cuts and increasing taxes and fees.

As part of his gubernatorial campaign, Lamont opposed tax rate increases. But with Connecticut facing sizeable budget deficits in fiscal 2020 and fiscal 2021, both he and the General Assembly focused on increasing state revenues. As the budget process advanced, there were several calls to raise income, corporation business, and sales and use taxes. This article looks at some of the more prominent changes to those taxes, as well as other surcharges and fees affecting individuals and business.

Income Tax

The budget process often pitted Lamont, who was initially against raising income taxes, against a legislature that proposed to either increase the top marginal rate or impose an additional tax on high earners. Ultimately, the governor and the legislature agreed in principle on a number of budget legislation provisions.

The most significant income tax change is the reduction to the tax credit taken by shareholders, members, and partners of passthrough entities required to pay the affected business entity tax. The tax was enacted as a workaround to the federal limitation on the personal income tax deduction for state and local taxes established by the 2017 federal Tax Cuts and Jobs Act. The tax is imposed at a rate of 6.99 percent on the Connecticut income of S corporations, limited liability companies, and partnerships. Before the budget legislation, each shareholder, member, or partner could take a credit against his or her Connecticut income tax equal to 93.01 percent of his or her pro rata share of the tax paid by the entity. This tax on the entity and the corresponding credit for the individual were intended to offset the SALT cap limitation. Beginning with tax and income years on or after January 1, 2019, the credit will be reduced to 87.5 percent of a shareholder's, member's, or partner's pro rata share of the tax paid by the relevant entity.

There are other changes affecting income tax credits. The angel investor tax credit program, which provides an income tax credit to investors in start-up businesses, will be extended an additional five years to July 1, 2024. Also, the aggregate amount of angel investor tax credits for each fiscal year will increase from $3 million to $5 million, and the total amount of tax credits

[1] H.B. 7424.

allowed to any angel investor will rise from $250,000 to $500,000.

The budget legislation will also repeal the five-year, refundable income tax credit for graduates in science, technology, engineering, or math fields, who reside in or move within two years of graduation to the state. Also, the limits on eligibility for the property tax credit for those 65 years or older, or who validly claim one dependent on their federal income tax returns, will be extended to the 2019 and 2020 tax years.

Another provision will delay scheduled increases in the amount of teacher pension income excluded from Connecticut adjusted gross income. The 25 percent exclusion that was to increase to 50 percent beginning in tax year 2019 will now remain in effect through tax year 2020, with the scheduled increase taking effect in tax year 2021.

Corporation Business Tax

While the budget bill contains only a few changes to the corporation business tax, it will phase out the capital base tax component. Currently, the corporation business tax is calculated as either 7.5 percent of net income; 3.1 mills per dollar of capital base, up to $1 million; or $250 — whichever produces the highest tax. The phaseout will decrease the calculation based on capital base by reducing the rate to 2.6 mills in tax year 2021, 2.1 mills in tax year 2022, 1.1 mills in tax year 2023, and zero mills beginning in tax year 2024.

The budget legislation will also extend, by two years to 2020, the current 10 percent corporation business tax surcharge. The surcharge is imposed on corporations that have more than $250 in corporation business tax liability, and either $100 million or more in annual gross income or — regardless of annual gross income — that are taxable members of a combined group filing a combined unitary return. Fortunately, because the surcharge applies to income years beginning on or after January 1, taxpayers will not be subject to estimated tax payment requirements or interest on underpayments for the 2019 income year.

Finally, the 65 percent limitation on the use of aggregate tax credits and excess credits against corporation business taxes due will be eliminated.

Business Entity Tax

The business entity tax will be eliminated for tax years commencing on or after January 1, 2020. It is currently imposed at a rate of $250 on limited liability companies, limited liability partnerships, limited partnerships, and S corporations, and is due semiannually.

Sales Tax

One of the governor's budget proposals was to "modernize" sales and use taxes to increase revenues without raising the rate. As such, amendments were made to fully tax digital products, extend the tax to previously untaxed services, eliminate some exemptions, and change the nexus standard to reach additional out-of-state retailers.

Connecticut currently taxes digital goods and software delivered electronically at the reduced rate of 1 percent. Seeking to eliminate the difference in tax treatments between digital goods, software delivered in tangible form, and software delivered electronically, the legislation redefines tangible personal property to include digital goods and expands canned or prewritten computer software to include software that is electronically accessed or transferred, and any additional content regarding that software. Beginning October 1, this will effectively eliminate the 1 percent reduced rate and increase the tax to the full 6.35 percent rate, regardless of delivery. However, this excludes purchases by a business for use by those businesses.

The legislation goes on to define digital goods as audio works, visual works, audio-visual works, reading materials, or ringtones that are electronically accessed or transferred. It sets forth the conditions for which a sale of canned or prewritten computer software will be treated as a sale for resale. A sale of that software will only be considered a sale for resale if it was later sold, licensed, or leased unaltered by the purchaser to an ultimate consumer.

Some new goods and services will be taxable. Dry cleaning services, laundry services (excluding coin-operated services), specific parking services, and interior design services will be subject to tax beginning January 1, 2020. However, the legislation also provides that interior design services will not be subject to tax when purchased by a business for use by that business, and provides the criteria for the exemption. Purchasers seeking the exemption will be required to provide a certificate to the retailer certifying that the purchaser is a business and is purchasing the services for its business. The purchaser will be liable for the tax if the certificate was improperly provided, and persons willfully delivering a certificate known to be fraudulent or false in any material matter to a seller shall, in addition to any other penalty, be guilty of a class D felony.

There will be an additional 1 percent tax on meals sold by eating establishments, caterers, or grocery stores, as well as liquors, soft drinks, sodas, or beverages ordinarily dispensed at or in connection with bars and soda fountains beginning October 1. The sales and use tax exemption for safety clothing and protective equipment worn by employees at work will be eliminated on January 1, 2020.

Lastly, the budget legislation will expand sales tax nexus by lowering the sales thresholds for economic nexus and click-through nexus. Currently, out-of-state retailers who regularly and systematically solicit sales of tangible personal property into the state must collect and remit sales tax if they have gross receipts of at least $250,000 and made 200 or more retail sales from out of state into the state during the 12-month period ending September 30. Beginning July 1, gross receipts will include the sales of services, and the threshold will be lowered to $100,000. Likewise, the requirement for regular and systematic soliciting of sales will be eliminated. Similarly, the sales threshold for click-through nexus will be lowered from $250,000 to $100,000.

Beginning October 1, short-term rental facilitators will be required to collect and remit the applicable tax if they facilitate retail sales of at least $250,000 during a 12-month period. Short-term rental facilitators are defined as persons who facilitate retail sales of at least $250,000 during a 12-month period by short-term rental operators by providing a short-term rental platform, directly or indirectly through agreements or arrangements with third parties; collect rent for occupancy and remit payments to the short-term rental operators; and receive compensation or other consideration for such services.

Real Estate Conveyance Tax

While not increasing the income tax on high earners, the legislation will raise the real estate conveyance tax on sales of homes exceeding $2.5 million. On and after July 1, 2020, the rate will increase from 1.25 percent to 2.25 percent on that portion of the consideration paid that exceeds $2.5 million. Regarding this, the legislation will also provide for a property tax credit against personal income tax for persons who paid the increased real estate conveyance tax and remained state residents. The credit is for a three-year period, beginning in the third year after the real estate conveyance tax is paid, and, in each year, equals 33.3 percent of such tax paid at the 2.25 percent rate.

Some transfers of properties with concrete foundations that have deteriorated because of the presence of pyrrhotite will be exempt from the real estate conveyance tax. The exemption will apply to the first transfer and not be available to a transferor who received financial assistance to repair or replace such foundation from the state's Crumbling Foundations Assistance Program.

Hospital Provider Tax

The legislation will eliminate the planned hospital provider tax reduction and require the base year for calculating the tax to be adjusted each biennium. In 2017 Connecticut imposed the tax on the total net revenue received by hospitals for the provision of inpatient hospital services at a 6 percent rate, and outpatient hospital services at a total of $900 million to be divided among all hospitals subject to the tax. Through a complex arrangement between the state and the hospitals, the hospitals receive payments from the state based on the state's ability to leverage federal Medicaid payments. Now, beginning in fiscal 2020, the $900 million, which was scheduled to be reduced to $384 million, will remain at $900 million, and the base year will be the fiscal year three years before the first year of the biennium.

Miscellaneous

Finally, there are a number of other new and increased fees. Effective July 1, user fees imposed on intermediate care facilities will increase from $27.26 per resident day per quarter to $27.76 per resident day per quarter, the various rates of the alcoholic beverages taxes will increase, and the fee imposed on transportation network companies (that is, Uber and Lyft) for each prearranged ride will increase from $0.25 per ride to $0.30 per ride. On and after August 1, a new 10-cent fee will be collected on each single-use checkout bag provided by stores to customers at the point of sale. A new tax will also be imposed on the first sale of electronic cigarette products on and after October 1 by electronic cigarette wholesalers. ■