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Connecticut Budget Impasse Resolved

Governor Rell announced that she will not veto (other than certain select line items) the biennial budget legislation passed August 31, 2009, by the Democratic-controlled Connecticut General Assembly. As a result, *An Act Concerning Expenditures and Revenue for the Biennium Ending June 30, 2011* (the "Act"), will become law on September 8, 2009. Among the more significant tax-related provisions contained in the Act are the following:

- **Personal Income Tax Increases.** Effective January 1, 2009, the Connecticut personal income tax is increased for joint filers with taxable income of over \$1 million, heads of households with taxable income over \$800,000, and single filers and married people filing separately with taxable income over \$500,000. A third tax bracket is added increasing the marginal tax rate for income over these thresholds from 5.0% to 6.5%. In addition, the scheduled income tax reductions for single filers, and the scheduled increases in income ranges that allow single filers to qualify for personal credits against their income tax, are delayed for three years. The flat income tax rate for trusts and estates is also increased from 5.0% to 6.5%.
- **Corporation Business Tax Surcharge.** A 10% surcharge is imposed for tax years commencing in 2009, 2010 and 2011 on the corporation business tax liability of a corporation, regardless of whether the tax is based upon the corporation's net income or capital base, unless either (i) the tax is equal to \$250 (i.e. the minimum tax) or (ii) the gross income of the corporation is less than \$100 million. The gross income exemption from the surcharge is not available to any corporation that files a combined or unitary return. The surcharge is calculated based upon the tax liability of the corporation excluding any credits.
- **Economic Nexus.** Effective for taxable years commencing on or after January 1, 2010, an out-of-state Subchapter C corporation, as well as the owners of an out-of-state partnership or Subchapter S corporation, shall be subject to income taxation in Connecticut if the out-of-state corporation or partnership derives income from sources within Connecticut, or has a "substantial economic presence" within Connecticut, as evidenced by a "purposeful direction of business toward this state." To the extent permitted under the United States Constitution, a physical presence in Connecticut will no longer be required to impose the Connecticut corporation business tax or the Connecticut personal income tax.
- **Decoupling of Federal Qualified Domestic Production Activities Deduction.** Effective for tax years commencing on or after January 1, 2009, corporations, trusts, estates and individuals will be required, when determining their Connecticut taxable income, to disregard or otherwise add back any federal

income tax deduction taken under Section 199 of the Internal Revenue Code for income from qualified domestic production activities.

- Corporation Combined Reporting Preference Tax. The maximum preference tax for groups of corporations filing combined corporation business tax returns is doubled from \$250,000 to \$500,000.
- Film Production, Entertainment Infrastructure Projects and Digital Animation Production Credits. Effective for tax years commencing on or after January 1, 2010, numerous changes are made to the rules governing the film production tax credit, the tax credit for infrastructure projects in the entertainment industry and the tax credit for digital animation production companies. In the case of the film and digital animation production credits: (i) the minimum amount of eligible production expenses that must be incurred in the state is increased from \$50,000 to \$100,000; and (ii) the flat credit rate of 30% of eligible production costs is replaced with a “tiered” credit rate of 10% for companies incurring expenses between \$100,000 and \$500,000, 15% for companies incurring expenses between \$500,001 and \$1 million, and 30% for companies incurring expenses over \$1 million. By way of contrast, the credit for infrastructure investments is amended so as to convert its current tiered rate structure (10% to 20%) to a flat rate of 20%, but the minimum qualifying expenditure is increased to \$3 million. In addition, the project must be 100% complete, rather than at least 60% complete, before it can be eligible to receive a credit voucher. Other changes to the credits include: (i) the transfer of the administration of the credits from the Connecticut Commission on Culture and Tourism to the Department of Economic and Community Development (“DECD”); (ii) the elimination of the ability to obtain an interim film production credit (although annual applications remain available); (iii) the requirement of an independent certification of production expenses and costs by a DECD-approved audit professional; (iv) the authorization of DECD to charge a reasonable administrative fee to cover its costs; (v) the limitation on the ability of the DECD or DRS to have credits be recaptured, disallowed, recovered, reduced, repaid, forfeited or decertified after they have been certified is restricted to only transferred credits; (vi) infomercials are made ineligible for the film production credit; and (vii) the categories of eligible and ineligible production expenses are amended to require that at least 50% of a production company’s principal photography days be conducted in Connecticut, the phase-out date for the eligibility of out-of-state expenses is moved up from January 1, 2012 to January 1, 2010, and the star salary limitation is changed from \$15 million per star to \$20 million in the aggregate.
- Tax Credit for Donating Open Space. The credit against the corporation business tax for donations or discounted sales of open space land or interests in land is amended to extend the period during which a credit earned on or after January 1, 2000 may be carried forward from 15 to 25 years.
- Sales and Use Tax Rate. Starting January 1, 2010, the sales and use tax rate applicable to most taxable goods and services will be reduced from 6.0% to 5.5%, but: (i) the reduction will not go into effect if, prior to January 1, 2010, the Comptroller’s monthly statement indicates that the General Fund tax revenues for the 2010 fiscal year is at least 1% less than the 2010 fiscal year revenue estimate adopted by the Finance Revenue and Bonding Committee; and, if the reduction does go into effect, (ii) the reduction will not remain in effect, and the 6% rate must be reinstated as of July 1, 2010, if any of the Comptroller’s monthly statements issued between January 1, 2010 and June 30, 2010, show a similar 1% or greater shortfall in state tax revenues.
- Estate and Gift Tax. Effective for deaths occurring and gifts made on or after January 1, 2010: (i) the threshold for the value of an estate or gift subject to the estate and gift tax is increased from \$2 million to \$3.5 million; (ii) the marginal tax rates on estates and gifts are reduced by 25%; and (iii) the tax “cliff” is eliminated, by applying the tax only to the marginal value of the estate or gift over the new threshold. In addition, the time an executor has to file an estate tax return is reduced from nine months to six months after the date of death, starting with deaths on or after July 1, 2009.



Notes

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

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- **Real Estate Conveyance Tax on Foreclosures.** The exemption from the real estate conveyance tax for deeds made pursuant to a foreclosure by sale is repealed effective for conveyances occurring on or after January 1, 2010.
- **Cigarette Tax Increase and Floor Tax.** The cigarette tax is increased from \$2 to \$3 per pack of 20 (from 10 cents to 15 cents per cigarette), starting October 1, 2009. A floor tax of \$1 is imposed on each pack of cigarettes that dealers and distributors have in their inventories at the later of the close of business or 11:59 p.m. on September 30, 2009. A floor tax report must be filed, and the tax paid, by November 15, 2009.
- **Tobacco Products Tax.** For sales occurring on or after October 1, 2009, the tax on tobacco products is increased from 20% to 27.5% of the wholesale price, and the tax on snuff tobacco is increased from 40 cents to 55 cents per ounce.
- **Tax Settlement Initiative Program.** A new tax settlement initiative program is established for the period from October 1, 2009 through December 31, 2009, whereby the Commissioner of Revenue Services (the "Commissioner") may send to taxpayers who owe tax for a particular tax period a statement that they may settle their claim by paying the tax due and 50% of the interest due on that tax. If the taxpayer elects to participate in the program, the Commissioner will waive his right to seek the remaining interest or any penalties due for the period, and the taxpayer will waive its right to contest the tax liability for that period or to seek a refund of the payment made.
- **Fee Increases.** A wide range of fees are increased effective October 1, 2009, including those for tobacco-related licenses and sales and use tax permits.

Please note that the descriptions contained herein are only summaries: the application of a change in tax law to your business or to you, individually, may be impacted by tax law provisions not included in our summary that are nevertheless applicable to your particular facts and circumstances. We encourage you to contact any member of our State and Local Taxation Practice Group if you have any questions.

This newsletter is for informational purposes only. It is not intended as legal advice. How the laws and principles described here will apply in a particular matter depends on the facts of that situation.

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