

CONNECTICUT STATE TAX DEVELOPMENTS
(Updated as of September 30, 2022)



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I. LEGISLATION

The budget in effect for the fiscal biennium—beginning July 1, 2021 and ending June 30, 2023—was signed into law by Governor Ned Lamont on June 23, 2021.

On February 2, 2022, Governor Lamont unveiled a package of legislative budget proposals for the 2022 regular session. The 2022 legislative session began on February 8, 2022 and adjourned on May 4, 2022.

This update includes a discussion of the major legislative developments from the biennial budget currently in effect, as well as recent legislative proposals.

A. Enacted Budget Currently in Effect for Fiscal Biennium (FYE 2022 – 2023)

1. *Extension of Corporation Business Tax Surcharge*: The surtax of 10% has been extended to income years beginning on or after January 1, 2021, and prior to January 1, 2023.
2. *Delay to Capital Base Tax Phase-out*: Previously, the capital base tax phase-out was scheduled to begin in the 2021 income year. However, new legislation delayed the phase-out until 2024. Starting in the income year 2024 the capital base tax portion of the corporate business tax will phase-out as follows:

Period	Capital Base Tax Rate
Before 1/1/2024	0.0031
From 1/1/2024 through 12/31/2024	0.0026
From 1/1/2025 through 12/31/2025	0.0021
From 1/1/2026 through 12/31/2026	0.0016
From 1/1/2027 through 12/31/2027	0.0011
Beginning 1/1/2028	0.0000

The minimum tax will remain at \$250 for all income years.

3. *Increase in Cap to Research & Development Tax Credits:* Beginning with the income year in 2022, companies may utilize tax credits in excess of the standard credit limitation for research and experimental tax credits under Conn. Gen. Stat. § 12-217j (R&E Tax Credits) and research and development tax credits under Conn. Gen. Stat. § 12-217n (R&D Tax Credits). R&E Tax Credits and R&D Tax Credits may be used up to 60% of the tax due in income year 2022, and up to 70% of the tax due in income year 2023 and thereafter.
4. *Elimination of Admissions Tax for Places of Amusement, Entertainment, and Recreation:* Beginning July 1, 2021, admissions tax has been eliminated for admissions to most places of amusement, entertainment, and recreations. However, there is a 6% tax for admission to motion picture shows where the charge is greater than \$5. There will be no refunds issued in connection with admissions tax collected on or before June 30, 2021 even if the event occurs on or after July 1, 2021. (The remaining tax on admission to motion picture shows where the charge is greater than \$5 was eliminated as part of the Fiscal Year 2023 budget, see below.)

B. Fiscal Year 2023 Budget Adjustment Bill (Signed May 9, 2022)

1. *Excise Tax on Gasoline Suspended:* The budget suspends Connecticut's excise tax on gasoline from April 1, 2022 through November 30, 2022. The suspension affects the application of the motor vehicle fuels tax to gasoline and gasohol.
2. *Jobs CT Tax Rebate Program:* Beginning on or after January 1, 2023, qualified businesses that create jobs in CT may be allowed a tax rebate which can act as a credit against corporate business tax or pass-through entity tax. The rebate is based upon the number of new full-time equivalent employees (FTE) the business creates/maintains, the FTE's average wage and the state income tax that would be paid on the average wage for a single filer. Credits cannot exceed \$40 million in any single year.
3. *Tax Amnesty for Captive Insurance Companies:* The budget adjustment bill authorized a tax amnesty program for eligible noncompliant captive insurance companies that come forward. In order to be eligible for the program, the captive insurance company must either (a) establish a branch captive insurance company in CT, or (b) transfer the domicile of its out-of-state captive insurance company to CT. Captive insurance companies who satisfy these requirements are eligible for a waiver of penalties that would otherwise be due for taxable periods beginning on or after July 1, 2019 and ending prior to July 1, 2022. We note that taxpayers that do not participate in the tax amnesty program and are assessed penalties may have a claim that Connecticut's program violates the Commerce Clause of the U.S. Constitution because of the preferential treatment under the program for captive insurance companies domiciled in or with branches in Connecticut.

4. *Elimination of the Admission Tax on Movie Theatres:* Effective January 1, 2023, the admissions tax on any admission charge of more than \$5 to any motion picture show is eliminated.
5. *Pass-Through Entity Composite Return:* Any affected business entity may elect to file a composite income tax return on behalf of each nonresident individual who is a member of such affected business entity, subject to any requirements and conditions the Commissioner may prescribe in the return form and instructions for such return. The affected business entity must make the election by the due date or extended due date of the affected business entity's return. The affected business entity must pay the tax due plus any penalties and interest due, on behalf of each nonresident individual member of the affected business entity. Any payment made by an affected business entity with respect to any taxable period will be considered to be a payment by the nonresident individual member for the personal income tax imposed on the member for the taxable period. The composite income tax due on behalf of each nonresident individual member is equal to the member's distributive share of the affected business entity's Connecticut source income multiplied by the highest marginal rate (currently 6.99%) in effect for the taxable year, less the pass-through entity tax credit under Conn. Gen. Stat. §12-699(g) allowed to the nonresident individual member. If the only Connecticut source income for the nonresident member is from one or more electing pass-through entities, the composite income tax return and payment remitted on the nonresident's behalf satisfies their Connecticut income tax filing and payment requirements. The nonresident member must file a separate Connecticut income tax return if the nonresident has Connecticut source income from other sources.
6. *Cap on Interest Paid on Refunds:* Effective on its passage, the budget adjustment bill places a new cap on Connecticut's payment of refund interest in all cases such that the State will not pay interest in excess of \$5 million. The State's justification for the cap is to put the Department on equal footing with taxpayers in light of the taxpayers' ability to stop interest from running on assessments by filing cash bonds.
7. *Limitation of Refund Claims for Audited Periods:* Effective on its passage, the budget adjustment bill prohibits taxpayers from filing refund claims for issues the Department already has addressed through an audit or other investigation, during periods for which the statute of limitations period is open.

C. Recent Legislative Proposals

1. *Extension of R&D Credit for Pass-Through Entities*: On March 18, 2022, House Bill 5488 was introduced which would have allowed owners of pass-through entities to claim a 6% income tax credit for R&D expenses incurred by the entity for tax years beginning on and after January 1, 2023. Per the proposal, if an entity was treated as a partnership or an S corporation, the credit could have been claimed by shareholders, partners, or the pass-through entity's owner if the taxpayer was a single-member LLC. The bill was not enacted prior to the conclusion of the 2022 legislative session.

II. RECENT CASE LAW AND ADMINISTRATIVE DECISIONS

A. *Costas v. Comm'r of Revenue Servs.*, 213 Conn. App. 719 (2022) (Allocation of Income from Stock Options)

In a win for commissioner discretion and a loss for taxpayers who argue for alternative apportionment methods, the Connecticut Appellate Court recently upheld the disallowance of income tax credits relating to stock options and restricted stock paid as compensation for work performed in New York and Connecticut.

The case involved interpretations of Conn. Regulations §12-711(b)-17(c) and -18(c), which dictate the amount of income from stock options and grants of restricted stock that should be allocated to Connecticut when the employee performs services both within and outside Connecticut during the “grant-to-exercise period” (in the case of stock options) and “grant-to-vest period” (in the case of restricted stock).

Relying on the regulations, the Commissioner found that compensation for purposes of calculating income allocation was the total compensation that the taxpayers received during the grant-to-exercise and grant-to-vest periods, including deferred compensation received in those periods but earned prior to those periods. The taxpayer argued that deferred compensation should not be included in the calculation of allocable income unless it was both received and earned during the relevant periods.

Disagreeing with the taxpayer, the Connecticut Appellate Court held that the Commissioner properly included deferred compensation in computing the total compensation received. The Court found that the plain language of the regulations required the credit to be calculated based on a ratio reflecting compensation received for services performed within Connecticut to the total compensation received for services performed within and outside Connecticut. Thus, the commissioner was correct in disallowing the claims for refund because the taxpayer was not entitled to any further credit for taxes paid to New York.

Secondarily, the taxpayer argued that the Commissioner incorrectly refused to exercise his discretionary authority under § 12-711(b)-15 to approve alternative apportionment methodology resulting in unfair and inequitable allocation of income and tax credits. The Court declared this argument to be without merit and reiterated that the Commissioner correctly interpreted §§ 12-711(b)-17 and 12-711(b)-18 when calculating the taxpayer’s total allocable income for purposes of computing the tax credit to which the taxpayer was entitled for taxes paid to another state. Therefore, the Commissioner’s method is presumptively fair and equitable. Furthermore, the Court reasoned the commissioner “must be afforded wide latitude to accept or reject a proposed alternate methodology pursuant to § 12-711(b)-15 (a).” (*Id.* 738).

B. Connecticut Legal Ruling No. 2022-2, 04/21/2022 (Sales and Use Tax on Digital Goods and Training Services)

In its April 21, 2022 ruling, the Department determined that online learning plans and services, such as courses taken for college credit, are generally considered nontaxable services and not subject to sales and use taxes as digital goods. However, such services may still be deemed taxable services if they include consultant-related job training or software or computer training.

The Department explained that, although digital educational products generally are subject to tax as digital goods, sales for access to online services are nontaxable when the primary purpose of the transaction is to provide a service related to education or vocational training. Taxability depends on “whether the true object of that transaction is to provide students with a digital good in the form of an electronically accessed or transferred audio-visual product [taxable], or whether the true object is to provide students the opportunity to access the learning plan’s educational or training offerings [nontaxable].” In addition, to be classified as a nontaxable service, an online learning platform must provide some level of interactive learning services, beyond mere access to course catalogues. In the ruling, the Department concluded that a company’s sales for access to its subscription-based online learning platform, which offered courses with assessments, access to live tutors, and educational plans, were nontaxable services.

The Department provided two possible exceptions to the reasoning in the ruling. First, online educational services consisting of job related training could be taxed as business management consulting services. Such services include “include furnishing advice and assistance on the management of a service recipient’s core business activities or human resource management activities.” *See* Conn. Gen. Stat. section 12-407(a)(37)(J). General education seminars, such as refresher courses, courses on current developments in a particular field, and courses for continuing education credits are not subject to tax as job-related training services.

Second, computer training or software training that is job-related may be taxed at the full sales and use tax rate or taxed in proportion to the sale or lease of software if not job-related. *See* Conn. Gen. Stat. § 12-407(a)(37).

III. RECENT REGULATIONS AND ADMINISTRATIVE GUIDANCE

A. Guidance for Payers of Non-Payroll Amounts (Conn. Dept. of Rev. Svcs., Income Tax Withholding Requirements, IP 2022(8))

This guidance provides information on recent changes, frequently asked questions, and instructions regarding the filing requirements. Recent changes includes a subtraction modification for certain IRA distributions beginning with the year 2023. The subtraction modification will be allowed to the extent the IRA distributions are included in federal adjusted gross income.

The guidance explains that anyone who maintains an office or transacts business in Connecticut must withhold Connecticut income tax whether or not the payroll or accounts receivable department is located in Connecticut. Income that is subject to Connecticut income tax withholding includes pension and annuity distributions to Connecticut residents, unemployment compensation payments, gambling winnings other than Connecticut lottery, Connecticut lottery winnings, and payments made to athletes or entertainers. Alternatively, income not subject to federal withholding is generally not subject to Connecticut income tax withholding. A taxpayer is required to withhold Connecticut income tax from non-payroll amounts at the time those amounts are paid. Additionally, each year the Department will determine a taxpayer's remitter classification as either weekly, monthly, or quarterly.

The guidance also provides information on the necessary forms to file, how to file amended returns, how to register for income tax withholding, interests and penalties, and how to cancel registration for withholding Connecticut income tax.

IV. PROVIDERS' BRIEF BIOGRAPHIES

A. Jennifer S. White

Jennifer is a partner in Reed Smith's New York office. She works with companies and individuals to assist in reducing state tax liabilities and to eliminate risk of audit exposure. Jennifer's practice focuses on New York State and City, New Jersey, and Connecticut issues. She excels at providing effective and practical counsel that meets the unique goals of each client. Through years of work in private practice and time spent with the New York City Department of Finance, Jennifer has learned the most effective strategies to both settle and litigate cases, and most importantly, when to pursue each avenue of resolution.

B. Georgios I. Tsoflias

Georgios (George) is a member of the firm's State Tax Group. George's practice is concentrated on tax controversy—including federal and state tax audits, appeals, and judicial litigation—and a broad range of multistate tax issues involving sales and use tax, corporate income tax, and franchise tax.

C. Chandler N. Scanlon

Chandler is an associate in Reed Smith's Philadelphia office. Her practice consists of State and Local Tax matters.