State & Local Tax Alert

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Connecticut Budget Revises Net Deferred Tax Liability Deduction Provisions

On October 31, Connecticut Governor Dan Malloy signed budget legislation markedly extending the period over which the net deferred tax liability deduction under the state's unitary combined reporting system may be claimed.[1] Shortly after enactment of the budget, the governor signed a technical amendments bill, S.B. 1503, delaying the first year the deduction may be claimed from the 2018 income year to the 2021 income year.[2]

Net Deferred Tax Liability Deduction

In 2015, Connecticut enacted legislation that required certain taxpayers to calculate their Connecticut Corporation Business Tax liability using combined unitary reporting, effective for income years beginning on or after January 1, 2016.[3] In conjunction with this transition, the state offered certain publicly traded members of a unitary combined group a deduction designed to limit the impact of this change on financial income statements.[4] This deduction was available in one-seventh increments over a period of seven years beginning in the group's first income year beginning in 2018.[5]

The budget legislation, and companion legislation making technical changes to the budget, maintain the framework relating to the net deferred tax liability deduction, except that the deduction will now be available in one-thirtieth increments over a period of thirty years beginning with the unitary group's first income year beginning in 2021.[6] The legislation also removes the requirement that the deduction be calculated without regard to the federal tax effect.[7] The delay of the deduction from the 2018 income year to the 2021 income year took effect November 21, 2017[8] and the remaining provisions took effect on October 31, 2017.[9]

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[1] Public Act 17-2 (S.B. 1502), June Special Session, Laws 2017.
[2] S.B. 1503, Laws 2017.
[3] Connecticut Department of Revenue Services, *Instructions Form CT-DTLD - Statement of Net Deferred Tax Liability Deduction* (Due Date: July 3, 2017).
[4] CONN. GEN. STAT. § 12-218g(d).
[5] *Id.*
[6] *Id.*
[7] CONN. GEN. STAT. § 12-218g(e).
[8] S.B. 1503, Sec. 19.
[9] Act 17-2, Sec. 661.

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Creation of Fresh Start (Tax Amnesty) Program

The legislation also authorizes the Commissioner of Revenue Services to establish a fresh start (tax amnesty) program under which certain noncompliant taxpayers that have not been previously contacted by the Department will be given the opportunity to pay delinquent state taxes in exchange for full relief from penalties and partial relief from interest that would otherwise be due.[10] Specifically, until November 30, 2018, the Commissioner is authorized to enter into fresh start agreements with "qualified taxpayers"[11] for all taxes, except the motor carrier road tax.[12] Under a fresh start agreement, the taxpayer will receive a waiver of all penalties[13] and 50 percent of the interest related to a failure to pay any amount due by the payment's due date.[14] A fresh start agreement for a qualified taxpayer that has failed to file a tax return or returns may also provide for a limited look-back period.[15] In exchange, a qualified taxpayer is required to file all tax returns or documents required by the Commissioner and fully pay the tax and applicable interest as provided in the fresh start agreement.[16] As a means to address situations where a qualified taxpayer does not comply with the terms of the fresh start agreement, the legislation enumerates several circumstances under which the waiver of penalties and interest will be considered non-binding on the Commissioner.[17]

Expansion of Sales and Use Tax Exemption for Certain Services

While Connecticut subjects numerous types of services to sales and use tax, an exemption is generally available for services provided for a business entity that is affiliated with the business entity providing the service when: (i) either business entity in the transaction owns a controlling interest in the other business entity; or (ii) a controlling interest in each business entity in the transaction is owned by the same person or persons or business entity or business entities.[18]

The legislation revises this exemption for certain media businesses by lowering the ownership threshold required to be a controlling interest.[19] Specifically, for a corporation (or a single-member limited liability company treated as a corporation) engaged in the

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[10] Act 17-2, Sec. 656.
[11] Act 17-2, Sec. 656(a). The legislation enumerates seven criteria that a taxpayer must meet in order to a "qualified taxpayer." A qualified taxpayer is one that, among other things, failed to file a tax return, or failed to report the full amount of tax properly due on a previously filed tax return, that was due on or before December 31, 2016 and voluntarily comes forward prior to receiving a billing notice or a notice from the Department that an audit is being conducted for the tax type and taxable period the taxpayer is seeking a fresh start agreement.
[12] Act 17-2, Sec. 656(b).
[13] A waiver of all penalties that may be imposed under Title 12, Taxation.
[14] Act 17-2, Sec. 656(b).
[15] *Id.*
[16] Act 17-2, Sec. 656(c). The legislation also requires that the taxpayer agree to: (1) voluntarily and fully disclose on the application all material facts pertinent to such taxpayer's liability for taxes due to the commissioner; (2) timely file any required tax returns and pay any associated tax obligations to Connecticut for a period of three years after the date the fresh start agreement is signed; and (3) waive all administrative and judicial rights of appeal that have not run or expired for the penalty and interest waiver period.
[17] Act 17-2, Sec. 656(d).
[18] CONN. GEN. STAT. § 12-412(62)(A).
[19] Connecticut Office of Legislative Research, *Bill Analysis for SB-1502*, Sec. 640, Sales and Use Tax on Services Rendered Between Parent Companies and Subsidiaries (2017).

media business with its principal place of business in the state, the "controlling interest" is determined through an 80 percent voting or value ownership test, rather than a 100 percent ownership test.[20] This change takes effect on or after July 1, 2019[21] and will expand "the number of affiliated businesses that qualify for the exemption."[22]

Expansion of Economic Development Programs

The legislation also authorizes the Department of Economic and Community Development (DECD) to establish programs that will allow businesses to use certain "accumulated credits" against the Connecticut Corporation Business Tax and the sales and use tax in exchange for undertaking certain capital projects in the state.[23] "[A]ccumulated credits" are defined as the amount of the research and development expense credits allowed under Conn. Gen. Stat. Sec. 12-217n that that have not been taken through an applicant's last income year completed prior to the date of its application for the program.[24] This provision is effective October 31, 2017.[25]

Along similar lines, the legislation also requires the DECD to establish innovation investment fund tax credit auctions or enter into agreements to allow taxpayers with accumulated research and development expense credits under Conn. Gen. Stat. Sec. 12-217n or research and experimental expenditure credits under Conn. Gen. Stat. Sec. 12-217j to utilize such credits in exchange for making an investment in their corporate venture capital fund.[26] This provision is also effective October 31, 2017.[27]

Commentary

After 123 days without a budget,[28] Gov. Malloy signed a two-year budget bill which, after its enactment, landed Connecticut the notable distinction of being the "the last state to enact a budget" in 2017.[29] Unfortunately, however, the enactment of the budget appears to have done little to solve the massive shortfalls facing the state. It has been said that "legislators averted a potential, two-year deficit of $3.5 billion" and avoided income or sales tax rate increases by "relying on smaller tax hikes and significant spending cuts."[30] But, in doing so, "they set up the winners of the next state election to close a [significantly larger] $4.6 billion gap."[31]

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[20] CONN. GEN. STAT. § 12-412(62)(B)(ii)(I), (V).
[21] *Id.*
[22] *Bill Analysis for SB-1502*, Sec. 640, *supra*.
[23] Connecticut Office of Legislative Research, *Bill Analysis for SB-1502*, Secs. 701-703, Stranded Tax Credits (2017).
[24] Act 17-2, Sec. 701.
[25] *Id.*
[26] *Bill Analysis for SB-1502*, Secs. 701-703, *supra*; Act 17-2, Sec. 702.
[27] *Id.*
[28] Keith M. Phaneuf and Mark Pazniokas, *Malloy Rejects Hospital Tax Plan But Signs Most of CT Budget Into Law,* THE CT MIRROR, October 31, 2017, *quoting* Gov. Dan Malloy.
[29] Rick Rojas, *Connecticut Adopts a Budget After Months of Debate and Delays*, THE NEW YORK TIMES, October 31, 2017, *quoting* Gov. Dan Malloy.
[30] Keith M. Phaneuf, *Newly Adopted CT Budget Already Showing Red Ink*, THE CT MIRROR, November 13, 2017.
[31] *Id.*

The changes to the state's net deferred tax liability deduction, as well as the fresh start program, are unlikely to raise more than a small amount of revenue in comparison to the prospective budget gap, based on initial estimates. By increasing the time over which a company claims the overall deduction from seven to 30 years, and delaying the first year the deduction can be claimed, the state is expected to generate $20.3 million in FY18 and $34 million in FY19.[32] Interestingly, Connecticut's action in this area follows a similar change made by Massachusetts to its net deferred tax liability deduction in 2015.[33] The fresh start program is projected to raise $60 million in FY18 and $25 million in FY19[34] and will mark the state's "seventh amnesty program … since 1990."[35]

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[32] Connecticut Office of Fiscal Analysis, *OFA Fiscal Note SB-1502, Emergency Certification* (2017); Connecticut Office of Fiscal Analysis, *OFA Fiscal Note SB-1503, Emergency Certification* (2017).
[33] Ch. 52 (H.B. 3671), § 2, Laws 2015.
[34] *OFA Fiscal Note SB-1502, supra.*
[35] Keith M. Phaneuf, Jacqueline Rabe Thomas and Mark Pazniokas, *After 117-day Marathon, Senate Passes Bipartisan Budget*, THE CT MIRROR, October 26, 2017.