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Enacted Connecticut budget increases income, sales-use taxes

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On May 4, 2011, Governor Malloy signed the Connecticut budget package that increases and extends the corporate tax surcharge, increases personal income tax rates, adopts a "click-through" nexus provision, increases sales and use tax rates and expands the base, and increases other taxes. [S.B. 1239, enacted, 5/4/11]

Corporate Tax Changes

(Sections 76 and 79) The legislation extends the corporate tax surcharge through 2013 and increases the amount of the surcharge to 20 percent from the original 10 percent. Taxpayers whose gross income for the income year is less than $100 million are exempt from the surcharge. However, this exemption does not apply to companies that file a combined or unitary return. **Note**. A provision that would have imposed a sales factor throwback rule was removed from the legislation.

(Section 78) The legislation allows a business that adds employees a credit for an amount equal to its "average monthly net employee gain for an income year" multiplied by $6,000. For such business, the cap on credits is increased from 70 percent of tax liability to 100 percent. These provisions apply to income years beginning in 2011 and 2012.

Click-Through Nexus

(Section 128) The legislation creates a presumption that a person is a retailer if that person makes sales of tangible personal property or services "through an independent contractor or other representative if the retailer enters into an agreement with a resident" of Connecticut, who for a commission or other consideration, directly or indirectly refers potential customers to the retailer via a link on an Internet Web site or otherwise, if the cumulative gross receipts from such sales are more than $2,000 during the preceding four calendar quarters. The presumption can be overcome by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the state on behalf of the retailer that would satisfy the nexus requirements of the U.S. Constitution. The legislation applies to sales that occur on or after July 1, 2011.

Sales and Use Taxes

(Sections 93 through 127) The legislation increases the state sales tax rate from 6 percent to 6.35 percent (7 percent on a variety of deemed luxury items) and proposes to eliminate a number of sales tax exemptions, most notably the exemption for clothing and footwear under $50. The legislation subjects to tax services such as cosmetic surgery services, manicure and pedicure services, automotive storage, and pet grooming services. The legislation also increases the hotel occupancy tax rate and imposes a rental car surtax. These changes apply to sales occurring on or after July 1, 2011.

Personal Income Taxes

(Section 107) Presently, the state has a three-bracket personal income tax system, with rates ranging from 3 percent to 6.5 percent. The legislation replaces this with a six-bracket system, with rates ranging from 3 percent to 6.7 percent. Trusts and estates will be taxed at 6.7 percent. The lower brackets are phased out at certain income levels through a "benefit recapture" provision. In addition, a new earned income tax credit equal to 30 percent of the federal credit is allowed (Section110) and the current $500 personal income tax credit for property tax paid to a Connecticut municipality on a principal residence or motor vehicle is reduced to $300 and will be phased out at a steeper rate (Section 111). These changes apply to taxable years commencing on or after January 1, 2011.

Insurance Companies

(Section 75) The legislation lowers, to 30 percent from 70 percent, the credit cap by which an insurer can reduce its premium tax liability. In addition, an insurer would be entitled to a new credit for an amount equal to $6,000 multiplied by its average monthly net employee gain for a calendar year, up to 100 percent of its tax liability depending on the increase in employment level.

Other. In addition, the legislation:

- Limits the transfer of film production tax credits (Section 77);
- Increases tax on cigarettes and tobacco products (Sections 80 through 83);
- Lowers estate and gift tax thresholds (Sections 84 through 87 and 119);
- Increases taxes on alcoholic beverages (Sections 98 and 99);
- Increases tax on diesel fuel (Sections 100 and 101); and

- Imposes a tax per kilowatt-hour of electricity generation through June 30, 2013 (Section 104).

PwC Observes

"Despite the tax increases in the budget bill, the state still has a $2 billion shortfall that is supposed to be filled by concessions from state employees" notes Stephen LaRosa, SALT Director in Hartford.

"It remains to be seen how this budget gap will be resolved if the governor is unable to obtain the desired level of concessions from state labor. The administration has not been shy about openly discussing and taking the necessary steps to prepare for layoffs of state workers, which may prove to be the resolution of the budget deficit, instead of further tax or other revenue increases," LaRosa suggests.

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