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New CT laws aim to counteract higher costs from federal tax reforms


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The Connecticut General Assembly recently passed legislation intended to provide workarounds for taxpayers impacted by the new $10,000 limitation on the deduction of state and local taxes (SALT) under the Tax Cuts and Jobs Act of 2017.

The Connecticut law contains two major components that individual and business taxpayers should be aware of:

A new entity-level tax on pass-through entities

Beginning in 2018, an entity-level flat tax of 6.99 percent (the highest personal state rate) is imposed on partnerships, certain limited liability companies and S corporations. The tax is based on either the entity's taxable income or its Alternate Tax Base, at the taxpayer's discretion. If the entity produces a net loss, this can be carried forward for an indefinite period.

The intention is to provide a tax benefit to partners and S-corporation shareholders through a business deduction that reduces flow-through income. Since the flow-through income is also included on the Connecticut individual tax return of the owner, the law provides a tax credit equal to 93.01 percent of the allocated Connecticut tax.

For example, consider a Connecticut resident who is a partner in a partnership that allocates $100,000 of income. At a 6.99 percent personal state tax rate, there is a $6,990 Connecticut income tax that might not be deductible if the $10,000 SALT limitation applies (i.e., if the taxpayer owes more than $10,000 in state and local taxes).

The new Connecticut law addresses this problem by making the $6,990 income tax the responsibility of the pass-through entity, so that only $93,010 of income is allocated to the owner. Since the resident must include $93,010 in his or her personal income, an amount that has already been taxed for state purposes, the Connecticut law gives a credit of 93.01% of the $6,990 to the resident to offset the personal tax on this includible amount. This causes no additional personal tax on the flow-through income.

The law also accelerates the due date for the tax return for a pass-through entity. A calendar year tax return will now be due on March 15 of the following year.

Estimated taxes will be required for this entity-level tax.

Charitable contributions and property tax credit

The new law also follows the actions of several other states and authorizes municipalities to provide property tax credits to a taxpayer who makes unrestricted contributions to designated and approved community organizations.

The credit is to apply to property taxes on "residential property" and will equal 85 percent of the amount donated. The intention of this approach is to characterize the payment as a charitable contribution deduction.

The IRS has implied it will be attacking some of these workaround proposals enacted by Connecticut and other states. A notice from the agency suggests that the approach most subject to attack will be the conversion of a state income or property tax payment into a charitable deduction. Consequently, it is not clear that this part of the new Connecticut legislation will be effective for federal tax purposes. Further guidance is expected from the IRS.

The new law makes several other Connecticut modifications that will significantly impact businesses in the state. They include:

• Individuals and pass-through entities will not be allowed to get the full benefits of the new 100 percent bonus depreciation and increased section 179 tangible property expense amounts.

• Connecticut will not follow the new federal interest limitation rule and will allow the full business interest deduction.

While hoping to assist Connecticut businesses and residents, an unintended consequence of the new legislation is that the new rules may produce many implementation issues and increase business administrative costs.

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