



General Assembly

February Session, 2006

Raised Bill No. 5607

LCO No. 2412

02412_____FIN

Referred to Committee on Finance, Revenue and Bonding

Introduced by:
(FIN)

AN ACT CONCERNING CONNECTICUT'S INTEREST ADD-BACK LAW.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

1 Section 1. Section 12-218d of the general statutes is repealed and the
2 following is substituted in lieu thereof (*Effective July 1, 2006, and*
3 *applicable to income years commencing on or after January 1, 2006*):

4 (a) As used in this section:

5 (1) "Affiliated group" has the same meaning as in Section 1504 of the
6 Internal Revenue Code.

7 (2) "Effective tax rate" means the product of a corporation's income
8 apportionment fraction reported on a tax return filed in a jurisdiction
9 and the maximum corporate income tax rate in such jurisdiction,
10 determined without regard to net operating losses or tax credits.

11 [(2)] (3) "Interest expenses and costs" means amounts directly or
12 indirectly allowed as deductions under Section 163 of the Internal
13 Revenue Code.

14 [(3)] (4) "Related member" means a person that, with respect to the
15 taxpayer during all or any portion of the taxable year, is: (A) A related
16 entity, as defined in this subsection, (B) a component member, as
17 defined in Section 1563(b) of the Internal Revenue Code, (C) a person
18 to or from whom there is attribution of stock ownership in accordance
19 with Section 1563(e) of the Internal Revenue Code, other than a
20 statutory business trust of which each beneficiary is not a related entity
21 to the taxpayer, or (D) a person that, notwithstanding its form of
22 organization, bears the same relationship to the taxpayer as a person
23 described in subparagraphs (A) to (C), inclusive, of this subdivision.

24 [(4)] (5) "Related entity" means (A) a stockholder who is an
25 individual, or a member of the stockholder's family enumerated in
26 Section 318 of the Internal Revenue Code, if the stockholder and the
27 members of the stockholder's family own, directly, indirectly,
28 beneficially or constructively, in the aggregate, at least fifty per cent of
29 the value of the taxpayer's outstanding stock; (B) a stockholder, or a
30 stockholder's partnership, limited liability company, estate, trust or
31 corporation, if the stockholder and the stockholder's partnerships,
32 limited liability companies, estates, trusts and corporations own
33 directly, indirectly, beneficially or constructively, in the aggregate, at
34 least fifty per cent of the value of the taxpayer's outstanding stock; or
35 (C) a corporation, or a party related to the corporation in a manner that
36 would require an attribution of stock from the corporation to the party
37 or from the party to the corporation under the attribution rules of the
38 Internal Revenue Code, if the taxpayer owns, directly, indirectly,
39 beneficially or constructively, at least fifty per cent of the value of the
40 corporation's outstanding stock. The attribution rules of the Internal
41 Revenue Code shall apply for purposes of determining whether the
42 ownership requirements of this subdivision have been met.

43 (b) For purposes of computing its net income under section 12-217, a
44 corporation shall add back otherwise deductible interest expenses and
45 costs directly or indirectly paid, accrued or incurred to, or in
46 connection directly or indirectly with one or more direct or indirect

47 transactions with, one or more related members.

48 (c) The adjustments required in subsection (b) of this section shall
49 not apply to an otherwise deductible interest expense or cost if the
50 corporation establishes by clear and convincing evidence, as
51 determined by the commissioner, that: (1) A principal purpose of the
52 transaction giving rise to the payment of interest was not to avoid
53 payment of taxes due under this chapter; (2) the interest is paid
54 pursuant to a contract that reflects an arm's length rate of interest and
55 terms; and (3) either (A) (i) the related member was subject to tax on its
56 net income in this state or another state or possession of the United
57 States or a foreign nation; (ii) [a measure of said tax] computation of
58 the net income or net loss of the related member reported on tax
59 returns filed in this state or one or more other states or possessions of
60 the United States or a foreign nation included the interest received
61 from the corporation; and (iii) [the rate of tax applied to the interest
62 received by the related member] the sum of the related member's
63 effective tax rates in each jurisdiction for which it files tax returns is no
64 less than the statutory rate of tax applied to the corporation under
65 section 12-214, as amended, without regard to subsection (b) of section
66 12-214, as amended, minus three percentage points, or (B) the related
67 member is a company subject to tax under chapter 207 or comparable
68 tax under the laws of another state.

69 (d) (1) The adjustments required in subsection (b) of this section
70 shall not apply if [(1)] (A) the corporation establishes by clear and
71 convincing evidence, as determined by the commissioner, that the
72 adjustments are unreasonable, [(2)] (B) the corporation and the
73 commissioner agree in writing to the application or use an alternative
74 method of determining the combined measure of the tax, provided
75 that the Commissioner of Revenue Services shall consider approval of
76 such petition only in the event that the petitioners have clearly
77 established to the satisfaction of said commissioner that there are
78 substantial intercorporate business transactions among such included
79 corporations and that the proposed alternative method of determining

80 the combined measure of the tax accurately reflects the activity,
81 business, income or capital of the taxpayers within the state, or [(3)] (C)
82 the corporation elects, on forms authorized for such purpose by the
83 commissioner, to calculate its tax on a unitary basis including all
84 members of the unitary group provided that there are substantial
85 intercorporate business transactions among such included
86 corporations. Such election to file on a unitary basis shall be
87 irrevocable for and applicable for five successive income years.

88 (2) In determining whether the adjustments required in subsection
89 (b) are unreasonable, as provided in subdivision (1) of this subsection,
90 the commissioner may consider whether (A) the interest expenses and
91 costs are consistent with those established on an arm's length basis
92 between unrelated members, (B) there are other factors that indicate a
93 traditional intercorporate financing arrangement, including whether
94 the intercorporate interest expenses and costs are paid, accrued or
95 incurred (i) in connection with a regular and systematic funds
96 management or portfolio investment management activity conducted
97 by the related member, whereby the funds of two or more related
98 members are aggregated for the purpose of achieving economies of
99 scale, the internal financing of the active business operations of the
100 related members, or the benefit of centralized management of funds,
101 (ii) in connection with the disbursement by the related member of
102 funds derived directly or indirectly from loans or equity investments
103 made by unrelated members, or (iii) under circumstances in which the
104 ratio of debt to equity of the corporation is not excessive, given the
105 nature of its business, and (C) such other factors as the commissioner
106 may find to be relevant.

107 (3) A corporation seeking to establish, pursuant to subdivision (1) of
108 this subsection, that adjustments are unreasonable may provide
109 evidence thereof in a petition filed in advance of the applicable return
110 or as part of such return.

111 (4) Nothing in this [subdivision] subsection shall be construed to

112 limit or negate the commissioner's authority to otherwise enter into
113 agreements and compromises otherwise allowed by law.

114 (e) The adjustments required in subsection (b) of this section shall
115 not apply if interest is paid to a related member located in a country
116 with which the United States has a comprehensive income tax treaty.

117 (f) (1) Gross income, as defined in section 12-213, as amended, shall
118 not include any amount received or accrued from a related member
119 that is added back to the preapportionment income of such related
120 member pursuant to subsection (b) of this section.

121 (2) The receipts factor determined under section 12-218 or 12-218b
122 shall not include any amount received or accrued from a related
123 member that is added back to the preapportionment income of such
124 related member pursuant to subsection (b) of this section.

125 (g) Nothing in this section shall require a corporation to add to its
126 net income more than once any amount of interest expenses and costs
127 that the corporation pays, accrues or incurs to a related member
128 described in subsection (b) of this section.

129 (h) Nothing in this section shall be construed to limit or negate the
130 commissioner's authority to make adjustments under section 12-221a
131 or 12-226a.

This act shall take effect as follows and shall amend the following sections:		
Section 1	<i>July 1, 2006, and applicable to income years commencing on or after January 1, 2006</i>	12-218d

Statement of Purpose:

To clarify the statutory restrictions on the deductibility of interest expenses and costs in transactions with related members.

[Proposed deletions are enclosed in brackets. Proposed additions are indicated by underline, except that when the entire text of a bill or resolution or a section of a bill or resolution is new, it is not underlined.]