CONNECTICUT'S BUSINESS TAX STRUCTURE

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QUESTION

Provide an overview of Connecticut's business tax structure.

SUMMARY

Businesses operating in Connecticut must pay various state and local taxes on the income they generate (e.g., corporation and personal income taxes); property they own, use, or transfer (e.g., property and conveyance taxes); goods and services they purchase (e.g., sales and motor fuels excise taxes); and people they employ (e.g., unemployment insurance tax). Certain business entities, known as pass-through entities, must also pay a business entity tax to operate in the state. Specified businesses must pay taxes on the earnings generated from certain business activities (e.g., distributing, refining, or importing certain petroleum products or providing certain utility services).

For purposes of this report, we have excluded certain taxes businesses collect from people purchasing goods and services and remit to the state (e.g., excise taxes on tobacco and alcohol sales, admissions and dues taxes, and room occupancy taxes) and other taxes that apply to or affect specific types of businesses (e.g., hospital net patient revenue tax and dry cleaning tax).

INCOME TAXES

Corporation Income Tax

Connecticut's corporation tax applies only to businesses that are organized as "C" corporations and that do business in the state. It does not apply to other types of businesses organized as partnerships and limited partnerships, sole proprietorships, limited liability companies, limited liability partnerships, or S corporations. (These business entities are collectively referred to as "pass-through" entities, signifying that while they pay no corporation income tax, their owners pay personal income tax on the income they receive from the entity.)

Corporations must calculate tax liability in two ways. One method uses net income and the other the company's "capital base" (outstanding stock, profits, and reserves). The net income calculation method uses the company's federal taxable income as its starting point and therefore incorporates most federal income definitions, deductions, rules, and exclusions.

Companies that do business in other states as well as Connecticut pay taxes only on the share of their net income or capital base attributable to Connecticut. They determine this share by apportionment formulas specified in Connecticut law that compare a company's Connecticut operations with its overall operations. For most corporations, apportionment is based on three factors: sales, payroll, and property, with a double weight in the formula given to sales. For financial services companies, manufacturers, and broadcasters, apportionment is determined solely by their sales in Connecticut as a proportion of their national sales.

For most corporations, the tax rate is 7.5% of net income or 3.1 mills per dollar of capital base, whichever produces the larger tax, but no less than $250. Financial services companies, however, pay the greater of 7.5% of net income or $250. For the 2012 through 2015 income years, a 20% tax surcharge applies to companies that have more than $250 in corporation tax liability and either (1) have at least $100 million in annual gross income in those years or (2) file combined or unitary returns.

A company can reduce its tax bill by subtracting any corporation tax credits for which it may be eligible. But the reduction for credits is limited to 70% of its total liability and, in any event, every company must pay the minimum tax of $250 (CGS § 12-213 et seq.).

Personal Income Tax

Rather than pay the corporate income tax, the owners, members, shareholders, and partners of pass-through entities doing business in the state must pay personal income taxes on their share of income the business generates.

The tax applies to full-time residents who meet specific income thresholds or conditions and part-time residents and non-residents with income derived from sources within the state. The starting point for calculating the tax is the amount of federal Adjusted Gross Income (AGI) on a taxpayer's federal tax return.

Taxpayers make several additions or subtractions to federal AGI to determine the portion of their income subject to Connecticut's income tax. For some filers, this amount is further reduced by a personal exemption. Taxpayers then apply tax rates that vary depending on the amount of taxable income and filing status. There are six income brackets and six tax rates, ranging from 3% to 6.7%, as shown in Table 1.

Table 1: Connecticut Personal Income Tax Rates and Brackets

TAX RATE	CONNECTICUT TAXABLE INCOME							
	Married Filing Jointly		Single		Head of Household		Married Filing Separately	
	Over	But Not Over	Over	But Not Over	Over	But Not Over	Over	But Not Over
3.0%	$0	$20,000	$0	$10,000	$0	$16,000	$0	$10,000
5.0%	20,000	100,000	10,000	50,000	16,000	80,000	10,000	50,000
5.5%	100,000	200,000	50,000	100,000	80,000	160,000	50,000	100,000
6.0%	200,000	400,000	100,000	200,000	160,000	320,000	100,000	200,000
6.5%	400,000	500,000	200,000	250,000	320,000	400,000	200,000	250,000
6.7%	Over $500,000		Over $250,000		Over $400,000		Over $250,000	

Taxpayers with CT AGI over certain thresholds are also subject to a (1) phase-out of the lowest tax bracket and (2) "benefit recapture" which eliminates the benefits they receive from having a portion of their taxable income taxed at lower marginal rates.

The amount of tax a filer actually pays may be offset by credits, including credits for (1) income taxes paid to other states and jurisdictions, (2) businesses creating jobs, and (3) taxpayers investing in eligible start-up companies (CGS § 12-700 et seq.).

For your further information, OLR report 2011-R-0383 provides a more detailed description of the personal income tax.

Income Tax Withholding

Businesses that operate in Connecticut and are considered employers for federal income tax withholding purposes must withhold Connecticut income tax from the wages they pay resident employees and nonresident employees who work in Connecticut and remit these amounts to the state (CGS § 12-707).

Unrelated Business Taxable Income Tax

Nonprofit tax-exempt organizations must pay state tax on any trade or business they conduct that does not "substantially relate" to their tax-exempt purpose (i.e., unrelated business taxable income). The tax is paid at the same rate as the corporation income tax (CGS § 12-242aa, bb).

BUSINESS ENTITY TAX

Businesses organized as limited partnerships, limited liability partnerships, limited liability companies, or S corporations are subject to the business entity tax if they were formed under Connecticut law or are foreign entities doing business in the state. The tax is $250 every other year (CGS § 12-284b).

PROPERTY TAX

Businesses, like other property owners, must pay local property taxes on their real and tangible personal property. Real property includes land and improvements that are permanently attached to land. Personal property is all property that is not classified as real property, including machinery, equipment, furniture, fixtures, and motor vehicles. The tax is based on a portion of the property's fair market value (i.e., its assessment) and the town's mill rate.

Generally, most business property is subject to taxation. However, state law requires towns to exempt a number of business-related personal property, in whole or part, from the property tax, including:

1. manufacturing machinery and equipment (CGS § 12-81 (76));
2. manufacturer, wholesaler, and retailer business inventories (CGS § 12-81 (50) & (54));
3. tools used in certain trades and occupations (CGS § 12-81 (36)-(38));
4. certain new trucks, truck tractors, tractors, and semi trailers used exclusively to haul freight for hire (CGS § 12-81 (74));
5. state-certified air pollution control equipment (CGS § 12-81 (52));
6. commercial fishing vessels (CGS § 12-81 (61)); and
7. farm machinery up to $100,000 and livestock (CGS §§ 12-81 (39)-(42) & 12-91)).

There are also a number of mandatory limited-time property tax exemptions targeted to specific business incentive zones. For example, state designated enterprise zones, targeted investment communities (i.e., towns with enterprise zones), distressed municipalities, and other specified designated areas (e.g., enterprise corridor zones or the Bradley Airport Development Zone) must exempt real and personal property taxes for manufacturers, financial service firms, and other specified businesses that build, expand, or rehabilitate a facility and install new or newly acquired machinery and equipment in it (CGS § 12-81 (59) and (60)).

In addition to these mandatory property tax exemptions, state law allows towns the option of offering business tax incentives for a wide range of economic development purposes. OLR report 2011-R-0312 lists these local option exemptions.

SALES AND USE TAX ON BUSINESS PURCHASES

Tax Rate

Businesses must pay state sales and use taxes on certain goods and services they purchase. The 6.35% tax applies, with some exceptions, to retail sales of tangible personal property purchased in the state and specific services provided by companies doing business here. There are several exceptions to the 6.35% rate, including certain "luxury" goods taxed at 7%, computer and data processing services taxed at 1%, short-term stays in hotels and lodging houses taxed at 15%, and short-term car rentals taxed at 9.35% (CGS § 12-406 et seq.).

Taxable Goods

With the exception of "sale for resale" transactions (i.e., wholesale sales), businesses must pay sales and use taxes on the items they purchase or lease. Building contractors, for example, generally must pay sales and use tax on materials, supplies, and equipment used in their construction contracts (as well as charge sales tax on their services when appropriate) (see DRS' *Building Contractors' Guide to Sales and Use Taxes* for additional information).

But there are certain exemptions for business inputs purchased by manufacturers, fabricators, and processors. They include:

1. machinery used directly in the manufacturing production process, including repair, replacement, component, or enhancement parts for the machinery (CGS § 12-412 (34));

2. materials that become an ingredient or component part of the products to be sold (CGS § 12-412 (18));

3. tools, fuel, and materials used directly in an industrial plant in the actual fabrication of finished products to be sold (CGS § 12-412 (18));

4. calibration services for manufacturing machinery, equipment, or instrumentation (CGS § 12-412 (104)); and

5. materials, tools, fuel, machinery, and equipment used in manufacturing that is not otherwise eligible for a sales tax exemption (exemption applies to 50% of the gross receipts from such items) (CGS § 12-412i).

The Department of Revenue Services (DRS) *Sales and Use Taxes Guide for Manufacturers, Fabricators, and Processors* provides detailed information on these and other exemptions applicable to such businesses.

Taxable Services

The sales and use tax applies to services specifically enumerated in the statutes, including several services purchased primarily by businesses (so called "business-to-business" services). They include:

1. computer and data processing services (taxed at 1%);
2. business analysis, management, management consulting, and public relations;
3. advertising and public relations not related to developing media or direct mail advertising;
4. credit information and reporting;
5. employment agencies and agencies providing personnel services;
6. telephone answering services;
7. lobbying or consulting services for representing a client's interests in relation to any governmental body;
8. maintenance and janitorial services;
9. window cleaning services;
10. sales agent services for selling tangible personal property; and
11. piped-in music provided to business or professional establishments (CGS § 12-407 (a)(37)).

However, the sales tax does not apply to services between two affiliated businesses. To qualify, one of the businesses participating in the transaction must own a controlling interest in the other or a third person or company must own a controlling interest in both of them (CGS § 12-412 (62)).

CONVEYANCE TAXES

Real Estate Conveyance Tax

With certain exceptions, businesses that sell or transfer real property valued at $2,000 or more must pay the state's real estate conveyance tax. The tax has two parts: a state tax and a municipal tax. The applicable state and municipal rates are combined to get the total tax rate for a particular transaction. The seller pays the tax.

The state portion of the tax is 0.75% of (1) the first $800,000 of the sale price of a residential property and (2) the full sale price of unimproved land and certain bank foreclosures for mortgage delinquencies. A 1.25% rate applies to (1) sales of nonresidential property other than unimproved land (e.g., commercial real estate) and (2) any portion of the sale price of a residential dwelling that exceeds $800,000.

The municipal portion of the tax is 0.25% for all towns, plus an additional tax of up to 0.25% in 18 towns that are permitted by law to impose this additional rate.

An additional tax of up to 10% applies if the property is transferred within 10 years after receiving the statutory tax benefit granted to farmland, open space, forest, and maritime heritage property ("490 program"). Such classified property is assessed based on its current use, rather than its fair market value, which could result in a lower tax bill (CGS § 12-494 et seq.).

Controlling Interest Transfer Tax

A business that owns certain real property in the state must pay a tax on any sale or transfer of a "controlling interest" in the business. In a corporation, a "controlling interest" means more than 50% of the total voting power of its stock. For other business entities, "controlling interest" means more than 50% of the capital, profits, or beneficial interest in the entity.

The tax applies to any person or business transferring a controlling interest in a corporation, partnership, association, trust, LLC or other entity that owns, directly or indirectly, an interest in Connecticut real property with a value of at least $2,000. The tax is 1.11% of the sale or transfer, with 1% going to the state and 0.11% to the town in which the real property is located, and is payable by the person or business selling or transferring the controlling interest.

As with the real estate conveyance tax, an additional tax applies if the entity has an interest in "490 program" property that is transferred within 10 years after its classification (CGS § 12-638a et seq.).

UNEMPLOYMENT INSURANCE TAX

Connecticut businesses are liable for unemployment insurance taxes depending on: (1) the amount of wages they paid that are included in their taxable wage base, (2) the amount of unemployment benefits paid to their workers (the experience rate), and (3) the solvency of the unemployment trust fund (the fund balance rate). Since 2011, the state's employers must also repay the principal and interest on loans from the federal government.

To calculate its UI tax liability, the employer multiplies its taxable wage base by its wage rate. Connecticut's taxable wage base is currently $15,000, meaning that the first $15,000 of every covered employee's salary is taxable. An employer's tax rate is determined by adding its experience rate and fund balance rate. The experience rate is based on a three year ratio of the employer's benefit charges to its payroll and ranges from 0.5% to 5.4%. The fund balance rate is based on the state's unemployment trust fund's solvency and is set each year by the labor commissioner. The rate can reach a maximum of 1.4%, which is the current fund balance rate. Thus, under current requirements, an employer's total tax rate can be between 1.9% and 6.8%.

Employers must also pay a special assessment to repay the principal and interest on loans the federal government made to Connecticut when its unemployment trust fund became insolvent in 2009. The assessment is currently $1 per thousand dollars of taxable payroll (about $15 per full-time employee). Annual special assessments will continue until the loans are repaid in full.

In addition to the state's UI tax and special assessment, employers must also pay a federal tax to help pay the costs of administering the federal unemployment account trust fund (FUTA) (CGS § 31-222 et seq.)

OTHER BUSINESS TAXES

Fuel Taxes

Motor Vehicle Fuels Tax. The motor vehicle fuel tax is levied on fuel distributors, but it is passed through to consumers at the pump. Businesses must pay the tax on the same basis as other consumers. The tax on gasoline and gasohol is 25 cents per gallon. The tax on diesel is currently 54.5 cents per gallon and is comprised of two parts: (1) a flat base rate of 29 cents per gallon and (2) a variable rate based on the average wholesale per-gallon price of diesel for the prior year and the petroleum products gross earnings tax rate in effect for the upcoming year starting every July 1 (CGS § 12-455a et seq.).

Petroleum Products Gross Earnings Tax. Companies refining, distributing, or importing petroleum products in Connecticut must pay a tax on their gross earnings from the first sale of certain petroleum products within the state. Taxable products include gasoline, aviation fuel, kerosene, diesel fuel, number 2 heating oil, greases, lubricants, mineral oils, and motor oil. The tax is 8.1% of the revenue from the initial sale, but taxable gross earnings from first sales of gasoline and gasohol are limited to the first $3 per gallon.

Other businesses who purchase taxable petroleum products from a retailer are not liable for paying the tax, but the cost of the tax payment is likely reflected in the retail price (CGS §12-587 et seq.).

Motor Carrier Road Tax. Motor carriers operating qualified motor vehicles in Connecticut must pay a tax on the fuel they use in the state. The tax rate is equivalent to the Connecticut motor vehicle fuels tax rate. Motor carriers receive a credit for any motor vehicle fuels tax paid on fuel purchases in the state (CGS § 12-478 et seq.).

Insurance Premiums Tax

Insurance companies must pay a 1.75% annual tax on the total net direct premiums they receive from policies written on property or risks in Connecticut. Health care centers (e.g. health maintenance companies or HMOs), with certain exceptions, must also pay a 1.75% annual tax on the total net direct subscriber charges they receive on any new or renewal contract or policy approved by the insurance commissioner. Any insured in Connecticut who obtains insurance from an unauthorized insurer (an insurance company not licensed to do business in the state) must pay an annual tax of 4% of gross premiums charged for the insurance and applicable to the risks or exposures located in Connecticut (CGS § 12-201 et seq.)

Public Service Companies Tax

The public service companies tax applies to gross earnings from certain utility companies. Tax rates are:

1. for community antenna TV system companies, certified competitive video service providers, and satellite TV companies, 5.25% (including 0.25% tax used to fund the public, educational, and governmental programming and education technology investment account) (CGS §§ 12-256 et seq. & 16-331cc);

2. for electric companies, 8.5% for nonresidential customers and 6.8% for residential customers (CGS § 12-264 et seq.);

3. for gas companies, 4% for residential customers and 5% for all other customers, less certain deductions (CGS § 12-264 et seq.); and

4. for railroad companies, 2% to 3.5% (CGS § 12-249 et seq.).

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