

## Connecticut's Conformity With Corporation Tax Provisions in the CARES Act

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### Issue

Do the federal corporate income tax changes in the Coronavirus Aid, Relief, and Economic Security (CARES) Act impact Connecticut's corporation business tax?

The Office of Legislative Research is not authorized to provide legal opinions and this report should not be considered one.

### Summary

The federal CARES Act, signed into law on March 27, 2020, contains several corporate income tax provisions designed to increase companies' liquidity and cash flow during the COVID-19 pandemic. As a recent *State Tax Notes* article highlighted, these provisions could impact state corporate income taxes in states that conform to the federal rules for determining taxable business income. The three primary provisions that could have state implications change the rules for (1) deducting net operating losses (NOL), (2) calculating the limitation on the business interest deduction, and (3) depreciating certain business property improvements (i.e., qualified improvement property) (Frieden, Karl and Do, Stephanie. "State Tax Conformity to Key Taxpayer-Favorable Provisions in the CARES Act." *State Tax Notes*. April 20, 2020).

Neither the changes to the federal business interest deduction nor NOL rules will impact Connecticut's corporation business tax. This is because Connecticut has its own NOL rules and is decoupled from the federal business interest expense limitation. However, the changes to the depreciation rules for qualified improvement property will flow through for state corporation tax

purposes. Any bonus depreciation deduction allowed under federal law for such property will not impact Connecticut's tax because Connecticut does not conform to the federal bonus depreciation deduction for corporation business tax purposes.

This report discusses the impact on corporation business taxpayers only. Different rules apply to personal income taxpayers with income from pass-through businesses. We will issue a supplementary report on those impacts at a later date.

## **Net Operating Losses**

The CARES Act relaxes some of the NOL rules that were enacted as part of the 2017 Tax Cuts and Jobs Act (TCJA) (PL 115-97). The TCJA (1) eliminated the two-year carryback period (which previously allowed companies to receive a refund of some of the tax paid in prior years) and (2) limited the NOL deduction to 80% of taxable income for losses generated after 2017. The CARES Act allows NOLs generated in the 2018, 2019, or 2020 tax years to be carried back up to five years and suspends the 80% limitation for these tax years, thus allowing companies to recoup their losses more quickly. (The IRS has issued [guidance](#) on these changes.)

These changes have no impact on Connecticut's state corporation tax because Connecticut has its own NOL calculation and carryforward rules. (Connecticut limits the NOL deduction to 50% of a corporation's net income.)

## **Business Interest Expense Limitation**

The 2017 TCJA limited the amount of business interest most companies could deduct from their gross income. The CARES Act increases this limit for the 2019 and 2020 tax years by allowing companies to calculate the limit based on 50%, rather than 30%, of their adjusted taxable income for the year. (It also allows taxpayers to elect to use their 2019 adjusted taxable income in 2020 for purposes of calculating the deduction limitation. Special rules apply in the case of partnerships.)

This change does not impact Connecticut's corporation income tax calculations because Connecticut is decoupled from the federal business interest expense limitation. Since 2018, Connecticut has required companies to calculate the business interest deduction for state corporation income tax purposes as provided under federal law, but without regard to the federal limit.

## Depreciation Rules for Qualified Improvement Property

Bonus depreciation is a special deduction that allows businesses to recover the cost of certain qualified property more quickly than standard depreciation. The TCJA allows a 100% first-year bonus depreciation rate for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. It generally applies to qualifying property (e.g., buildings and equipment) that is depreciable over 20 years or less.

The CARES Act reclassifies “qualified improvement property” to make it eligible for this bonus depreciation deduction or a shorter depreciation schedule. In doing so, it corrects a TCJA provision that inadvertently required this property to be depreciated over 39 years, rather than the 15 years allowed for other property improvements, and consequently made it ineligible for bonus depreciation.

“Qualified improvement property,” is generally defined as internal improvements to nonresidential real property (e.g., interior remodeling of a retail store or restaurant). The CARES Act defines this property as 15-year property, thus allowing a bonus depreciation deduction for any such property acquired and placed in service after September 27, 2017. Taxpayers may file an amended return for the 2018 and 2019 tax year to reflect this new shorter depreciation period or take the bonus depreciation deduction.

Connecticut state law has disallowed the federal bonus depreciation deduction for state corporation tax purposes since 2001 ([CGS 12-217\(b\)\(1\)](#)). However, it requires companies to calculate the standard depreciation deduction as provided under federal law. This means that the CARES Act provision that treats qualified improvement property as a 15-year depreciable asset will flow through for state corporation tax purposes. The bonus depreciation deduction for such property, however, is not allowed.

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