Connecticut General Assembly

Office of Fiscal Analysis
Office of Legislative Research

TO: Members of the Finance, Revenue, and Bonding Committee

FROM: OFA & OLR Staff

RE: Items for April 6, 2010 Agenda

III. FINANCE COMMITTEE BILLS FOR JF CONSIDERATION

1. S.B. No. 478 (RAISED) AN ACT CONCERNING INTRA-CORPORATION PAYMENTS TO RELATED ENTITIES (JFS) (New Title and Content)

Fiscal Impact:
The bill is anticipated to result in a net General Fund revenue gain of: (1) $8.6 million in FY 10, (2) $164.8 million in FY 11, and (3) $148.1 million in FY 12. These figures are a combination of the following provisions in the bill:

1. A General Fund revenue gain of approximately $5.9 million in FY 10, $70.3 million in FY 12, and $64.4 million in FY 13 resulting from the modifications to the Gift and Estate Tax;

2. A General Fund revenue gain of approximately $207 million beginning in FY 11 from implementing a hospital gross earnings tax of 5.5%, effective July 1, 2010;

3. A General Fund revenue gain of approximately $83.5 million resulting from an increase in federal matching funds due to appropriating the proceeds from the Hospital Tax to hospitals for disproportionate share payments and providing an additional $20 million of the revenue generated to be allocated to hospitals;

4. A general Fund gain of approximately $2.7 million in FY 10 and $10.8 million in FY 11 as result of from achieving a higher federal stimulus match rate for certain hospital payments.

5. A general Fund revenue gain of approximately $200,000 per year beginning in FY 11 as a result of eliminating the exemption for attorneys who practice law as state employees.

Summary:

<u>Estate and Gift Tax</u>

The substitute bill increases estate and gift tax rates for deaths occurring and gifts made on or after January 1, 2010 and before January 1, 2012.

Under current law, the following changes in the estate and gift taxes took effect starting with deaths occurring and gifts made on or after January 1, 2010: (1) an increase, from $2 million to $3.5 million, in the threshold value of an estate or gift subject to the estate and gift tax; (2) elimination of the so-called tax "cliff" (see explanation below); and (3) a 25% reduction in tax rates.

The bill retains the higher tax threshold and eliminates the cliff but, to compensate for the resulting revenue loss, it increases the marginal tax rates on estates and gifts over $3.5 million from between 7.2% and 12% to between 14.8% and 20% for two years. These higher rates affect estates of those who die, and gifts made on or after January 1, 2010 and before January 1, 2012. The bill restores the current rates starting with deaths occurring and gifts made on or after January 1, 2012 as shown in the table below.

VALUE OF TAXABLE ESTATE OR GIFT		CURRENT LAW		THE BILL			
		On or After January 1, 2010 (Add cols. C & D)		On or After January 1, 2010 and Before January 1, 2012 (Add cols. E & F)		On or After January 1, 2012 (Same as Current Law) (Add cols. G & H)	
Col. A: Over	Col. B: But not over	Col. C: Tax on Col. A	Col. D: Tax rate on excess over Col. A	Col. E: Tax on Col. A	Col. F: Tax rate on excess over Col. A	Col. G: Tax on Col. A	Col. H: Tax rate on excess over Col. A
0	3,500,000	NO TAX		NO TAX		NO TAX	
3,500,000	3,600,000	0	7.2%	0	14.8%	0	7.2%
3,600,000	4,100,000	$7,200	7.8%	$14,800	15.6%	$7,200	7.8%
4,100,000	5,100,000	46,200	8.4%	92,800	16.4%	46,200	8.4%
5,100,000	6,100,000	130,200	9.0%	256,800	17.2%	130,200	9.0%
6,100,000	7,100,000	220,200	9.6%	428,800	18.0%	220,200	9.6%
7,100,000	8,100,000	316,200	10.2%	608,800	18.8%	316,200	10.2%
8,100,000	9,100,000	418,200	10.8%	796,800	19.2%	418,200	10.8%
9,100,000	10,100,000	526,200	11.4%	998,880	19.6%	526,200	11.4%
Over $10,100,000		640,200	12.0%	1,184,800	20.0%	640,200	12.0%

The "Cliff"Explained

Under prior law, in effect from January 1, 2005 to January 1, 2010, the estate and gift tax contained a so-called "cliff." The cliff was produced because, under the pre-January 1, 2010 tax, an estate or gift valued at $2 million or less was not taxed at all, while the full value of an estate or gift of more than $2 million was taxed. Thus, a $1 increase in value from $2,000,000 to $2,000,001 increased the tax liability for a gift or estate over $2 million by $101,700 (the "cliff"). The current law and the bill eliminate the cliff by applying the tax only to the portion of the estate or gift that exceeds the tax threshold. This change also took effect with deaths occurring and gifts made on or after January 1, 2010.

EFFECTIVE DATE: Upon passage and applicable to estates of those who die, and gifts made on or after January 1, 2010.

Hospital Gross Earnings Tax

The substitute bill imposes a 5.5% tax on hospital gross earnings. The tax applies to short-term, acute care hospitals licensed by the DPH. Hospitals licensed as children's general hospitals and those operated exclusively by the state are exempt, unless the state is operating the hospital as a receiver.

For tax purposes, a hospital's "gross earnings" are its net revenue minus the amount of federal payments it is projected to receive for Medicare patients and the amount it expects to receive from the DSS. In each case, the projections must be based on its budget authorization.

The tax is payable quarterly on the last day of January, April, July, and October, starting with calendar quarters beginning on and after July 1, 2010.

The substitute bill requires $20 million of the revenue raised from the tax to be reallocated to hospitals according to a formula to be determined by the Appropriations Committee.

EFFECTIVE DATE: July 1, 2010

Disproportionate Share (DSH) Payments

Beginning in FY 10 and for each subsequent fiscal year, the substitute bill requires that funds appropriated to hospitals in the DSH-Medical Emergency Assistance, DSH-Urban Hospitals in Distressed Municipalities, and the Connecticut Children's Medical Center (state match for drawing down federal

DSH money) accounts be transferred to the Medicaid Rates-Hospitals account. (All of these are line items in DSS' budget.)

The purpose of the transfer is for the state to obtain federal matching funds (an enhanced federal match (61.9% versus 50%) is available until December 30, 2010, under the American Recovery and Reinvestment Act). State DSH payments are eligible for only a 50% federal match. By moving these funds to the Medicaid Rate line item, the state qualifies for the enhanced match. The bill requires that the transferred funds be used to increase each hospital's Medicaid (presumably fee-for-service) rate by an amount that fully offsets the loss of DSH payments resulting from the transfer.

The bill also requires the DSS commissioner to require each managed care organizations (MCO) participating in HUSKY to pay hospitals with which they contract at least the rate established by the DSS commissioner for hospitals participating in the Medicaid fee-for-service program. Currently, the MCOs use the FFS rates as a base rate.

EFFECTIVE DATE: July 1, 2010

Attorney Occupational Tax

The substitute bill eliminates an exemption from the $565 annual attorney occupational tax for attorneys who practice law as state employees.

EFFECTIVE DATE: July 1, 2010

2. S.B. No. 484 (RAISED) - AN ACT CONCERNING THE GOVERNOR'S REVENUE PLAN. (JFS) (New Title and Content)

Fiscal Impact:
Assuming that $1.44 billion is securitized (composed of: (1) $1.3 billion in principal and (2) $140 million in issuance costs and a 10% reserve fund) over a ten year period at a 4% interest rate, the amount of debt service per year would be approximately $180 million per year.

The table below shows the total annual revenue generated by the two charges being securitized and the amounts that would be used for annual debt service payments:

	Estimated Annual Revenue Currently Generated	Annual Debt Service	Remaining Revenue
CL&P CTA/RRB Charge	$234,000,000	$144,000,000	$90,000,000
UI CTA Charge	$85,000,000	$36,000,000	$49,000,000
Total	**$319,000,000**	**$180,000,000**	**$139,000,000**
		56% of Annual Revenue	

Summary:
The bill authorizes issuance of 10-year, special tax obligation rate reduction bonds (RRBs) to securitize revenue from charges on consumers' electric bills currently earmarked to pay off electric company stranded costs. Under the bill, after the stranded costs are fully amortized or paid off (December 2010, in the case of CL&P and 2013 in the case of UI), an "RRB charge" on electric bills would continue and be redirected to pay off the bonds. The RRB charge would be lower than the current CL&P and UI CTA charges because the annual revenue required would be about 56% of the current combined revenue from two charges ($180 million vs. $319 million).

EFFECTIVE DATE: Upon passage

3. S.B. No. 485 (RAISED) AN ACT CONCERNING TAX FAIRNESS

Fiscal Impact:
The bill could result in a General fund revenue gain of between $15 million and $35 million. However, measuring the fiscal impact of the change in combined reporting requirements on the overall Connecticut Corporation Businesses Tax base is difficult because specific data on combined groups is not available.

The estimate is based on recent fiscal estimates from other states that have considered requiring corporations to file combined returns. Their estimates are generally that the change will increase the existing collections base between 3% and 7%. It should be noted that the impact in Connecticut will be influenced by: (1) recent measures to prevent the shifting of expenses from Delaware Holding Companies (interest add back, trademark/royalty expensing) to companies that have nexus for Connecticut Corporate Tax purposes, and (2) allowing taxpayers to elect to file a combined return.

Summary:
This bill requires any company that is (1) a member of corporate group of related companies meeting certain criteria and (2) subject to the Connecticut corporation tax (a "taxable member"), to determine its Connecticut corporation tax liability based on the net income and capital base of the entire group. Under the bill, a

company must use this method of computing tax liability if it is part of a corporate group engaged in a "unitary business," as defined in the bill. The bill thereby eliminates deductions and other adjustments for intercompany transactions between the group's members.

Under current law, a company doing business in Connecticut that is part of a larger group determines its Connecticut net income separately. A corporate group doing business in Connecticut and that files consolidated federal corporate tax return has the option of filing a combined Connecticut return, but first has to separately apportion each member's net income or capital base separately among the states where the member operates. The separately apportioned Connecticut shares of income and losses of group members doing business here are then combined to determine their corporation tax liability. The DRS commissioner can also require groups that do not file consolidated federal returns to file combined Connecticut reports under certain circumstances. The bill eliminates these optional combined returns for income years starting on or after January 1, 2010 (§ 19).

The bill establishes (1) the corporate groups that must file unitary returns; (2) how unitary groups must apportion net income, net operating losses, and capital base for Connecticut corporation tax purposes; (3) apportionment methods for groups whose members are subject to different apportionment formulas; (4) treatment of certain tax credits, credit limits, tax surcharges, and minimum taxes in a unitary filing; and (4) filing and estimated tax payment requirements for groups filing unitary returns.

The bill also establishes special estimated tax filing deadlines and safe harbor provisions for taxpayers required to file unitary returns in 2010 and makes conforming changes.

EFFECTIVE DATE: Upon passage and applicable to income years starting on or after January 1, 2010.

§ 3 - Unitary Business and Combined Group

The bill defines a "unitary business" as a single economic enterprise that is interdependent, integrated, or interrelated enough through its activities to provide mutual benefit and produce significant sharing or exchanges of value among its entities or a significant flow of value among its separate parts. A unitary business can be either separate parts of a single entity or a group of separate entities under common ownership. Businesses conducted or connected through partnerships or S corporations ("pass-through entities") may be considered unitary if they meet certain conditions.

Under the bill, businesses are considered to be under common ownership if the same entity or entities directly or indirectly own more than 50% of voting control of each of them. The owners do not themselves have to be members of the combined group. Indirect control must be determined according to the federal tax code.

A "combined group" is all the companies that (1) have common ownership and (2) are engaged in a unitary business.

§ 2 – Boundaries of a Unitary Business' Net Income, Capital Base, and Apportionment Factors

For purposes of a unitary tax filing, the bill requires a combined group to determine its net income, capital base, and apportionment factors on a "water's-edge basis." Under the bill, this means that a group must include the net income, capital base, and apportionment factors of only those nontaxable members that:

1. are incorporated in, or formed under the laws of, the United States, any state, the District of Columbia, or a U. S. territory or possession; or

2. directly or indirectly earn more than 20% of their income from intangible property or service-related activities whose costs are generally deductible from federal taxes against the income of other group members, either currently or over a period of time. These nontaxable members must be included only to the extent of this income and its related apportionment factors.

The bill gives a combined group the option of determining all its members' net income, capital base, and apportionment factors on a world-wide basis. The election of a world-wide basis for a unitary filing must be made on an original tax return filed on-time by the group's designated taxable member (see below) for an income year. A world-wide election is binding for the income year in which it is made and the following 10 years.

§ 1 – Net Income and Capital Base

Net Income or Loss. When determining the total income or loss subject to apportionment for Connecticut corporation tax purposes, the bill requires the combined group to include the following.

1. For each group member incorporated in the United States, (a) if included in a consolidated federal corporate return, its gross income minus

Connecticut corporation tax deductions as if it were not consolidated for federal tax purposes or (b) if not included in a consolidated federal return but required to file its own return, its gross income minus Connecticut corporation tax deductions.

2. For each member incorporated outside the United States, not included in a federal consolidated return and not required to file its own return, the income determined from regularly maintained profit and loss statements for each foreign office or branch (a) adjusted to conform to U.S. accounting standards and to take account of "book-tax" differences required by federal or Connecticut law and (b) converted on any consistent and reasonable basis from or into the currency in which the parent company maintains its books and records. Income must be expressed in U.S. dollars. Reasonable alternate procedures may be applied if the DRS commissioner determines that the reported income reasonably approximates the income determined under the Connecticut corporation tax law.

3. If the unitary business has income from a pass-through entity, the members direct and indirect share of that entity's unitary business income.

The bill establishes specific rules for treating the following income:

1. dividends paid by one group member to another, which must be eliminated;

2. business income from an intercompany transaction with another group member, which must be deferred under federal tax rules unless the object of the transaction is sold or otherwise removed from of the unitary business;

3. charitable expenses incurred by a group member, which may be deducted from the combined group's net income subject to federal income limits applicable to the entire group's business income;

4. capital gains and losses, which must be combined for all members without netting among classes of gains and losses, apportioned to Connecticut, and applied to the income or loss of the Connecticut taxable members; and

5. expenses directly or indirectly attributable to tax-exempt income, which must be disallowed in determining the combined group's net income.

Income Apportionment Percentages. In determining the share of its income subject to Connecticut corporation tax, the bill requires each taxable member of a combined group to use the otherwise applicable Connecticut statutory apportionment percentage. It specifies how taxable members of the combined group must incorporate the property, payroll, and receipts of nontaxable group members into the apportionment factors they use to apportion the group's income for purposes of the taxable members' Connecticut corporation tax liability.

The bill requires transactions between or among group members to be eliminated in determining the apportionment factors.

Net Operating Loss Carryover. The bill allows each taxable group member to deduct its share of the group's net operating loss (NOL) from its income apportioned to Connecticut and allows the following carryovers:

1. For income years starting on or after January 1, 2010, if the combined group's net income computation results in a net operating loss, the taxable members can carry forward the share apportioned to Connecticut consistent with existing NOL carryover limits (i.e., for up to 20 years). If the taxable member has more than one NOL carryover, it must apply them in the order they were incurred, deducting the older one first. The bill allows a taxable member who has an NOL carryover derived from the combined group in an income year beginning on or after January 1, 2010, to share it with other taxable group members if they were part of the group when the loss was incurred. Any such sharing reduces the taxable member's original NOL carryover.

2. A taxable member can deduct an NOL carryover derived from either pre-January 1, 2010 losses or losses incurred before the taxable member joined the combined group, but it cannot share it with other group members.

Capital Base Apportionment. The bill requires combined groups to determine their alternative capital bases by combining their separate bases, including those of the nontaxable members, but excluding inter-corporate or private stockholdings in the combined group. Group members that are financial services companies must calculate the value of their annual capital base as required by existing law.

A taxable member must apportion the combined group's capital base according to the ratio of the taxable member's individual capital base to that of the combined capital bases of all the other taxable members of the group.

Minimum Tax. Under the bill, as under existing law, taxable members must pay a minimum tax of $250 regardless of tax credits. In addition, no taxable member may use tax credits to reduce its tax liability by more that 70% of the amount it would owe without credits.

§ 18 - Designated Taxable Member

The bill requires a combined group to designate one of its Connecticut taxable members to file the unitary return and pay the tax on behalf of all its taxable members. To this end, the designated member may, on the taxable and nontaxable members' behalf, (1) sign a unitary return, (2) apply for filing extensions, (3) agree to an examination or assessment of the return, (4) make offers of compromise and closing agreements regarding tax liability, and (5) receive tax refunds.

A combined group member whose income year is different from that of the rest of the group must report amounts from its return for its income year that ends during the group income year. No such reporting is required until the beginning of the member's first income year starting on or after January 1, 2010.

The bill allows the designated taxable member to recover the payments from the other taxable members and prohibits those members from holding the designated taxable member liable for the payments. However, each taxable member of the combined group is jointly and severally liable for the taxes plus any interest, penalties, or additions due from any other taxable member.

A combined group required to name a designated member must give the DRS commissioner written notice of the selection by the date the tax is due. The commissioner must approve any change in the designated member.

The bill gives the commissioner the sole discretion to (1) send notices, make deficiency assessments, and provide tax refunds and credits to the designated member or any other group member and (2) require a unitary return to be filed electronically and any tax payment to be made by electronic funds transfer.

§ 24 - Estimated Tax and Safe Harbor

The bill applies estimated tax requirements to taxable members of combined groups required to file unitary returns. It makes the designated taxable member responsible for paying the estimated tax installments.

By law, corporations must pay the following percentage of their annual taxes by the following dates: 30% by March 15, 40% by June 15, 10% by October 15, and 20% by December 15. The bill extends the due dates for the first estimated tax payment for combined groups whose 2010 income years start in January, February, or March 2010 to June 15, 2010; July 15, 2010; and August 15, 2010, respectively. Such groups must pay 70% the required annual payment on those dates.

The bill exempts taxable members of combined groups required to file unitary returns from interest and penalties for underpaying estimated tax if they meet any of the following conditions:

1. for the income year starting in 2009, they paid taxes equal to at least 90% of that shown on their unitary tax filing for the 2010 income year;

2. if the 2009 income year was a 12-month year, the taxable members of the combined group paid 100% of the tax liability, before credits, shown on either their individual separate returns or their optional combined return, as applicable.

§§ 6-17; 20-23 & 25 - Conforming Sections

The bill makes additional statutory changes to conform to the unitary filing requirements described above.

IV. BILL REFERRED FROM HOUSE TECH SESSION 4/5/10

4. Substitute for H.B. No. 5433 (RAISED) (File No. 156) AN ACT ADJUSTING INSURANCE GUARANTY FUND CREDITS. (INS)

Please refer to File 156.

V. CHANGE OF REFERENCE BILLS FOR JF CONSIDERATION

5. Substitute for H.B. No. 5467 (RAISED) AN ACT CONCERNING CUSTOMER REBATES FOR ELECTRICITY RATEPAYERS. (ET)

Fiscal Impact:
There will be a General Fund revenue gain beginning in FY 11 to the extent that electric generators earn windfall profits that qualify for this tax. The fiscal impact cannot be quantified at this time because the data needed for an estimate is not currently available.

Summary:
This bill subjects electric generators in the state to a 50% quarterly tax on their "windfall profits." The bill defines these profits as a company's earnings from selling electricity and rights to electricity from its plants in the state that exceed 20% on the generator's equity. The bill requires the use of the Federal Energy Regulatory Commission's uniform system of account to determine these earnings. In calculating its earnings, the bill requires a company to deduct its reasonable expenses in operating its plants in the state. The bill also establishes filing requirements.

The bill requires that the tax revenues go to a nonlapsing General Fund account. It requires the Department of Public Utility Control to conduct a contested case proceeding to disburse the money in the account to directly reduce ratepayers' electric bills.

EFFECTIVE DATE: Upon passage, with the tax applying to profits generated on or after January 1, 2010