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Connecticut's Trump tax dodge tops $1B plateau

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With a month to go in Connecticut's fiscal year, a new tax surpassed $1 billion in collections after former Gov. Dannel P. Malloy and the state's General Assembly created it as a countermeasure to a federal cap on IRS deductions that has impacted some Northeast homeowners.

The federal Tax Cuts and Jobs Act of 2017 imposed a $10,000 cap on IRS deductions for state and local taxes. The SALT change took away a significant break for filers who write off property taxes on upper tier homes they own, as part of the process of itemizing taxes to take advantage of varying shelters. While the new law doubled the standard deduction available to all taxpayers to $24,000, multiple studies have suggested that homeowners in costlier states have absorbed a disproportionate tax burden under the law.

In response, Malloy authorized a new "pass-through entity" tax through which owners of limited liability companies and partnerships can use to report income for tax purposes that they previously filed on personal tax forms, with the backing of state Sen. Martin Looney (D-New Haven), Sen. Bob Duff (D-Norwalk) and other legislative leaders.

In May for the first time, taxes on Connecticut's pass-through entities pushed by $1 billion for the 2019 fiscal year that ends in two weeks. That has not resulted in any windfall for the state, with personal income tax collections are down by about the same amount as business owners merely shift reported income to the new mechanism. But it is a striking statement on how Connecticut business owners regard the potential impact of the SALT cap, with the pass-through entity tax collections amounting to 11 cents of every dollar in personal income taxes collected last year, from business owners and employee taxpayers alike.

Malloy's successor Gov. Ned Lamont reduced the benefit of the pass-through entity tax in his first budget passed this month, which the Hartford law firm Murtha Cullina estimated amounts to an increase of nearly 0.4 percent on the income taxes for business owners that use the measure.

"If its a little bit more, we're still much better off than we were a year ago," said Joe McGee, vice president of public policy for the Business Council of Fairfield County, in reference to Lamont's tweak of the pass-through entity tax rate. "You don't like seeing it move in that direction, but ... I just talked to a whole bunch of accountants about it, and it’s not like a terrible, onerous change.”

Connecticut entered June on pace to record a $572 million surplus for its 2019 fiscal year, according to state Comptroller Kevin Lembo.

Mindful of machinations in some states to help residents dodge the SALT cap impact through credits issued for charitable contributions, the U.S. Department of the Treasury this week issued new regulations that require taxpayers to reduce their charitable contribution deductions by the amount of any SALT credits they receive in return.
The Treasury Department stated it is considering a number of issues raised by people who commented on the new regulations, without providing details.

“Prior statements from Treasury indicate that these workarounds are on their radar,” stated Michael D’Addio, a tax principal in the New Haven office of Marcum, in a note this week to clients.