



STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES

IP 2010(29.1)

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Hartford CT 06106-5032

INFORMATIONAL PUBLICATION

Q & A on Economic Nexus

Purpose: This Information Publication answers frequently-asked questions about Sections 90 and 91 of 2009 Conn. Pub. Acts 3 (June Spec. Sess.) (the “Economic Nexus Legislation”).

This publication has been revised to address the filing obligations of foreign (non-U.S.) corporations. See “Important note for foreign (non-U.S.) corporations” below.

Effective Date: Effective upon issuance and applicable to tax years beginning on or after January 1, 2010.

Statutory Authority: 2009 Conn. Pub. Acts 3, §§90-91 (June Spec. Sess.).

1. What is the purpose of the Economic Nexus Legislation?

The purpose of the Economic Nexus Legislation is to provide public notice that, effective for tax years beginning on or after January 1, 2010, any companies, partnerships, and S corporations that derive income from Connecticut or have a substantial economic presence within Connecticut, in either case attributable to the purposeful direction of business activities toward Connecticut, will be subject to tax in Connecticut.

2. How will the purposeful direction of business activities toward Connecticut be evaluated?

The purposeful direction of business activities toward Connecticut will be evaluated based on the frequency, quantity, and systematic nature of the business’s economic contacts in Connecticut.

Subject to the provisions of Question 3 below, the following are examples of the purposeful direction of business activities towards Connecticut:

Example 1: Midwest Bank is an out-of-state banking corporation with no office or employees in Connecticut and is not otherwise subject to Connecticut income taxation. Midwest Bank engages in active solicitation of Connecticut residents. Moreover, Midwest Bank had significant receipts attributable to Connecticut customers. Midwest Bank has economic nexus with Connecticut.

Example 2: Company X is an out-of-state corporation with no office or employees in Connecticut and is not otherwise subject to Connecticut income taxation. Company X engages in active solicitation of Connecticut residents. Moreover, Company X performed online financial services for Connecticut customers from which it generated significant receipts. Company X has economic nexus with Connecticut.

Example 3: Car Loan Corporation is an out-of-state corporation with no office or employees in Connecticut and is not otherwise subject to Connecticut income taxation. Motor Company is an automobile manufacturer. Car Loan Corporation made or held loans issued to customers who purchased automobiles from dealerships that sell Motor Company brand automobiles. Car Loan Corporation generated substantial interest and other income from its loans to Connecticut customers. Car Loan Corporation has economic nexus with Connecticut.

3. Is there a bright line test for determining when the frequency, quantity and systematic nature of a business’s contacts with Connecticut will cause the business to have economic nexus?

Yes. A company, partnership, or S corporation that is not otherwise subject to income taxation or a requirement to file a return in this state under Chapter 208 or Chapter 229 of the Connecticut General Statutes shall not be deemed to have economic nexus for a taxable year if the frequency, quantity, and systematic nature of the business’s economic contacts with the state are such that it has

receipts from business activities that are less than \$500,000 attributable to Connecticut sources during such taxable year. This bright line test does not preclude the Commissioner from contending that a company, partnership, or S corporation has an obligation to file a return or pay a tax under Chapter 208 or Chapter 229 of the Connecticut General Statutes as a matter of law other than attributable to the Economic Nexus Legislation. **Note:** The determination as to whether a pass-through entity, including, but not limited to partnerships and S corporations, satisfies the bright line test shall be made at the entity level.

4. Could the licensing of intangible property rights in Connecticut be considered a significant economic presence in the state, subjecting the licensor to taxation on its income?

The in-state ownership and use of intangible property by a company, partnership, or S corporation in Connecticut would subject it to tax on its income when:

1. The intangible property generates, or is otherwise a source of, gross receipts within the state for the corporation, including through a license or franchise;
2. The activity through which the corporation obtains such gross receipts from its intangible property is purposeful (e.g., a contract with an in-state company); **and**
3. The corporation's presence within the state, as indicated by its intangible property and its activities with respect to that property, satisfies the bright line test set forth in Question 3.

Note: Taxpayers subject to the provisions of the Economic Nexus Legislation are not required to include in gross income those amounts that have been added back by a related member in accordance with Conn. Gen. Stat. §12-218c. For purposes of this pronouncement, a "related member" is defined as provided in Conn. Gen. Stat. §12-218c(a)(5).

Example: Intangible Corp. is an out-of-state corporation with no office or employees in Connecticut and is not otherwise subject to Connecticut income taxation. Corporation T, which is a related member to Intangible Corp., operates in Connecticut. Intangible Corp. licensed Corporation T to use its intangible property (e.g., trademarks, trade names) in its Connecticut business operations. Under the license agreement, Corporation T pays Intangible Corp. a fee based on gross sales from its operations. As Intangible

Corp. derived receipts in excess of \$500,000 from its Connecticut business operations under the license agreement, Intangible Corp. has economic nexus with Connecticut. **Note:** For purposes of this example, Intangible Corp. will be considered by the Department to have nexus with Connecticut even if it were not a related member to Corporation T.

5. Can economic nexus be found to exist based on income derived from Connecticut that is passive investment income?

No. Income arising from a passive investment activity shall not be considered the basis for a finding that a company, partnership, or S corporation has economic nexus.

Example 1: Southern Corp., an out-of-state corporation, derives \$500,000 from a bank account and an investment account at a Connecticut-based financial institution. Southern Corp. does not have any other assets, operations, or activities in Connecticut. Southern Corp. does not have economic nexus in Connecticut.

Example 2: An out-of-state partnership purchases shares of common stock in a Connecticut corporation with operations in Connecticut. A representative of the partnership sits on the Board of Directors of the Connecticut corporation and attends meetings of the Board of Directors in Connecticut. The partnership has no assets, operations or activities in Connecticut. The partnership will not be deemed to have a "substantial economic presence within this state" that would require the partnership to file a tax return pursuant to Chapter 229 of the Connecticut General Statutes by virtue of the Economic Nexus Legislation.

Example 3: Mortgage Inc. is an out-of-state corporation with no office or employees in Connecticut and is not otherwise subject to Connecticut income taxation. Mortgage Inc. engages in active solicitation of Connecticut residents, either directly or through mortgage brokers. Moreover, Mortgage Inc. generated receipts in excess of \$500,000 from loans it made to Connecticut customers. Mortgage Inc. has economic nexus with Connecticut.

6. Does federal Public Law 86-272 provide protection to businesses that have economic nexus in Connecticut against Connecticut taxation?

Yes. P.L. 86-272, 15 U.S.C. 381-384, restricts Connecticut from imposing an *income tax* on income derived within its borders from interstate commerce if the only business activity of the business within

Connecticut consists of the solicitation of orders for sales of *tangible personal property*, which orders are to be sent outside Connecticut for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside Connecticut. P.L. 86-272 protection is not afforded to transactions other than sales of tangible personal property. In addition, P.L. 86-272 does not apply to taxes that are not based on income.

Example: Catalog Corp., an out-of-state corporation that is not otherwise subject to Connecticut income taxation, remotely solicits (i.e. by mail and telephone) orders for the company's tangible products from Connecticut customers. Sales are approved and shipped via common carrier from outside Connecticut. Although Catalog Corp. may have a substantial economic presence within Connecticut, it is nevertheless immune from Connecticut *income* taxation pursuant to P.L. 86-272.

7. Can economic nexus apply to a company, partnership, or S corporation based on its transactions with related members?

Except for the licensing of intangible property as discussed in Question 4, transactions between related members will not be treated as creating economic nexus. Please note, however, that even though a transaction with a Connecticut related member may not create economic nexus, such a transaction remains subject to the other provisions of Chapter 208, including without limitation Sections 12-218c, 12-218d, and 12-226a.

Example: An out-of-state headquarters corporation is not otherwise subject to Connecticut income taxation. It provides legal and accounting services to its wholly-owned subsidiary located in Connecticut. The provision of such services does not constitute the conduct of "business" under the Economic Nexus Legislation and shall not cause the out-of-state headquarters corporation to be subject to the Connecticut corporation business tax.

Important note for foreign (non-U.S.) corporations: After passage of the Economic Nexus Legislation, DRS established a working group to address issues associated with this legislation. With input and feedback from the working group, DRS issued **Informational Publication 2010(29)**, *Q & A on Economic Nexus*, wherein it answered many of the questions raised by practitioners and the business community. Since that time, the working group has continued to study issues associated with the application of these provisions to foreign

(non-U.S.) corporations. Based on its review and analysis of these issues, and to make certain that the provisions of the Economic Nexus Legislation are not applied other than as intended, DRS has drafted and submitted to the State Office of Policy and Management an amendment to clarify Conn. Gen. Stat. §12-216a. The proposed amendment will provide certainty that the provisions of Conn. Gen. Stat. §12-216a do not apply to any company that is treated as a foreign corporation under the Internal Revenue Code and that has no income effectively connected with a United States trade or business.

Moreover, as the amendment is intended as a clarification, DRS will administratively adhere to the provisions of the proposal until such time as the proposal is acted upon. Consequently, affected taxpayers can rely on this proposal for purposes of determining their filing obligations under Conn. Gen. Stat. §12-216a for income years commencing on or after January 1, 2010. Please be advised, however, that because a taxpayer may not be obligated to file under the provisions of Conn. Gen. Stat. §12-216a does not relieve the taxpayer from filing obligations imposed by other provisions of Chapter 208.

Effect on Other Documents: Informational Publication 2010(29), *Q & A on Economic Nexus*, is superseded and may not be relied upon after the date of issuance of this publication.

Effect of This Document: An Informational Publication issued by the Department of Revenue Services (DRS) addresses frequently-asked questions about a current position, policy, or practice, usually in a less technical question and answer format.

For Further Information: Call DRS during business hours, Monday through Friday:

- **1-800-382-9463** (Connecticut calls outside the Greater Hartford calling area only); **or**
- **860-297-5962** (from anywhere).

TTY, TDD, and Text Telephone users only may transmit inquiries anytime by calling 860-297-4911.

Forms and Publications: Visit the DRS website at www.ct.gov/DRS to download and print Connecticut tax forms and publications.

Paperless Filing/Payment Methods (fast, easy, free, and confidential):

Business and individual taxpayers can use the **Taxpayer Service Center (TSC)** at www.ct.gov/TSC to file a variety of tax returns, update account information, and make payments online.

File Electronically: You can choose first-time filer information and filing assistance or log directly into the **TSC** to file returns and pay taxes.

Pay Electronically: You can pay taxes for tax returns that cannot be filed through the **TSC**. Log in and select the *Make Payment Only* option. Designate

a payment date up to the due date of the tax and mail a paper return to complete the filing process.

DRS E-Alerts Service: Get connected to the latest news from DRS. Receive notification by email of changes to legislation, policies, and procedures. **DRS E-Alerts** provide information for employer's withholding tax, News – Press Releases, and Top 100 Delinquency List. Visit the DRS website at www.ct.gov/DRS and select *e-alerts* from the left navigation bar.

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