



JULY 2011

Recent Legislative Changes in Connecticut: The Environmental Exception and Treatment of Nonresident Contractors

Recently enacted changes to the Connecticut sales tax have a direct impact on the construction industry. One set of changes relates to environmental services and waste-to-energy facilities. The other is a significant modification to the provisions dealing with bonding and other requirements regarding nonresident contractors.

ENVIRONMENTAL SERVICES AND WASTE-TO-ENERGY

In the budget act, the General Assembly repealed the exception from taxable services for services rendered in the voluntary evaluation, prevention, treatment, containment or removal of hazardous waste. Public Act 11-6, § 88. This repeal is applicable to sales made on or after July 1, 2011. The transition rules for transactions which span the July 1 effective date are in Special Notice SN 2011(9), June 30, 2011. Note that this amendment does not affect the existing exclusion for environmental consulting services in Conn. Gen. Stat. § 12-407(a)(37)(J).

The budget act also repealed the section 12-412(95) exemption for tangible personal property or services incorporated into, or used and consumed in, the operation of a solid waste-to-energy facility. Public Act 11-6, § 166. However, this provision was restored in the budget implementer act. Public Act 11-61, § 184. Unaffected by legislation in 2011 are the section 12-412(92) exemption for tangible personal property or services to be incorporated into, or used in, the operation of a Connecticut Resource Recovery Authority project and the section 12-412(21) and (22) exemptions for tangible personal property incorporated into, or used in, facilities for the treatment of industrial waste or in air pollution facilities.

NONRESIDENT CONTRACTORS

One of the provisions of the budget implementer act makes sweeping changes in the treatment of nonresident contractors, with significant potential impact on general contractors and

subcontractors as well as property developers, effective October 1, 2011. P.A. 11-61, § 66.

To ensure payment of Connecticut taxes under current law, nonresident contractors—those construction contractors who do not maintain permanent business offices in Connecticut—are required to post a bond, in the nature of a commercial surety bond, of five percent of the contract price for each nonresidential construction contract to be performed in Connecticut. Current law also provides that any person who hires a nonresident contractor who has not posted such a bond must withhold five percent from the contract price. Failure to comply renders that person liable for the contractor's Connecticut taxes to the extent of five percent of the contract price.

Because this statutory scheme facially discriminates against out-of-state businesses, it is of questionable constitutionality. The disparate treatment not only requires bonds that are not required of in-state businesses but also, as administered under current law, imposes a contract-by-contract audit process on nonresidents, which may substantially delay their receipt of any amounts withheld or release of their bonds. The burdens extend to general contractors, developers, and property owners who hire contractors. It may not be apparent that a contractor is not a resident contractor and there is currently no way for someone considering hiring a contractor to verify the DRS position on whether a bond or withholding is required. Even when nonresident status is clear, general contractors who hire nonresident contractors often find themselves dealing with issues relating to withholding and bonding long after the contract is completed.

The act does not change the basic definition of a nonresident contractor nor does it change the five percent tax imposed under current law on any person who contracts with a nonresident contractor who has not complied with the provisions of the statute. What it does do is ease the burdens on nonresident contractors conducting business in Connecticut and on contractors who hire nonresident subcontractors. However, in doing so, it eliminates the right of developers and property owners who retain nonresident contractors to protect themselves from the additional five percent tax by withholding from amounts paid to the nonresident contractor.

Easing the Burdens on Nonresident Contractors

A major departure from prior practice eases the burdens on nonresident contractors conducting business in Connecticut by permitting them to become "verified nonresident contractors" who are not required to file a bond for each contract. A nonresident contractor achieves this status by registering with DRS for all applicable taxes, being current in filing and payment requirements, and posting a bond of six times its average tax liability per return period or a lesser amount as determined by the commissioner. Once a nonresident contractor has registered and remained current in filing and paying for three years, the requirement to post a bond is eliminated. Having satisfied the registration and bond requirements, the verified nonresident contractor is on a par with a resident contractor and there is no requirement that a person dealing with that contractor withhold any amount from the contract price.

DRS to Advise Whether Nonresident Contractor is "Verified"

DRS is required to verify upon request whether a contractor is in fact a verified nonresident contractor. The precise means by which the DRS will provide that verification has not been determined, but once in place, this procedure will ease the due diligence burden on those dealing with nonresident contractors who become verified nonresident contractors.

No Change for Nonresident Contractors Who Do Not Comply

Nonresident contractors who are not verified nonresident contractors are treated the same as nonresident contractors under the existing statute. They are required to post a bond equal to five percent of the price of each contract, and the act requires that any resident or nonresident general contractor who contracts with an "unverified" nonresident contractor must withhold five percent of the contract price until it receives a certificate of compliance from the DRS authorizing release of all or part of the withheld amount.

Developers and Property Owners Provided No Right to Withhold

General contractors continue to have the right to protect themselves from liability for nonresident contractor taxes by withholding. Developers and property owners, however, are left with no means of self-protection when hiring a nonresident contractor because there is no provision permitting them to withhold. Of course, if the contractor is known to be nonresident and the DRS either verifies that it is a verified nonresident contractor or provides certification that bond has been posted, the owner or developer has no need to withhold. However, if a contract is signed without knowledge that the contractor is nonresident or in advance of the provision of a certificate of compliance, the owner or developer is left with no statutorily sanctioned authority to withhold against the five percent tax and must rely for protection on provisions of the contract.

Affects Only Nonresidential Contracts of \$250,000 or More

With that exception, the act represents a significant improvement in the administration of the nonresident contractor provisions. In particular, the requirement that DRS confirm the status of verified nonresident contractors will ease the burdens on those who deal with them. Also, in a major departure from past practice, the nonresident contractor provisions will apply only to contracts in which the total contract price (including deposits, retainage, and charges for change orders and add-ons) is \$250,000 or more. This new threshold is in addition to the existing exclusion for residential contracts—a contract with an "owner or tenant of real property used exclusively for residential purposes and consisting of three or fewer dwelling units, in one of which the owner or tenant resides"—which is retained in P.A. 11-61.

Speedier Resolution of Nonresident Contractor Audits?

The act also institutes improvements in the administration of the nonresident contractor provisions. One such improvement requires the DRS to issue a certificate of compliance to an unverified subcontractor within 120 days of receipt of a request, together with required documentation. If the DRS fails to issue the certificate within that time, the certificate is deemed to have been issued. Once issued or deemed issued, the certificate provides the subcontractor the right to receive from the general contractor any amounts withheld or a lesser amount as specified in the certification. The act does not specify how the parties know when the 120-day period has commenced.

Another improvement is that the DRS is required to release an unverified general contractor from its bond obligation once the contractor submits to the DRS documentation showing either (1) that it and all of its unverified subcontractors have paid all required taxes or (2) that the general contractor has paid all the taxes it owes in connection with the contract, withheld five percent on payments to all of its unverified subcontractors, and released all withheld amounts in accordance with a certificate of compliance.

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