

**Sec. 12-708-9. Change from accrual to installment method of accounting**

(a) **General.** If a person has changed the method of accounting from the accrual to the installment method for federal income tax purposes, any installment payments actually received in the year of change or in subsequent taxable years (such year or years being referred to as “adjustment years”), on account of sales or other disposition of property made in any taxable year prior to the year of the change, are required to be included in federal adjusted gross income and consequently are included in Connecticut adjusted gross income. Therefore, profits attributable to installment sales which were taxed in the year of sale, because the person was then on the accrual method of accounting, would also be taxed in the adjustment years (i.e. during the years the installments are actually received after the change to the installment method of accounting). To avoid such duplication of Connecticut income tax, any additional Connecticut income tax for the adjustment years attributable to the receipt of installment payments properly accrued in a prior year shall be reduced by an amount equal to the portion of Connecticut income tax, for any year or years preceding the year of change, attributable to the prior accrual of income from installment sales included in Connecticut income in the adjustment years.

(b) **Reduction in Connecticut income tax for adjustment.** The Connecticut income tax for an adjustment year shall be reduced by the lesser of the following amounts:

*Method 1:* that proportion of the Connecticut income tax for the prior year (in which the installment sales were reported on the accrual basis) which the amount of installment sales gross profits reportable in the prior year of sale and in the adjustment year bears to the Connecticut adjusted gross income for such prior year of sale; or

*Method 2:* the excess, if any, of the amount of the Connecticut income tax for the adjustment year on the entire Connecticut taxable income over the amount of Connecticut income tax for such year, computed without regard to the amount of the installment sales gross profits reported in both the prior year of accrual and in the adjustment year.

Where previously reported installments received in an adjustment year include installments on sales made in more than one prior year, the reduction allowable with respect to the installments for each prior year shall be computed separately. In such a case, the excess Connecticut income tax, calculated under Method 2 above, computed with respect to the installments from all prior years shall be prorated over the several prior years in proportion to the amount of the duplicated installment sales profits attributable to each such prior year.

*Example:* The computation of the reduction of Connecticut income tax of a resident individual for adjustment years is illustrated by the following example (assume that the tax rate remains at 4.5% for all taxable years involved):

|                        | <i>Year 1</i>          | <i>Year 2</i>            | <i>Year 3</i>            |
|------------------------|------------------------|--------------------------|--------------------------|
|                        | <i>(accrual basis)</i> | <i>(adjustment year)</i> | <i>(adjustment year)</i> |
| Gross profit from in-  | \$10,000               | \$ 2,000                 | \$ 2,000                 |
| installment sales (re- |                        | (from year 1 sales)      | (from year 1 sales)      |
| ceivable in 5          |                        |                          |                          |
| installments)          |                        | \$3 ,000                 | \$ 3,000                 |

*Regulations of Connecticut State Agencies*

|                            |                 |                     |  |
|----------------------------|-----------------|---------------------|--|
|                            |                 | (from year 2 sales) | (from year 2 sales)<br>\$ 5,000<br>(from year 3 sales) |
| Other gross income         | <u>\$ 8,000</u> | <u>\$15,000</u>     | <u>\$11,000</u>  |
| Total gross income         | \$18,000        | \$20,000            | \$21,000   |
| Personal exemption         | <u>\$12,000</u> | <u>\$12,000</u>     | <u>\$12,000</u>  |
| Connecticut taxable income | \$ 6,000        | \$ 8,000            | \$ 9,000   |
|                            | <u>x 4.5%</u>   | <u>x 4.5%</u>       | <u>x 4.5%</u>  |
| Connecticut income tax     | \$ 270          | \$ 360              | \$ 405   |

*Computation of adjustment-year 2:* Connecticut income tax attributable to year 1 installment payments in year 2 (first adjustment year), the year in which the change was made from the accrual basis to the installment basis:

*Method 1:*

Connecticut income tax attributable to prior inclusion in year 1:

$$\frac{\$2,000}{\$18,000} \times 270 = \$30$$

*Method 2:*

Connecticut income tax on Connecticut taxable income, including

|  |                |
|--|----------------|
| Connecticut income tax on Connecticut taxable income, including gross profit from year 1 sales . . . . .                         | \$360          |
| Connecticut income tax on Connecticut taxable income, excluding such gross profit: Connecticut taxable income as above . . . . . | \$8,000        |
| Less gross profit from year 1 sales accrued in prior year . . . . .  | <u>\$2,000</u> |
| Revised Connecticut taxable income . . . . .   | \$6,000        |
| Connecticut income tax on revised Connecticut taxable income . . . . .   | \$270          |
| Additional Connecticut income tax attributable to prior year installment payments (\$360–\$270) . . . . .                        | \$90           |

Therefore, the Connecticut income tax for year 2 (first adjustment year) may be reduced by \$30, the lesser of the two amounts computed above.

*Computation of adjustment—year 3:* Connecticut income tax attributable to year 1 installment payments in year 3 (second adjustment year):

*Method 1:*

Connecticut income tax attributable to prior inclusion in year 1:

$$\frac{\$2,000}{\$18,000} \times 270 = \$30$$

*Method 2:*

|  |                |
|--|----------------|
| Connecticut income tax on Connecticut taxable income, including gross profit from year 1 sales . . . . .                         | \$405          |
| Connecticut income tax on Connecticut taxable income, excluding such gross profit: Connecticut taxable income as above . . . . . | \$9,000        |
| Less gross profit from year 1 sales accrued in prior year . . . . .  | <u>\$2,000</u> |
| Connecticut income tax on revised Connecticut taxable income . . . . .   | \$315          |
| Additional Connecticut income tax attributable to prior year installment payments (\$405-\$315) . . . . .                        | \$90           |

Therefore, the Connecticut income tax for year 3 (second adjustment year) may be reduced by \$30, the lesser of the two amounts computed above.

(c) **Change by a partnership from accrual to installment method of accounting.** In the case of a change by a partnership from the accrual method of accounting to the installment method, partnership income includes for each adjustment year any installment payments actually received in such year, even though such amounts were included in partnership income from prior years under the accrual method. Each partner shall determine separately such partner's distributive share of profits attributable to installment payments included in partnership income in the year of sale and in any adjustment year, and shall compute the partner's Connecticut income tax reduction with respect thereto in accordance with the provisions of this section.

(d) Statement to be attached to Connecticut income tax return. A taxpayer who changes from the accrual method to the installment method shall attach a statement to the Connecticut income tax return for each adjustment year showing:

- (1) the pertinent facts as to sales in each year preceding the year of change;
- (2) the number of remaining taxable years over which it shall be necessary to compute adjustments; and
- (3) a schedule showing the computation, as prescribed by this section, of the adjustment for the taxable year.

(Effective November 18, 1994)