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District of Columbia Mayor introduces combined reporting statute, proposes other tax changes

April 8, 2011

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District of Columbia Mayor Vincent Gray's proposed budget legislation would implement combined reporting, adopt a double-weighted sales factor, create a two-tier minimum franchise tax, and make other tax changes. [[Fiscal Year 2012 Budget Support Act of 2011](#), introduced 4/1/11]

Combined reporting

Under the Mayor's budget proposal, combined reporting would be required for any taxpayer engaged in a unitary business with one or more other corporations that are part of a water's edge combined group. The term "unitary business" means a single economic enterprise that is made up of either separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. (Secs. 801 and 803) Alternatively, taxpayers may elect to report unitary combined income on a worldwide basis. Such election must be made on a timely filed, original return by every member subject to tax and is binding for ten years. (Sec. 807) If enacted, combined reporting would be effective for tax years beginning after December 31, 2010.

The proposed combined reporting provisions generally mirror the Multistate Tax Commission model combined reporting statute. Like the model act, the proposal would require the use of a *Joyce* methodology in apportioning income of the group. In addition, the proposal limits the use of credits and net operating loss carryovers to the member that earned such credits or losses. The proposal also allows a charitable deduction incurred by one member of a group to be used

by the combined group. The proposal gives the Mayor broad discretion to adopt regulations necessary to ensure that income derived from sources in the District as reflected on a combined report is properly reported.

S Corporation taxation in question

The District does not currently conform to the federal pass-through treatment of S corporations. Rather, entities defined as S corporations under I.R.C. Sec. 1371 are included in the definition of "corporation" under the current version of D.C. Code Sec. 47-1801.04(16). Accordingly, S corporations are taxed as any other corporation with nexus in the District and must timely file Form D-20.

The proposal would amend and renumber the definition of "corporation" to conform to the MTC model act definition of corporation. In doing so, the proposal would remove references to S corporations from the definition of corporation. As amended, the statute would define corporation to include "any corporation ... treated as a corporation for [District tax purposes]." The proposal leaves open the question of how S corporations will be taxed, should the proposal be adopted. Consequently, it is unclear whether S corporations would be subject to combined reporting under the budget proposal.

Reconciling proposed combined reporting with the unincorporated business tax

The District of Columbia imposes an income tax upon the taxable income of every unincorporated business for the privilege of carrying on or engaging in business within the District under Secs. 47-1808.01 et seq. In general, the tax mirrors the corporate income tax, which is imposed under Sec. 47-1807.01 et seq. As proposed, the statute does not appear to include unincorporated businesses in the combined reporting provisions.

Other tax proposals

In addition to combined reporting, the proposed budget legislation would:

- Modify the apportionment formula for corporate and unincorporated business taxpayers to adopt a double-weighted sales factor (Sec. 821);
- Create a two-tier minimum franchise tax based on gross receipts - \$250 for taxpayers with gross receipts of \$1,000,000 or less and \$1,000 for

taxpayers with gross receipts of more than \$1,000,000 (Sec. 872);

- Require taxpayers to withhold or make estimated payments equal to 110% of their prior year tax liability to avoid penalties for underwithholding (Sec. 861);
- Increase sales taxes on parking (Sec. 841) and cigarettes (Sec. 851);
- Set the District's general sales tax rate at 6% indefinitely (Sec. 831); and
- Impose the hotel occupancy tax on the net charges and additional charges received by an online travel company for rooms or accommodations furnished in the District (Sec. 712).

In addition, the proposal makes a number of housekeeping changes to Sec. 47-1801.4 (General definitions) in part to incorporate MTC model act terms. The proposal expands the definition of "trade of business" under Sec. 47-1801.4 by eliminating the exclusion for "sales of tangible personal property whereby title to such property passes within or without the District, by a corporation or unincorporated business which does not physically have or maintain an office, warehouse, or other place of business in the District, and which has no officer, agent, or representative having an office or other place of business in the District, during the taxable year." The proposal also defines "affiliated group" as an affiliated group as defined in I.R.C. Sec. 1504; provided, that the affiliated group shall not include any corporation that does not have gross income derived from sources within the District.

PwC observes

"Despite strong opposition by some in the business community and certain members of D.C. Council, the Mayor is moving forward with combined reporting," says Karen Nakamura, State and Local Tax Director with PwC in Washington, D.C. "As some may recall, permanent legislation enacted in 2010 directed the District of Columbia Council to enact combined reporting for tax years beginning after December 31, 2010. At that time, the 'must enact' provision was used to fill a more than \$22 million budget gap. While many question the ability of an outgoing administration to adopt legislation that mandates how an incoming administration must act in developing a fiscal plan, it appears that the current Council is willing to leave the question unanswered for now. The budget will be up for a vote in about two months and, if passed, will be forwarded to the U.S. Congress for the mandatory 30-day review

period. The proposal will become law if Congress does not act to modify the proposed budget. The next two months will provide interested parties an opportunity to raise concerns regarding the components of the budget, including combined reporting. It remains to be seen if any changes will be made to the proposed budget during the next two months or if the Council will resort to emergency legislation to

extend the two-month deadline for passing a permanent budget."

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