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*Combined reporting remains "alive and well" in DC, along with other tax increases*

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The enrolled version of the District of Columbia Fiscal Year 2012 Budget Support Act of 2011 ([B19-0203](#)), released July 8, 2011, does the following:

- mandates the use of water's edge combined reporting by corporations engaged in a unitary business operation;
- requires the use of a three-factor apportionment formula that includes a double weighted sales factor;
- establishes a two-tier minimum tax structure;
- imposes income tax on non-District municipal obligations, effective October 1, 2011, for individual taxpayers, and January 1, 2011, for all other taxpayers;
- limits itemized deductions in computing taxable income;
- expands the list of services subject to sales tax and makes permanent a temporary sales tax rate increase;
- increases the parking tax rate to 18 percent from 12 percent;
- increases to 110 percent from 100 percent the prior year tax liability estimated tax safe harbor;
- requires sales/use tax collection by "nexus" and "remote" vendors selling via the Internet to District purchasers;
- increases the hospital "bed tax" to \$2529 in 2011, and to \$3,788 in 2012 through 2014; and
- modifies property tax rate calculations, among other changes.

The bill, which was introduced on April 1, 2011, and amended on June 14, 2011, contains a much anticipated "ASC 740 fix," addresses concerns regarding the tax



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treatment of unincorporated business entities owned by combined reporting group members, clarifies when a non-US corporation may be brought into a water's-edge return, and updates the definition of "tax haven." The just released bill does not significantly change the business income tax provisions set forth in the originally-proposed budget bill.

The Mayor is expected to sign B19-0203 in short order. Once signed, the bill will be returned to the District of Columbia Council, which will assign an Act number and forward the bill to Congress. Once submitted to Congress, the Act will be subject to a mandatory 30-day Congressional review period. The 30-day period considers only in-session days; i.e., holidays, recess days, weekends and other similar non-session days are not considered in determining the 30-day review period. Should the Act clear Congress without action on the part of Congress or the President, the bill will become law on the 30<sup>th</sup> day.

While the release of B19-0203 provides some certainty for taxpayers, it is important to understand the potential impact of a soon to be released series of emergency and temporary bills and recently enacted emergency and permanent bills, which do not incorporate the above tax proposals. The various proposed and enacted bills, discussed in greater detail below, are needed to ensure that the District can meet revenue and spending obligations for the remainder of the fiscal year, which ends on September 30, 2011, given the potential that B19-0203 may not become law before that time. That said, because the proposed and enacted bills incorporate almost none of the tax proposals set out in B19-0203, but which are key to fund current and future spending commitments, the District may need to issue an emergency or temporary bill that mirrors B19-0203. However, information regarding the potential for further legislation is unavailable at this time.

**Proposed Tax Provisions Included in B19-0203.** As noted above, the Fiscal Year 2012 Budget Support Act of 2011 (B19-0203), as enrolled, includes many of the provisions set forth in the enrolled version of the proposal. Of note, the proposal mandates the use of combined reporting for any taxpayer engaged in a unitary business with one or more other corporations that are part of a water's edge combined group. While the provisions generally mirror the Multistate Combined Reporting statute, there are a number of notable changes, including the use of water's-edge default rather than world-wide combined reporting, unless the taxpayer elects or the District requires an alternative filing method. 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.

Two notable amendments since original introduction deal with the taxation of unincorporated businesses owned by combined reporting group members and the ASC 740 fix. As amended, B19-0203 provides that where a combined group includes or member owns an unincorporated business that "would be subject to [the District unincorporated business tax]" the group or member excludes from District taxable income its pre-apportioned distributive share of unincorporated business income in computing District taxable income. The group or member then makes an addition modification to include in District taxable income its distributive share of post-apportioned unincorporated business income.

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With respect to the ASC 740 fix, B19-0203 provides that if the enactment of combined reporting requirements for unitary businesses result in an increase to a combined group's net deferred tax liability, the combined group is entitled to a deduction, claimed ratably over the seven-year period beginning in 2015, in an amount equal to 1/7th of the net increase in the taxable temporary differences that caused the increase in the net deferred tax liability, as computed at the time of enactment in accordance with either generally accepted accounting principles or international financial reporting standards. The amount of the deduction may not exceed the amount necessary to offset any increase in net deferred tax liability, as computed in accordance with either generally accepted accounting principles or international financial reporting standards that would result from the imposition of all of the provisions included in B19-0203, but for the ASC 740 deduction.

The bill defines "net deferred tax liability" as the net increase, if any, in deferred tax liabilities minus the net increase, if any, in deferred tax assets of the combined group, as computed in accordance with either generally accepted accounting principles or international financial reporting standards.

The ASC 740 deduction is only available to publicly traded companies, including affiliated corporations participating in the filing of a publicly traded company's financial statements prepared in accordance with either generally accepted accounting principles or international financial reporting standards, as of the effective date of B19-0203.

The bill provides that to the extent the deduction would produce a net operating loss in any tax year, the unused deduction may be carried forward to each succeeding tax year indefinitely by the combined group and deducted without regard to any limitation.

One other change added with respect to combined reporting - the Chief Financial Officer must, after two full years of combined reporting, determine the economic effects of the combined reporting requirements on affected taxpayers.

**Pending Emergency, Temporary Proposals.** Based on information circulated to members of the District of Columbia Council, it is expected that a series of emergency budget support (i.e., revenue) proposals and emergency budget request (i.e., spending) proposals, along with a temporary budget support proposal will be issued on or about July 14, 2011. Those proposals are in addition to a permanent budget request act and an emergency budget support act signed by the Mayor on June 29, 2011. Fiscal Year 2012 Budget Request Act of 2011 (Bill 19-0202/Act 19-0092), Fiscal Year 2012 Budget Support Emergency Act of 2011 (Bill 19-0338/Act 19-0093).

The emergency and temporary bills expected to be introduced on or about July 12, 2011, include: the Fiscal Year 2012 Budget Support Technical Clarification Emergency Declaration Resolution of 2011; the Fiscal Year 2012 Budget Support Technical Clarification Emergency Amendment Act of 2011; and the Fiscal Year 2012 Budget Support Technical Clarification Temporary Amendment Act of 2011. In general, the above measures are necessary to make minor amendments of a technical, clarifying, or conforming nature to the emergency and permanent versions of the Fiscal Year 2012 Budget Support Act of 2011. Accordingly, proposed amendments may include clarification of the requirements a hotel must meet to qualify for the special events exemption; language preventing the potential overfunding of programs receiving certain funding; clarifying provisions recommended by the District of Columbia Office of Tax and Revenue; and conforming amendments needed to

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effectuate the October 1, 2011, applicability date for several tax enhancements incorporated into the budget support act.

In addition, at this time, it is anticipated that the Fiscal Year 2011 Second Revised Budget Request Emergency Act of 2011 will be introduced on or about July 12, 2011. The budget request emergency act is expected to make use of the additional FY 2011 revenues identified in a June 22, 2011, revised revenue estimate issued by the District of Columbia Chief Financial Officer. The Fiscal Year 2012 Dedicated Tax Technical Amendment Emergency Act of 2011 is also expected to be introduced on or about July 12, 2011, and will adjust certain budget estimates to take the revised figures into account and ensure that appropriations match certified revenues.

As emergency bills, the above proposals would follow an expedited approval process within the Council, but expire 90 days after Mayoral approval. Emergency bills are not subject to Congressional review. Temporary bills, which would follow a somewhat less expedited approval process, would expire 225 days after mayoral-review and a 30-day Congressional review period.

**Congress May Act to Limit District Laws.** Act 19-0092 contains a number of controversial provisions that may prevent it from passing through the Congressional review process unchallenged. Of note, Act 19-0092 provides that income from District of Columbia obligations are exempt from all personal and corporate income taxes of the District, state, and federal governments, including from taxation by any county, municipality, or other political subdivision of a State and any territory or possession of the United States. In providing such, the Act goes beyond providing an income tax exemption for District residents, but attempts to provide a nationwide income tax exemption for investments in District municipal obligations.

In addition, the Act authorizes the District to impose personal income tax on the personal income earned in the District of any professional athlete. The provision is in direct conflict with existing law that prohibits the District from imposing personal income taxes non-resident individuals, including those who work within the District limits.

The Act also imposes sales tax on a wide array of items sold at federal buildings and by government-sponsored enterprises and corporations, institutions, and organizations, which are currently exempt under existing laws.

One of the more controversial provisions deals with the taxation of remote sellers. The provision would require every remote vendor that does not qualify as an exempted vendor to collect and remit sales and use taxes on items sold to District purchasers. Unlike the remote seller laws in place in New York and North Carolina, which specify a threshold level of sales and a relationship with an instate entity (e.g., associated sales agent), the District provision authorizes District government officials to establish the parameters to implement the law, including establishing a remote seller registry, setting "small vendor" exemptions, implementing rules on the types of products subject to tax, and more. This provision, as currently written, arguably conflicts with current constitutional provisions, including the Commerce Clause and Due Process Clause, as those provisions have been interpreted in *Quill*.

As a permanent bill, Act 19-0092 is subject to Congressional review before it becomes law. Accordingly, it remains to be seen whether Congress will issue a joint resolution disapproving the Act, and how the President will respond. If the joint resolution is approved, the Act will not become law.

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