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D.C. Official Responds to Practitioners' Combined Reporting Concerns

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Summary by taxanalysts

Though the District of Columbia followed up its 2011 enactment of combined reporting by releasing proposed regulations, practitioners contend that the new law has unresolved issues; an Office of Tax and Revenue official responds in an interview with Tax Analysts.

Full Text Published by taxanalysts

News Analysis

Though the District of Columbia followed up its 2011 enactment of combined reporting by releasing proposed regulations in January, practitioners contend that the new law has unresolved issues.

Despite the additional guidance in the proposed regulations, practitioners say that questions remain on the issues of *Joyce* versus *Finnigan*, qualified high-technology companies (QHTCs), and renewal of the worldwide combined reporting election. (For prior coverage, see *State Tax Notes*, Jan. 30, 2011, p. 361, *Doc 2012-1235*, or *2012 STT 14-14*. For the proposed regulations, see *Doc 2012-1198* or *2012 STT 14-15*.)

Aaishah Hashmi, assistant general counsel for the D.C. Office of Tax and Revenue (OTR), responded to those concerns in an e-mail interview with Tax Analysts. Hashmi was the primary drafter of the statutes and the regulations.

Mandatory combined reporting became effective in the district on September 14 and applies to tax years beginning after December 31, 2010. On January 20 the OTR published its proposed regulations.

Joyce vs. *Finnigan*

Has the district adopted the *Joyce* or *Finnigan* approach? Neither the statute nor the regulations make it clear which one the district is taking and therefore additional guidance is needed, according to Diann Smith, counsel with Sutherland Asbill & Brennan LLP, Washington.

Catherine Roehl, senior tax consultant with Argy, Wiltse & Robinson P.C., McLean, Va., said in an e-mail that some elements of the combined reporting law appear to imply that the district has adopted the *Joyce* approach:

> Other areas of the combined reporting law seem to suggest that the individual nature of the separate identities of the members of a group will be preserved. For example, since each entity is responsible for reporting its taxable income based on its apportioned share of income, and the application of [net operating losses] is only to the entity that attributed the loss, it appears that the *Joyce* approach has been adopted.

Hashmi responded that "for apportionment purposes, the district is following the *Joyce* application."

Qualified High-Technology Companies

Under the new combined reporting rules, there is also uncertainty for entities that are deemed to be QHTCs, which are entitled to various benefits and credits.

Hashmi confirmed that QHTCs are subject to the new combined reporting rules, but acknowledged their special nature: "QHTCs are corporations and therefore subject to combined reporting unless they become exempt by statute. We are hoping to work towards that due to their unique status."

The combined reporting statute and regulations also do not address questions regarding the revenue standard that an entity must meet to qualify as a QHTC. In addition to meeting other statutory requirements, to qualify as a QHTC an entity must derive at least 51 percent of its gross revenue from certain qualifying activities listed by statute (the revenue test). (D.C. Code Ann. section 47-1817.01(5)(A).)

Roehl said it is unclear how the 51 percent standard will be applied to gross revenue: "Some companies have more than one aspect and/or revenue stream in their business and/or related businesses. If the revenue test is applied to the combined group's revenue as a whole, a separate entity within the group that may otherwise qualify independently as a QHTC, may now be unable to meet the criteria (mainly the 51 percent revenue test) for QHTC status."

Roehl also said that it appears that a *Joyce* approach has been adopted: "Since *Joyce* stands for the proposition that each member in a combined group is treated as the actual taxpayer, this may lead to the conclusion that QHTC status would continue to be determined on an individual entity basis."

Hashmi said that "each member is treated as a separate taxpayer and therefore, the test would be determined on a per entity basis."

Under the new combined reporting regime, Roehl said, there is also some question regarding the credits available to QHTCs. QHTCs are entitled to the following credits against their district franchise tax liability:

- a credit for relocation costs for each qualified employee relocated to the district from a location outside the district;
- a credit for 10 percent of the wages paid during the first 24 calendar months of employment to a qualified employee hired after December 31, 2000;
- a credit for expenditures paid or incurred during the tax year for retraining of a qualified disadvantaged employee; and
- a credit for 50 percent of the wages paid to a qualified disadvantaged employee during the first 24 calendar months of employment. (D.C. Code Ann. sections 47-1817.02(b)(1); 47-1817.03(a); 47-1817.04(b); 47-1817.05(a).)

It remains to be determined whether employees will have to be hired specifically by the entity claiming the QHTC credit or if they can be hired by any member of the combined group, according to Roehl.

Although not addressed by the statute or the regulations, Hashmi said the QHTC "has to independently qualify."

Worldwide Combined Unitary Reporting Election

District law provides that a combined group may make an election to report district tax based on worldwide unitary combined reporting. There is uncertainty regarding the renewal and revocation of the worldwide combined unitary reporting election.

The statute provides that "if no withdrawal is properly made, the worldwide unitary combined reporting election shall be in place for an additional 10-year period, subject to the same conditions as applied to the original election." (D.C. Code Ann. section 47-1810.07(d)(4).) However, the new proposed regulations state that "if a prior worldwide election is neither affirmatively revoked nor renewed after ten (10) taxable years, the election shall terminate for the subsequent taxable year, but a new worldwide election may be made for any ten (10)-year period thereafter by election."

Smith said the portion in the regulation pertaining to the revocation and renewal of the worldwide election is problematic because it is "directly contradictory to the statute."

Hashmi said the OTR is aware of the inconsistency between the statute and the regulations, adding:

> By automatically terminating the worldwide election after 10 years, the regulation provides a more flexible approach in that it protects the taxpayer from being bound to the election for an additional 10 years if the taxpayer inadvertently fails to revoke or renew the election. Any inconsistencies between the regulation and the statute regarding the mechanics of the election will be reconciled through a statutory amendment.

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