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Issues Remain With D.C. Combined Reporting Regs, Practitioners

Say

by **Waltreese Carroll**

Summary by **taxanalysts**[®]

Practitioners say there are still unresolved issues with the District of Columbia's new combined reporting regime; an Office of Tax and Revenue official discussed the proposed regulations in an interview with Tax Analysts.

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As taxpayers file their first tax returns under the District of Columbia's new combined reporting regime, practitioners say that issues still remain unresolved as they wait for final regulations.

The district enacted combined reporting in 2011 and released proposed regulations in January. (For prior coverage, see *State Tax Notes*, Jan. 30, 2012, p. 361, *Doc 2012-1235* , or *2012 STT 14-14* . For the proposed regulations, see *Doc 2012-1198*  or *2012 STT 14-15* .)

The proposed regulations were available for public comment through February 21, according to Aaishah Hashmi, assistant general counsel for the D.C. Office of Tax and Revenue (OTR). (For Hashmi's analysis of the proposed regulations, see *State Tax Notes*, Feb. 13, 2012, p. 547, *Doc 2012-1782* , or *2012 STT 29-2* .) As of May 29, the district has not released its final combined reporting regulations.

Practitioners have cited unresolved issues regarding combined groups with entities that have special apportionment methods, groups that include or have members with interests in unincorporated business entities, the filing deadline for entities filing their returns on extension, and whether the final regulations will expressly say that the district has adopted the *Joyce* approach. (For an analysis of other combined reporting issues previously identified by practitioners, see *State Tax Notes*, Feb. 13, 2012, p. 513, *Doc 2012-2038* , or *2012 STT 24-11* .)

In an e-mail interview with Tax Analysts, Hashmi, the primary drafter of the combined reporting statutes and regulations, answered questions regarding the status of the proposed regulations and responded to practitioners' concerns.

Status of the Combined Reporting Regulations

Hashmi said the OTR hopes the proposed regulations will be completed this summer.

Under the district's Administrative Procedure Act, an agency is not required to hold a public hearing on a proposed regulation, Hashmi said. The OTR is reviewing and analyzing the numerous comments made during the comment period, which ended in February, and is in the process of drafting clarifying amendments to the regulations, she said.

"OTR continued to receive comments well after the comment period and is still doing so for purposes of obtaining taxpayer insight and to determine further required amendments," Hashmi said.

Hashmi also said that any substantive changes to the regulations will have to be proposed again and undergo an additional comment period. However, she added that because a 30-day comment period was already provided for

the same regulations, the OTR has the discretion to shorten the second comment period so long as it is at least seven days. "If additional comments are submitted at this time, it may create additional delay," she said.

Combining Special Apportionment Methods

The proposed regulations provide special rules for unitary groups that include some members that are required to use the standard four-factor apportionment formula and others that use special apportionment methods, such as financial institutions and transportation companies.

The unitary group members that use the four-factor formula and those that use special apportionment methods must be separated into subgroups for purposes of allocation and apportionment. Each subgroup is required to separately calculate its modified federal taxable income (FTI) and apportionment factors, which are to be applied to the business income or loss portion of the modified FTI of each subgroup. Each subgroup is also required to separately allocate any allocable income or loss. (Proposed D.C. Mun. Regs. tit. 9, section 164.1(a), (b), (c).)

All income or loss allocated and apportioned to the district by each subgroup should be added together to produce an aggregated district tax base to which the district's income tax rate should be applied to determine the tax due. (Proposed D.C. Mun. Regs. tit. 9, section 164.1(d), (e).)

Walter Nagel, a partner at Reed Smith LLP, Washington, told Tax Analysts that he does not believe the statutes and proposed regulations adequately address how unitary groups with members that use the four-factor formula and other members that use a special apportionment formula calculate their district tax to be reported on the 2011 tax return.

Nagel, an adjunct professor of law at Georgetown University Law Center, said the statute is silent on how banks and transportation companies are to be treated in a combined return, "leaving taxpayers to rely entirely on the proposed regulations, which hopefully will be finalized sometime soon."

Nagel said there are issues with the proposed regulations' requirement that unitary groups with members using special apportionment methods be separated into subgroups for purposes of computing the district tax due:

The proposed regulations would have combined groups create subgroups to include general corporations on the one hand, and corporations that use a special apportionment formula on the other hand. However, the precise manner in which the subgroup's income and apportionment is determined is not entirely clear, and the aggregation of the tax bases appears to be inconsistent with the "separate taxpayer identity" that the district purports to maintain despite combination.

Nagel added that he hopes the OTR "will clarify or do away with the aggregation rules and simply resort to separate unitary groups, all subject to the same calculation rules."

"OTR has determined that each entity will separately determine its taxable income with its own apportionment method on the combined report and so subgrouping will not be necessary as originally determined," Hashmi responded. "Regulations on subgrouping will be revised accordingly. We will be providing a financial institution example on the combined reporting schedule shortly."

Passthrough Entities

For combined groups that include unincorporated business entities that would be subject to the tax imposed under D.C. Code section 47-1808.03 or that have members with ownership interests in such entities, the proposed regulations provide specific rules and various examples.

Nagel said that while he thinks the OTR has done a good job of trying to provide guidance on this issue by including different examples in the regulations, he expects additional guidance to be included in the final regulations.

Hashmi said there are areas in which additional clarifications and modifications will be made, such as for unincorporated business entities, qualified high-tech companies, and net operating losses. She added that the OTR is creating several additional examples regarding the treatment of unincorporated business entities and that the final regulations will provide additional guidance for groups that contain such entities.

"OTR views regulatory or other guidance in the area of combined reporting as ongoing and as such will continue to provide additional guidance as necessary," Hashmi said.

Other Issues

Filing Deadline for Tax Returns

District corporate franchise tax returns are generally due on March 15 for calendar-year filers; taxpayers on a fiscal year must file by the 15th day of the third month following the close of their tax year. If an extension has been filed, the due date of the return is extended an additional six months.

Jamie Yesnowitz, a senior manager with Grant Thornton LLP, Washington, said that without a final regulation, taxpayers cannot be expected to file their returns. With a September 15 due date for calendar-year taxpayers filing on extension, the deadline should be extended, he said.

Asked whether corporate taxpayers that filed their returns on extension would receive additional time to file in light of the fact that the combined reporting regulations have not been finalized, Hashmi said that sufficient guidance has been given to taxpayers and that any revisions to the regulations will not depart from the original version, so the OTR does not anticipate granting any extensions. "OTR's goals are to clarify and modify the regulations and not to repeal them," she said. All combined reporting schedules are available on the OTR website, Hashmi added.

Joyce v. Finnigan

While Hashmi told Tax Analysts in January that the district is following a *Joyce* approach, this information has not been included in the proposed regulations.

Yesnowitz said the regulations should state whether the district has adopted a *Joyce* approach.

Hashmi responded that the final regulations will specify that for apportionment purposes, the district has adopted the *Joyce* method.

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