

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE CHIEF FINANCIAL OFFICER
OFFICE OF TAX AND REVENUE**



**OTR TAX NOTICE 2010-04
March 4, 2010**

**Disallowance of Certain Interest and Intangible Expenses Paid
to Related Parties**

The Fiscal Year 2010 Budget Support Act of 2009 disallows certain interest and intangible payments to related parties.

The text of the new legislation is appended to this notice.

The new law, codified as (DC Code § 47-1803.03 (d) (7)), repeals the previous rules and replaces them with new rules relating to the disallowance of certain interest and intangible expenses, including royalty expenses, paid to related parties either directly or indirectly. The new rules are effective for taxable years beginning after December 31, 2008

In general, the interest and intangible payments will be disallowed unless:

- 1) The principal purpose of the payments was not the avoidance of tax;
- 2) The payments were made at arm's length; and
- 3) The related party paid tax equal to or greater than 4.5 percent of the amount of interest or intangible payments in another jurisdiction.

If you are the recipient of a related party's interest or other intangible payments and you are filing a return in the District and paying tax on these payments, you may be able to deduct all or a portion of these payments to the extent they were included on the related entity's return filed in the District or in another state where a similar adjustment was made.

FISCAL YEAR 2010 BUDGET SUPPORT ACT OF 2009
TITLE VII. FINANCE AND REVENUE.

SUBTITLE F. DISALLOWANCE OF CERTAIN EXPENSES PAID TO RELATED PARTIES

Sec. 7080. Short title.

This subtitle may be cited as the "Interest Expense and Intangible Expense Paid to Related Parties Disallowance Act of 2009".

Sec. 7081. Section 47-1803.03 of the District of Columbia Official Code is amended as follows:

(a) Subsection (a)(19) is repealed.

(b) Subsection (d) is amended as follows: to add a new paragraph (7) to read as follows:

"(7)(A) Any otherwise deductible interest expense or intangible expense if the interest expense or intangible expense is directly or indirectly paid to, or accrued or incurred by, one or more related members in connection directly or indirectly with one or more direct or indirect transactions.

"(B) The disallowance under subparagraph (A) of this paragraph shall not apply to any portion of the interest expense or intangible expense to the extent that the corporation establishes, as determined by the Chief Financial Officer, that:

"(i) The transaction giving rise to the payment of the interest expense or intangible expense between the corporation and the related member did not have as a principal purpose the avoidance of any portion of the tax due under this title;

"(ii) The interest expense or intangible expense was paid pursuant to arm's length contracts at an arm's length rate of interest or price; and

"(iii)(I) During the same taxable year, the related member directly or indirectly paid interest expense to, or the interest expense or intangible expense was accrued or incurred by, a person who is not a related member; or

"(II)(aa) The related member was subject to a tax measured by its net income or receipts in the District, a state or possession of the United States, or a foreign nation that has entered into a tax treaty with the United States government;

"(bb) A measure of the tax imposed by the District, a state or possession of the United States, or a foreign nation that has entered into a comprehensive tax treaty with the United States government included in the interest expense or intangible expense received by the related member from the corporation; and

"(cc) The aggregate effective tax rate imposed on the amounts received by the related member is equal to or greater than 4.5%; provided, that a related member receiving the interest or intangible payment shall not be considered to be subject to a tax merely by virtue of the related member's inclusion in a combined or consolidated return in one or more states.

"(C) A subtraction from federal taxable income shall be allowed from the taxable income of a corporation equal to the amount received as royalties, interest, or similar income from intangibles from a related member, to the extent the related member, with respect to the payment, is denied a deduction under subparagraph (A) of this paragraph or there is a similar deduction denial or addition modification of a state, possession of the United States, or of a foreign nation that has entered into a comprehensive tax treaty with the United States government for intangible expenses or interest expenses paid to related members.

"(D) For the purposes of this paragraph, the term:

"(i) "Aggregate effective tax rate" means the sum of the effective rates of tax imposed by the District of Columbia, states, or possessions of the United States, and foreign nations that have

entered into comprehensive tax treaties with the United States government, where a related member receiving a payment of interest expense or intangible expense is subject to tax and where the measure of the tax imposed included the payment.

“(ii) "Intangible expense" means:

“(I) An expense, loss, or cost for, related to, or in connection directly or indirectly with the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property, to the extent the expense, loss, or cost is allowed as a deduction or cost in determining taxable income for the taxable year under the Internal Revenue Code of 1986;

“(II) A loss related to or incurred in connection directly or indirectly with factoring transactions or discounting transactions; or

“(III) A royalty, patent, technical, or copyright and licensing fee; or

“(IV) Any other similar expense or cost.

“(iii) "Intangible property" means patents, patent applications, trade names, trademarks, service marks, copyrights, and similar types of intangible assets.

“(iv) "Interest expense" means an amount directly or indirectly allowed as a deduction under section 163 of the Internal Revenue Code for purposes of determining taxable income under the Internal Revenue Code of 1986.

“(v) "Related entity" means a person that, under the attribution rules of section 318 of the Internal Revenue Code of 1986, is:

“(I) A stockholder who is an individual or a member of the stockholder's family enumerated in section 318 of the Internal Revenue Code of 1986, if the stockholder and the members of the stockholder's family own directly, indirectly, beneficially, or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock;

“(II) A stockholder or a stockholder's partnership, limited liability company, estate, trust, or corporation, if the stockholder and the stockholder's partnership, limited liability company, estate, trust, or corporation own directly, indirectly, beneficially, or constructively, in the aggregate, at least 50% of the value of the taxpayer's outstanding stock; or

“(III) A corporation or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of section 318 of the Internal Revenue Code of 1986, if the taxpayer owns directly, indirectly, beneficially, or constructively, at least 50% of the value of the corporation's outstanding stock.

“(vi) "Related member" means:

“(I) A person that, with respect to the taxpayer any time during the year, is a related entity;

“(II) A component member, as defined in section 1563(b) of the Internal Revenue Code of 1986;

“(III) A controlled group of which the taxpayer is also a component; or

“(IV) Is a person to or from whom there is attribution of stock ownership in accordance with section 1563(e) of the Internal Revenue Code of 1986.”.

Sec. 7082. Applicability

Section 7081 shall be effective for taxable years beginning after December 31, 2008.