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A Washington National Tax Services (WNTS)
Publication

January 20, 2012

D.C. Office of Tax and Revenue issues proposed combined reporting regulations



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The District of Columbia Office of Tax and Revenue on January 20, 2012 issued long-awaited [proposed regulations](#) to implement mandatory unitary combined reporting, effective in D.C. for taxable years beginning on or after January 1, 2011. Below is an overview of and some key considerations raised by the regulations. A more in-depth analysis and additional considerations will be published in a future myStateTaxOffice mailing.

Sec. 156 -- Purpose, General Rule, and Definitions. The regulations provide definitions of terms and phrases for purposes of combined reporting. Among these definitions, a "commonly controlled group" exists where there is common ownership or control of stock representing more than 50% of the voting power of the corporations in the group.

Key consideration: The regulations provide that any existing taxpayer election to file a consolidated return is revoked for tax years beginning after December 31, 2010, and any such prior election shall have no further effect.

Sec. 157 -- Entities Required Combined Reporting. A corporation subject to tax under chapter 18 of title 47 of the D.C. Official Code (Income and Franchise Taxes) and engaged in a unitary business with one or more other entities related by common ownership must determine its tax liability based on the income and apportionment factors of all corporations included in the combined group using a



combined report. The corporations to be included in the combined group include all entities of the kind that are subject to tax under chapter 18 or would be subject to tax if doing business in the District.

Key consideration: The regulations specify that the entities in the combined group include, but are not limited to: any financial institution, utility company, transportation company, S corporation, real estate investment trust (REIT), and regulated investment company (RIC). Insurance companies are excluded from the combined group.

Secs. 158-160 -- Determination of a Unitary Business; Determination of Unity; Passive Holding Companies. A unitary business is a single economic enterprise that is made up of either (1) separate parts of a single business entity or (2) a commonly owned or controlled group of business entities that are sufficiently interdependent, integrated, and interrelated through their activities so as to provide synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. The definition of "unitary business" is to be construed to the broadest extent permitted by the U.S. Constitution. Further, the regulations provide situations where the presence of a unitary business will be inferred or presumptively shown (*i.e.*, same type of business, steps in a vertical process, and strong centralized management). The regulations provide that passive holding companies are specifically includable in the unitary group.

Key consideration: The regulations provide that the common owner of the group does not need to be a part of the combined group, and envision situations where a commonly controlled group may be engaged in multiple unitary businesses. Further, the regulations address the issue of "instant unity" and provide that newly-formed corporations are presumed to be instantly unitary (however, this may be rebutted), while newly-acquired corporations are not.

Sec. 161 -- Statute of Limitations. The regulations provide that the statute of limitations for refunds and assessments may remain open for a particular member of a combined group notwithstanding the fact that the statute may have expired for one or more other members of the combined group.

Sec. 162 -- Water's Edge and Worldwide Reporting; and Initiation and Withdrawal of Election. The regulations provide that unitary combined reporting shall be made on a water's edge basis, unless the taxable members of the combined group elect to make the report on a worldwide basis.

Key consideration: The worldwide election, if made on an original, timely filed return, is effective for 10 years. If, after the 10-year period, the prior worldwide election is neither revoked nor renewed, the election shall terminate for the subsequent taxable year. In such case, however, a new worldwide election may be made for any 10-year period thereafter.

Sec. 163 -- Determination of Taxable Income or Loss Using Combined Report. The regulations provide that each taxable member of the combined group shall be responsible for tax based on its taxable income or loss apportioned or allocated to the District, and including the taxable member's apportioned share of the combined group's business income.

Sec. 164 -- Combining Special Apportionment Methods. The regulations provide guidance on how to determine the apportioned income of a combined group that contains members required to use special apportionment formulas, including financial institutions and transportation companies. Generally, each "subgroup" based on like apportionment method must separately calculate modified federal taxable income (based on a pro-forma federal consolidated return for the subgroup, with elimination of all intercompany transactions, even those between subgroups). All income or loss allocated and apportioned to the District by each of the subgroups is then added together to produce an aggregated District tax base, to which the District's income tax rate is applied.

Secs. 165-166 -- Net Operating Loss and Credits. The regulations provide that net operating losses and credits are attributes of the taxable member rather than of the combined group.

Key consideration: Losses and credits carried forward into the unitary group from before 2011 must follow the entity that earned the attribute. If the net operating loss was generated during a tax year in which the taxable member filed a consolidated return, the net operating loss must be determined on a separate entity basis, and the carryover of that loss may be utilized only by that taxable member which is part of the unitary group in offsetting that member's District taxable income. Note that the proposed regulations do not address pre-2000 loss carryovers.

Secs. 167-168 -- Taxable Year of Combined Report; Designated Agent, Liability. The regulations provide that the combined group's taxable year is that of the agent designated by the taxable members of the combined group. The designated agent is either the parent of the combined group or the member that is expected to have the highest apportionment to the District on an ongoing basis. The regulations further provide that every member of a combined group shall be jointly and severally liable for any tax due from any member of the combined group subject to tax in the District. Any assessment against one member of a combined group is deemed to be an assessment against all members of the combined group.

Key consideration: The regulations provide the *pro rata* method for determining the income and apportionment data to be included in the combined report, where a combined group member's taxable year differs from that of the designated agent. The *pro rata* method must be used unless the designated agent obtains written approval from the Chief Financial Officer to use another method.

Sec. 169 -- Calculating the Apportionment Factor Numerator and Denominator. Each taxable combined group member must determine its share of combined group income attributable to the District using a four factor apportionment formula with numerators that reflect only that member's own property, payroll and sales attributable to the District. A taxable combined group member's denominator contains the property, payroll, and sales of the entire combined group wherever those property, payroll, and sales are attributed.

Sec. 170 -- Unincorporated Business Entities / Partnerships. If the combined group includes, or any member of the combined group owns, an unincorporated business that would be subject to unincorporated business franchise

tax, the income or loss of such unincorporated business must be apportioned to the District using its apportionment factors, and the combined group member's distributive share of income from the Schedule K-1 must be added to the member's taxable income as computed for the District. The pro rata share of that income that was actually taxed at the unincorporated business level by the District is then subtracted. The regulations provide examples with respect to varying ownership interests in a partnership or LLC.

Key consideration: The taxation of unincorporated business income and the allowance of a deduction at the ownership level is reflective of historical practice in the District, but may not reflect the combined reporting statutory approach.

Secs. 171-172 -- Minimum Tax Payable and Estimated Tax Payments. The minimum tax applies to each "taxable member" of the combined reporting group, and such minimum tax of each taxable member must be included in the combined report.

Key consideration: The term "taxable member" does not appear in the statutory language, and, although referred to frequently in the regulations, is not specifically defined.

For the first year taxable year for which a combined group files a combined return, any member of the group may make estimated payments on its own behalf, and, similarly, for the first taxable year for which a corporation is a member of a combined group, that corporation may make estimated payments on its own behalf. Otherwise, only the designated agent of a combined group may make estimated tax payments.

Issues Not Addressed

Among issues not addressed in the proposed rulemaking are the *Joyce* apportionment rule, Qualified High Technology Companies (QHTC's), and the ASC 740 deduction.

Next Steps

Comments on the proposed rulemaking should be submitted no later than 30 days after publication of the notice in the D.C. Register.

For more information, please do not hesitate to contact:

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