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D.C. Appeals Court: Company does not have to maintain its own office to qualify for high tech franchise tax exemption

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In brief

The District of Columbia Court of Appeals upheld a Qualified High Technology Company ("QHTC") corporate franchise tax exemption for a federal contracting company. At issue was whether the company "maintained a base of operations" in the district during the tax years at issue.

The taxpayer was not required to exercise "predominant dominion, control, or autonomy" over an office or base of operations in the District. Because employees reported to work at locations in the District to conduct the business of providing services to federal government agencies, the court concluded that the taxpayer maintained a base of operations and qualified for the exemption. [[*D.C. Office of Tax and Rev. v. BAE Systems Enterprise Systems Inc.*](#), D.C. Ct. App., Dkt. No. 10-AA-1071 (11/29/2012)]

In detail

Background and procedural history

The District provides certain tax benefits to QHTC's, including a temporary exemption from corporate franchise tax if the QHTC is located in certain locations



within the District. Among the criteria for qualification as a QHTC are requirements that a company has two or more employees, derives at least 51% of its gross revenues from specified high-technology activities, and maintains an office, headquarters, or base of operations in the District. The franchise tax exemption is available for five years after the company commences business in designated "high technology development zones" in specific parts of the District. [Note that recent legislation signed by the District Mayor would make a number of changes to the treatment of QHTCs. [Click here](#) for a summary of that legislation.]

BAE Systems Enterprise Systems Inc. (BAE) is a Virginia-based corporation that provides information technology products and services to the federal government based on long-term contracts, between one and seven years. In 2001 and 2002, approximately 180 BAE employees provided services under such contracts to the federal government at three separate government facilities within the District. The government assigned specific work areas in its facilities for BAE employees. Within these designated work areas, BAE selected office space for its own employees and signs identifying BAE employees were placed outside of their workspaces. BAE employees worked full-time from these facilities, reporting to the same location each day for the duration of the contract. BAE records reflected the address of the government facilities as its employees' official places of work. Each of the government facilities fell within a designated "High Technology Development Zone."

BAE employees at the government facilities were only permitted to work on matters relating to BAE's contracts with the government. BAE employees could access the facilities only as authorized by the government and such access was generally restricted to weekday business hours. BAE's relationship with the government and presence at government facilities was not made public.

On its 2001 and 2002 corporate franchise tax returns, BAE claimed the temporary exemption from the franchise tax. Office of Tax and Revenue (OTR) issued a notice of deficiency, taking the position that BAE was not exempt because it did not "maintain" an office or base of operations in the District. The Office of Administrative Hearings concluded that BAE did maintain a base of operations in the District because its employees reported to work daily at locations within the District to conduct BAE's "business of providing services to federal government agencies."

The plain meaning of "maintain" advanced by OTR is unpersuasive and its interpretation of the statute cannot be sustained

OTR asserts that BAE did not "maintain" an office or base of operations in the District and is therefore not exempt from the corporate franchise tax. OTR argues that, in this context, "maintain" means "'to keep,' especially in a 'state of repair,' and to 'provide for/bear the expense of [or] support.'" According to OTR, a company does not "maintain" an office or base of operations unless it exercises "predominant dominion, control or autonomy" over the office or base of operations. In this case, OTR claims that BAE did not exercise the requisite dominion, control or autonomy over its space in the government facilities to be eligible for exemption from franchise tax.

However, the court finds OTR's definition of "maintain" unpersuasive. The court notes that other common definitions of the word fit within the present context and that OTR's conclusion about the definition is without logic. In particular, the court

finds that, even if the meaning of "maintain" were restricted to "keep in a state of repair" or "bear the expense of" as OTR asserts, neither concept necessarily implies "predominant dominion, control or autonomy."

OTR asserts that the exemption should be strictly construed against the claiming party. The court does not disagree with this assertion, but points out that strict construction of tax exemptions does not require adoption of an interpretation that is "not reasonable in light of statutory language, structure, and history." In this case, the court finds that OTR's interpretation of the franchise tax exemption is not reasonable. The court holds that eligibility for an exemption from franchise tax for QHTCs does not require the exercise of "predominate authority, dominion or control" over an office or base of operations. Rather, it is enough that a company has a sufficient number of employees performing qualified activities at a fixed location in a high-technology zone for a sufficiently extended period of time.

Actions to think about

It is interesting that this decision came down so soon after the Mayor signed the Technology Sector Enhancement Act of 2012 (A19-0513), which amended the statutory requirements for qualification as a QHTC. Although such an interpretation would raise constitutional concerns, the OTR may interpret the Act's provisions to require 51% of the entity's activities to be earned in the District. Such an interpretation could affect the ability of a company like BAE to qualify as a QHTC, regardless of the interpretation of the statute's "base of operations" provision.

Let's talk

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