

myStateTaxOffice

A Washington National Tax Services (WNTS)
Publication

September 14, 2012

D.C. issues final combined reporting regulations

Authored by: Michael Santoro

 Follow @twitter

In brief

The District of Columbia published its final combined reporting regulations on September 14, 2012. The final regulations are substantially similar to the proposed regulations issued on August 31, 2012, with a few changes. For a summary of the proposed regulations, please see our August 31 summary attached to this alert.
[\[Office of Tax and Revenue, Notice of Final Rulemaking \(9/14/12\)\]](#)

In detail

On September 14, 2012, the District of Columbia issued final regulations on combined reporting. The final regulations make the following changes to the regulations that were proposed on August 31, 2012:

- **"Taxable Member" definition clarified.** "Taxable member" means a member of a combined group that has nexus in the District and is therefore subject to tax on its income under chapter 18 of title 47 of the D.C. Official Code. **Sec. 156.6(k).**
- **Passive holding companies.** Language was added to this section related to passive holding companies, requiring entities to be "engaged in a unitary business." Note that this language was originally present when the regulations were first proposed in January 2012, but had been removed in the August version. **Sec. 159.**

- **Combining entities with different apportionment formulas.** Further guidance was provided, including a specific example related to financial institutions, with respect to entities with different apportionment formulas. The final regulations provide "[e]ach member shall separately compute its District apportionment factor numerators, determine its District apportionment factor based on the group's denominators, and then apply its factors to the group's business income or loss subject to apportionment to arrive at net income or loss apportioned to the District." **Sec. 164.**
- **Unincorporated business entity / partnership nonbusiness income.** Language was added to address nonbusiness income. The final regulations provide "[i]f the income from the ownership interest in the partnership or UB is non-business income, then that income will be subject to allocation to the combined group member-partner." **Sec. 170.**
- **Treatment of partnerships that are not unincorporated business entities.** The final regulations provide guidance on the treatment of partnerships that are not unincorporated businesses. **Sec. 170.**
- **Extended deadlines for combined reports and FAS 109 Schedule.** The final regulations extend the due date for combined returns and the FAS 109 Schedule to October 15, 2012. Both extensions were previously reported in [Notice 2012-07](#) (9/7/12) and [Notice 2012-07](#) (9/5/12), respectively. **Secs 175 and 176.**
- **Zero returns required.** If an entity filed a District return on a separate reporting basis or on a District consolidated basis for the tax year beginning prior to December 31, 2010, and that entity will now be filing on a combined reporting basis for the tax year beginning after December 31, 2010, that entity (or entities), except for the designated agent, shall file a separate final zero return along with the combined report. **Sec. 176.**

For a summary of the August 31, 2012, proposed regulations please see our summary following this alert. (and also [available here](#)).

Let's talk

If you have questions about the D.C. combined reporting regulations, please contact either of the following individuals:

Steve Arluna
 Partner
 (713) 918-1521
steve.arluna@us.pwc.com

John Majowka
 Director
 (703) 762-7299
john.majowka@us.pwc.com

For more information on PricewaterhouseCoopers' state legislative tracking service, [click here](#).

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2012 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

myStateTaxOffice

A Washington National Tax Services (WNTS)
Publication

August 31, 2012

*District of Columbia issues
revised proposed combined
reporting regulations*



Authored by: Kate Thurber

In brief

The District of Columbia Office of Tax and Revenue (OTR) on August 31, 2012, issued its revised proposed combined reporting regulations. The revisions update the OTR's initial draft regulations issued on January 20, 2012. The OTR will allow a seven day comment period and provide final rules "before September 15, 2012, the due date for Corporate Franchise Tax Returns with extensions in the District." [[Office of Tax and Revenue, Second Notice of Proposed Rulemaking](#) (8/31/12)]

In detail

The following summarizes major changes provided in the August 31, 2012, proposed revised regulations. [[Click here](#) for a summary of the regulations as originally proposed]

Sec. 156.6(k) -- Definitions of terms and phrases. *Taxable member* is defined as "a member of a combined group that [is] subject to tax on its income under chapter 18 of title 47 of the D.C. Official Code."

Key consideration: This is a notable change from the original proposed regulations and statutory guidance, which referenced "taxable member" but did not define it.



Secs. 157 and 158 -- Composition of the Combined Group and Determination of a Unitary Business; Commonly Controlled; and Unitary Presumptions. Throughout these sections, the revised proposed regulations change the terminology from "Included corporations" and "Excluded corporations" as used in the original proposed regulations to "Included persons" and "Excluded persons."

Key consideration: The revised proposed regulations specify that unincorporated businesses are includable. This is consistent with informal discussions with the OTR and treatment of unincorporated businesses elsewhere in the proposed regulations.

Sec. 157.3 -- Composition of the Combined Group. *Excluded persons.* Persons that are excluded from a combined group and therefore not included in a combined report, irrespective of whether they are engaged in a unitary business with a member of such group, include a Qualified High Technology Company (QHTC) and entities with 80% of their factors outside of the US.

Key consideration: This position marks a shift as previous guidance issued by D.C. ([OTR Tax Notice 2012-03](#), March 8, 2012, revised March 13, 2012) indicated that QHTCs would be included in the unitary group. The revised proposed regulations give no further guidance on QHTCs.

Sec. 158.2(c)(3) -- Determination of a Unitary Business; Commonly Controlled; and Unitary Presumptions. *Commonly controlled.* A group of related entities may satisfy the commonly controlled requirement of a unitary business if they are in the same "commonly controlled group" for District purposes. "Commonly controlled group" includes two or more entities including unincorporated businesses or partnerships if a common owner, regardless of whether the owner is a corporate entity, directly or indirectly owns more than 50% of interest in the entities.

Key consideration: The specific reference to "unincorporated businesses" is further evidence of the OTR's intention to include these entities in combined reports.

Sec. 158.9 -- Examples of flow of value. This section provides examples of activities between segments that constitute a flow of value between them. The revised regulations added nine more examples, including: centralized purchasing, intercorporate services, and common employees.

Sec. 158.11(d) -- Determination of a Unitary Business; Commonly Controlled; and Unitary Presumptions. The instant unity section regarding newly formed entities is updated to include the creation of unincorporated entities.

Key consideration: Instant unity as a concept was addressed in the version that was originally proposed. However, the revised proposed regulations specifically reference the creation of an unincorporated business for purposes of instant unity.

Sec. 161 -- Water's Edge Determination. This section provides 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. The revised proposed regulation provides more guidance on what entities are included in the water's edge group.

Key consideration: For purposes of water's edge combined reporting, all of the income and apportionment factors must be included for the following members: domestic corporations and entities; any member, regardless of where it is incorporated or formed, if the average of its property, payroll, and sales factors within the US is 20% or more; domestic international sales corporations (DISC), foreign sales corporations (FSC), and export trade corporations (ETC); and any member doing business in a tax haven. Certain other members are included only to the extent of US source income, including CFCs.

Sec. 163.2 -- Determination of Taxable Income or Loss Using Combined Report. This section provides an example for the general computation of a taxpayer member's income.

Sec. 164 -- Combining Special Apportionment Formulas. This section provides 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.

Key consideration: The revised proposed regulations remove the "subgrouping" methodology used in the original proposed regulations.

Sec. 165 -- Net Operating Losses. This section provides that net operating losses are attributes of the taxable member rather than of the combined group.

Key consideration: Losses 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. Of concern is the methodology taxpayers should use in determining how to allocate the loss incurred by the consolidated filing group (pre-2011) to the members of the group. The proposed regulations appear to follow the guidance present in the D.C. regulations addressing consolidated returns. However, applying treatment under consolidated return filing methodology to future combined reporting years could potentially lead to inequitable treatment.

Sec. 167.2 -- Taxable Year; Part Year Members. *52 to 53 week tax years.*

Where a member files federal income tax returns on the basis of an annual period which varies from 52 to 53 weeks, its taxable year shall be treated as beginning with the first day of the calendar month beginning nearest to the first day of such taxable year or ending with the last day of the calendar month ending nearest to the last day of such taxable year.

Sec. 169 -- Apportionment. For apportionment purposes, this section clarifies that the District will use the *Joyce* rule in which each taxpayer member of the

combined group is treated as a separate taxpayer and that taxpayer's numerators will include only that taxpayer's own property, payroll, and sales factor numerators attributable to the District and will not include a share of a non-nexus member's factors. Each taxpayer member's denominator shall contain the property, payroll, and sales of the entire combined group wherever those property, payroll, and sales are attributed regardless of nexus.

Sec. 170 -- Unincorporated Business Entities/Partnerships. This section provides further clarification of the treatment of unincorporated businesses. Notably, the revised proposed regulations provide that:

- Unincorporated businesses must be included in the combined report if unitary;
- Members of the unincorporated business that are also in the combined report shall make an adjustment for income that was already taxed at the unincorporated business level; and
- Members of the unincorporated business need to add their distributive share of the unincorporated business income to their sales factor denominator and include in their numerator the distributive share multiplied by the unincorporated business's own apportionment factor.

Key consideration: The taxation of unincorporated business income and the allowance of a deduction at the ownership level are reflective of historical practice in the District. However, the revised proposed regulation still appears to contradict statutory language.

Key consideration: The revised proposed regulation also provides a presumption of nexus. "If a partner takes a deduction for salary allowance or other distribution for services rendered to the unincorporated business or if a combined group member is the general partner or managing member, the partner or member shall be deemed to be actively engaged in the conduct of the business which shall create nexus in the District." This language is not present in D.C.'s tax statutes.

Secs. 173 and 174 -- Real Estate Investment Trusts and Regulated Investment Companies. Under District law, REITs and RICs shall be allowed a deduction of dividends paid by a qualified REIT or RIC, respectively, which qualify for the dividends paid deduction under the Internal Revenue Code.

Key consideration: The proposed regulations provide language similar to what is found in D.C. Code Secs. 47-1803(a)(12) and (13).

Sec. 175 -- Financial Accounting Standards No. 109 (FAS 109) Deduction. If the enactment of combined reporting requirements for unitary businesses in the District results in an increase to a combined group's net deferred tax liability, the combined group is entitled to a FAS 109 deduction. The FAS 109 deduction shall be claimed annually over a seven-year period beginning with the combined group's taxable year that begins in 2015 equal to one-seventh (1/7) of the deduction amount.

Let's talk

If you have questions about the D.C. revised proposed combined reporting regulations, please contact any of the following individuals:

Steve Arluna
Partner
(713) 918-1521
steve.arluna@us.pwc.com

John Majowka
Director
(703) 762-7299
john.majowka@us.pwc.com

For more information on PricewaterhouseCoopers' state legislative tracking service, [click here](#).

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2012 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.