

District of Columbia FY 2015 Budget Support Act of 2014

December 5, 2014

Overview

On November 12, 2014, the District of Columbia ("District") Fiscal Year 2015 Budget Support Act of 2014 (Permanent Act)¹ ("Budget Support Act") was transmitted to the U.S. Congress.² In the District, permanent legislation only becomes law after it is approved by Congress,³ which is deemed to occur if Congress does not enact a joint resolution to repeal the legislation within the 30-calendar-day period defined in D.C. Code Ann. § 1-206.02(c)(1). As of the date of this Tax Alert, the *projected* law date (enactment date) of the Budget Support Act is December 27, 2014.⁴ If enacted as final law, this legislation would make the following permanent changes to District law:

- A phased-in reduction of the Unincorporated and Incorporated Business Franchise Tax rates
- The use of single sales factor apportionment for all business income
- A revision to the sourcing rules for sales apportionment purposes
- The exemption of certain investment fund income from the Unincorporated Business Franchise Tax
- The addition of a new personal income tax bracket and a reduction of personal income tax rates for certain taxpayers
- The expansion of the sales tax base to include a variety of services

In this Tax Alert we summarize these provisions of the Budget Support Act, which have various effective dates as specified in the discussion that follows.

Reduction of the Unincorporated and Incorporated Business Franchise Tax Rates

The current unincorporated and incorporated business franchise tax rate of 9.975%⁵ would be reduced to 9.4% for taxable years beginning after December 31, 2014.⁶ Subject to availability of funding, the tax rate would be further reduced to 9.0%, 8.75%, 8.5%, or 8.25%.⁷

Single Sales Factor Apportionment

Business income subject to apportionment is currently apportioned based on payroll, property and a double-weighted sales factor.⁸ For tax years beginning after December 31, 2014, all business income would be apportioned based solely upon a single sales factor.⁹

¹ The Permanent Act was preceded by two emergency bills. The first, D.C. Act A20-0377 (B20-0849), was enacted on June 24, 2014 and expired on October 12, 2014. The second, D.C. Act A20-0461 (B20-0957), was enacted on October 6, 2014, before the expiration of the first emergency bill, and is set to expire on February 4, 2015. Consequently, the sales tax provisions have been in effect as of October 1, 2014, and currently remain in effect.

² D.C. Act 20-0424 (B20-0750).

³ District of Columbia Home Rule Act, D.C. Code Ann. § 1-206.02(c)(1).

⁴ The projected law date is based on the expiration of the 30-calendar-day review period, which excludes holidays, weekends, and any day in which neither house is in session because of an adjournment or recess of more than three days. Based on the projected law date, the income tax provisions may have potential financial statement implications to calendar year taxpayers in the 2014 fourth quarter. The current status of the Budget Support Act can be found online at <http://lms.dccouncil.us/Legislation/B20-0750?FromSearchResults=true>.

⁵ D.C. Code Ann. §§ 47-1807.02(a)(4); 47-1808.03(a)(4).

⁶ B20-0750, adding D.C. Code Ann. §§ 47-1807.02(a)(5); 47-1808.03(a)(5).

⁷ B20-0750, adding D.C. Code Ann. §§ 47-1807.02(a)(6); 47-1808.03(a)(6).

⁸ D.C. Code Ann. § 47-1810.02(d-1).

⁹ B20-0750, adding D.C. Code Ann. § 47-1810.02(d-2).

Sales Sourcing for Apportionment

Sales other than sales of tangible personal property are currently deemed to occur in the District if the greatest proportion of the income producing activity is performed in the District, based on costs of performance.¹⁰ For tax years beginning after December 31, 2014, sales other than sales of tangible personal property would be in the District if the taxpayer's market for the sales is in the District.¹¹ The Budget Support Act includes detailed rules as to when the sales of tangibles, intangibles and services are in the District.¹² If the state or states of assignment cannot be determined using these detailed rules, the state or states of assignment would be reasonably approximated.¹³ If the taxpayer is not taxable in a state in which a sale is assigned using the detailed rules or by reasonable approximation, or if the state or states of assignment cannot be determined using the detailed rules or by reasonable approximation, then the sales would be excluded from the numerator and denominator of the sales factor.¹⁴

Investment Funds and the Unincorporated Business Franchise Tax

Currently, the District exempts from the Unincorporated Business Franchise Tax ("UBFT") certain businesses, including but not limited to a trade or business in which more than 80% of the gross income is derived from personal services in which capital is not a material income-producing factor (e.g., law firms, accounting firms), and a Qualified High Technology Company.¹⁵

The Budget Support Act, effective for taxable years beginning after December 31, 2014, would expand the exemption to include certain investment fund income. Specifically, it provides that "a trade or business that arises solely by reason of the purchase, holding, or sale of, or the entering, maintaining, or terminating of positions in, stocks, securities, or commodities for the taxpayer's own account," subject to certain limitations, shall not be subject to the UBFT.¹⁶

Individual Income Tax / Estate Tax Rate

For tax years beginning after December 31, 2014, the personal income tax rate for residents would be reduced from 8.5% to 7.0% for the \$40,001 to \$60,000 tax bracket.¹⁷ The \$60,001 to \$350,000 bracket (currently taxed at 8.5%) and the \$350,001 and above bracket (currently taxed at 8.95%) would remain unchanged.¹⁸

For taxable years beginning after December 31, 2015, the \$40,001 to \$60,000 individual income tax bracket would be further reduced to 6.5%, and the creation of the new \$350,001 to \$1,000,000 individual income tax bracket would result in a reduced tax rate for this bracket of 8.75% from 8.95%, subject to availability of funding.¹⁹

For the taxable estates of decedents who die after December 31, 2015, there would be an estate tax rate change applied at graduated tax rates starting at 8% for estates exceeding \$2 million, to 16% for estates exceeding \$10 million.²⁰ Also, for a resident decedent with any real or tangible property that is taxable outside the District, the tax due would be proportionally reduced by a ratio of the value of real or tangible property outside of the District to the total value of the estate of the resident decedent.²¹

¹⁰ D.C. Code Ann. § 47-1810.02(g)(3).

¹¹ B20-0750, amending D.C. Code Ann. § 47-1810.02(g)(3).

¹² B20-0750, adding D.C. Code Ann. § 47-1810.02(g)(3)(A)(i)-(iv).

¹³ B20-0750, amending D.C. Code Ann. § 47-1810.02(g)(3)(B).

¹⁴ B20-0750, adding D.C. Code Ann. § 47-1810.02(g)(3)(C).

¹⁵ D.C. Code Ann. § 47-1808.01(1)-(5).

¹⁶ B20-0750, adding D.C. Code Ann. § 47-1808.01(6). The exemption from the UBFT would not apply to: (i) a taxpayer that holds property, or maintains positions, as stock in trade, inventory, or for sale to customers in the ordinary course of the taxpayer's trade or business; (ii) a taxpayer that acquires debt instruments in the ordinary course of the taxpayer's trade or business for funds loaned or services rendered; or (iii) a taxpayer that holds either of the following that is not traded on an established securities market: (1) stock in a real estate investment trust; or (2) a partnership interest.

¹⁷ B20-0750, adding D.C. Code Ann. § 47-1806.03(a)(9).

¹⁸ *Id.*

¹⁹ B20-0750, adding D.C. Code Ann. § 47-1806.03(a)(10).

²⁰ B20-0750, adding D.C. Code Ann. § 47-3702(a-1)(1).

²¹ B20-0750, adding D.C. Code Ann. § 47-3702(a-1)(2). B20-0750, adding D.C. Code Ann. § 47-3703(b-1), provides "[f]or every nonresident decedent dying after December 31, 2015, the tax shall be an amount computed by multiplying the tax determined under § 47-3702(a-1) by a fraction, the numerator of which shall be the value of that part of the gross estate that has its taxable situs in the District and the denominator of which shall be the value of the nonresident decedent's gross estate."

Sales and Use Tax Reform

As of October 1, 2014, the District sales and use tax base is expanded to include a variety of services, including but not limited to, bottled water delivery services, household good storage services, carpet and upholstery cleaning services, health-club services and/or tanning studios, car washing/cleaning services, and charges for the services of a bowling alley or a billiard parlor.²²

Qualified High Technology Companies

Incentives that apply to a Qualified High Technology Company (“QHTC”) were enacted in 2000 by the District’s Council to attract certain types of technology business. Under these provisions, a business had to meet certain requirements in order to qualify for the tax benefits afforded to QHTCs.

Pursuant to Section 47-1817.01(5)(A), a QHTC means:

- (i) An individual or entity organized for profit and maintaining an office, headquarters, or base of operations in the District;
- (ii) Having two or more employees in the District; and
- (iii) Deriving at least 51% of its gross revenues earned in the District from qualifying activities.

Under the Budget Support Act,²³ the phrase “maintaining an office, headquarters, or base of operations” would be replaced with “leasing or owning an office.”²⁴ The statutory change would appear to nullify the District of Columbia Court of Appeal decision in *District of Columbia Office of Tax & Revenue v. BAE Systems Enterprise Systems, Inc.*,²⁵ which had affirmed the 2010 Office of Administrative Hearings decision²⁶ that a taxpayer with employees working in the District on a regular basis was maintaining a “base of operations” within the District even if the taxpayer did not have an actual leased location within the District.

In sub-subparagraph (ii) the word “employees” would be replaced with “qualified employees.”²⁷ A qualified employee is defined as a person who is employed in the District by a QHTC.²⁸

Lastly, an on-line or brick-and-mortar retail store²⁹ and a building or construction company would be excluded from the definition of a QHTC.³⁰

These QHTC provisions do not have a specific effective date. As of the date of this Alert, the Office of Tax and Revenue has not issued a formal position with respect to the applicability date.

Additional Changes

In this Alert we do not provide a comprehensive summary of all changes contained in the Budget Support Act.

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²² B20-0750, adding D.C. Code Ann. § 47-2001(V)-(AA). There is no separate applicability provision; therefore, the general applicability date of October 1, 2014, noted in B20-0750, Title XI, Sec. 11001 applies.

²³ The QHTC provisions contained in the Budget Support Act are referred to as the “Qualified High Technology Clarification Amendment Act of 2014.”

²⁴ B20-0750, amending D.C. Code Ann. § 47-1817.01(5)(A)(i).

²⁵ *District of Columbia Office of Tax & Revenue v. BAE Systems Enterprise Systems, Inc.*, 56 A.3d 477 (Nov. 29, 2012).

²⁶ *District of Columbia, Office of Administrative Hearings*, Case No. TR-C-04-800012 (Aug. 4, 2010).

²⁷ B20-0750, amending D.C. Code Ann. § 47-1817.01(5)(A)(ii).

²⁸ D.C. Code Ann. § 47-1817.01(4).

²⁹ B20-0750, amending D.C. Code Ann. § 47-1817.01(5)(B)(I).

³⁰ B20-0750, adding D.C. Code Ann. § 47-1817.01(5)(B)(III).

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