



TaxNewsFlash

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District of Columbia: Legislation delaying combined reporting deduction, eliminating UBT liquidation exception

The District of Columbia's "Fiscal Year 2021 Budget Support Act" includes measures that defer the deduction intended to defray the financial statement effects of the District's move to combined reporting; that modify the term "taxable income" for purposes of the District's unincorporated business tax (UBT); and that amend deductions from gross income for investments in qualified opportunity zones.

Background

The District of Columbia's "Fiscal Year 2021 Budget Support Act" was sent to Congress for review on September 3, 2020. In the interim, an emergency version of the legislation is in effect until November 16, 2020. After the mandatory 30-day congressional review period, the "Permanent Fiscal Year 2021 Budget Support Act" will become law—unless a joint resolution disapproving the legislation is adopted by Congress and signed by the president. Only days when one or both houses of Congress are in session count for purposes of the 30-day period.

Combined reporting

On the corporate franchise tax side, one of the changes in the legislation is to defer the deduction that was intended to defray the financial statement effects of the District moving to combined reporting beginning in 2011. Under current law, if the adoption of combined reporting results in an increase to a combined group's net deferred tax liability, the combined group is entitled to a deduction equal to the net increase in the taxable temporary differences causing the increase in the net deferred tax liability, as computed at the time of enactment of the combined reporting provisions. Originally, the deduction was to be taken in seven equal installments, beginning with the fifth year of the combined filing (which would have been 2015). In 2015, the deduction was delayed to the tenth year of combined filing (which is 2020).

Under the Act, the deduction is delayed until the 15th year of the combined filing—which would be 2025. If there is an underpayment of estimated tax for tax year 2020 due to the anticipated deduction, the estimated tax interest resulting from such underpayment, upon application, would be waived.

Unincorporated business tax (UBT)

Another provision in the Act modifies the term “taxable income” for purposes of the District’s unincorporated business tax (UBT). Under District law, UBT is imposed on unincorporated businesses such as partnerships and limited liability corporations (LLCs).

As modified, the UBT definition of taxable income includes a new clause providing that “taxable income shall include gain from the sale or other disposition of any assets, including tangible assets and intangible assets, including real property and interests in real property, in the District, even when such a sale or other disposition results in the termination of an unincorporated business.” This provision becomes effective January 1, 2021, and has significant implications for pass-through entities subject to the District’s UBT.

Current District regulations provide that gain (other than ordinary gain resulting from the recapture of depreciation) or loss from the sale or other disposition of property that results in the termination of an unincorporated business subject to UBT must be recognized and reported by the owners of the business—rather than by the business entity. Gain or loss from sales or other dispositions of property that do not result in the termination of an unincorporated business would be recognized and reported by the unincorporated business. The amendment to the definition of taxable income would effectively change this historic tax treatment and subject the gain to the District’s UBT, rather than subjecting the owners of the pass-through entity on the gain. Notably, the District cannot impose income tax directly on nonresident individuals.

Qualified opportunity zones

Finally, the Act amends the District statute that provides deductions from gross income for corporations, financial institutions, and unincorporated businesses to address investments in qualified opportunity zones. As amended, certain tax benefits stemming from investments in qualified opportunity funds—such as deferrals of capital gain—will be realized only if (1) the taxpayer invests in a qualified opportunity fund that is certified by the mayor of the District, and (2) the taxpayer’s investment in the fund is invested in an opportunity zone in the District. In other words, the District appears to be limiting the tax benefits of making such investments to local opportunity zones.

Other changes

Other tax related changes in the Act include the imposition of a motor vehicle fuel tax surcharge and revisions to the District’s qualified high technology company incentives.

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