

DC, Maryland, and Virginia Tax Legislation Update

DC legislation expands related party expense add-backs, predicts combined reporting

Late last year, Mayor Fenty signed the Fiscal Year 2010 Budget Support Act of 2009, which became effective March 2, 2010. This Act made permanent the emergency legislation enacted last summer, which made two significant changes to DC entity taxation:

- > Expanding its existing related party expense add-back statute to cover related party interest expenses
- > Calling for the enactment of unitary combined reporting for tax years after 2010

Related party add-back statute

DC existing law required corporations to add back expenses deducted for federal tax purposes that were attributable to intangible assets. A common example is royalty fees. The existing statute also required an add-back for related party interest expenses if related to intangible assets. Under the new law, corporations must add back all related party interest expenses. The change is retroactive for tax years beginning after December 31, 2008.

The statute includes two exceptions to the add-back. You will not have to add back the related party interest expense to the extent you establish that you did not engage in the related party transaction primarily to avoid DC income tax and the terms were made pursuant to arm's length conditions, and either:

1. During the same taxable year, the related party receiver either paid or incurred the expense to an unrelated third party, or
2. The related party receiver was subject to a tax measured by net income or receipts in DC, another state, or a foreign nation (that has a U.S. tax treaty); the related party income was subject to that tax; and the aggregate effective tax rate imposed on the income was equal to or greater than 4.5 percent. Inclusion in a combined report alone is insufficient for the related member to be considered "subject to tax" in that jurisdiction.

Unitary combined reporting

The new law does not enact combined reporting, but it mandates the Council to do so in the future. Once the Council follows through, unitary combined reporting will apply to tax years beginning after December 31, 2010. The statute states that such reporting will apply to corporations taxable in DC that are in a commonly controlled group and engaged in a unitary business, but no definitions are given for any of the relevant terms. The law does not discuss how the combined income of the group will be determined.

Other Changes

- > Decouple from IRC section 108(i), which allows for a deferral of income recognition income related to qualified cancellation of debt income. The statute does not provide an effective date, but guidance from the Office of Tax and Revenue suggests that the change is effective in 2009.
- > Increase in sales and use tax rates from 5.75 percent to 6 percent (effective October 1, 2009).
- > Increase in gasoline excise tax and certain tobacco taxes.
- > Authorization of an amnesty program in DC. Details have not yet been established.

Maryland enacts jobs credit

Maryland recently enacted a new tax credit for employers hiring unemployed workers. The credits are capped statewide and will be available on a first-come, first-served basis. You should be aware of these rules so that you can promptly claim any credits to which you may be entitled while they are still available.

Qualified workers are Maryland residents who receive unemployment insurance benefits (or whose benefits expired in the last year) and are not employed full-time. The credit is \$5,000 per qualified employee.

The new employee must be hired to fill a full-time position in Maryland that is:

- > Expected to be for an indefinite duration and without interruption for 12 months or more, and
- > Is either a new position or a position that has been vacant for at least six months at the time of hiring.

Certain exclusions apply:

- > To qualify for the credit, the employee must begin work between March 25, 2010, and December 31, 2010.
- > Credits are capped at \$250,000 per employer. Total credits approved by the state are capped at \$20,000,000.

The employer must apply for the credits with the Secretary. The state has not yet issued an application form. Once approved for the credits, the employer claims the credit based on the number of months worked in 2010 and 2011 on their Maryland income tax returns for those years, respectively. For example, if a calendar-year employer hires a qualified worker to start work on July 1, 2010, the employer will claim half of the credit during 2010 and half during 2011.

Not-for-profit taxpayers may claim the credit against state income taxes on unrelated business taxable income (UBTI).

Virginia enacts green jobs credits

Virginia recently enacted two new tax credits for certain employers creating new jobs in Virginia. The first credit is \$500 per employee for each full-time job created that pays at least \$50,000 annually and lasts for at least one year. Employers are limited to a total of 350 new full-time jobs. The credit may be claimed annually for five years, and any unused credit may be carried forward for up to five years. The credit applies to tax years beginning on or after January 1, 2010 and before January 1, 2015. To qualify, the employer must be focused on development or commercialization of renewable or alternative energy in Virginia. The Secretary of Commerce and Trade is responsible for developing detailed definitions of the types of companies and jobs eligible for the credit.

The second credit is the Virginia Enterprise Zone (VEZ) credit. This credit applies to eligible companies that create jobs in Virginia Enterprise Zones. The employer is eligible for a \$500 per-hire credit or may opt to receive an \$800 per-hire grant if he offers health insurance and pays 200 percent or greater of federal minimum wage for the position. However, the employer cannot claim the credit if he received a per-hire tax break under Virginia's Major Business Facility Jobs Tax Credit program or claimed the federal tax credit for new hires in clean energy manufacturing facilities.

Virginia IRC conformity update

The Virginia Assembly has passed a bill that would update Virginia's conformity to the Internal Revenue Code to January 22, 2010. The bill is awaiting the governor's signature.

If passed, the bill would conform Virginia's tax law to the Internal Revenue Code with the following exceptions:

1. No federal legislation passed after January 22, 2010, would be adopted. This includes tax provisions in the recent healthcare legislation. Examples include:
 - > The tax credits for small employers who contribute to an employee's health insurance premium.
 - > Health insurance fringe benefits that cover adult children up to age 26 and are excluded from income.
2. Virginia would continue to disallow five-year net operating loss (NOL) carrybacks.
3. Virginia would continue to disallow any bonus depreciation deductions (except qualified disaster assistance property in section 168(n)).
4. Virginia would disallow original issue discount (OID) on applicable high-yield discount obligations (section 163(e)(5)(F)).
5. Virginia would disallow the five-year cancellation of debt (COD) income deferral (section 108(i)). However, for Virginia purposes, taxpayers that incur COD income from transactions in 2009 and elect to defer for federal purposes will be able to elect to report the addition required by conformity in equal amounts over three years (2009-2011).

Virginia repeals accelerated sales tax payments and suspends dealer discounts

Beginning on May 31, 2010, Virginia was scheduled to require dealers and direct payment permit holders with taxable sales or purchases of \$12 million or greater in the preceding calendar year to file and pay Virginia sales and use taxes under an accelerated schedule. The Virginia governor recently signed budget legislation that repeals that accelerated filing and payment.

The new legislation imposes a new accelerated payment regime. Beginning in 2010, in addition to regular sales and use tax returns and payments, dealers and direct payment permit holders with taxable sales and purchases of \$1 million or greater for the twelve month period beginning July 1 and ending June 30 of the immediately preceding calendar year, must make a payment equal to 90 percent of the sales and use tax liability for the previous June. Payment of the tax is due on or before June 25, unless payment is made by EFT. If this payment is made by EFT, it must be made on or before June 30. Dealers or direct payment holders subject to this new regime will be entitled to a credit for the payment on the return for June of the current year that is due July 20.

Taxable sales or purchases must be computed without regard to the number of certificates of registration held by the dealer. The accelerated sales tax payment will not apply to persons who are required to file only a Form ST-7 (Consumer's Use Tax Return).

Taxpayers required to report under the new regime who do not timely file or pay will be subject to a penalty of six percent of the underpayment plus interest. The penalties under Va. Code Ann. § 58.1-635 will not apply, except in cases of fraudulent returns. The required payment will become delinquent on the first day following the due date if not paid.

The legislation also provides that, beginning with the return for June 2010 (due July 2010), dealer discounts will be suspended for dealers required to remit sales and use tax by EFT. The compensation available to all other dealers will be limited to the following percentages of the first three percent of the sales and use tax levied:

Monthly taxable sales of \$0 to \$62,500	1.6%
Monthly taxable sales of \$62,501 to \$208,000	1.2%
Monthly taxable sales of \$208,001 and above	0.8%

If you have any questions regarding any of the above state tax changes, please contact your Baker Tilly advisor or send an e-mail to tax@bakertilly.com.