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Home > Businesses > Help & Resources > Legal Library > Letter Rulings > Letter Rulings - By Year(s) > (1990-1994) Rulings >

## Letter Ruling 94-8: Credit for District of Columbia Unincorporated Franchise Tax

October 4, 1994

You represent \*\*\*\*\* ["the Taxpayer"] a Maryland resident who owns income producing real estate in the City of Washington, District of Columbia ("D.C."). [The Taxpayer] files and pays an annual D.C. Unincorporated Business Tax on this property and takes a credit for the allowed amount against the income taxes owed to the State of Maryland for each year. [The Taxpayer] is considering giving the property to her daughter, a Massachusetts resident. You ask whether the District of Columbia Unincorporated Business Franchise Taxes (hereinafter "UBT") may be credited against the Massachusetts Individual Income Tax.

### Discussion

Massachusetts residents are allowed a credit "for taxes due any other state, territory or possession of the United States, or any of its provinces on account of any item of Massachusetts gross income...." G.L. c. 62, § 6(a). Under Massachusetts General Laws, G.L. c. 4, § 7, Thirty-first para., "state" is defined to include the District of Columbia. The credit is allowed for any income tax, which is generally defined as a contribution, measured by a taxpayer's ability to pay on the basis of income, exacted from those domiciled or doing business within a state, to defray the expenses of government. See Letter Ruling 77-10. The credit is not allowed for other types of taxes, such as excise or property taxes or for franchise taxes which are imposed for the privilege of doing business in a given state.<sup>[1]</sup> Therefore, the question to be decided is whether or not the UBT is in the nature of an income tax as opposed to a franchise tax imposed for the privilege of doing business in D.C.

The UBT is codified as Chapter 18 of Title 47, Secs. 47-1801 - 47-1816.3, D.C. Code, and imposes a tax on any trade or business engaged in by a resident or nonresident individual, trust, estate, partnership, society, association, executor, administrator, or any other entity, excepting corporations. However, businesses with less than \$12,000 in gross income, businesses which cannot be incorporated, professional corporations or businesses which derive 80% or more of income from personal services, are not subject to the UBT.

The UBT computation starts with gross income as defined for federal income tax purposes under Internal Revenue Code Section 61. Similarities exist between the UBT and the D.C. personal income tax. The tax base is reduced by various deductions and exclusions commonly found in personal income tax schemes such as business deductions, exclusion for interest derived on D.C. obligations, an exemption amount similar to the exemption amount allowed for the D.C. personal income tax. A deduction for owners' services is allowed (not to exceed 30% of net income before such deduction).

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Given that the 1994 tax rate for the UBT is the same as the top D.C. personal income tax rate on net income over \$20,000, the deduction for owners' services brings the UBT and personal income tax bases closer together. This is so because while the first \$20,000 of net income under the personal income tax is taxed at rates lower than the UBT rate, a portion if not all of the first \$20,000 of UBT net income is not taxed based on the deduction for owner's salaries. Finally, it would seem the UBT is an alternate income tax to the D.C. personal income tax since the income tax excludes income taxed under the UBT.

While the D.C. legislature and the Comptroller refers to the UBT as a franchise tax, and has so named it, we find such label not controlling. We need only find that the UBT is in the nature of an income tax as opposed to non-income taxes such as property and excise taxes. In that vein, the incidents of an income tax are prevalent and numerous as summarized above, especially in light of the fact that the tax is based on a net income figure rather than a gross receipts amount. Further, we have allowed a credit for taxes paid under the New Hampshire Business Profits Tax, a statute similar to the UBT. See Letter Ruling 87-10.

Most compelling, however, is the case law holding that the UBT is an income tax. The highest court of D.C. jurisdiction, the District of Columbia Court of Appeals, has held that the UBT is in nature and incidents a tax on personal income. Bishop v. District of Columbia, 401 A.2d 955, 960-961 (D.C. App. 1979) (deciding that the UBT was an income tax and therefore in violation of the Home Rule Act). The neighboring states of Virginia and Maryland have also found the UBT to be an income tax. King v. Forst, 239 Va. 557, 391 S.E.2d 60 (1990) (held that the UBT was an income tax and that Virginia resident entitled to credit against Virginia income tax); Roach v. Comptroller of the Treasury, 327 Md. 438, 610 A.2d 754 (1992) (held that the UBT was an income tax and that Maryland resident entitled to credit against Maryland income tax).

#### Conclusion

Based on the foregoing analysis, the District of Columbia Unincorporated Franchise Tax is in the nature, and has the incidents, of an income tax and may be credited against the Massachusetts Personal Income Tax, as determined under G.L. c. 62, § 6(a).

Very truly yours,

/s/Mitchell Adams

Mitchell Adams  
Commissioner of Revenue

MA:HMP:jmw

LR 94-8

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[1] The general purpose of the credit is to prevent double taxation of a taxpayer's income. This purpose, coupled with the statutory language requiring a correlative relationship between the "taxes due" to be credited and "any item of Massachusetts gross income" as defined under the Massachusetts personal income tax, compels the interpretation that such credit is limited to income taxes.