Update on the District of Columbia’s Qualified High Technology Company Program

June 4, 2020
Overview

- Introduction
- History of the QHTC Program
- Update on the Requirements of the Program
- Current Benefits of the QHTC Program
- Audit Observations
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Introduction
The District of Columbia’s Qualified High Technology Company Program (Then)

- Enacted in April 2001 as the “New E-Conomy Transformation Act of 2000” to encourage technology companies to:
  - Move to the District of Columbia
  - Hire and create technology jobs in the District
  - Retrain workers into technology jobs

- At the time, enacted with a 100% vote by DC City Council

- Companies meeting the requirements are “QHTCs”
The District of Columbia’s Qualified High Technology Company Program (Now)

- DC City Council has been enacting legislation to reduce the benefits

- Office of Tax and Revenue ("OTR") is charged with administration of the program
  - Increased audit activities
  - Releasing Regulations and Guidance
The Qualified
High Technology
Company
Program
QHTC Program Historic Requirements

When initially enacted in 2001 under D.C. Code § 47-1817.01(5)(A), the business had to meet the following requirements to qualify as a QHTC:

- Be an individual or entity organized for profit
- Maintain an office, headquarters or base of operations in the District
- Have two or more employees
- Be registered to do business in the District and be current in all District filing requirements and payment obligations

- Derive at least 51 percent of its gross revenues from qualifying activities
  - Generally, the qualifying activities fell into five categories:
    - Internet related services and sales
    - Information and communication technologies, equipment and systems
    - Advance material and processing technologies
    - Engineering, production, biotechnology and defense technologies
    - Electronic and photonic devices and components
Corporate Franchise Tax Reduction - reduced 6% rate, five year abatement if in a qualified high technology development zone (and then the 6% rate would apply)

Entities that are subject to the unincorporated business tax ("UBT") and a QHTC are exempt from the UBT.

- Job-related Credits
  - New Hire Tax Credit - 10% credit on new hires wages, up to $5k per employee per tax year for the first 24 months of employment at the QHTC
  - Disadvantaged Qualified Employees - 50% credit on the wages of the new hire, not to exceed $15k per year.
  - Worker retraining credit, Relocation credit

- Property Tax
  - 10 year exemption from personal property tax
  - Real property tax abatement for five years on certain improvements and renovations

- Sales Tax Exemptions - repealed October 1, 2019
  - Exemption on purchases in the District of certain equipment and services
  - Sale of qualified services would be exempt

- Enhanced IRC 179 deduction, exemption from taxable income of capital gain from sale of assets held for more than 5 years, deferral of gain on sale of QHTC stock.
Updates to QHTC Program

TECHNOLOGY SECTOR ENHANCEMENT ACT OF 2012

The Act added “in the District” to the D.C. Code § 47-1817.01(5)(A) definition of a QHTC to subsections (ii) and (iii). As a result of this change, the revised sections read (emphasis added) as follows:

▶ “Qualified High Technology Company” means: (i) An individual or entity organized for profit and maintaining an office, headquarters, or base of operations in the District of Columbia; (ii) Having 2 or more employees in the District; and (iii) Deriving at least 51% of its gross revenues earned in the District from qualifying activities.

▶ The Act expanded the five year abatement of corporate franchise tax from companies located in a high technology development zone, to any location “in the District.” *

▶ In addition, the Act amended D.C. Code § 47-1817.06(a)(2)(B) to introduce a $15m limitation on the total abatement taken.

*Except for the DC Ballpark TIF area, which has a separate benefits program.
Updates to QHTC Program

BUDGET SUPPORT ACT OF 2014

In *BAE Systems Enterprise Systems Inc. v. District of Columbia Office of Tax and Revenue*, 56 A.3d 477 (D.C. 2012), the District Court of Appeals held that the original QHTC definition did not require property ownership or the payment of rent or the exercise of predominant authority, dominion, or control over an office or base of operations in the District. A client site where the taxpayer’s employees reported to each day met the requirement of the statute of having a “base of operations” in the District.

The District responded by updating the statutory definition of a QHTC by adding the requirement to D.C. Code § 47-1817.01(5)(A) that the QHTC must “own or lease a location in the District.”

The Budget Act also added that a Taxpayer with an online or brick and mortar retail store or a construction company in the District could not qualify as a QHTC.
Updates to QHTC Program
BUDGET SUPPORT ACT OF 2014

The Budget Act also introduced other provisions that impacted the benefits businesses received from QHTC:

- Phased Reduction of the DC Franchise Tax rate from 9.975% to 8.25%
- Apportionment factor changed to Single Sales Factor, Market sourcing of sales of services
- Expansion of sales tax base to include more services
Updates to QHTC Program

ONLINE CERTIFICATION

- In order to claim QHTC Status, under D.C. Code § 47-1805.05 Taxpayers were required to attach Form QHTC-CERT to their DC income tax filings for any tax years they were claiming QHTC status.


- Taxpayers were required to “self-certify” online via the Taxpayer’s myTax.DC.gov account before filing the tax return claiming the status.

- Among other information required:
  - NAICS code
  - Copy of DC lease
  - Explanation of principle business activity
  - Summary of employees hired
Updates to QHTC Program
DOWNLOADING LOST REVENUES AMENDMENT ACT OF 2019

Tax Credits:
- Reduces the tax credit for wages to qualified employees to 5 percent of wages paid in the first 24 months after hiring;
- Reduces the maximum allowable credit to $3,000 for each qualified employee; and
- Eliminates the ability to carry forward unused credits for employees hired on or after October 1, 2019.

Corporate Franchise Tax:
- Limits application of the reduced 6 percent corporate franchise tax rate to 5 years; and
- Caps the total amount of franchise tax reduction that a QHTC may receive as a result of the reduced rate to $250,000 per taxable year

Sales Tax:
- Repeals the exemption for most sales by QHTCs in the District; and
- Repeals the exemption for sales to QHTCs of certain computer and technology equipment.
On May 1, 2020 the District of Columbia updated D.C. Muni. Regs. 9 § 1199.2

- (b) “Having 2 or more qualified employees in the District” shall require that the qualified employees spend the majority of their time working in an office owned or leased by the taxpayer in the District of Columbia and directly engaging in one or more of the activities enumerated in D.C. Code § 47-1817.01(5)(A)(iii).

- (c) “Leasing an office in the District of Columbia” shall require a written contract conveying real property for a specified term and for a specified rent where the lessee has continuous use of the premises during business and non-business hours. “Leasing an office in the District of Columbia” shall not include maintaining a virtual office, contracting for use of a co-working office space or a licensing arrangement. A lease must be maintained for the entirety of the period for which QHTC status is sought.
Current Requirements of the QHTC Program
Requirements of the QHTC Program

- Deriving 51% or more of its gross revenues earned in the District from qualified activities (not just using technology in its business)

- “Having two or more qualified employees in the District”
  - Who are also spending most of their time working from the Taxpayer’s DC office in one or more of the qualifying activities
    - OTR website says 35 hours per week

- Leasing an office in the District For the entire tax period the QHTC status is claimed
  - Lease must specify the term, the rent, have the Taxpayer listed as the renter, not a shared space, Taxpayer has access during and after business hours

- “Owning an office in the District of Columbia” shall require the taxpayer to own real property in fee simple for the entirety of the tax year for which QHTC status is sought.

- Be compliant with all other tax filings with the District - ballpark fee, unemployment taxes, property taxes, sales and use taxes

- Be registered with the DC Department of Regulatory Affairs (“DCRA”)

- Self-certify online at myTax.DC.gov before filing income tax return
Current QHTC Benefits
Benefits of the QHTC Program

- Corporate Franchise Tax Reduction - five year income tax abatement and then taxed at 6% for five years beginning after December 31, 2019. Total benefit is capped at $250k per year and $15m overall.

- Entities that are subject to the unincorporated business tax (“UBT”) and a QHTC are exempt from the UBT.

- Job-related Credits
  - New Hire Tax Credit - 10% credit on new hires wages, up to $5k per employee per tax year for the first 24 months of employment at the QHTC. For tax years beginning after December 31, 2019, 5% of the wages paid, limited to $3k per employee.
    - 10 year carry forward of unused credits for credits generated for employees hired before October 1, 2019.
    - No carryforward of credits generated from employees hired after October 1, 2019.
  - Disadvantaged Qualified Employees - 50% credit on the wages of the new hire, not to exceed $15k per year.
  - Worker retraining credit
  - Relocation credit
Benefits of the QHTC Program

- **Property Tax**
  - 10 year exemption from personal property tax
  - Real property tax abatement for five years on certain improvements and renovations

- Enhanced IRC 179 deduction, for tax years beginning on or after December 31, 2018, the capital gain from the sale or exchange of a qualifying investment in a QHTC is 3%
Audit Observations
Audit Observations

- Desk audit requests
  - Requests for substantiation
  - Copy of Leases
  - Description of Services
    • Master Service Agreements, Invoices

- Cross Check with Other DC Agencies
  - DCRA
  - DC Unemployment Insurance (SUI)
  - Property Tax
  - A taxpayer certifying in good faith that it is a QHTC is not subject to any penalties under the franchise tax law if it is determined that the taxpayer does not qualify as a QHTC. D.C. Code § 47-4218
Substantiation Requirements

- Maintain Records for each open year on how Company qualified for QHTC Status
  - File Memo, workpapers, other contemporaneous documentation

- For any abatements, credits, maintain the workpapers
  - If you are still carrying forward credits from a closed tax year, maintain the records
  - For the $15m cap, summary of exemptions from DC Franchise taxes

- How to substantiate “2 employees in the District working from leased location”?
  - Before/After COVID
  - Due to COVID related Closures
Questions?
Elil Shunmugavel Arasu

EXPERIENCE

Elil has more than 15 years of state tax consulting experience within a public accounting environment and concentrates on income and franchise tax issues such as nexus, state tax base modifications, apportionment of income, business/non-business income, unitary taxation, gross receipt taxes, allocation of partnership items, and state filing options.

Elil also has extensive experience in gross receipts taxes, including the Virginia Business, Professional and Occupational License (“BPOL”) tax.

Elil consults on all aspects of state income tax, including participating in mergers and acquisition transactions, due diligence reviews, representation on state tax controversy matters, and assisting companies with state tax compliance and state tax accrual reviews. She has worked with Fortune 1000 and mid-size companies in industries such as manufacturing, retail, healthcare, hospitality, real estate, technology, and transportation.

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