

Opinion No.
1213

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SUPERIOR COURT OF THE
DISTRICT OF COLUMBIA
TAX DIVISION

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Tax Division

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HORACE G. WARD, JR. and
BARBARA WARD,

Petitioners,

v.

DISTRICT OF COLUMBIA,

Respondent.

FILED

Tax Docket No. 3104-82

OPINION AND ORDER

This matter came before the Court on December 9, 1982, on Cross-Motions for Summary Judgment. The Petitioners appeal from an income tax assessment made against them for the January 1st to August 15th, 1979, tax year in the amount of \$8,310.00. The assessment results from the denial of deductions for partnership losses and expenses claimed on their 1979 District of Columbia Income Tax Return. The tax, together with assessed interest, was paid on December 31, 1981.

This Court has jurisdiction to hear this appeal pursuant to D.C. Code 1981 §§11-1201 and 47-3303.

I.

The Respondent District of Columbia ("the District") claims that the Petitioners, Horace G. Ward, Jr. and Barbara Ward ("the Wards"), could not deduct partnership losses incurred in 1979 from their D.C. income taxes because the Wards were not residents of the District of Columbia on December 31, 1979, the "closing date" of the partnerships. The Wards contend that in computing their net income for D.C. income tax purposes they are permitted to deduct the percentage of partnership losses, derived by apportionment of the annualized figure, attributable to the partner's taxable year ending on August 15, 1979, the date on which the Wards moved out of the District. Therefore, the issue before the Court, simply put, is whether the Department of Finance and Revenue correctly disallowed partnership loss deductions on the Wards' part year return

for 1979 when those losses were reported at the close of the partnership taxable year on December 31, 1979, while the Wards were residents of Maryland? Finding that the District acted properly, this Court grants the District's Motion for Summary Judgment.

II.

The material facts of this case are not in dispute, and may be briefly summarized:

1. The Wards are husband and wife. They were residents of the District of Columbia from January 1, 1979, until August 15, 1979. On August 15, 1979, they moved to Bethesda, Maryland, and were residents of Maryland for the remainder of the calendar year.

2. During 1979, Horace Ward was a partner in at least twelve partnerships. The partnerships had various addresses in the District of Columbia, Maryland, Pennsylvania, and New York. The Wards introduced no evidence to show that any of the partnerships had a fiscal year other than the calendar year. Therefore, pursuant to D.C. Code 1981 §47-1801.4 (9) and §47-1804.1, the taxable year of each partnership is deemed to be the calendar year. Since the partnerships share the same taxable year, ending on December 31, 1979, they present no different issues of fact and will be referred to as a conglomerate "partnership" for the purposes of this opinion.

3. Horace Ward's pro-rata share of the ordinary losses and expenses reported by the partnership for the 1979 taxable year was \$751,142 and \$9,094 respectively.

4. The Wards filed a part year D.C. income tax return. The Wards' taxable year for D.C. income tax purposes was January 1 to August 15, 1979, reflecting the part of 1979 in which they were D.C. residents.

5. On the 1979 D.C. income tax return, the Wards apportioned 62.5% of the partnership losses and expenses to the District. This figure was determined by the number of months they had been D.C. residents during 1979 (7.5) over 12 months. The Wards therefore reported partnership losses of \$392,603 and partnership expenses of \$5,634.

6. The Wards also filed a fractional year Maryland income tax return. They allocated 37.5% of the partnership losses and expenses to their Maryland income.

7. The D.C. Department of Finance and Revenue disallowed the Wards' partnership loss and expense deduction on their part year return for 1979, and assessed additional tax and statutory interest in the amount of \$10,572.93 on August 20, 1981. The Wards paid the assessment and interest on December 31, 1981. They filed this appeal on February 18, 1982, seeking a refund of \$25,691.93.

III.

The sole issue in this case is whether the Wards, who lived in the District of Columbia for the first seven months of 1979 and in Maryland for the remainder of the year, may prorate a loss incurred as a result of being a partner in a partnership whose taxable year did not close while they resided in the District. There is little case law on the question, and thus resolution of the issue depends primarily on statutory construction. Under D.C. Code 1981 §47-1801.4(17), the Wards were required to file a part year D.C. income tax return. The Wards' taxable year for D.C. income tax purposes was January 1st to August 15th, 1979. District of Columbia v. Davis, 125 U.S. App. D.C. 311, 371 F.2d 964, cert. den. 386 U.S. 1034 (1967). In the District of Columbia partnerships not conducting unincorporated businesses are not subject to tax. Resident individuals who are members of such a partnership, however, are subject to tax in their individual capacities upon their individual distributive share of the partnership. The distributive share of each partner is includible in that partner's gross income. D.C. Code 1981 §47-1808.6 provides the framework for computation of a partner's income:

Individuals carrying on any trade or business in partnership in the District, other than an unincorporated business, shall be liable for income tax only in their individual capacities. The tax on all such income shall be assessed against the individual partners under §47-1806.1 to 1806.6. There shall be included in computing the net income of each partner his distributive share, whether

distributed or not, of the net income of the partnership for the taxable year; or if his net income for such taxable year is computed upon the basis of a period different from that upon the basis of which the net income of the partnership is computed, then his distributive share of the net income of the partnership for any accounting period of the partnership ending within the taxable year upon the basis of which the partner's net income is computed.

The critical language of the statute for resolution of the issue in this case is the last clause. Here the Wards' taxable year was January - August, 1979. The partnership's taxable year was January - December, 1979. The net income or loss of the partnership was computed as of December, 1979. The Wards did not allege that there were any formal accounting periods for any of the partnerships ending on a date other than December 31, 1979. The distributive share of a partner can only be determined at the conclusion of a formal accounting. In this case then, the partnership determined the Wards' share of the partnership losses on December 31, 1979. The Wards were then residents of Maryland. This accounting period did not fall within the Wards' D.C. taxable year. Therefore the distributive share of the partnership's losses is attributable to Maryland, not to the District.

The Wards rely primarily on Hunter v. District of Columbia, No. 2212 (D.C. Sup. Ct., Tax Division, April 9, 1979) to support their argument that a partner's distributive share may be appropriately apportioned among fractional year returns for different jurisdictions.^{1/} That case

1/ The Wards also point to several D.C. Code sections which they argue are consistent with apportioning income between different geographical jurisdictions. A careful reading of the tax statutes reveals that there is no provision for the allocation or apportionment of income of resident individuals, or resident estates or trusts, except to the extent that they are conducting an unincorporated business. See: [1982] D.C. Tax Reports (CCH) 512-405.

D.C. Code 1901 §47-1803.4 applies to unincorporated businesses. The Wards do not claim that they filed as an unincorporated business. D.C. Code 1901 §47-1803.2 requires proration of personal exemptions on a fractional year return. This section does not address allocation of income. D.C. Code 1901 §47-1801.3 provides for the filing of fractional year returns. That section states: "Such portion of such person's income as is received or accrued, according to his method of accounting, during taxable years or parts thereof to which this chapter is applicable shall be reported and taxed under the provisions of this chapter." (Emphasis added) By citing these code sections the Wards show that they have missed the point of this appeal. The issue is, in the language of the last section, did the Wards "receive or accrue" their partnership losses while they were residents of the District or while they were residents of Maryland?

involved similar facts. The Hunters lived in the District of Columbia until September 30, 1971, when they moved to Maryland. Mrs. Hunter was a partner in a real estate partnership whose taxable year closed December 31, 1971. Then Superior Court Judge Penn held that the Hunters could allocate the proportional amount of the partner's distributive loss, as declared on December 31, 1971, to the District of Columbia fractional year return. He found that the "accounting period" of the partnership ended with the conclusion of the Hunters' taxable year on September 30, 1971, and that therefore the Hunters were entitled to allocate the net income attributable to that accounting period to the District.

This court notes at the outset that it is not bound by the decision of a fellow Superior Court Judge. Further, this Court respectfully disagrees with Judge Penn's conclusion, finding that it was grounded in equities not present in the instant case. First, the Hunters relied on erroneous advice from Maryland tax authorities that Maryland law required apportionment of partnership losses when partners filed fractional year income tax returns. The Wards received no such advice. Second, by the time the Hunter decision was written, the Maryland statute of limitations precluded the Hunters from filing for a refund due to overpayment of their 1971 taxes to Maryland. Here, under MD. CODE ANN. §81-215 and §81-310 (1981), the Wards may file for a Maryland refund until April, 1983.

This Court is not persuaded by Judge Penn's construction of D.C. Code 1981 §47-1808.6. A partner's distributive share cannot be computed until the end of a formal accounting period. Unless otherwise indicated, under relevant D.C. statutes, a partnership's accounting period ends on the last day of the partnership's taxable year. In order for a partner to ascertain and include the distributive share of loss or income in the partner's net income for the partner's taxable year, the partnership's accounting period must end within the partner's taxable year. This is the plain meaning of the D.C. statute at issue here: "any accounting period of the partnership ending within the taxable year upon the basis

of which the partner's net income is computed." The Wards' partnership had no formal accounting period other than the last day of the partnership's taxable year. The last day of the partnership's taxable year, December 31, did not fall within the partner's taxable year January 1 to August 15. Thus the Wards did not receive partnership income or loss within their D.C. taxable year. It follows logically and legally that the D.C. Department of Finance and Revenue correctly disallowed the Wards' deduction for partnership losses and expenses when those losses and expenses were not incurred during the Wards' taxable year.

The D.C. Department of Finance and Revenue has consistently followed this interpretation. (See Affidavit of Edward M. Many.) It is published in the informational material which accompanies several Income Tax Return Forms. For example page 6 of the Form D-40 (District of Columbia Individual Income Tax Form) contains instructions for reporting partnership income: "Partnerships - For the tax year in which the last day of the partnership year falls, report your share of the ordinary income (or loss) of the partnership whether actually received by you or not." The instruction sheet which accompanies Form D-65 (District of Columbia Partnership Return of Income) explains that the partnership as such is not subject to tax, but that the distributive shares of the partners are. It then addresses the Wards' problem:

**SCHEDULE C - PARTNERS' SHARES OF NET INCOME, CREDITS
AND DEDUCTIONS**

If the taxable year on the basis of which the partner's income tax return is filed does not coincide with the annual accounting period of the partnership, the D.C. resident partner or member should include in his D.C. income tax return his distributive share of the net income (or loss) and any salaries and interest for the accounting period of the partnership ending within the period for which the partner's income tax return is filed.

A brief look at federal law on taxation of an individual's partnership income provides support for this Court's construction of D.C. Code 1981 §47-1803.6. I.R.C. §705 and Treas. Reg. §1.705-1 (1956) provide that when the taxable years of a partner and a partnership differ, a

partner must include in his or her taxable income the distributive share for any partnership year ending within or with the partner's taxable year. (Emphasis added.) The Commerce Clearing House Reports explains this Internal Revenue Code section:

It may happen that the partnership keeps its books on a fiscal or calendar year which is different from the taxable year of the partner. In such case, the partner reports his or her share of the partnership income in the taxable year in which or with which the partnership year ends.

[1982] Stand. Fed. Tax Rep. (CCH) §3930.015. The Tax Court of the United States and the United States Court of Claims agree with this interpretation. See: Dockendorff v. United States, 84 F.Supp. 372 (Ct. Cl. 1949) and McGrew v. United States, 59-2 USTC 9794, both holding that a partner on a calendar year basis is taxable on the distributive share of the income from the partnership for its fiscal year ending within the partner's calendar year. See also: Myers v. United States, 72-2 USTC 9670, in which the Tax Court held that a payment received by a partnership on September 25, 1961, as partial payment for the involuntary conversion of its property was reportable on the partnership's fiscal year return ending June 30, 1962, and the gain, therefore, must be borne by the partners in 1962, not 1961. Cf.: Jones v. United States, 12 BTA 471 (1928) holding that where two accounting periods of a partnership ended within the taxable year of the members, partnership income for both periods should be included in the taxable year of the partners.

Although the federal analogy is imperfect in that it does not address the geographical limitations on tax jurisdiction, it is sufficiently close to the issue at hand to be given great weight. The Internal Revenue Service takes the view that a partner's distributive share is received by the partner at the close of the partnership's taxable year or other formal accounting period. The partner then must include the distributive share in the partner's taxable income for the year in which it is received. Applying this rule to the facts of the case before the Court, the Wards received no partnership income (or

loss) in their January - August 1979 taxable year, since their partnership's taxable year did not close within their own taxable year. Their partnership's taxable year closed while they were residents of Maryland, and thus within their Maryland taxable year.

This conclusion is buttressed by a careful review of Maryland law. Maryland, with a statute strikingly similar to the D.C. statute at issue here, has taken the ^Qposition that a partner's distributive share is considered as received on the last day of the partnership's taxable year. MD. CODE ANN. §81-315 (1981) provides:

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity, and no income tax shall be assessable hereunder upon the income of any partnership. All such income shall be assessable to the individual partners; it shall be reported by such partners as individuals upon their respective individual income returns, and it shall be taxed to them as individuals along with their other income at the rates and in the manner herein provided for the taxation of income of individuals. In computing the tax of each partner there shall be included in his income and allowable deductions, respectively, that proportion of the income and allowable deductions, respectively, of the partnership ending with or in the taxable year of the partner, for the annual accounting period of the partnership that such partner's distributive share (whether distributed or not) of the net income of the partnership for such annual accounting period, bears to the total net income of the partnership for such annual accounting period.

In considering this statute the Court has had the benefit of an interpretive memorandum released by the Maryland Comptroller of the Treasury on July 1, 1982. This Memorandum makes it clear that the word "proportion" in the Maryland statute does not refer to apportionment of total partnership income among fractional year returns, but rather "proportion" refers to the method by which a partner's distributive share is determined. Memorandum Release No. 25 states in part:

Concerning a partner's share of income, gain or loss from a partnership, it is generally established under Maryland as well as federal law that such income, gain or loss is considered as received or incurred on the last day of the partnership's taxable year. Therefore, whether and to what extent a partner's share of income, gain or loss from a partnership is taxable by Maryland when the individual partner establishes or abandons the Maryland residence, depends upon the close of the taxable year for the partnership and when the individual establishes or abandons Maryland as his State of residence.

. . . If . . . the individual established Maryland as his State of residence prior to the close of the partnership's taxable year, the partner's share of the income, gain or loss from the partnership is considered as having been received or incurred while a resident of Maryland and thus reportable on the Maryland return, regardless of whether or not the partnership does business in Maryland.

The Court finds Maryland's interpretation highly persuasive. The taxing authorities of the District and of Maryland are in complete agreement. The Wards received their distributive share of the partnership on December 31, 1979, while they were Maryland residents. The partnership's taxable year ended within the Wards' Maryland taxable year. Thus any deduction for partnership losses and expenses is allocable solely to the Wards' Maryland income.

IV.

CONCLUSION

Therefore, this Court holds that in order for a partner to claim a partnership loss deduction on the partner's fractional year income tax return for the District of Columbia, the partnership's taxable year, or other formally recognized accounting period during which all partner's distributive shares are commonly computed, must close with or within the partner's fractional tax year. The close of one partner's taxable year, through removal from the jurisdiction, does not constitute the close of an "accounting period" for the whole partnership, such that each partner's distributive share is then determined, as contemplated by D.C. Code D31 §47-1003.6. It follows that the District correctly disallowed the Wards' partnership loss deduction from their fractional year 1979 income tax. The additional assessment is sustained.

Wherefore, it is this 11th day of January, 1983,

ORDERED that the Respondent, District of Columbia's Motion for Summary Judgment be, and hereby is, granted. And it is

FURTHER ORDERED that the Petitioners' Motion for Summary Judgment be, and hereby is, denied.


JUDGE WILLIAM G. SULLIVAN

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