

**District of Columbia
Office of Administrative Hearings**

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TOUCHSTONE CONSULTING GROUP, INC.
Petitioner

v.

DISTRICT OF COLUMBIA OFFICE OF TAX
AND REVENUE
Respondent

Case No.: 2010-OTR-00007

FINAL ORDER

I. INTRODUCTION

On January 25, 2010, Respondent District of Columbia Office of Tax and Revenue (“OTR”) issued a Notice of Proposed Assessment of Tax Deficiency (“Notice”) to Petitioner Touchstone Consulting Group, Inc. (“Touchstone”). The Notice alleged a corporate franchise tax deficiency in the amount of \$1,738,568.411 for a short tax year beginning January 1, 2005, and ending April 21, 2005. On February 23, 2010, Petitioner Touchstone, through Stephanie Anne Lipinski Galland, Esquire, of Lipinski, Galland & Associates, LLP, requested a hearing to appeal the Notice.

Petitioner Touchstone contests the tax deficiency on the following grounds: (1) Touchstone itself did not receive such income because of an election made pursuant to Internal Revenue Code (“IRC”) § 338(h)(10); rather its shareholders did.¹ (2) Further, OTR

¹ The Internal Revenue Code of 1986 (100 Stat. 2085; 26 U.S.C.S. Sec. 1 *et seq.*) shall be cited in this order as IRC.

misinterpreted net income as defined in D.C. Code, 2001 ed., § 47-1803.02(a) (referring to IRC § 61's definition of gross income). (3) Additionally, OTR did not give effect to D.C. Code, 2001 ed., § 47-1804.04 (allowing a taxpayer to report its income in the same manner as that income would be treated under federal tax law. (IRC § 453)). (4) Also, OTR did not pay heed to Petitioner Touchstone's status as an S Corporation. (5) Alternatively, Petitioner Touchstone should not have been considered to have recognized any income, because an IRC § 338(h)(10) election is only valid if the entity is considered to be an S Corporation (and District of Columbia tax laws do not recognize an S Corporation). (6) Finally, OTR could not make an assessment because the statute of limitations period under D.C. Code, 2001 ed., § 47-4301(a) had expired. Petitioner Touchstone requests that I grant summary judgment in its favor.

Based on the evidence and arguments presented, this administrative court ("OAH") finds that Petitioner Touchstone is not liable for any of the proposed tax deficiency, since the transaction that precipitated the deficiency was, in essence, an installment stock sale for which neither Petitioner nor its shareholders received any payment (income) during the tax year in question.

II. PRELIMINARY PROCEEDINGS

On March 11, 2010, this administrative court issued a Case Management Order scheduling a status conference for April 8, 2010. Petitioner Touchstone appeared through counsel Stephanie Anne Lipinski Galland, Esquire. Anne Donohue of Systems Research and Applications Corporation ("SRA") also appeared on Petitioner's behalf. Edward A. Blick, Esquire, appeared on behalf of Respondent OTR.

At the status conference, the parties requested 180 days to file stipulated facts and motions for summary judgment. On April 22, 2010, this administrative court issued a Prehearing Conference Order, directing the parties to file a joint stipulation of facts and a joint stipulation as to the admissibility of documents to be considered in this matter, along with motions for summary judgment, no later than October 12, 2010, and that briefs in response should be filed no later than November 12, 2010.

Both Petitioner Touchstone and Respondent OTR filed documents captioned “stipulation of facts,” although they did not submit a joint stipulation of facts as ordered by this tribunal (thus, they will be referenced as statements of fact). Petitioner’s statement of facts was filed on October 12, 2010, and its Motion for Summary Judgment on October 13, 2010, the same day OTR’s filed its statement of facts (one day later than ordered). The statements differed in ten respects; specifically on points 11, 14, 15, 17, 20, and 21 in both statements, and, in addition, Respondent’s points 18, 22, and 23 do not appear in Petitioner’s statement. I list below both the facts which were agreed to by the parties, and separately, the facts alleged by only one party.

Following the non-joint stipulation of facts, came a plethora of motions and cross-motions. First, on November 12, 2010, Petitioner filed a brief responding to Respondent’s stipulation of facts and requesting a ruling on its motion for summary judgment. On November 15, 2010, Respondent cross-moved for summary judgment and opposed Petitioner’s motion for summary judgment; Petitioner opposed that cross-motion on November 29, 2010, in addition to moving to dismiss that cross-motion. On November 30, 2010, Respondent moved for leave to file a motion for summary judgment out of time, which Petitioner opposed that same day. That same day, Respondent replied to Petitioner’s Brief in Response to Respondent’s Stipulation of Facts. On December 1, 2010, Petitioner responded to Respondent’s reply and moved for leave to

respond to Respondent's Reply to Petitioner's Brief responding to Respondent's Stipulation of Facts. Finally, on December 2, 2010, Petitioner opposed Respondent's Motion for Leave to File Motion for Summary Judgment out of time.

On December 1, 2010, the parties appeared as scheduled for oral arguments on the motions for summary judgment. Both Ms. Galland and James P. Joseph, Esquire, of Arnold and Porter, who had entered an appearance in this matter after the status conference, argued on Petitioner Touchstone's behalf. Mr. Blick appeared and argued for Respondent OTR. I advised the parties that the standards for summary judgment had not been met in the filings submitted, and neither party objected at that point or offered any further submissions.²

At oral argument, the parties disagreed as to the applicability of Petitioner's attempted IRC § 338(h)(10) election³ and its impact on the transaction at issue. However, in response to my questioning, the parties conceded that the installment notes received for the stock sale (a deemed sale of Respondent's assets) to SRA that precipitated the alleged corporate franchise tax deficiency, whether issued to Respondent Touchstone directly or to its shareholders, cause a taxable event under District of Columbia law *only* when payment on the installment notes were actually made or became due. The parties also agreed that no payments were made or became due during the short taxable year at issue.

² At the hearing, counsel for Respondent stated that if this administrative court found for the Petitioner, then Respondent would have to pay Petitioner a considerable sum of money. However, the only issue in this matter is whether the Proposed Assessment of Tax Deficiency for January 1 to April 21, 2005, was correct; all other tax liabilities are outside the scope of these proceedings.

³ An IRC § 338(h)(10) election provides that on the purchase of stock of an eligible corporation, the corporation is deemed to have sold its assets in a taxable transaction in exchange for the amount paid for its stock plus its liabilities, and then immediately distributed the net proceeds of the sale in complete liquidation to the corporation's shareholders.

III. STIPULATIONS OF FACTS

Although filed in separate documents, the parties agreed, and thus stipulated to the following facts, as presented below:

1. Touchstone Consulting Group, Inc. (“Touchstone”) was a Virginia corporation conducting a consulting business during its taxable year beginning on January 1, 2005.
2. Touchstone’s Federal Identification Number is 52-1767261.
3. Touchstone filed a 2005 District of Columbia Form D-20 Corporation Franchise Tax Return for its taxable year ended April 21, 2005 on January 13, 2006, pursuant to D.C. Code Secs. 47-1807.01(2), Sec. 47-1803.01, and 47-1803.02(a)
4. The District of Columbia Office of Tax and Revenue issued a Notice of Proposed Assessment of Deficiency (“Proposed Assessment”) on January 25, 2010 for a corporate franchise tax liability for Touchstone short taxable year ended April 21, 2005 in the amount of \$1,738,568.11.
5. Touchstone filed a timely Protest Appeal with the District of Columbia Office of Administrative Hearings on February 22, 2010.
6. Touchstone had in effect for its taxable year beginning January 1, 2005 a valid election under Sec. 1362(a) of the Internal Revenue Code of 1986 (the “Code”) to be treated as an S Corporation for purposes of federal income taxation.
7. Touchstone’s federal election to be an S Corporation was in effect from the date of its incorporation on March 1, 1992, and at all times thereafter until April 22, 2005 when all of Touchstone’s stock was purchased by Systems Research and Applications Corporation.
8. By a Stock Purchase Agreement (“Agreement”) dated April 18, 2005 between Touchstone, Touchstone shareholders, and SRA International, Inc. and its wholly owned subsidiary, Systems Research and Applications Corporation, (“SRA”), all of the stock of Touchstone was sold by the Touchstone shareholders to SRA.
9. Pursuant to the Agreement, all consideration payable by SRA for the Touchstone stock was payable to the Touchstone shareholders, and as part of the total consideration, SRA issued nine separate promissory notes (“Notes”) for an aggregate amount of \$21,498,733.
10. Each Touchstone shareholder received one of such Notes directly from SRA as part of such shareholder’s proportionate share of the total consideration payable under the Agreement (determined by reference to each shareholder’s percentage ownership of the stock of Touchstone).

11. The Agreement provided that the Touchstone shareholders and SRA would jointly make an election under IRC § 338(h)(10) with respect to the purchase of the Touchstone shares.⁴

12. A timely and valid IRC § 338(h)(10) election for federal income tax purposes was filed on December 12, 2005 on Form 8023 with respect to SRA's purchase of Touchstone's stock.

13. The IRC § 338(h)(10) election caused Touchstone's taxable year to close on April 21, 2005, and required the filing of a short taxable year return for the period January 1, 2005 through April 21, 2005 for both federal income tax purposes and for District of Columbia corporate franchise tax purposes.

14. Touchstone's Form 1120-S for its taxable year ending on April 21, 2005 properly included a Form 6252 (Installment Sale Income), reflecting the receipt of the Notes and treating the Notes as deemed to have been received by Touchstone in connection with an installment sale under IRC §453.⁵

15. Each Note had a maturity date after the closing on the sale of Touchstone's stock by the shareholders on April 21, 2005.⁶

16. All payments by SRA to each Touchstone shareholder were required for federal income tax purposes to be reported by each shareholder as receipts in exchange for their Touchstone stock.

17. Touchstone's federal income tax reporting has been accepted by the Internal Revenue Service, and the time for assessing any additional federal income tax against Touchstone or its shareholders in respect to transactions occurring in 2005 has expired under the relevant federal statute of limitations on assessments.

Petitioner alleged the following facts, which correspond to bullets 17, 19, 20, and 21, respectively in its document captioned "Stipulation of Facts" filed October 12, 2010:

1. Touchstone's Form 1120-S for its taxable year ended April 21, 2005 correctly reported for federal income tax purposes that no amount was includible with respect to

⁴ The wording of this particular note differs in the parties' factual statements, but it is not a material difference.

⁵ Again, the wording differs between the parties' factual statements, but this is not a material difference in this proceeding. OTR added at the beginning "For federal and District tax purposes, Touchstone filed a U.S. Income Tax Return for an "S" Corporation" and omitted the word "properly." Petitioner objected to the reference to the Form 1120-S for District tax purposes, as it asserted that it correctly filed the District of Columbia Corporation Franchise tax return, Form D-20.

⁶ Petitioner's factual statement further alleges that no payments were made under any of the Notes during Touchstone's taxable year ending April 21, 2005; Respondent's statement makes no mention of this.

the amount of the Notes in its federal gross income (within the meaning of IRC § 61) by reason of IRC § 453.

2. The increase in tax liability asserted in the Deficiency Notice is entirely attributable to a proposed inclusion of the aggregate amount of the Notes (\$21,498,733.00) in Touchstone's net income within the meaning of D.C. Code Sec. 47-1803.01.
3. D.C. Code Sec. 47-1801.04 in part, provides that the District of Columbia conforms to the Internal Revenue Code of 1986 (100 Stat. 2085; 26 U.S.C.S. Sec. 1 *et seq.*) as amended from time to time.
4. D.C. Code 47-4301 provides in part that the amount of a tax imposed under Title 47 "shall be assessed within three years after the return was filed". Subparagraph (2) further states "if the taxpayer omits an amount properly includible in gross income which is in excess of 25% of the amount of gross income included in the return, the tax may be assessed...at any time within 6 years after the return was filed."

Respondent OTR alleged the following facts, which correspond to bullets 17, 18, 20, 21, 22, and 23 in its document captioned "Stipulation of Facts" filed October 13, 2010⁷:

1. Touchstone's Form 1120-S for its taxable year ending April 21, 2005 deferred for federal income tax purposes \$21,498,733.00 of the gain under the provision of IRC §453.
2. Touchstone's District of Columbia Corporation Franchise tax return, Form D-20 for its taxable year ending April 21, 2005 deferred for District income tax purposes \$21,498,733.00 of the gain under the provision of IRC §453.
3. Touchstone's District of Columbia Corporation Franchise tax reporting has not been accepted by the Office of Tax and Revenue on the basis that the IRC §338(h)(10) was not valid.
4. The District does not recognize flow thru of transaction of an "S" Corporation and for District of Columbia Corporation Franchise tax purposes; an "S" Corporation is taxed in the same way as a "C" Corporation.
5. Treasury Regulation §1.338(h)(10)-1(b) provides that an IRC §338(h)(10) election is only available for a selling consolidated group, selling affiliate or selling S Corporation shareholders.
6. Touchstone has always filed a District of Columbia Corporation Franchise Tax Return, Form D-20.⁸

⁷ Petitioner adamantly disagreed with some of these statements as conclusions of law, rather than facts.

⁸ The text on the statement of facts provided by Respondent cuts off after "D-", but it seems a fair assumption that D-20 was the form Respondent meant.

IV. DISCUSSION AND CONCLUSIONS OF LAW

This case arises under D.C. Code, 2001 ed. (2005 Supp.), § 47-1804.04, and the Office of Administrative Hearings Establishment Act, D.C. Code, 2001 ed. (2007 Supp.), § 2-1831.03(b)(4), as amended.

A. Summary Judgment Standard of Review

The parties in this matter have cross filed for summary judgment. Rules of this administrative court provide that parties may file motions for summary adjudication or comparable relief. OAH Rules 2812 and 2828.⁹ The Rules also state that “[w]here a procedural issue coming before this administrative court is not specifically addressed in these Rules, this administrative court may rely upon the District of Columbia Superior Court Rules of Civil Procedure as persuasive authority.” OAH Rule 2801.2. This administrative court therefore adjudicates motions for summary judgment based on the persuasive authority of D.C. Superior Court Rule of Civil Procedure 56(c) and the identical Federal Rule of Civil Procedure 56(c), which specify that summary judgment is appropriate if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Super. Ct. Civ. R. 56(c); Fed. R. Civ. P. 56(c).

⁹ OAH promulgated revised procedural rules on December 31, 2010 (57 D.C. Reg. 12540), which went into effect on January 1, 2011. Pursuant to Title 1 District of Columbia Municipal Regulations (OAH Rule) 2800.7, the former procedural rules shall be applied to the adjudication of the motions in this matter.

Here, although the parties failed to meet the requirements to file joint stipulations of fact and filed no supporting affidavits, the parties agree that there are no material factual disputes to be decided.

B. Issue to be Addressed

Petitioner Touchstone argued that it explicitly and accurately followed the directions on the 2005 District of Columbia Form D-20 Corporation Franchise Tax Return for its taxable year ended April 21, 2005, and as such it cannot be assessed a deficiency.

Respondent OTR assessed a corporate franchise tax deficiency of \$1,738,568.11 on deferred income of \$21,498,733, which arose out of a stock sale, and contends the tax assessed is due since the District of Columbia does not recognize an election, made by Petitioner in its federal tax filing, under IRC § 338(h)(10). Further, the District of Columbia does not recognize the federal election of a corporation as an “S” corporation, which would allow tax benefits to flow through to Petitioner’s shareholders.¹⁰

Whether or not I accept Respondent OTR’s position on these issues (the invalidity of IRC § 338(h)(10) election and the failure to recognize an S corporation) is irrelevant to the outcome of this case, since the stock sale at issue was paid for with installment sale promissory notes, with no payments due on the notes during the short tax year in question.

¹⁰ Respondent asks that I address the issue of the applicability of IRC § 338(h)(10) in this case as this is an issue of first impression in the District of Columbia that will come up again, and OTR requests some judicial authority on the issue of the applicability of IRC § 338(h)(10) to other entities that might take the same path as Petitioner. I decline Respondent’s invitation to determine an unnecessary basis for relief, *see generally Old Dominion Copper Mining & Smelting Co. v. Lewisohn*, 210 U.S. 206, 216 (1908) (Justice Holmes noting, “We decide only what is necessary.”); accord *Paschall v. D.C. Dep’t of Health*, 871 A.2d 463, 466 (D.C. 2005), and thus do not reach this issue.

I note that in its Notice of Proposed Audit Changes and Computation of Corporation Franchise Tax Deficiency, Respondent OTR made the following statement:

An S corporation is treated as a "Corporation" for DC tax purpose under DC Code Section 47-1801.04(16). If an election is made under IRC 338(h)(10), the target corporation recognizes gain or loss on the deemed sale of assets in a single taxable transaction. Since taxpayer did not report \$21,498,733.00 gain under 338(h)(10) deemed sale of assets, Corporation franchise tax return (D-20) for the period 01/2005-04/2005 has been revised.

Since the flow-through provision of an S Corporation is not recognized for DC tax purposes, the installment sale provision of the IRS Code Section 453 is not applicable in this case.

Neither in its filings nor in its argument at the December 1, 2010, hearing did Respondent OTR provide any authority for the second sentence in its Notice to Petitioner. Whether or not OTR recognizes an "S" Corporation for D.C. tax purposes, I can find no authority that installment sales valid under federal law (no matter who or what the entity is that makes the sale) are not valid under DC law.

C. Statutory Interpretation

In analyzing a question of statutory interpretation, the District of Columbia Court of Appeals always begins by examining "the plain language of the statute." *Cass v. D.C.*, 829 A.2d 480, 482 (D.C. 2003). If the meaning is clear from the face of the statute, courts must give effect to that plain meaning. *BSA 77 P Street LLC v. Hawkins*, 983 A.2d 988, 995 (D.C. 2009).

In the context of a tax statute, the Court of Appeals has noted:

"The settled rule that tax laws are to be strictly construed against the state and in favor of the taxpayer," if the statute in controversy is unclear and ambiguous. 3A SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 66.01 (C. Sands, 4th ed. 1986).

Hospitality Temps Corp. v. District of Columbia, 926 A.2d 131, 138 (DC 2007) (citing *District of Columbia v. Acme Reporting Co.*, 530 A.2d 708, 712 (DC 1987) (internal citations omitted).

D. The Statute

The issue to be decided here is the applicability of the installment sale provision in the D.C. Code. D.C. Code, 2001 ed. § 47-1804.04 governs income from installment sales, and refers taxpayers to IRC § 453. The D.C. Code explains that if the taxpayer reports income “in the same manner and upon the same basis” as the taxpayer does for federal income tax purposes, and if the Commissioner of Internal Revenue (“Commissioner”) accepts that manner and basis for federal income tax purposes, the District of Columbia will tax the taxpayer in the same way that the Internal Revenue Service does.

IRC § 453 governs installment sales. IRC § 453(b) defines an installment sale as a sale of property where at least one payment is made after the close of the taxable year during which the sale occurs.¹¹ IRC § 453(c) clarifies that, when income is realized in such an installment sale, the amount taxed in a taxable year is the proportion which the amount realized in that taxable year bears to the total contract price. IRC § 453(h) discusses the use of the installment method by shareholders in certain liquidations, but does not change the fact that the receipt of the installment obligation, without payments on that obligation, is not a taxable event. Thus, Petitioner Touchstone, whether or not recognized by Respondent OTR as an “S” corporation or a party to an IRC § 338(h)(10) transaction, is entitled to the tax benefits of an installment sale transaction under IRC § 453(b).

¹¹ While IRC § 453(b) contains some exceptions and restrictions for dealer distributions and inventories of personal property, those exceptions do not apply in this case.

The parties agree that no payments were due, and neither Petitioner Touchstone nor its stockholders received any income during the taxable year ending April 21, 2005, on the promissory notes in the aggregate amount of \$21,498,733 issued in payment for the sale of Petitioner Touchstone's stock to SRA. For that reason, Petitioner Touchstone reported no taxable income arising from this transaction to either the IRS or to the District of Columbia. The IRS never made an assessment against Petitioner Touchstone, so it can be inferred that the IRS Commissioner accepted and approved the manner and basis that Petitioner Touchstone used. For that reason, under D.C. Code, 2001 ed. § 47-1804.04, the installment method used by the Petitioner Touchstone on both its federal and District of Columbia tax returns must be given credence. Since it was acceptable to the IRS that the Petitioner Touchstone incurred no tax liability from this transaction in the taxable year in question, it must be acceptable to the District.

Given that there are no disputes as to any material facts, Petitioner Touchstone is entitled to a decision in its favor as a matter of law. D.C. Superior Court Civil Rules 12-I(k) and 56; *Kissi v. Hardesty*, 3 A.3d 1125, 1128 (D.C. 2010).

V. ORDER

Based upon the foregoing findings of fact and conclusions of law, and the entire record in this matter, it is hereby, this 27th day of April, 2011:

ORDERED, that Petitioner Touchstone properly reported no taxable income from the installment sale for the short taxable year ending April 21, 2005, and for that reason, is not liable for any of the proposed tax deficiency, and it is further

ORDERED, that Respondent OTR's January 25, 2010, Notice of Proposed Assessment of Tax Deficiency for the Corporate Franchise Tax D-20 for the tax period of January through April 21, 2005, is hereby **REVERSED**, and it is further

ORDERED, that the appeal rights of any person aggrieved by this Order are stated below.

Beverly Sherman Nash
Administrative Law Judge