Recent Developments in Virginia Taxation

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RECENT DEVELOPMENTS
IN VIRGINIA TAXATION

A discussion of 2010 tax legislation, recent court decisions, Tax Department rulings, and opinions of the Attorney General from July 1, 2009 through September 30, 2010

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I. CORPORATE INCOME TAX

A. Legislation

Conformity. Buried in the budget bills is Virginia’s conformity to the Internal Revenue Code as of January 1, 2010. As originally passed by the General Assembly, there would have been “deconformity” to the provisions of IRC § 199 (domestic production deduction). Thanks to help from Governor McDonnell during the Veto Session, this deduction will be kept at the 6% rate previously in effect in 2009 (i.e., but not increased to the 9% now applicable under the IRC).

B. Court Decisions

1. Virginia Cellular LLC v. Virginia Department of Taxation, 276 Va. 486, 666 S.E.2d 374 (2008). Department of Taxation’s regulations have long required all telephone companies, whether C corps, pass-through entities or otherwise, to pay the minimum tax. Supreme Court of Virginia holds that plain language of the statute applies the minimum tax only to “corporations.” The minimum tax provisions in the statute do not apply to partnerships and other pass-through entities.

C. Rulings of the State Tax Commissioner

1. NOLs. PD 09-108 (July 24, 2009). Affiliated group had filed a consolidated Virginia return for many years. When holding company of the affiliated group moved to Virginia, it was entitled to bring into the Virginia consolidated return the NOLs generated in prior years in its former headquarters state.

2. NOL/SRLY. PD 09-126 (August 7, 2009). SRYL limitation applies to a corporation which has had an ownership change. Therefore, SRYL rules do not apply to a corporation which acquires another corporation. Nor do the SRYL rules apply to the acquired corporation after the date of acquisition.

3. Intercompany Expenses/Factors. PD 09-148 (October 8, 2009). Although intercompany expenses can be included in the sales factor, they are not included when the affiliated entities do not deal with each other at arm’s length. Thus, intercompany services provided at cost do not generate gross receipts for purposes of calculating the sales factor. Observation. Note the effect of this rule on nexus issues when, for example, an out-of-state entity provides services to affiliates in Virginia at cost. In such a case, there are no Virginia sales and, if there is no property or payroll in Virginia, no nexus.
Commissioner also holds that a controlled foreign corporation organized under the laws of the Marshall Islands has no federal taxable income and, therefore, no Virginia taxable income.

4. **Nexus/Factors.** PD 09-121 (August 7, 2009). Construction contractor completed job in 2002 but received final progress billing payment in 2003. It had no property or payroll in Virginia in that year. It did, however, have employees visiting Virginia to solicit more business. Commissioner holds that taxpayer could not be included in Virginia consolidated return. Although all costs of performance that generated the receipt occurred in Virginia, they did not occur during the taxable year. Activities of visiting salesmen were protected under PL 86-282.

5. **Nexus/Technology Services.** PD 10-217 (September 16, 2010). Taxpayer provided a variety of technology services for businesses that provide content for mobile telephones. Commissioner holds that it is not possible to tell if activities of taxpayer are protected by PL 86-272. Nevertheless, the Commissioner holds that there is no nexus with Virginia because the taxpayer has no positive apportionment factors here. Sales would not be deemed to occur in Virginia, even though customers may be here, because the activities giving rise to those sales are all performed by employees based outside Virginia.

6. **Nexus/Investment Pools.** PD 10-163 (August 6, 2010). Manufacturer purchased loans from its retail customers and transferred the loans to bankruptcy remote companies (BRC), retaining servicing on those loans. Applying PD 86-272, the Commissioner holds that the BRCs do not have nexus with Virginia. Commissioner also holds that BRCs may have no nexus with Virginia under the traditional test because they have no property, payroll or sales in Virginia depending on the servicing relationship with the manufacturer. The Commissioner, however, notes that the relationship with the BRCs may be subject to the equivalent of “combined reporting” under Section 58.1-446 depending on the facts and circumstances.

7. **Pharmaceuticals/PL 86-272.** P.D. 08-142 (July 30, 2008). Manufacturer of animal pharmaceuticals held to have nexus in Virginia notwithstanding PL 86-272. Commissioner concludes that activities of district supervisors in filing various administrative reports and overseeing sales activities in state exceeded PL 86-272 (sic!). Commissioner also holds that activities of veterinarian supporting sales staff exceed PL 86-272 because they are directed at instructing veterinarians how to use products safely which is not in support of sales. [Taxpayer disagrees with Commissioner’s characterization of facts]

8. **PL 86-272/Veterinarian.** PD 09-172 (October 23, 2009). On a petition for rehearing, the State Tax Commissioner reverses her earlier determination that company selling veterinarian pharmaceuticals had nexus with
Virginia. Facts presented during the rehearing clearly contradicted assumptions that had been made in earlier determination about the role of veterinarian in sales solicitation versus technical advice made after sales. **Comment:** This a classic example of how taxpayers need to be very careful in developing and presenting facts in the appeal process. Without such careful development, staff will often assume that factual patterns in other taxpayers’ determinations apply to all members of similar industry.

9. **Officer Liability.** PD 10-133 (July 12, 2010). President and sole stockholder had filed corporation’s income tax returns and paid income taxes for many years. She signed the final return but did not make the final payment, alleging that there were insufficient funds upon closing the business to pay secured creditors and the Department. Commissioner holds that she clearly had the duty and obligation to pay the taxes and therefore the burden of proof to establish that funds were not available to make those payments either with the final return or during the previous year by estimates. Taxpayer loses for lack of proof.

10. **Officer Liability.** PD 10-184 (August 16, 2010). Corporation sold its only asset (raw land), paid its known creditors, and distributed the net sales proceeds to its president who is the sole stockholder. This was apparently done on the advice of the accountant that no corporate income taxes would be owed. When the Virginia return was filed, taxes were due, and president/sole stockholder argued that he should not be personally liable for those taxes because his failure to pay them was not intentional. Commissioner holds that reliance on accountant’s advice does not provide reasonable cause for avoiding personal liability for the taxes. The taxpayer’s recourse is against the accountant. Department’s position is that it may convert the taxes so long as the officer had knowledge of the deficiency within the period of limitations for making an assessment against the corporation.

11. **Combined Election.** PD 10-185 (August 16, 2010). Taxpayer was permitted to elect to file on a combined basis in the first full taxable year that two or more members of the affiliated group were subject to Virginia income tax. It appears that the “flow through status” of an LLC subjected parent to Virginia income taxation with its Virginia subsidiary that had previously been subject to Virginia income tax.

12. **Consolidated/Merger of Equals.** PD 10-219 (September 16, 2010). Taxpayer was permitted to elect to file on a consolidated basis, even though it had previously filed combined, because it met the “merger of equals” standards. Under this test, when a merger occurs between two affiliated groups, consolidated filing will be allowed if (1) neither group owned a substantial interest in the other prior to the merger and (2) the total assets or net value of the target group is almost equal to or greater than that of the acquiring group applying a 45% test.
13. **Withholding.** PD 10-173 (August 10, 2010). North Carolina contractor had employees working in Virginia. Because Virginia has no reciprocal agreement with North Carolina, contractor was required to hold Virginia income taxes from the wages of its employees. **Observation.** The ruling notes that Virginia does have reciprocal agreements with Maryland, West Virginia and Pennsylvania.

14. **Withholding/Aggregate Reporting.** PD 10-176 (August 12, 2010). Citing authority to prescribe form of return and to make tax collections more efficient, Commissioner authorizes an entity to provide payroll and tax services on an aggregate basis for an estimated 6,000 homecare patients even though those patients are deemed to be the employers of the service providers.

II. **TAX CREDITS**

A. Legislation

**MBF Credit.** The major business facility job tax credit is expanded by reducing the threshold job requirement to 50 from 100. Virginia Code § 58.1-439.

**Green Jobs.** Section 58.1-439.12:03 is amended to provide a tax credit of $500 a year, for up to five years, for new green jobs paying $50,000 or more annually. The maximum number of credits is with respect to 350 green jobs.

**Film Production.** Another obvious economic development move, § 58.1-439.12:03 is amended to allow a refundable income tax credit equal to 15 - 20% of a film production company’s qualifying expenses. There is also an additional 10% credit allowed for the aggregate payroll for Virginia residents when production costs are $250,000 - $1 million. The credit rises to 20% when production costs exceed $1 million.

B. Rulings of the State Tax Commissioner

1. **Recycle Credits.** PD 10-136 (July 12, 2010); PD 10-227 (September 29, 2010). After reviewing the legislative history of these credits, the Commissioner concludes that the tax credits for machinery and equipment used in the recycling process could not be passed through to individuals from 2004 - 2007. A pass through was permitted beginning in 2008. Rehearing denied.

2. **Kentucky Credit.** PD 10-196 (August 30, 2010). Commissioner allows as a credit against the Virginia individual income tax of a Virginia resident the Kentucky income tax paid by his professional LLC. Although the LLC was required to file a Kentucky return as if it were a corporation, members’ shares of that tax payment were allowed as a credit against their Kentucky income tax.
3. **NC Credit.** PD 10-205 (September 7, 2010). North Carolina resident could not claim credit for income tax paid on Virginia S corp income because North Carolina does not provide a credit in similar circumstances.

4. **Telecommuting.** PD 10-182 (August 16, 2010). Taxpayer telecommuted from his Virginia home to his New York employment. The Commissioner notes that the New York courts permit taxation in such situations under a "convenience of the employer" test. Although New York would not allow a credit for the Virginia taxes, the Commissioner does allow a credit for the New York taxes paid, limited to the lesser of the New York tax or Virginia tax.

III. **PASS THROUGH ENTITIES**

A. **Rulings of the State Tax Commissioner**

1. **Nexus/LLC.** PD 09-103 (July 24, 2009). Even though individuals were not Virginia residents, they are taxable on their shares of income from LLC and S Corp.

2. **LLC.** PD 09-103 (July 24, 2009). Even though individuals were not Virginia residents, they are taxable on their shares of income from LLC and S Corp.

B. **Rulings of the State Tax Commissioner**

1. **Management Fees.** PD 10-135 (July 12, 2010). Two Virginia S corporations paid management fees and royalties to an out-of-state corporation owned by the same stockholders. Commissioner allows the deduction for management fees because the fees paid represented services, charged at cost without profit, that would have had to be purchased from a third party if not provided by the affiliate. The royalty fees paid, however, were subject to the Virginia add-back statute in the absence of any showing that an exception applied.

2. **Distorted Income.** PD 10-116 (July 1, 2010). Taxpayer owned substantial amounts of stock in two S corps, one in Virginia and one outside Virginia. The Commissioner rules that the activities conducted by the out-of-state corporation for its Virginia affiliate were substantial, charged at a reasonable fee, and did not distort income. However, the common shareholder in the two companies spent substantial time working in Virginia which gave the out-of-state corporation nexus in this state and also meant that the shareholder had Virginia source income based on days working here.

3. **Pass Through Income.** PD 10-168 (August 10, 2010). LP liquidated and showed distribution of gains to taxpayers. Department holds that
taxpayers cannot offset the Virginia income with previous years’ NOLs because those NOLs are not reflected in any continuing federal return. The NOLs had already been used to offset income in the taxpayer’s home state. Department continues to hold that nonresident owners are subject to tax on their pass through income notwithstanding circuit court decisions to the contrary.

IV. INDIVIDUAL INCOME TAX

A. Rulings of the State Tax Commissioner

1. **Disability Income.** PD 09-125 (August 7, 2009). Disability income received from the VRS was deductible.

2. **Disability Income.** PD 10-113 (July 1, 2010). To receive the $20,000 subtraction for disability income, an individual (i) must receive disability income and (ii) must be absent from work. Taxpayer had been found to be permanently disabled by the Social Security Administration, but auditor asserted that she was gainfully employed. Commissioner holds that taxpayer’s activities in obtaining a few antiques for sale in a stall at an established store, with the store doing the selling, does not reflect gainful employment.

3. **Disability Income.** PD 10-128 (July 7, 2010). Taxpayer was not entitled to the disability deduction because he was employed in the retail food industry earning an amount in excess of what would be earned by someone working full-time at minimum wage.

4. **Disability Income.** PD 10-139 (July 14, 2010). Taxpayer not eligible for the disability income deduction with respect to “sick pay” reported by an employer on a W-2 form as wages.

5. **Disability Income.** PD 10-153 (July 28, 2010). Husband received disability income as surviving payee under his deceased wife’s disability insurance policy. Husband was not entitled to deduction because he was not disabled.

6. **Combat Pay.** PD 09-105 (July 24, 2009). The deduction for combat pay is allowed only to the extent included in federal adjusted gross income. Thus, the deduction for income not so included in FAGI was not permitted, nor was the portion of combat pay earned while actually in Virginia.

7. **Combat Pay.** PD 09-124 (August 7, 2009). The Virginia deduction for combat pay applies only to the extent that the compensation is included in federal adjusted gross income. Because enlisted personnel can exclude all combat pay from FAGI, there will be no deduction from Virginia taxable income.
income. In this case, an officer was not able to deduct all of the combat pay from his F AGI so the excess was deductible for Virginia tax purposes.

8. **Pa. Retirement.** PD 10-214 (September 15, 2010). Taxpayer’s deferred compensation distributed from a qualified Pennsylvania retirement plan was held available for the statutory subtraction “to the extent the contributions … were subject to taxation …” in Pennsylvania. Even though the contributions were fully taxable in Pennsylvania, the Commissioner holds that the earnings on those contributions were not so taxed. Accordingly, the Commissioner requires the taxpayer to pay Virginia tax on a pro rata amount: taxable contributions as a numerator and total distribution as a denominator.

9. **Sale of Residence.** PD 09-110 (July 16, 2009). Taxpayer sold their homes in both Virginia and another state. The gain on both sales qualified for exclusion under IRC § 121. Commissioner agrees and allows taxpayer to elect to exclude the Virginia gain from taxable income.

10. **Depreciation.** PD 09-104 (July 24, 2009). Taxpayers expensed certain business equipment and claimed an additional 30% depreciation allowance on their Virginia returns. Disallowed.

11. **Virginia Residents.** The following rulings all deal with who is a domiciliary or resident of Virginia: PD 09-111 (July 16, 2009); PD 09-107 (July 24, 2009); PD 09-123 (August 7, 2009); PD 09-128 (September 8, 2009); PD 09-129 (September 8, 2009); PD 09-130 (September 8, 2009); PD 09-131 (September 8, 2009); PD 09-132 (September 8, 2009); PD 09-133 (September 8, 2009); PD 09-143 (September 29, 2009); PD 09-144 (September 29, 2009); PD 09-173 (October 23, 2009); PD 10-7 (January 13, 2010); PD 10-107 (June 22, 2010); PD 10-108 (June 22, 2010); PD 10-111 (June 25, 2010); PD 10-112 (July 1, 2010); PD 10-114 (July 1, 2010); PD 10-123 (July 7, 2010); PD 10-134 (July 12, 2010); PD 10-148 (July 26, 2010); PD 10-149 (July 26, 2010); PD 10-155 (July 28, 2010); PD 10-169 (August 10, 2010); PD 10-170 (August 10, 2010); PD 10-172 (August 10, 2010); PD 10-180 (August 16, 2010); PD 10-181 (August 16, 2010); PD 10-203 (September 1, 2010); PD 10-206 (September 7, 2010); PD 10-221 (September 17, 2010).

12. **Working in Virginia.** PD 10-148 (July 26, 2010). Although the Commissioner holds that the taxpayer is not a Virginia resident, during the information exchange process taxpayer revealed that he had spent time in Virginia working on behalf of his employer. Commissioner requires taxpayer to file an amended Virginia return reporting a portion of his salary as Virginia source income. Ruling indicates a ratio of days worked in Virginia as a numerator and 260 days as a denominator.

13. **Indian Reservation.** PD 10-158 (July 30, 2010), PD 10-157 (July 30, 2010), PD 10-156 (July 30, 2010). The Commonwealth’s policy is not to
tax income earned by an Indian who resides on a reservation if the income derives from pursuits on that reservation. Even though interest, dividends and a pension were collected by an Indian living on a reservation, those items of income do not derive from pursuits on the reservation unless the payor is located on the reservation or the employment that led to the pension occurred on the reservation.

14. Conformity. PD 09-122 (August 7, 2009). Commissioner confirms that auditor had authority to “go behind” federal returns and question whether taxpayers’ activities were engaged in for a profit. After examining the facts, however, the Commissioner concluded that taxpayers were engaged in a start up real estate businesses and that losses were deductible.

15. Federal Return Challenged. PD 10-127 (July 7, 2010). Taxpayer’s claim of ordinary and necessary business expenses denied for home IT business. Taxpayer did not show a profit but, more importantly, deductions were claimed for landscaping, personal recreational equipment, consumer electronics and designer clothing.

16. Federal Return Challenged. PD 10-126 (July 7, 2010). Taxpayer’s activities were held to be engaged in for profit because she worked in a businesslike manner, had the necessary expertise, spent substantial time and effort in the activity and was not engaged in the activity for recreational purposes. Expenses incurred for renovations to taxpayer’s home, however, were not allowed as a business expense even though customers were seen at the home.

17. Federal Return Challenged. PD 10-209 (September 9, 2010). The Department challenges the losses claimed with respect to yet another horse farm. Commissioner concludes that taxpayer proved that horse farm was engaged in with an intent to make a profit.

18. Federal Return Challenged. PD 10-207 (September 7, 2010). Commissioner holds that taxpayer met its burden of proving that horse farm was operated for the purpose of making a profit notwithstanding series of losses.

19. Service Member Deductions. PD 10-171 (August 10, 2010). Commissioner holds that deductions for dependent exemptions are deemed to be allocated as the taxpayers’ indicate on their income tax returns. Itemized deductions, however, must be apportioned based on relative incomes unless the taxpayers can establish evidence of which spouse incurred the expense.

20. Domicile/Military. PD 10-220 (September 16, 2010). Under the Service Members Civil Relief Act, a service member and spouse do not change their domicile simply by moving to Virginia to comply with military orders. But they must maintain their domicile in another state, and both
the service member and spouse must have the same state as domicile. Because of conflicts between records, it appeared that spouse and service member claimed different states as domicile. Commissioner resolves case in service member’s favor.

21. Statute of Limitations/Double Tax. PD 09-112 (July 16, 2009). IRS recharacterized payments as capital gain and dividends instead of compensation. State of taxpayers’ former residence disputed that classification. Taxpayer settled the issue and then claimed a credit against his Virginia tax because he had been taxed by both Virginia and the state of his former residence. The Commissioner allows the credit based on the “intent” of Virginia Code § 58.1-332. Furthermore, Commissioner, applying conformity, classifies the income the same way as the IRS, thereby permitting the credit.

22. Statute of Limitations. PD 10-110 (June 22, 2010). Taxpayer did not notify the Department of federal changes within one year. Accordingly, Department assessed tax for one year based on the federal changes, but did not allow an offset for the refund attributable to the second year in the federal audit. Taxpayer’s claim for an adjustment based on equitable recoupment denied. Comment. Be very careful when federal audit adjustments produce “timing changes” which deny deductions in one year and defer them to subsequent years or accelerate income.

23. NOL/SOL. PD 10-183 (August 16, 2010). IRS took seven years to allow the taxpayers’ NOL, and Virginia auditor disallowed the state refund saying that the statute of limitations had expired. Commissioner holds that the initial amended return was timely filed and that the refund should be allowed notwithstanding the delayed action by the IRS.

24. Healthcare Insurance/SOL. PD 10-175 (August 11, 2010). Although Department of Taxation’s interpretation of the deduction for long term health care insurance premiums changed, that does not extend the statute of limitations for filing amended returns.

25. SOL. PD 10-204 (September 2, 2010). After failing to file a Virginia return, taxpayer was assessed by the Department. Taxpayer then corresponded some years later providing income information by fax. Commissioner holds that three year statute of limitation bars refund. Taxpayer had not proved a “financial disability” under IRC § 6511(h) even if Virginia had that procedure.

26. Burden of Proof. PD 09-151 (October 8, 2009). Department made “statutory assessments” against non-filers who then filed Virginia income tax returns. Although taxpayers were unable to provide documentation supporting those returns, the late filed returns did match up with information on the federal returns and were accepted.
27. **Burden of Proof.** PD 10-218 (September 16, 2010). Taxpayer successfully established it is entitled to a deduction for interest on federal obligations. Instruments of the Federal Home Loan Bank were eligible for subtraction.

28. **Tax Fraud.** PD 09-163 (October 16, 2009). Taxpayer claimed she had no taxable income because she was not working during the years in issue. Commissioner’s review of records of her personal accounts and corporation for which she served as president showed transfers of funds from corporation to personal accounts at a time when she was serving as an officer. Tax, penalty and interest upheld.

29. **Fraud.** PD 09-164 (October 16, 2009). Taxpayer has a history of not filing Virginia income tax returns. 100% fraud penalty will be applied unless taxpayer pays statutory assessment promptly.

30. **Recycling Credit.** PD 09-174 (October 23, 2009). Credit for equipment used to process recyclable materials was not available to individual for the 2005 taxable year.

31. **Collections Nightmare.** PD 10-164 (August 6, 2010). This ruling provides a good illustration of why one never wants to be involved with the “collections process” in Virginia. Taxes for unfiled returns were collected by the IRS and sent to Virginia; when returns were filed, assessments were abated, but computer returned the payments to the IRS which repaid the taxpayers. Taxpayers were then assessed for the taxes that were erroneously refunded, with additional interest. Commissioner rules that an erroneous refund is an underpayment which can be assessed and collected.

32. **VEST Account.** PD 10-191 (August 26, 2010). Parents who establish Virginia Savings Trust accounts for their three children, but as UTMA accounts were not entitled to the income tax deduction for their contributions. Eligibility for the deduction requires that the parent be listed at the owner of the account, not a custodian.

V. RETAIL SALES & USE TAXES

A. Legislation

**Dealer Discount & Accelerated Payments.** Also buried in the budget bills are provisions reducing the dealer discount paid to those who collect and remit sales and use taxes. This will be effective for the June, 2010 tax return. In the same budget balancing vein, dealers are required to accelerate July tax payments (collections in June).
**Computer Data Centers.** As an obvious economic development tool, Virginia Code § 58.1-609.3(18) is amended to provide a sales and use tax exemption for “computer equipment or enabling software purchased or leased for the processing, storage, retrieval or communication of data … in a data center.” Legislation specifies certain criteria for any such new facility including at least $150 million investment and creation of 50 new jobs.

**Kitchen Counters.** The “contractor’s use tax” provided by § 58.1-610 is amended to add to the list of businesses who are treated as retailers and not contractors those who install “countertops.” This is an obvious rebuff to multiple rulings of the Commissioner holding that retailers of kitchen counters were not deemed to be in a similar business to retailers of kitchen cabinets and kitchen equipment.

### B. Rulings of the State Tax Commissioner

#### Taxable Transactions & Measure

1. **Affiliated Sales.** PD 10-124 (July 7, 2010). Affiliate A purchased property for Affiliate B, paid the sales tax to vendors, and handled the intercompany payments by accounting entries. The Commissioner confirms that the transfer of the property from A to B is a potentially taxable event, but further rules that the purchase by A should be exempt as a purchase for resale.

2. **Sale.** PD 10-151 (July 28, 2010). When owner transferred equipment to new company in exchange for reduction in loans, that constituted a taxable sale.

3. **Resale/Operational.** PD 09-135 (September 8, 2009). Purchase for exempt resale to government was allowed even though contract denoted that taxpayer had some operational function with regard to the system being sold. The true object of the transaction was for the sale and maintenance of tangible personal property, with the minimal operational role being of secondary importance.

4. **Basketball Courts.** PD 10-223 (September 22, 2010). The rental of basketball courts and other sports facilities does not constitute the sale of tangible personal property and is not taxable.

5. **Countertop Maker.** PD 09-102 (July 24, 2009). Persons who make and install countertops are real property contractors. They may not purchase materials exempt for resale. The fact that taxpayer’s customers charged and remitted tax erroneously on their sales to customers does not absolve the taxpayer from its responsibility to pay tax on its purchases.

6. **Fencing Contractor.** PD 09-157 (October 16, 2009). Fencing contractor held not to be a retailer because it had no inventory of goods for sale. Its warehouse contained only construction materials for future jobs and left...
over materials. **Observation.** Although Commissioner reaches the right result on the no inventory basis, she reads out of the traditional regulation and analysis the requirement of a “showroom,” saying that any place of business will qualify.

7. **Subcontractors.** PD 10-125 (July 7, 2010). Based on Department’s new policy, landscaping subcontractor involved in site preparation was deemed to be the user and consumer of plant materials. Subcontractor which provided only labor to pump and place concrete, but not sell the concrete, was not taxable on the concrete. Walk-in refrigeration system for a military PX held to be tangible personal property in the absence of proof that it was intended to be permanently affixed to the real estate.

8. **Floor Covering/Contractor.** PD 10-141 (July 23, 2010). Company selling floor coverings, basketball goals, and fencing held to be a using and consuming contractor. It had no retail or wholesale place of business and no inventory to cause it to be taxable as a retailer under this statutory exception.

9. **Drilling/Contractor.** PD 10-122 (July 7, 2010). General contractor cannot use a customer exemption certificate when providing construction services related to gas wells. The contractor must apply to the Department for the exemption for items used directly in drilling and mining.

10. **Real Estate Contractor/AV.** PD 09-117 (July 31, 2009). Audio visual equipment systems installed in buildings are not part of the real estate. They do not serve a building function. They can be easily removed and moved. Accordingly, the sale of these items is a retail sale subject to taxation. Wiring that is installed in ceilings or behind the wall is generally treated by the Department as an installation material, taxable to the installing retailer.

11. **Fabricator/Retailer.** PD 09-142 (September 29, 2009). Taxpayer principally fabricated for its own use in real estate construction contracts. Materials in such contracts are taxable at cost price. When taxpayer sells at retail, however, it is taxable based on the sales price not the cost price.

12. **Use Tax.** PD 09-154 (October 16, 2009). Subcontractor held to be retailer of “floating floors” and should have charged sales tax. General contractor was liable for paying use tax.

13. **Software & Servers.** PD 09-169 (October 23, 2009). Company located outside Virginia shipped to customers in Virginia servers loaded with canned software. Commissioner rules that taxability depends on nature of company’s business. If a service provider, company is the taxable user and consumer of the software and servers and must pay tax to Virginia, less a credit for any tax paid out of state. On the other hand, if the company is selling or leasing tangible personal property, the presence of
that property, owned by the company, in Virginia gives it nexus and requires it to collect and remit Virginia sales and use tax. Because the equipment is leased and delivered in Virginia, no credit would be allowed for any tax paid out of state.

14. Demurrage Charges. PD 10-11 (February 4, 2010). Charges for intermodal containers used on ships, railroads, trucks, etc. are part of the charge for the transportation service and are not subject to sales and use taxation.

15. CO2/Fountain Drinks. PD 10-190 (August 26, 2010). Company sold carbon dioxide which was used by customers to carbonate fountain drinks. As long as invoices separately state charges, taxpayer can take resale exemption certificate for Co2 and not charge tax on transportation. Charges for the use of the tanks, however are taxable.

16. Core Charges. PD 10-189 (August 26, 2010). As an example, when a customer buys a new battery for $40, he also pays $8 as a “core charge” representing the battery that is being replaced. Core charges are taxable. When the “core item” is returned for a credit, the customer is entitled to a refund of both the core charge and the applicable sales tax.

17. Chinese To Go. PD 10-9 (January 19, 2010). Take out delivery service offered contracts to vendors requiring the vendor to remit tax based on a lump sum sales price of the food delivered to customers. Commissioner rules that the delivery service is making purchases for resale and is responsible for collecting and remitting the tax.

18. Retail Sale. PD 10-195 (August 30, 2010). Taxpayer selling food product to Virginia customers through distributors also had transactions with large retailers, taking back accounts receivable in payment. Taxpayer is told that these transactions are not an “administrative convenience” and that it must take a resale exemption certificate from the retailers or collect the tax from them.

19. No Virginia Use. PD 10-202 (September 1, 2010). Paint cards shipped from a third party vendor to Virginia retailers were not subject to tax because paint manufacturer made no use of those cards in Virginia.

20. Delivery Charges. PD 09-113 (July 16, 2009). Manufacturer of roof trusses was allowed to prove a reasonable delivery charge that was not separately stated on invoices. Note: The Commissioner will sometimes do this as a one-time leniency in a first audit. Taxpayer was also permitted to claim a refund directly from the Department for sales taxes mistakenly paid to vendors. The Department generally requires these claims to be made against the vendor notwithstanding the fact that taxpayers can seek these refunds directly from the state in litigation.
Finally, no adjustment was allowed in the interest calculation since the delay in the audit was caused by the taxpayer’s accountant.

21. **Constructive Delivery.** PD 10-161 (August 6, 2010). Tax was assessed on items shipped by vendors directly to the taxpayer’s franchisee outside Virginia. An auditor took the position that there was a constructive delivery within Virginia. Recognizing the cases it lost in *Hennage Creative Printers* and *Bloomingdale’s*, the Commissioner agrees that there was no taxable event until the goods in question were physically delivered to recipients outside Virginia.

22. **Freight In.** PD 09-119 (August 7, 2009). Freight in charges are part of the cost of goods sold and, when included in the charge to customers, can be purchased for resale. They are not subject to tax.

23. **Membership Fees.** PD 09-167 (October 23, 2009). Payment of membership fees automatically entitled members to receive discounts on various financial, personal and health care services, in addition to cash rebates on purchases. These benefits were automatic. Membership did not entitle members to receive any tangible personal property. Membership fees were not taxable.

24. **Savings Club Fees.** PD 09-168 (October 23, 2009). Membership in a prescription savings club entitled customers to discounts at drugstore. Membership in the club, however, did not entitle members to receive any tangible personal property. Membership fees are not taxable.

25. **Reward Programs.** PD 10-140 (July 15, 2010). The Commissioner rules that customer "reward programs" as follows do not require the collection of additional sales tax: (i) free item provided based on purchase of other items; (ii) dollar reduction on purchases based on amount of previous purchases; (iii) redemption of “points” earned based on previous purchases; (iv) nominal consideration paid for additional goods (nominal consideration is taxable). When third party consideration is provided, such as a manufacturer’s coupon, the value of that coupon is taxable.

26. **Loyalty/Three Strikes And ...** PD 10-212 (September 15, 2010). Notwithstanding having lost in its appeal and lost again in a petition for reconsideration, the taxpayer finally wins. Commissioner holds that taxpayer has proved that its “loyalty program” provided discounts on purchases and not free merchandise. Accordingly, the loyalty program fees were not taxable. **Observation.** When you know you are right, persistence pays, and this ruling proves that the Department will listen. It also proves that there is no substitute, in the first instance, for presenting the case carefully and thoroughly.
27. **Federal Taxes/Sales Price.** PD 09-161 (October 16, 2009). Taxable sales price properly includes federal storage taxes as those were simply part of the cost of taxable fuels sold by the taxpayer.

28. **Separately Stated Services.** PD 09-165 (October 23, 2009). Services by an interior designer rendered when there is no sale of tangible personal property are not subject to tax. On the other hand, placement fees and other services, even if separately stated, are taxable when provided “in connection with” the sale of tangible personal property. **Query:** Does the same result apply if the interior designer has a published fee schedule showing an hourly rate for services which is clearly negotiated separately from the sale of tangible personal property?

29. **Orthophotograph.** PD 10-178 (August 16, 2010). Orthography is a type of photogrammetric service utilizing aerial photographs. It is a professional service. Transfer of those services in the form of a CD is not taxable personal property.

30. **Children's Parties.** PD 10-167 (August 10, 2010). Commissioner holds that charge made by a nonprofit museum for children’s parties was a charge for a service and not the sale of tangible personal property. Purchasers were given the use of a party room, balloons, decorated tables, goody bags, etc. The Commissioner, however, holds that the true object of the transaction was the “birthday party experience at the museum.”

31. **Pet Recovery.** PD 10-210 (September 13, 2010). Taxpayer provides a service which enables owners to recover lost pets through database maintained by taxpayer, microchips implanted by veterinarians, and scanners which can read those chips. Sales of microchips, scanners, etc. to veterinarians are taxable. Fees for the pet recovery service are not taxable.

32. **Separately Stated Services.** PD 10-208 (September 9, 2010). Taxpayer’s business was providing services in connection with tradeshow exhibits which, pursuant to directions from its customers, it would ship to tradeshow locations, set up, decorate, etc. Commissioner holds that when these services are provided in connection with the sale of the tradeshow exhibits, they are taxable. When they are provided without the sale of the exhibit, however, they are nontaxable services.

33. **Education.** PD 10-162 (August 6, 2010). Company providing at-home course instruction by computer was engaged in a service business. Accordingly, computers used by students to access tutorial services were used and consumed by the teaching company and taxable to them.

34. **Service Charge/Gratuity.** PD 10-200 (August 31, 2010). Service charges made in connection with the “set up” of catered events were not “mandatory gratuities” exempt from taxation. Commissioner also appears to hold that tax exempt charities must pay sales tax on room
accommodations. The opinion does not explain why room accommodations and meals are taxable but equipment rentals are not.

35. **Agency/Government Contracts.** PD 10-137 (July 12, 2010). This 13-page ruling provides an exhaustive analysis of what is required for a contractor, whether with respect to real estate or otherwise, to purchase tangible personal property exempt as the agent of a governmental entity. The basic rule is that the purchasing agent must be designated as such by the contract and have the authority to bind the credit of the governmental entity. The contracts, purchase orders, etc. must all be carefully done to be consistent with this relationship.

36. **Hotel Cancellations.** PD 10-3 (January 13, 2010). Cancellation fees charged in connection with hotel rooms are not taxable because there was never any sale of the hotel room “in connection with” the fee that is paid.

37. **Satellite TV.** PD 09-155 (October 16, 2009). Taxpayer providing cable television service to multiple dwelling units was not eligible for the sales and use tax exemption for broadcasting equipment. That exemption is available only for wire or land-based systems. Taxpayer used satellite system.

38. **Withdrawals from Inventory/Orthopedic Implants.** PD 10-138 (July 13, 2010). Although withdrawals from inventory for use are generally taxable, there is a statutory exception when the withdrawn goods are donated to a § 501(c)(3) organization or to the Commonwealth.

39. **Communications Sales Tax.** PD 10-150 (July 28, 2010). Taxpayer argued that enactment of the Virginia Communications Sales and Use Tax should affect how the Department analyzes sales and use taxes on equipment used in providing communication services to customers. Commissioner holds that the two sales taxes are separate and distinct. Commissioner further holds that under the “true object” test, the equipment utilized to provide the communications service is used and consumed by the service provider.

40. **CSUT Prepaid Cards.** PD 10-192 (August 26, 2010). A monthly plan that allows unlimited voice calling and text messaging does not meet the definition of a “prepaid calling service” and is generally subject to the Communications Sales and Use tax. When these services are paid for by prepaid calling cards, the sale of the cards is subject to the regular sales and use tax but not the CSUT.

41. **Rentals.** PD 10-187 (August 25, 2010). Tennessee law apparently imposes sales tax on all rental payments made during the entire lease term if possession of the property is taken in Tennessee. The Commissioner does not tax such transactions, but does require Virginia sales tax when subsequent lease extensions, etc. occur and the property is in Virginia at the time of those contracts.
Exemptions: Industrial

42. Manufacturing/Strapping. PD 10-145 (July 26, 2010). Strapping used to bundle wood products for shipment to customers does not constitute materials used to place goods in a package for shipment. Rather, the strapping is used to brace or secure the cargo and protect and is therefore taxable.

43. Maintenance Agreements/Manufacturing. PD 10-131 (July 12, 2010). Maintenance contract for exempt production equipment was exempt even though taxpayer did not have valid exemption certificate at the time of the purchase.

44. Tire Retreading. PD 09-159 (October 16, 2009). Sales of equipment to tire retreading companies were exempt even if those companies were not primarily engaged in such processing activities. Sales to trucking companies, however, who performed their own retreading were not exempt. They were trucking companies, not industrial processors.

45. Special Purpose Building Structure/Direct Use. PD 10-105 (June 18, 2010). This ruling provides a detailed analysis of when special modifications to an existing building can and cannot be made using the directly used in manufacturing exemption. Special purpose flooring necessary to support production machinery, eliminate vibrations, etc. was indirectly used and taxable. An HVAC system necessary to provide constant temperature and humidity for clean room was held to be exempt provided that a preponderance of the use was in manufacturing. The tax on duct work, however, was prorated, as was the high capacity natural gas line. Special purpose lighting that facilitated inspections was taxable. Electrical components used primarily to support production equipment were exempt, but wiring and conduit was taxable unless used to support production equipment, with proration being required when used for both exempt and nonexempt purposes. Pneumatic infrastructure was exempt because necessary to protect the integrity of the product. A freezer room used to store raw materials was also exempt. Observation. The Department of Taxation has come a long ways since its originally narrow views in Webser Brick and Wellmore Coal.

46. Manufacturing/Direct Use. PD 10-159 (August 3, 2010). Lengthy ruling reviews a number of issues that hold against the taxpayer on well established grounds, e.g., platforms, piping, conduits and other items that are not an immediate part of production or that are used in distribution activities. Other items for which taxpayer makes a substantial case lacks supporting proof which the taxpayer was given additional time to provide.

47. Manufacturing/Direct Use. PD 09-170 (October 23, 2009). Torque wrenches used to install items of production equipment as part of the daily set up process, and also used in the repair of equipment, are not used
directly in manufacturing because they are not used during the production process.

48. **Tools to Make Tools.** PD 10-225 (September 22, 2010). Machines and tools that are used by a manufacturing business to make production line equipment are exempt. This exemption, however, does not apply to real estate contractors renting similar tools to make a manufacturer's tools.

49. **Direct Use/Heat Recovery.** PD 09-134 (September 8, 2009). System used to recover heat from waste water was held to be used directly in laundering textile products. Recovered heat was used to preheat processed water.

50. **R&D.** PD 09-136 (September 8, 2009). Company that obtained and tested new technology for the government held not entitled to the R&D exemption because actual product development work was done by others. Charges by subcontractors for modifying prewritten software held exempt.

51. **R&D.** PD 10-144 (July 26, 2010). Taxpayer analyzed an optical image scanner’s technology to assist in developing its own product. Because this was the exclusive use of the scanner, it was held to be used for research and development purposes.

52. **Fabrication.** PD 10-146 (July 26, 2010). When taxpayer electrostatically powder coats products, that is taxable fabrication.

53. **Cardboard Liners.** PD 10-160 (August 6, 2010). Cardboard roof protectors were provided to customers, without additional charge, to protect their motor vehicles from damage while transporting purchased items. Citing the regulation on “packaging materials”, Commissioner holds that roof protectors are taxable transportation materials and not “packaging materials” within the meaning of Webster Brick. **Query.** It is true that cardboard liners would not qualify for the manufacturer’s “packaging exemption,” but why does the resale exemption not apply? For example, 23 VAC 10-210-930 treats “paper doilies, placemats, plastic silverware, bags and similar items furnished with meals to be part of the meal which is resold to the customer. How does a cardboard liner differ?

### Exemptions: General

54. **Occasional Sale.** PD 09-166 (October 23, 2009). Purchase of all the assets of an asphalt company held to qualify as an occasional sale. Approximately 80% of the total assets shown on the seller’s federal income tax return were sold, and items that were not sold were used by the seller in establishing a “substantially dissimilar business.”

55. **Occasional Sale.** PD 09-186 (December 18, 2009). Company liquidated all of its assets as part of a court supervised bankruptcy plan, selling all of
its assets to five separate entities in a period of five months. Commissioner holds that transactions qualify for occasional sale exemption.

56. **Occasional Sale.** PD 10-120 (July 1, 2010). A tax free reorganization pursuant to IRC § 368(a)(1)(C) qualifies as an occasional sale. Without regard to how the transaction is treated for federal tax purposes, the transfer of assets to a subsidiary in exchange for stock represents a reorganization to which the occasional sale exemption applies.

57. **Occasional Sale.** PD 10-197 (August 30, 2010). Corporation engaged in the business of developing hotel properties did so through a wholly owned LLC which then sold its assets to the taxpayer. Commissioner confirms that the LLC is a separate legal entity so that facts related to the parents' business are irrelevant. Commissioner holds that there were not sufficient facts developed in the audit to determine if the occasional sales exemption applies to the sale of assets by the LLC. **Comment.** Why did the taxpayer not simply transfer all ownership interest in the LLC?

58. **Data Center.** PD 10-121 (June 29, 2010). Ruling analyzes the application of the exemption provided by Virginia Code § 58.1-609.3 to computer data centers. Requires 50 new jobs, $15 million investment and MOD with VEDP. **Observation.** Ruling is a good example of how a major new business in Virginia should coordinate activities between VEDP and Virginia Department of Taxation to make sure that tax benefits achieved are consistent with what was anticipated.

59. **Greenhouse.** PD 09-153 (October 16, 2009). Agriculture exemption is available to greenhouses, but does not apply to equipment used to size logs used to fuel greenhouse heating system. That equipment is not used in agricultural production for market.

60. **Forest Products.** PD 10-152 (July 28, 2010). Company engaged in the business of woodland renovation land clearing was not entitled to a direct use exemption for its equipment, supplies, etc. The agricultural exemption does not apply. The exemption for "harvesting of forest products for sale" does not apply because the taxpayer is not engaged in that activity.

61. **Agency/Church Construction.** PD 10-4 (January 13, 2010). Although a church can purchase construction materials exempt if the installation is done by its own staff or members, it cannot establish an agency relationship with a contractor to do so. This is a different rule than for government contracts.

62. **Churches.** PD 09-150 (October 8, 2009). Taxpayer that provided "interior sanctuary finishes that enhance the worship experience" was not entitled to claim exemption because these were all part of real estate construction.
63. **Birth Control.** PD 09-127 (August 24, 2009), PD 09-185 (December 11, 2009). Two forms of birth control were held to be exempt drugs since they were classified as such by the FDA. These drugs can also be sold exempt to licensed physicians, hospitals and clinics.

64. **Controlled Drugs.** PD 10-118 (July 1, 2010). To qualify for the exemption for controlled drugs purchased by a physician for use in his practice, the taxpayer must have documentation showing the name of a licensed physician on the invoice or otherwise linking the purchase of controlled drugs to a licensed physician of the corporation or other entity making the purchase.

65. **Dentists.** PD 10-179 (August 16, 2010). Crowns, caps, alloys, etc. are classified by the FDA as medical devices rather than prescription or nonprescription drugs. Thus, they do not qualify for exemption as a drug or medicine even if, for example, some of the dental implants contain drugs. Some of these devices, however, may qualify as durable medical equipment.

66. **Medical Nutrition Products.** PD 09-171 (October 23, 2009). Nutritional supplements provided on doctors’ prescriptions for specific prison inmates do not qualify as being used in the treatment of dialysis patients, but do qualify for the exemption applicable to medicines or drugs. To the extent that the medicine and drug exemption does not apply, however, the Department will tax these items at a reduced sales tax rate applicable to “food for home consumption.” It was appropriate for the taxpayer, which operated managed health care services at correctional facilities, to pay the sales tax on these items to its vendors because it was a service provider.

67. **DME/Sinus Catheters.** PD 10-226 (September 22, 2010). Catheters and related instruments used by doctors on a one time basis to clean patients’ sinuses qualify for the “durable medical equipment” exemption if the doctor can prove that they are purchased for specific individuals. This proof will require a signed statement from each physician certifying that the system is purchased on behalf of a specific patient.

68. **DME/Mastectomy Bra.** PD 10-216 (September 16, 2010). A mastectomy bra does not qualify as durable medical equipment as it is not necessary to the proper functioning of the breast prosthesis.

69. **Government Cards.** PD 10-2 (January 13, 2010). Vendors who accept government credit cards must retain the full credit card number in order to establish the exempt status of the sale. If numbers are blacked out, even for security reasons, the dealer’s records will not be sufficient.

70. **State Department.** PD 09-179 (November 19, 2009). Department of Taxation will recognize tax exemption cards issued to eligible foreign missions by the State Department even though required information is
contained on the back of those cards instead of the "face of the cards" as required by the regulation. **Comment:** Only a federal bureaucrat would have anticipated that Virginia would reject a card because the information was on the back and not the front.

71. **School Yearbooks.** PD 10-1 (January 13, 2010). Virginia schools, both public and private, are permitted to buy school yearbooks exempt from tax, the public schools as governmental entities and the private schools if they have their exemptions issued by the Department of Taxation. Under the facts described, the Department will recognize that sales made by a third party, as agent for the schools, are exempt to the same extent that they would be exempt if made by the schools. Thus, the public schools will have the exemption for these sales, but the private schools will not.

72. **Internet Services.** PD 10-12 (February 9, 2010). Parent corporation was given the benefit of the exemption for internet service providers even though certain of the services in question were provided through a subsidiary. This was "because of the closely integrated commercial purpose of the parent's group of affiliated corporations."

**Audits & Procedure**

73. **Sample.** PD 09-141 (September 29, 2009). On reconsideration, Commissioner agreed to reopen audit when taxpayer showed that the sampling procedure reflected more taxable purchases than were claimed as exempt on sales tax returns.

74. **Sample.** PD 10-165 (August 10, 2010). Taxpayer's challenges to use of a sample audit rejected. Taxpayer's offer to do a detailed audit of 75 customers rejected. If there were to be a detailed audit, and neither the Department nor the taxpayer has the resources to do one, it would require an audit of all transactions, not part of the taxpayer's transactions.

75. **Communication Tax/Exemption Certificates.** PD 09-178 (November 19, 2009). Purchases of telecommunication services by cities and other state entities are exempt from the communications sales and use tax. Upon presentation of a proper exemption certificate, communications service providers should have exempted all of the local governments accounts.

76. **CSUT Payments to Localities.** PD 10-193 (August 27, 2010). Locality that did not correctly report its franchise revenues was permitted to submit corrected data and thereby receive adjusted payments in future distributions from the Communications Sales and Use Tax trust fund.

77. **Exemption Certificate/Detailed Audit.** PD 09-118 (July 31, 2009). Taxpayer not permitted to rely on public utility exemption certificates when utilities lost those exemptions by legislation. Taxpayer presumed to know the law even though utilities had legal obligation to advise it of
repeal of certificates. Taxpayer’s detailed audit rejected because it would be burdensome for the Department to have to confirm the details.

78. Exemption Certificates. PD 09-120 (August 7, 2009). Although not expected to police transactions, taxpayers are expected to exercise reasonable care in confirming that exemption certificates are reasonably complete and reasonably cover the types of property being sold. Taxpayer’s acceptance of exemption certificates in this case was upheld.

79. Exemption Certificates. PD 10-147 (July 26, 2010). Resale exemption certificates that were complete and proper on their face, and taken at the time of the purchase, will be honored.

80. Exemption Certificates. PD 10-201 (August 31, 2010). Exemption certificates obtained from customers after the transactions in question will be subject to “greater scrutiny.” In essence, if there is a theory on which the Department can conclude that the sale could have been taxable to the customer, it will be taxable to the vendor who did not take an exemption certificate at the time of the sale transaction.

81. Hand Delivered Appeals. PD 09-182 (December 11, 2009). Appeal was filed by hand one day late. Note that if the letter had been mailed the day it was dated, that should have been timely.

82. Oral Advice. PD 10-177 (August 16, 2010). Real estate contractor sought advice from the Department as to the sales and use taxability of a granite countertop. Consistent with the Department’s then position, it was told that such countertops are taxable to the vendor. Commissioner, however, notes that this is true only if the vendor installed the countertop which was not case in audit. Since the advice given was not in writing, the Commissioner gives it no credence.

83. Statute of Limitations. PD 09-160 (October 16, 2009), PD 09-183 (December 11, 2009), PD 10-5 (January 13, 2010. Appeal not filed within ninety days of the date of assessment is barred by statute of limitations.

84. Corporate Officers/Conversion. PD 09-116 (July 31, 2009). Citing Angelson v. Commonwealth, 25 Va. Cir. 319 (City of Richmond 1991), Commissioner acknowledges four tests that must be met before a person can be held responsible for unpaid corporate taxes: (1) willful failure to pay, collect or truthfully account for state tax; (2) officer or employee with a duty to perform the act; (3) actual knowledge of the failure; and (4) authority to prevent the failure. President and Secretary did not meet three of these four tests until VP and Store Manager was fired.

85. Officer Liability. PD 09-149 (October 8, 2009). Unpaid taxes were properly converted to the VP, Secretary and Treasurer of the corporation even though her husband, in the divorce, was liable for all debts.
Commissioner noted that wife was active in the company's business affairs and did have company records showing taxes were unpaid. **Comment:** When did officer have knowledge? At the time payment was not made or sometime subsequent to that?

86. *Burden of Proof.* PD 09-152 (October 16, 2009), PD 09-156 (October 16, 2009), PD 09-158 (October 18, 2009), PD 09-162 (October 16, 2009). PD 09-184 (December 11, 2009). Taxpayer has burden of maintaining accurate records to establish what sales and purchases are exempt, taxable, etc. Taxpayer did not carry its burden.

87. *Burden of Proof.* PD 10-132 (July 12, 2010). In the absence of any documentation or proof to the contrary, auditor's findings upheld that fencing contractor was taxable as a retailer.

88. *Burden of Proof.* PD 10-106 (June 18, 2010). Taxpayer failed to meet its burden of proof on all issues in the appeal. It did not have contemporaneously signed exemption certificate so it had the burden of proof. It did not have certifications from the DEQ for the pollution control exemption, did not prove how air conditioning helped an R&D effort, and could not prove that items purchased for resale were in fact resold and not used in its business.

89. *Burden of Proof.* PD 10-109 (June 22, 2010). When taxpayer did not provide requested records for audit, an estimated assessment was made. When taxpayer then did not file a complete administrative appeal, with supporting documentation, Commissioner held that no valid appeal had been filed. Estimated assessment was timely because within six years of purchase, and taxpayer had not filed returns.

90. *Burden of Proof.* PD 10-115 (July 1, 2010). Taxpayer failed to provide documentation proving that goods were picked up by a contractor at its North Carolina plant and therefore were not subject to Virginia tax. Moreover, auditor found invoices showing that some of these transactions included charges for transportation to the job site in Virginia.

91. *Burden of Proof.* PD 10-119 (July 1, 2010). When taxpayer attempted to obtain a refund for overpaid taxes, the Department audited and determined that it had not been correctly calculating tax. Taxpayer was unable to prove that these calculations were wrong. Assessment of additional tax and penalties upheld. *Burden of Proof.* PD 10-143 (July 26, 2010). Taxpayer’s records were incomplete, missing and contradictory, with sales tax returns not being consistent with bank deposit records, etc. Taxpayer has failed to carry its burden of proof of showing that the auditor’s estimated assessments were inaccurate.

92. *Burden of Proof.* PD 10-166 (August 10, 2010). Taxpayer’s representative argued (i) that sample was not representative, (ii) that
taxpayer relied on erroneous advice from previous auditor, (iii) that no credit was given for sales tax paid against the use tax assessed, and (iv) a three year statute of limitation should apply. Commissioner holds that “I find no basis to conclude that the sample used ... is not representative;” that the taxpayer “has not provided evidence of its receipt of erroneous written advice;” has not even proved that there were prior audits; and “has not proven that it is entitled to a credit.” No relief granted.

93. **Burden of Proof.** PD 10-224 (September 22, 2010). When sales for immediate consumption exceed 80% of gross receipts, store does not qualify for reduced tax rate on “food for human consumption.” Taxpayer apparently relied on general statistics for its stores but not the particular transactions in the audit. Commissioner holds that taxpayer failed to meet its burden of proof. **Comment.** If this reading of the vague facts in this ruling is correct, then the Commissioner is placing an unreasonable burden on business. If statistical samples are good enough for Virginia’s auditors, why shouldn’t sampling procedures be sufficient to establish compliance with legal requirements?

94. **Overcollected Tax.** PD 09-177 (November 19, 2009). Real estate contractor erroneously billed customers for consumer use tax that it had paid - - but it properly remitted that tax to the Department. Although the Commissioner will not allow a credit against the contractor’s taxes for those erroneously collected taxes, the contractor’s customers had signed documents assigning to it their interest in the erroneously collected taxes. Commissioner did allow the protective claim for refund to the contractor - - without interest, because the customers had not assigned their rights to the interest.

95. **Overcollected Tax.** PD 10-129 (July 7, 2010). Ice cream parlor collected tax at the general rate and remitted tax based on the reduced rate applicable to food for home consumption. Taxpayers were required to remit to the Department all taxes collected from customers.

96. **Overcollected Tax.** PD 10-215 (September 15, 2010). Out-of-state vendor delivered goods to Virginia and charged 7% tax which it apparently paid to another state. Virginia customer was assessed 5% Virginia use tax even though it had paid a 7% tax to the vendor. Although facts are confusing, vendor was apparently audited and required to pay the 2% spread to Virginia. Commissioner holds that there is no double tax. **Query.** Is it reasonable to expect a buyer to do anything more than confirm it is paying some state sales tax on every transaction? Telling the customer to go to the vendor, who is the state’s tax collection agent, for a refund would not be thought reasonable or “customer friendly” in the business world.

97. **Untaxed Sales.** PD 10-142 (July 26, 2010). Vendor was not registered as a dealer to collect sales tax. When buyer claimed that its purchase prices
included sales tax, Department rejected request to seek restatement of invoices from unregistered vendor.

98. **Refunds from Dealers.** PD 10-117 (July 1, 2010). Reiterates the Department’s policy that persons seeking sales tax refund must first apply to the vendors for those refunds. Only if the vendor refuses to provide the refund can the taxpayer apply directly to the Department for the refund, less dealer’s discount. **Comment.** This policy of the Department is questionable on a number of fronts. First, there is nothing in the statutes providing any such limitation, and taxpayers can certainly go directly to court to get their refunds without having to seek them from vendors first. Second, the Department’s policy puts vendors and their customers in an unreasonable position with the vendor having to verify that the customer’s claim meets all the technical requirements for exemption that the Department creates from time to time. Third, if the only basis for the Department’s policy is to net out the dealer discount, surely the Department can do that more simply. This policy gives the impression, perhaps mistaken, that the Department is simply trying to impede taxpayer’s rights to seek legitimate refunds.

99. **Use Tax Refund/Utility.** PD 10-198 (August 31, 2010). Although the exemption for equipment and supplies used directly in the provision of a utility service was repealed in 2004, the Commissioner confirms that a water service utility is entitled to the exemption for equipment and supplies used directly in processing. Commissioner carefully distinguishes the fact that taxpayer is requesting only a refund of use taxes and not sales taxes paid to vendors. **Comment.** Once again, the Department’s policy that taxpayer should go to vendors for refunds is not practical. Would any well-informed vendor have been comfortable in paying a refund under these circumstances without receiving guidance from the Department?

**VI. BUSINESS LICENSE TAX**

A. **Court Decisions**

1. **City of Lynchburg v. English Construction Company,** 277 Va. 574, 2009 Va. Lexis 46 (April 17, 2009). English Construction Company maintained its headquarters in Lynchburg but also had other offices and places of business throughout Virginia. Some of the localities where those other offices were located did not impose a BPOL tax on contractors. In a variation of the “throwback rule,” Lynchburg argued that it should be entitled to tax any receipts not taxed by another Virginia locality. The Supreme Court rejected this position, noting the clear legislative intent and wording of the statutes to restrict a locality’s tax base only to activities carried on (or through) at a definite place of business in the locality.
Comment. This was the first decision by the Supreme Court of Virginia under the gross receipts business license tax statutes as “reformed” effective January 1, 1997. Although the case deals with a very narrow issue affecting only contractors, there are two important principles noted in the opinion. First, the Court, yet again, rejects the argument of localities that questions involving their power to tax should be construed as “exemptions” against the taxpayer. The reformed BPOL statutes are very clearly a restriction on local taxing powers and the rules of construction are in favor of the taxpayer. Second, the Court notes:

... the clear legislative intent underlying the General Assembly’s 1996 revision of the business license tax laws .... That revision relies strongly on the importance of a “definite place of business” in determining the taxable situs of gross receipts.”

To the extent that gross receipts are attributable to a definite place of business in, for example, Locality A, they cannot be taxed by Locality B under a “throwback” to the headquarters concept.

2. Ford Motor Credit Company v. Chesterfield County, Cir. Ct. Chesterfield County (May 19, 2009) (petition for appeal pending). Trial court held that FMCC was taxable on all interest and fees earned on loans or leases originated in Chesterfield County. In life of a three year loan, processing by FMCC’s local office typically took three days before loans were transferred to out-of-state service centers for billing, collection and all other administration and maintenance. All funding for loans was provided by headquarters in Michigan. Nevertheless, trial court held that FMCC was not entitled to payroll apportionment of its gross receipts. Holding is contrary to regulations and rulings of the State Tax Commissioner. The Supreme Court of Virginia has granted FMCC’s Petition for Appeal.

B. Attorney General’s Opinions

1. Motor Vehicle Dealers. 210 Va AG Lexis 48 (August 24, 2010). Only motor vehicle dealers are specifically authorized by statute to separately state the amount of the BPOL tax and pass it on to their customers. The dealer, however, remains solely liable to the locality for payment of this tax. The locality has no power to seek payment from the customer.

C. Rulings of the State Tax Commissioner

Classification

1. Retail Merchant. PD 09-139 (September 21, 2009). Commissioner rules that “interior decorating company” is properly classified as making “retail sales.” Opinion dances around distinction between “making retail sales” and being a “retail merchant.” Nevertheless, opinion recognizes that sales
made at retail in fact counted for majority of company’s business. Opinion holds, however, that selling custom picture frames is a “business service.” **Observation.** Virginia case law is very clear about the definition of a “retail merchant,” and that is in fact the term most local ordinances in Virginia use. When a retail merchant sells picture frames to customers based on marked-up cost of framing materials, without any labor, why is that not a “retail sale”?

**Exclusions, Exemptions and Reductions**

2. **Contractor/Office.** PD 10-104 (June 18, 2010). Under *City of Lynchburg v. English Construction*, a contractor is not subject to taxation in the locality of its home office with respect to gross receipts allocable to any other office in Virginia, even if no BPOL taxes are payable to the localities where those offices are located. Taxpayer did not provide locality with sufficient evidence to prove that it had offices at its job locations. The Commissioner says this requires “some physical presence, be it an office, a trailer with a telephone, a desk with a telephone, etc., on a continuous basis ...”. **Observation.** There is nothing like a photograph of a construction trailer at the job site, perhaps with the company’s name on the side and some identifying name or number, to prove to an auditor that there was an office at that location.

3. **Home Office.** PD 10-154 (July 28, 2010). Foreign company providing on-line video games had officer who performed administrative and management tasks from his home office in Virginia. Commissioner rules that the home office does not provide a taxable definite place of business because there is no holding out to the public from that location. In addition, the Commissioner notes that no sale solicitation occurs from the home office so no gross receipts would be sitused there.

4. **Subcontracts.** PD 10-174 (August 10, 2010). Payments to a subcontractor are not deductible for BPOL tax purposes even though the subcontractor received 98% of the gross receipts from the particular construction contract.

5. **Tax Exempt Org.** PD 09-145 (October 8, 2009). Taxpayer was an IRC § 501(c)(6) entity that provided dispute resolution services to members. Taxpayer was reimbursed expenses by dispute resolution participants. Reimbursements were not reported as unrelated business taxable income. Based on terms of local ordinance, Commissioner holds that entity is federally exempt and therefore locally exempt.

6. **Interstate Deduction.** PDs 10-228 and 10-229 (September 29, 2010). Overruling at least two previous determinations, the Commissioner puts to rest the debate between large multi-state corporations and Virginia localities about how the deduction for out of state business is applied when gross receipts are sitused using apportionment. The Commissioner rejects
the localities’ arguments that a deduction is allowed only to the extent the taxpayer can prove that gross receipts sitused to the local office are included in an income tax return filed in another state. This recognizes that if apportionment must be used to determine income, it must also be used to determine deductions. In order to claim the deduction, however, the Commissioner requires that the taxpayer establish that the local office has some activities related to transactions in the states where income tax returns are filed. This can be done by travel logs, electronic means or otherwise. Once that nexus is established, a deduction is allowed for the apportioned share of receipts attributable to business in that state.

VII. PROPERTY TAXES

A. Court Decisions

1. Comcast of Chesterfield Company, Inc. v. Board of Supervisors, 277 Va. 293, 672 S.E.2d 870 (2009). Substantive issue was whether tuners, converters, amplifiers, power supplies, and radios were “machines” used directly in broadcasting and therefore taxable locally as machinery and tools. If not used directly in broadcasting, the items of property would be intangible and not subject to local taxation. Trial court held that property was “machines”, rejecting taxpayer’s argument that machines include only “devices consisting of fixed and moving parts that modify mechanical energy and transmitted in a more usable form.” When taxpayer appealed to the Supreme Court of Virginia, County argued that the trial court’s order was not “final” and therefore not appealable. County asserted the trial court had a duty to determine valuation of each item of property even though valuation was not put in issue by the taxpayer. Supreme Court agreed and dismissed the appeal.

Comment. This case is a good illustration of how many localities are now “playing the litigation game,” looking for every opportunity to make litigation for taxpayers difficult.

2. County of Albemarle v. Keswick Club, Record No. 091590 (September 16, 2010). In this second appeal concerning the assessed fair market value of Keswick Country Club, a divided court upholds the trial court’s decision reducing the assessed value by about one-third. Because the County Assessor had not considered all approaches to value, the Court originally held that the assessment was not subject to review under the strict standard of “manifest error.” On remand, the trial court selected the evidence it thought appropriate and reduced the assessment. A majority of the Supreme Court agrees that there was sufficient evidence to uphold the trial court’s decision.
B. Attorney General’s Opinions

1. **Storm Water Fee.** 210 Va. AG Lexis 8 (March 4, 2010). Storm water fee charged by the City of Chesapeake is a service fee and not a tax in disguise. The fee (1) does not discriminate against the federal government, (2) fairly approximates the government’s use of the storm water system and (3) produces revenues that will not exceed the total cost of benefits supplied. Fees are dedicated to the storm water system. Accordingly, the US Navy is not constitutionally exempt from paying the fee. **Comment.** Collecting the fee from the Navy, however, could be a challenge for the City of Chesapeake.

2. **Mineral Lands.** 210 VA AG Lexis 19 (April 26, 2010). Clay and sand removed from the land (or a riverbed) for use in making brick are subject to local property taxation beginning in the first year that the minerals are discovered. A capitalization of income approach is one acceptable valuation methodology.

3. **Storm Water.** 210 Va AG Lexis 35 (July 28, 2010). The utility or service charge for storm water runoff is a fee and not a tax.

C. Rulings of State Tax Commissioner

1. **Signage/Fixtures.** PD 09-147 (October 8, 2009). Retailer closed store and removed sign from leased premises. On audit, City reclassified sign as tangible personal property and assessed additional tax. Commissioner holds that taxpayer did not carry burden of proving intent to affix the sign to the property permanently. Taxpayer argued that his intent was to stay in business forever. Commissioner notes that lease specifies that signage belongs to tenant and will be removed on termination of lease.

2. **Merchants Capital/Daily Rental Property.** PD 10-102 (June 18, 2010). In determining whether a rental business meets the statutory definition (80% of receipts in any year are from rental periods of 92 consecutive days or less), the transactions to be considered are not only those that “originate and end within the tax year.” Similarly, in determining whether the 92 day period is met, “all extensions and renewals to the same or affiliated person” are included as one rental period.

3. **Appeals/Computer Software and Hardware.** PD 10-103 (June 18, 2010). Although the taxpayer ultimately failed to carry its burden of proof in this appeal, the Commissioner’s determination has several important points. First, when a locality denies a taxpayer’s amended returns/refund claim under § 58.1-3980, that becomes a determination which can then be appealed under Virginia Code § 58.1-3983.1. This essentially extends the time period for “business tax appeals” from one year to three years. Second, Virginia Code § 58.1-1101A(a) defining application software as intangible property is not an exemption to be strictly construed against the
taxpayer. Simply because the sales price bundles hardware and application software together does not prevent the taxpayer from proving the non-property taxable component attributable to application software. Finally, in a curiously vague analysis, the State Tax Commissioner apparently rejects the idea that anything that uses software to operate can be classified as "programmable computer equipment." A taxpayer who wishes to challenge a locality's factual determination about what is programmable computer equipment will have to make a much better record than this taxpayer did.

4. Local Appeal/Penalty. PD 10-213 (September 15, 2010). Taxpayer filed M&T return one day late, apparently because of accounting firm's failures. Commissioner holds that Department does not have jurisdiction to review assessments of penalties by local officials. In the alternative, the Commissioner holds that the local Commissioner of Revenue is the person charged with making determinations of fact and fault. Comment. This is a terrible ruling. As long as penalties and interest are considered to be part of the tax, which they are, there is no reason for the Department of Taxation to claim lack of jurisdiction. It is clear that the General Assembly intends the Department to provide taxpayers with an "honest and fair appeal" of their business tax issues. This ruling, contrary to that intent, provides taxpayers only with a court suit.

VIII. MISCELLANEOUS TAX

A. Legislation

Collections Limitations. Section 58.1-1802.1 reduces the time in which the Commonwealth can initiate collections actions on delinquent taxes from 20 years to 10 years.

Technology Startup. Beginning in 2011, allows an exemption from Virginia taxable income for long-term capital gain derived from an investment in a technology or science startup business having its principal place of business in Virginia and having less than $3 million in annual revenues before the year of investment.

Renewable Energy Property. Section 58.1-3221.4 creates a separate classification for real property used primarily for manufacturing a product from renewable energy. Separate classification allows locality to tax such improvements at a lower rate than applicable to other real estate.

Land Preservation Credits. Section 58.1-512 is amended to reduce the amount of credit that can be taken related to land preservation tax credits to $50,000 for 2011.
B. Attorney General’s Opinions

1. **Hidden Taxes.** 210 VA AG Lexis 15 (April 14, 2010). As summaries of legislation in this outline indicate, the General Assembly in recent years has adopted or modified many provisions of Virginia’s tax laws as part of a gigantic appropriations bill, without having a separate piece of legislation introduced and considered with respect to each such tax change. The Attorney General holds that because the Appropriations Bill is a complex piece of legislation necessarily dealing with revenues and expenses, this practice is not unconstitutional. It complies with the provision of the Constitution stating that “no law shall embrace more than one object.”

C. Rulings of the State Tax Commissioner

1. **Recordation Tax/Refinancing.** PD 10-6 (January 13, 2010). Mortgage was refinanced with company which was the survivor of a merger with the company that had made the original loan. Department holds that the merged entity is essentially the same entity as the first lender so that recordation tax was payable only on the amount of the refinanced mortgage that exceeded the original mortgage.

2. **Recordation Tax.** PD 10-130 (July 9, 2010). The day before the property was foreclosed, taxpayer signed a deed conveying his property to a relative. When that deed proved ineffective, he sought a refund of the recordation and grantor’s taxes. Although the deed did not recite that it was a “deed of gift,” and therefore could not qualify for that statutory exemption, the Commissioner allows a refund of the grantor’s tax because it appeared there was no consideration for the deed.

3. **Digital Media Fee/Agent.** PD 09-114 (July 16, 2009). Ruling permits the “content provider” of movies, video games, etc. in hotels and motels to file returns and pay taxes on behalf of its hotel and motel customers. Hotels and motels continue to be liable for proper collection of tax and possible verification audits.

4. **Statute of Limitations.** PD 10-8 (January 13, 2010). Appeal not filed within 90 days of the date of local determination.

5. **Bank Franchise Tax.** PD 10-16 & PD 10-17 (March 1, 2010). Taxpayers wanted to be classified as a bank, presumably to obtain the benefits of not paying corporate income tax and certain local taxes. Commissioner’s policy is that to qualify as a bank corporation must (i) conduct a banking business in Virginia; (ii) have an office for the conduct of a banking business in Virginia; or (iii) designates a place in Virginia as its principal office in its charter. Corporations did not conduct a banking business in Virginia because they did not accept deposits in Virginia. Accordingly, they were liable for the corporate income tax not the bank franchise tax.
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