Recent Developments in Virginia Taxation: The Present and the Future?

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RECENT AND FUTURE DEVELOPMENTS IN VIRGINIA TAXATION

A discussion of 2009 tax legislation, recent court decisions, Tax Department rulings, and opinions of the Virginia Attorney General.

I. VIRGINIA TAX AMNESTY

A. Tax Amnesty: The 2009 Virginia General Assembly authorized a tax amnesty period for 2009. Senate Bill 1120 (Chapter 611) authorizes the Tax Commissioner to administer an amnesty program for a period ranging between 60 and 75 days during Fiscal Year 2010 (July 1, 2009 to June 30, 2010). Taxpayers currently under investigation or prosecution for filing a fraudulent return or failing to file a return with the intent to evade tax, taxpayers with an assessment date or due date for an unfiled return less than 90 days prior to the first day of the amnesty program, and taxpayers with an individual, fiduciary or corporate income tax liability for Taxable Year 2008 or after would not be allowed to participate with respect to those liabilities. All penalties and 50 percent of the interest would be waived upon payment of the taxpayer's remaining balance. At the conclusion of the amnesty period, any remaining amnesty-qualified liabilities would be assessed an additional 20 percent penalty.


II. CORPORATE INCOME TAX

A. 2009 Legislation

1. Conformity: Senate Bill 985 (Chapter 3) and House Bill 1737 (Chapter 2) advance Virginia's date of conformity to the Internal Revenue Code from December 31, 2007 to December 31, 2008. Virginia will continue to disallow most bonus depreciation and any five year carry-back of certain net operating losses (NOL) allowed for NOLs generated in taxable years 2001 or 2002. In 2008, Congress enacted five significant measures that Virginia conforms with the enactment of this legislation:

- The Food and Energy Security Act and the Heartland, Habitat, Harvest, and Horticulture act, which provides targeted tax relief to conservation and agricultural interests;
- The Heroes Earnings Assistance and Relief Tax Act, which provides tax benefits to those serving in the military and in the Peace Corps;
- The Housing and Economic Recovery Act, which modifies certain rules applicable to bonds and provides other forms of tax relief; and
- The (2008) Emergency Economic Stabilization Act, which extends the exclusion of discharges of principal residence acquisition indebtedness from gross income of individuals, provides a specified method of cost recovery for certain business, and provides a variety of other tax benefits.
Virginia will not address the tax provisions contained in the 2009 Economic Stimulus Package until the 2010 session of the General Assembly.

2. Captive REIT Addback: Senate Bill 1147 (Chapter 558) and House Bill 2504 (Chapter 426) require a Captive Real Estate Investment Trust ("REIT") to add back any federal deduction for dividends paid by the REIT to its shareholders. For taxable years beginning on and after January 1, 2009, but before January 1, 2011, the addition is equal to one-half of the federal deduction. A Captive REIT is defined as a REIT whose shares are not publicly traded and 50% or more of the shares are owned by a corporate entity. In addition, more than 25% of the income of the REIT is required to consist of rents from real property in order for it to be considered a Captive REIT, thus excluding mortgage REITs. Exceptions are provided to ensure that an affiliated group of REITs would not be considered captive REITs unless the ultimate ownership of the group is by a single corporate entity. Entities organized under the laws of Australia and other foreign countries that are similar to REITs will also not be considered a captive REIT, if they are widely held. Currently, the income of a Captive REIT avoids all Virginia tax because a corporate shareholder can exclude REIT dividends from its Virginia taxable income, although the REIT income is included in federal taxable income.

3. Single Sales Factor: House Bill 2437 (Chapter 821) modifies the corporate apportionment formula by allowing manufacturing companies to use a single factor apportionment based on sales to determine their Virginia taxable income. This modification would be phased in as follows: for taxable years beginning on or after July 1, 2010, but before July 1, 2012, qualifying corporations may elect to use a triple-weighted sales factor; for taxable years beginning on or after July 1, 2012, but before July 1, 2013, qualifying corporations may elect to use a quadruple-weighted sales factor; and for taxable years beginning on or after July 1, 2013, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income. Once a corporation elects to use these methods, it may not change for two taxable years. This legislation also contains a provision that states that if any provision of the legislation is determined to be unconstitutional that the provision is not severable from the legislation and the legislation will be void.

4. Major Business Facilities Jobs Tax Credit Extension. House Bill 2575 (Chapter 753) extend the sunset date for the Major Business Facility Job Tax Credit from January 1, 2009, to January 1, 2020. In addition, taxpayers would be allowed to claim the credit over two years instead of three. The provision that would allow the taxpayer to claim one-half of the credit amount for two years would be effective for taxable years beginning on or after January 1, 2009, but before December 31, 2010.

5. Clean Fuel Job Creation Tax Credit Expansion. Senate Bill 1357 (Chapter 730) change the types of jobs that a corporation could create in order to qualify for the clean fuel vehicle job creation tax credit. The new job types involve (i) the manufacture of the major components of the energy storage, energy supply, or engine, motor, and power train mechanisms unique to a vehicle fueled by clean special fuels; (ii) the manufacture of components uniquely used to convert vehicles designed to operate on gasoline or diesel fuel to operate on clean special fuels or advanced biofuels; (iii) the conversion of vehicles designed to operate on gasoline or diesel fuel to operate on clean special fuels or advanced biofuels; (iv) the manufacture of
vehicles designed to operate on clean special fuels; (v) the manufacture of components designed
to produce, store, and dispense clean special fuels or advanced biofuels; or (vi) the production of
advanced biofuels. This legislation is effective for taxable years beginning on or after January 1,
2009.

6. Dispositions of Real Property. Senate Bill 978 (Chapter 508) allows
taxpayers to recognize income from dispositions of real property under Internal Revenue Code
sec. 453(l)(1)(B) using the installment method for Virginia tax purposes, even though they were
required to report the entire gain as income in the year of the disposition for federal income tax
purposes. The qualifying dispositions of real property are those in which the real property is
held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or
business. This legislation requires the election for the installment method to be made on or
before the due date of the taxpayer's tax return for the taxable year in which the disposition
occurred.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Qualified Settlement Funds. P.D. 09-12 (February 4, 2009). A ruling was
requested as to whether the income generated from a Qualified Settlement Fund (QSF) is subject
to tax in Virginia. For this ruling, the facts were as follows: Corporation A and its subsidiaries
(collectively, the "Group") filed for bankruptcy and ultimately ceased operations. Pursuant to the
liquidation plan, the bankruptcy trustee set up priority claims trust accounts and unsecured
claims trust accounts and funded them with cash transferred from the Trust. The priority claims
trust accounts and unsecured claims trust accounts were designated as disputed claims reserves
(DCR). For federal income tax purposes, the Trustee will treat each DCR as a disputed
ownership fund (DOF). Because the DOFs were funded with cash, each will be taxed as a QSF
for federal income tax purposes. The Trust will file an income tax return for estates and trusts
(Form 1041). Each DCR will file a separate corporate income tax return for settlement funds
(Form 1120-SF), on which its modified gross income will be subject to federal income tax at the
rates applicable to estates and trusts. The Tax Commissioner determined that the income
generated from the QSF is subject to Virginia income tax as the DCRs are treated as corporations
for federal income tax purposes and Virginia conforms to federal income tax definitions.

The taxpayer incorporated an intangible holding company ("IHC") outside of Virginia for the
purpose of holding the taxpayer's intangible property. The taxpayer paid royalties to IHC for the
use of the trademarks and trade names during the taxable years at issue. The taxpayer and
franchisees entered into a licensing agreement with IHC for the use of its trademarks and trade
names. Each franchisee pays a percentage of its gross sales to the taxpayer, not the IHC, on a
monthly basis. The taxpayer retains a quarter of this amount and then remits the remaining
royalty payments to the IHC along with other royalty amounts. The taxpayer filed Virginia
income tax returns and added back 100% of the royalties deducted on its federal income tax
returns. The taxpayer requested the Tax Commissioner to be allowed to report its Virginia taxable income without the add-back of the royalties on the grounds that IHC received more than one-third of its gross revenues from the Taxpayer's independently owned franchisees and that the royalty rate paid by the franchisees and the corporate owned restaurants were comparable. The Tax Commissioner denied the taxpayer's request as the franchisees paid royalties to the taxpayer who remitted the large portion of the royalties to the IHC. Even though it was not necessary in this case, the Tax Commissioner mentioned the authority under Virginia code sec. 58.1-446 to adjust returns when Virginia income has been misrepresented.

**Practice Point:** In the context of the request by this taxpayer, it was not necessary to mention Virginia code sec. 58.1-446. However, the mention of Virginia code sec. 58.1-446 is likely a message to all taxpayers from the Tax Commissioner. Clearly if the taxpayer simply restructures the royalty payments to have the IHC receive the payments directly from the franchisee, the taxpayer will benefit from the safe harbor. In such a case, the Tax Commissioner says that she would use Virginia code sec. 58.1-446 to adjust the return regardless of the safe harbor and cites statutory authority for doing so. Satisfying a safe harbor for the intangible add-back will not prevent the Tax Commissioner from adjusting a return.

3. **Biodiesel and Green Diesel Fuels Producers Tax Credit.** P.D. 09-21 (February 4, 2009). A taxpayer who has been producing Biodiesel and Green Diesel fuels for three or more years prior to January 1, 2008, requested a ruling on whether it would be eligible to receive the biodiesel and green diesel fuels producers tax credit. The Tax Commissioner determined that the language of Virginia Code sec. 58.1-439.12:02 limits the credit to producers who produce up to two million gallons and is only available to producers during the first three years of production.

4. **Fixed Date Conformity Tax Bulletin.** P.D. 09-24 (February 12, 2009). The Tax Commissioner issued Virginia Tax Bulletin 09-1 to provide instructions to taxpayer for complying with House Bill 1737 and Senate Bill 985 which update Virginia's date of conformity with the Internal Revenue Code.

5. **Alternate Method of Allocation and Apportionment.** P.D. 09-25 (February 13, 2009). The taxpayer filed a voluntary disclosure agreement with the Tax Department and requested an alternative method of allocation and apportionment. The taxpayer stated that Virginia's statutory method is inequitable based on the facts and circumstances giving rise to the taxpayer's taxable income. The taxpayer asserted that the statutory formula would result in double taxation of a certain income and requested permission to allocate only the Virginia source income from its partnerships to Virginia and allocate all remaining UBTI outside Virginia.

Unsurprisingly, the Tax Commissioner denied the taxpayer's request for an alternative method of allocation and apportionment. Per Virginia Code sec. 58.1-421 and Title 23 VAC 10-120-280, for a taxpayer to request an alternative method of allocation and apportionment, the taxpayer must file the return using the statutory method and pay any tax due. Next, the taxpayer is required to file an amended return proposing an alternative method within the time prescribed for filing amended returns claiming refunds. The amended return must include a statement of why the statutory method is inapplicable or inequitable and an explanation of the proposed
method of allocation and apportionment. The Tax Department will not grant an alternative method of allocation and apportionment unless it determines that: (1) the statutory method produces an unconstitutional result under the particular facts and circumstances of the taxpayer's situation; or (2) the statutory method is inequitable because it results in double taxation and the inequity is attributable to Virginia, rather than another state's method of apportionment. The taxpayer in this ruling did not comply with the steps required by the regulation.

### 6. Consolidated Return. P.D. 09-30 (March 31, 2009)
A taxpayer requested a ruling that its election to file a consolidated return was proper. In 2002, the taxpayer had sufficient contacts with Virginia to establish nexus. Prior to 2002, only one of the taxpayer's affiliates had nexus with Virginia. The taxpayer also acquired two new affiliates in 2002 that had Virginia nexus. The taxpayer requested permission in 2002 to switch from filing a return on a separate basis to a combined basis, and permission was granted. However when the taxpayer filed its 2002 return, it elected to file a consolidated return. The Tax Commissioner determined that the taxpayer's consolidated election in 2002 was proper. As 2002 was the first year in which the taxpayer and its affiliates had nexus with Virginia, the request for permission to switch from filing a return on a separate basis to a combined basis was unnecessary and the taxpayer could elect to file on a consolidated basis.

### 7. Nexus. P.D. 09-44 (April 27, 2009)
A taxpayer requested a ruling on whether it has nexus for purposes of the corporate income tax. The taxpayer sells storage systems for installation in buildings located in Virginia. The taxpayer is incorporated outside Virginia, maintains no physical presence in Virginia, and does not solicit sales in Virginia with employees or independent representatives. The taxpayer purchases the systems from third-party vendors and that the storage systems are shipped by the vendors directly to the customers or contractors in Virginia. Installation of the storage systems is performed by unrelated third-party contractors. The taxpayer has no ownership interest in any of the installation contractors and that the contractors are independent businesses that have customers other than the taxpayer. The taxpayer provides the installation contractors with quality standards for installation; however, the taxpayer does not provide any supervision over the contractors' work. The Tax Commissioner determined that the installation services provided by the third-party contractors do not establish corporate income tax nexus with Virginia for the taxpayer. Furthermore, the taxpayer's activities in Virginia do not exceed those permitted by P.L. 86-272 as the performance of services by the installation contractors would not exceed the protection afforded under to P. L. 86-272.

A partnership (the "taxpayer") owns two commercial rental properties in Virginia and ten similar properties in five other states. The taxpayer states the income or loss of each rental property is readily available. The taxpayer believes that Virginia's apportionment method does not reflect actual income earned in Virginia and requests permission allocate income to Virginia based on separate accounting for the 2008 taxable year and thereafter. The Tax Commissioner denied the taxpayer's request as the taxpayer did not demonstrate that the statutory method is unconstitutional or inapplicable as it would apply to the taxpayer and the taxpayer did not follow the established procedure for requesting an alternative apportionment method.
9. **Intangible Add-Back: Subject to Tax Exception.** P.D. 09-49 (April 27, 2009). A taxpayer paid royalties to an affiliated company for the use of intangible assets. The taxpayer claimed an exception to the requirement to add-back the royalties on its Virginia income tax return. The exception was for 100% of the royalties deducted on its federal income tax returns on the grounds that they were subject to tax in another state. The exception was adjusted by an auditor by reducing it to correspond to the amount of the affiliate's royalty income apportioned to each state in which the affiliates paid tax and increased the corresponding net add-back of royalties. The taxpayer appealed asserting that all of the royalties qualify for an exception to the add-back because they were subject to tax based on or measured by net income imposed by other states.

The Tax Commissioner denied the taxpayer's appeal. The Tax Commissioner stated that, "When considering this statute in its totality, the exception does not apply to the gross amount of payments that a taxpayer made to an affiliate merely because the gross amount is shown on another state's tax return. Instead, the exception is limited to the portion of a taxpayer's royalty payments to its affiliate that correspond to the portion of the affiliate's income subjected to tax in other states, as evidenced by the apportionment percentages shown on the affiliate's tax returns filed with other states."

10. **Coal Employment and Production Incentive Tax Credit.** P.D. 09-58 (May 1, 2009). The taxpayer files a combined Virginia Corporation Income Tax Return. Included in the combined return is the income of Subsidiary 1, a C Corporation that is a wholly owned subsidiary of the taxpayer. Included in the income of Subsidiary 1 is income from two single-member LLCs treated as divisions of their parent, Subsidiary 1. LLC 1 purchases coal mined in Virginia from a third party and sells the coal to LLC 2. LLC 2 burns the coal to make steam and mechanical energy used for electricity production by an unrelated manufacturing plant located at the same site. Subsidiary 1 owns all of the steam and electric generating equipment except the electric generator and exciter. The taxpayer requested a ruling that Subsidiary 1 is eligible for the credit because Subsidiary 1 actually consumes the Virginia coal used in the electricity production and that the production of electricity at the unrelated manufacturing plant would not be possible without the function performed by the equipment owned and operated by Subsidiary 1. The Tax Commissioner disagreed. Virginia Code § 58.1-433.1 states that the credit is available for electricity generators for each ton of coal purchased and consumed by the electricity generator, provided the coal was mined in Virginia. For the purposes of the credit, "electricity generator" is defined as "any person who produces electricity for self-consumption or for sale." Since Subsidiary 1 does not produce electricity, the Tax Commissioner determined that it was not eligible for the credit.

11. **Land Preservation Credit.** P.D. 09-61 (May 6, 2009). The Tax Commissioner issued Virginia Tax Bulletin 09-4 raising the annual aggregate cap for the Land Preservation Credit to $106,647,000 for calendar year 2009.

12. **Royalty Add-Back.** P.D. 09-67 and P.D. 09-68 (May 13, 2009). The taxpayer paid royalties to an affiliate for the 2004 and 2005 taxable years. It paid factoring fees to another affiliate for the 2004 through 2006 taxable years. The taxpayer filed Schedule 500AB with its 2004 through 2006 Virginia corporate income tax returns, listing one state in which the
affiliate that was paid the royalties files income tax returns, and two states in which the affiliate that was paid the factoring fees filed income tax returns. The affiliates reported the royalties and factoring fees paid by the taxpayer, and the amount of tax paid based on or measured by net income on the returns. The taxpayer claimed an exception for 100% of the royalties and factoring fees deducted on its federal income tax returns on the grounds that they were subject to tax in another state. On audit, the Tax Department limited the amount claimed as an exception to the add back by reducing it to correspond to the amount of the affiliates' royalty and factoring income apportioned to each state in which the affiliates paid tax and increased the corresponding net add back of royalties and factoring fees.

The taxpayer contested the assessment on the basis that all the royalties and factoring fees qualify for an exception to the add back because they were subject to tax based on or measured by net income imposed by other states. The taxpayer contended its interpretation of the add back provision is accurate, and the Tax Department failed to provide any guidance as to the interpretation of the add back statute. Finally, the taxpayer contended that even if it cannot claim a 100% exception of its royalty expenses and factoring fees on the basis that they were subject to tax in another state, the taxpayer's intercompany transactions have a valid business purpose other than the avoidance or reduction of tax.

The Tax Commissioner upheld the assessment. The Tax Commissioner stated that the exception is limited to the portion of a taxpayer's intangible expense payments to its affiliate that correspond to the portion of the affiliate's income subjected to tax in other states, as evidenced by the apportionment percentages shown on the affiliate's tax returns filed with other states. Also, the request for a valid business purpose exception was not made in accordance with the procedure for claiming the business purpose exclusion from the addition for intangible and interest expenses paid related entities pursuant to Virginia Code sec. 58.1-402 (B)(8)(b). As such, the taxpayer's request to exclude the add back of the royalties and factor fees on the basis that they were incurred for a valid business purpose was not considered.

13. **Nexus.** P.D. 09-81 (May 26, 2009). The taxpayer is a corporation commercially domiciled in State A and operates out of State B. It is not registered to do business in Virginia. The taxpayer provides logistical support for both affiliated and unrelated corporations for which it charges an arm's length rate. Specifically, it employs engineers, system planners, and logisticians to develop and maintain the delivery systems and manage the coordination and movement of tangible personal property (TPP). The taxpayer designs the routes and methods of package movement including the mode of transportation. It develops contingency plans to account for weather or other unexpected events that can delay package movement. The taxpayer also manages the contractual relationships with the affiliated and unrelated entities. It has no Virginia property or payroll. One of its affiliates (Corporation A) sorts and transports the TPP in Virginia. It has property, employees and sales in Virginia and contracts with the taxpayer for logistical support. The taxpayer's employees periodically enter Virginia to perform logistical support activities. The taxpayer's parent corporation files a combined Virginia return. The taxpayer is not included in the combined return. Based on the facts presented, the taxpayer requested a ruling that it does not have nexus with Virginia for purposes of corporate income tax.
The Tax Commissioner determined that the taxpayer would likely have nexus with Virginia as a result of its employees performing logistical support services in Virginia. However because the taxpayer has no property or payroll in Virginia and it appears unlikely that the Taxpayer would have a positive sales factor, the taxpayer would not have any Virginia source income and thus not be subject to the income tax.

14. **Royalty Add-Back.** P.D. 09-96 (June 11, 2009). For the taxable years at issue, the taxpayer paid royalties to two of its affiliated companies for the use of intangible assets. The taxpayer filed Schedule 500AB with its 2004 through 2006 Virginia corporate income tax returns listing four states in which the affiliates filed income tax returns. The affiliates reported the royalties paid by the taxpayer, and the amount of tax paid based on or measured by net income on the returns. The taxpayer claimed an exception for 100% of the royalties deducted on its federal income tax returns on the grounds that they were subject to tax in another state. On audit, the Tax Department limited the amount claimed as an exception to the add-back by reducing it to correspond to the amount of the affiliates' royalty income apportioned to each state in which the affiliates paid tax and increased the corresponding net add-back of royalties. The auditor also removed a subtraction for dividends and allocated them to the taxpayer's state of commercial domicile. The taxpayer contested the assessments on the basis that all the royalties qualify for an exception to the add-back because they were subject to tax based on or measured by net income imposed by other states. The taxpayer also contends that the auditor erroneously disallowed the subtraction for dividends.

The Tax Commissioner upheld the assessment. The Tax Commissioner stated that the exception is limited to the portion of a taxpayer's intangible expense payments to its affiliate that correspond to the portion of the affiliate's income subjected to tax in other states, as evidenced by the apportionment percentages shown on the affiliate's tax returns filed with other states. The Tax Commissioner also determined that the auditor correctly disallowed the subtraction and allocated the dividends to the taxpayer's state of commercial domicile on the multi-state apportionment schedule. Under Va. Code § 58.1-407, all dividends not otherwise subtracted are allocated to the state of commercial domicile of the corporation. The auditor merely moved the dividends to the correct place on the return resulting in no impact on the income tax liability for the taxable years at issue.

15. **Net Operating Losses.** P.D. 09-108 (June 24, 2009). The taxpayer is a holding company of an affiliated group of corporations. Some affiliates own and operate facilities in Virginia and have participated in a Virginia consolidated income tax return for many years. The holding company's headquarters' functions were previously performed in another state, but such functions are now performed in Virginia. The holding company has been included in the group's federal consolidated income tax return, but previously lacked nexus with Virginia and accordingly was never included in the group's Virginia consolidated tax returns. The holding company will be included in the affiliated group's Virginia consolidated tax return for the 2008 taxable year. On a separate company basis, the holding company generated NOLs in prior years that were absorbed in the group's federal consolidated returns. The NOLs were generated over a period of several years while the holding company's functions were performed in the former state and, with one exception, the NOLs were not utilized to reduce taxable income in that state. Because the holding company is now a member of the Virginia affiliated group due
to the relocation of the headquarters' functions to Virginia, the taxpayer requests a ruling on whether prior year losses will be available to offset the federal taxable income of the Virginia affiliated group. The Tax Commissioner determined that the fact that NOLs were incurred in a year when the taxpayer was not subject to Virginia income tax does not limit the taxpayer's ability to see the NOLs carryover on a Virginia return if the carryover is included in its federal taxable income. Virginia income tax law conforms to the federal definition of federal taxable income and does not have any provision prohibiting an inclusion of the NOLs.

16. Royalty Add-Back. P.D. 09-115 (July 31, 2009). For the taxable years at issue the taxpayer paid royalties and interest to an affiliated entity. On its income tax returns the taxpayer listed four states in which the affiliated entity filed income tax returns and claimed an exception for all of the royalty and interest deductions on the grounds that they were subject to tax in another state. On audit the Tax Department limited the amount claimed as an exception to the add back by reducing it to correspond to the amount of the affiliate's royalty income apportioned to each state in which the affiliates paid tax and increased the corresponding net add back of royalties and interest. The taxpayer filed an appeal contesting the assessments. The taxpayer argued that the add-back clause violates the Due Process and Commerce clauses of the United States Constitution. It also asserted that auditor's assessment limits the exception beyond the clear meaning of the statute.

The Tax Commissioner upheld the assessment. The Tax Commissioner stated that the exception is limited to the portion of a taxpayer's intangible expense payments to its affiliate that correspond to the portion of the affiliate's income subjected to tax in other states, as evidenced by the apportionment percentages shown on the affiliate's tax returns filed with other states. The Tax Commissioner also determined that the Commerce Clause is not violated by the add-back. The Due Process Clause argument was not addressed.

17. Consolidated Return: Affiliate with Nexus. P.D. 09-181 (August 7, 2009). The taxpayer was the lead corporation in an affiliated group (the "Group") that filed a consolidated Virginia corporate income tax return for the 2003 taxable year. Under audit the Tax Department removed an affiliate (S) from the consolidated return. The Tax Department's auditor determined that S lacked a positive apportionment factor and, therefore, did not have income from Virginia sources. S is a construction contractor based outside Virginia. For the 2003 taxable year, S's sole revenue resulted from a final progress billing invoice for a contract completed in a previous taxable year. In addition, S had out-of-state personnel traveling into Virginia soliciting additional contract work. The taxpayer contests the assessment, asserting that S had nexus with Virginia for the 2003 taxable year and was properly included in the Group's consolidated return because it was actively pursuing additional work in Virginia.

The Tax Commissioner upheld the assessment. S did have personnel traveling into Virginia to pursue potential contracts. These activities involved a bidding process the extended several months involving multiple visits to potential construction sites. The bid work was primarily conducted by a project superintendent who traveled into Virginia in a company owned truck. S was eventually granted a contract set to begin in 2004, but lack of funding caused the contract to be cancelled. Actively pursuing business in Virginia generally includes activities included in the solicitation of orders. Such activities cannot create nexus pursuant to P.L. 86-
The taxpayer provided no evidence that the project superintendent conducted any activities in Virginia that exceeded the protection afforded under P.L. 86-272.

18. SRLY Rules and NOLs. P.D. 09-126 (August 7, 2009). The taxpayer, the corporate parent of an affiliated group, is headquartered and domiciled outside of Virginia. The taxpayer and its Virginia nexus affiliates currently file a consolidated Virginia Corporation Income Tax Return. The taxpayer acquired 100 percent of the stock of Company X. Company X had nexus in Virginia and had been filing separate Virginia returns for several years prior to the acquisition. In the year of acquisition, Company X filed a short year separate federal return reflecting its separate income up to the date of acquisition by the taxpayer. Company X incurred a modest taxable loss on its separate short year return ending on the date of acquisition. From the date of acquisition through the end of the taxable year, Company X filed as part of the taxpayer's federal consolidated return. Neither the taxpayer nor any affiliate (other than Company X) had nexus in Virginia in the acquisition year. Accordingly, Company X filed a separate Virginia short year return reflecting NOL for the same post-acquisition period as the taxpayer's federal consolidated return. The taxpayer stated that the post-acquisition NOL generated by Company X in the post-acquisition short year would not be subject to SRLY limitations established by Treas. Reg. §1.1502-21(c) in determining the amounts available for carry forward to a Virginia consolidated return. The taxpayer requested a ruling confirming this treatment.

The Tax Commissioner determined that the SRLY limitation would apply to NOL carryovers of Company X, not the taxpayer. The NOL generated by the taxpayer during the acquisition year or prior would not be subject to the SRLY limitations in determining the amounts available for carry forward to a Virginia consolidated return. The fact that the loss was incurred in a year when the taxpayer was not subject to Virginia income tax does not limit the taxpayer's ability to see the NOL carryover on a Virginia return if the carryover is included in its federal taxable income.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

III. INDIVIDUAL INCOME TAX

A. 2009 Legislation

1. Land Preservation Credit Annual Limit: Senate Bill 986 (Chapter 510) and House Bill 1891 (Chapter 12) reduce the amount of Land Preservation Credits that may be claimed on income tax returns from $100,000 per taxpayer to $50,000 per taxpayer effective for credits claimed for taxable years beginning on and after January 1, 2009, but before January 1, 2011. This bill would also extend the carryover period by two years for those affected by this limitation.
2. Increase in Livable Home Tax Credit. House Bill 1938 (Chapter 15) and Senate Bill 845 (Chapter 496) increase the individual tax credit limit for the livable home tax credit. The maximum credit limit is increased from $500 to $2,000. For retrofitting an existing residence, the credit is increased from 25 percent to 50 percent of the amount for retrofitting to 50 percent which is also subject to the maximum limitations. This legislation is effective for taxable years beginning on or after January 1, 2010.

3. Dispositions of Real Property. Senate Bill 978 (Chapter 508) allows taxpayers to recognize income from dispositions of real property under Internal Revenue Code sec. 453(l)(1)(B) using the installment method for Virginia tax purposes, even though they were required to report the entire gain as income in the year of the disposition for federal income tax purposes. The qualifying dispositions of real property are those in which the real property is held by the taxpayer for sale to customers in the ordinary course of the taxpayer’s trade or business. This legislation requires the election for the installment method to be made on or before the due date of the taxpayer’s tax return for the taxable year in which the disposition occurred.

B. Recent Court Decisions

There are no recent court decisions to report.

C. Recent Virginia Tax Commissioner Rulings

1. Refund Request. P.D. 09-8 (February 4, 2009). The Tax Department received information from the IRS indicating that the taxpayer, a Virginia resident, had income for the 2000 taxable year, yet the taxpayer did not file a Virginia individual income tax return for the 2000 taxable year. The taxpayer was assessed with individual income tax liability as a full year resident in March 2003. The taxpayer paid the assessment pursuant to a payment plan from August 2003 through November 2004. In November 2006, the taxpayer filed a part-year return for the 2000 taxable year requesting a refund. The Tax Department denied the refund because the return was filed beyond the three-year statute of limitations. The taxpayer appealed and the Tax Commissioner granted a partial refund.

Virginia Code sec. 58.1-1823(A)(iv) provides that an amended return claiming a refund can be timely filed within "two years from the payment of an assessment, provided that the amended return raises issues relating solely to such assessment and that the refund does not exceed the amount of such payment." Under this section, only payments made within 2 years of the assessment, for which the refund is requested, are eligible for a refund. The Tax Commissioner found that only the taxpayer’s last payment of the payment plan was within two years of the date the amended return was filed. Accordingly, a partial refund was granted from this payment.

2. Combat Pay and Extended Duty Pay Subtractions. P.D. 09-9 (February 4, 2009). The taxpayers, enlisted military personnel, claimed subtractions on their 2005 through 2007 Virginia individual income tax returns for military wages resulting from combat duty or extended active duty. The Tax Department disallowed the subtractions for combat duty pay on the 2005 and 2006 Virginia returns, and adjusted the subtraction for extended active duty pay on
the 2007 return. The taxpayers appealed the assessments, asserting that the military wages at issue are exempt from Virginia tax. The Tax Commissioner denied the taxpayers’ appeal. Enlisted military personnel exclude combat duty wages from their FAGI. As such, combat duty wages were not present in the taxpayers’ FAGI to subtract in 2005 and 2006. Extended active duty pay is not excluded from FAGI. The Virginia subtraction allows taxpayers to subtract up to the first $15,000 of extended active duty pay which is reduced dollar for dollar by the amount exceeding $15,000. The Tax Commissioner determined that the auditor correctly calculated the reduction and upheld that portion of the assessment.

3. **Pension Income.** P.D. 09-10 (February 4, 2009). The taxpayers moved to Virginia in March 2007 and filed a 2007 Virginia part-year individual income tax return that attributed pension plan distributions to Virginia. The taxpayers did not pay the tax due reported on the return and as a result, the Tax Department issued an assessment of tax, penalty, and interest. The taxpayers appealed the assessment, contending that the pension distributions were derived from employment in their previous state and should not be subject to Virginia tax. The Tax Commissioner denied the taxpayers’ appeal citing *New York ex rel. Cohn v. Graves*, 300 U.S. 308, (1937), for the proposition that a state may tax all the income of its residents, even income earned outside the taxing jurisdiction. The Tax Commissioner also noted that under Title 4 U.S.C. sec. 114, states are prohibited from imposing an income tax on any retirement income of an individual who is neither an actual or domiciliary resident of such state. Under this federal statute, their previous state lost the legal authority to impose tax on the taxpayers' retirement income once they became residents of Virginia so the taxpayers’ pension income could not be taxed twice.

4. **S Corporation Income.** P.D. 09-11 (February 4, 2009). A shareholder in a Subchapter S corporation that operates an office in Virginia did not file a Virginia nonresident individual income tax return for the 2003 taxable year. For the 2003 taxable year, the S corporation filed an amended Virginia S corporation return reporting no distributions to its shareholders and filed a Virginia corporate income tax return as a taxable corporation. The Tax Department issued a tax assessment to the shareholder based on income passed through from the S corporation. The shareholder contested the assessment, asserting that Virginia failed to make its assessment within the statute of limitations period, that Virginia cannot tax the distributions received from the S corporation, and that his income was solely based on the amount he earned in California. The Tax Commissioner upheld the assessment. As the shareholder failed to file a 2003 Virginia income tax return, there was no statute of limitations on the assessment. The Tax Commissioner stated that Virginia can tax the distributions from the S corporation as it is treated as a pass-through entity and that it had nexus with Virginia in 2003. Finally, the Tax Commissioner determined that the shareholder’s income was based on his share of the apportioned income produced by the S corporation in Virginia, not on the amount of work that he personally performed in California or Virginia.

5. **Government Employee Subtraction.** P.D. 09-17 (February 4, 2009). The taxpayer is retired government employee and receives a pension. Because he is still covered by life insurance through his retirement plan, the premiums for coverage in excess of $50,000 is taxable income under Internal Revenue Code ("IRC") § 79. The plan administrator reported this income as wages on Form W-2 whereas the pension income is reported separately on Form 1099.
On his Virginia return for 2006 the taxpayer claimed a subtraction under Code of Virginia sec. 58.1-322(C)(24) for the income reported on his Form W-2. This W-2 was the only one received by the taxpayer and the amount is less than $15,000. The subtraction was denied by an auditor because the salary was related to former employment, not employment for the current year and an assessment issued. The taxpayer appealed arguing that no such restriction for the subtraction exists.

The subtraction permitted by Virginia Code sec. 58.1-322(C)(24) states:

Effective for all taxable years beginning on and after January 1, 2000, the first $15,000 of salary for each federal and state employee whose total annual salary from all employment for the taxable year is $15,000 or less.

The Tax Commissioner examined the subtraction and ruled that the subtraction is not limited to salaries for current year employment. Accordingly, the assessment was abated.

6. **Death Benefit Annuity Payment Subtraction.** P.D. 09-36 (March 31, 2009). The Taxpayer has received death benefits from two separate annuities following the death of the Annuitant in 2007. The death benefit payments from the annuities were reported for federal income tax purposes; and the interest earned from the initial investments was subjected to federal income taxation. The taxpayer requested a ruling as to whether the payments are eligible to be subtracted from taxable income pursuant to Virginia Code sec. 58.1-322(C)(32). The Tax Commissioner determined that the payment are eligible for the subtraction. In order to qualify for the subtraction, a death benefit payment is required to meet the following criteria: 1) the source of the payment is an annuity contract between a customer (the Annuitant) and an insurance company; 2) it has been awarded to the beneficiary in a lump sum; and 3) the payment is subject to taxation at the federal level.

7. **Foreign Source Income.** P.D. 09-50 (April 27, 2009). The taxpayers subtracted foreign source income on their 2007 individual income tax return. Upon review, the subtraction was disallowed an assessment was issued. The taxpayers appealed the assessment contending the subtraction is allowable as a special fixed date conformity adjustment on the individual income tax return and the amount claimed conforms to the foreign dividends amount used to compute the foreign tax credit on their federal return. The Tax Commissioner denied the appeal. Virginia’s foreign source income subtraction for individuals was repealed in 2003 and no subtraction is allowed under any fixed date conformity adjustments. Furthermore, Virginia’s authority to tax foreign source income of its residents is not prohibited by the United States Constitution or United States tax treaties.

8. **Statute of Limitations.** P.D. 09-64 (May 13, 2009). In January 2008, the taxpayer filed individual income tax returns for the 2001 through 2003 taxable years, each of which reported overpayments resulting from payments applicable to the 2001 taxable year. The 2001 taxable year overpayment was denied because the return was filed beyond the three-year statute of limitations. An assessment was issued after the resulting adjustment created a balance due for the 2003 taxable year. The taxpayer requested issuance of a refund for the taxable year 2001, or as an alternative, that it be allowed to offset the 2003 taxable year balance due. The Tax
Commissioner denied the request as the 2001 refund was requested after the statute of limitations expired.

9. Virginia Source Income. P.D. 09-66 (May 13, 2009). The taxpayer, the sole owner of a Virginia C corporation (VC), moved from Virginia to State A in 2004. After establishing domicile in State A, the taxpayer formed a State A C corporation (AC) for the purpose of providing consulting services to VC. During the taxable years at issue, VC issued dividends to the taxpayer. In addition, the taxpayer earned a salary from AC resulting from consulting services provided by VC. On his Virginia nonresident individual income tax returns for these taxable years, the taxpayer attributed all of the dividends from VC and salary from AC to State A. Under review, the Department's auditor stated that the consulting fees paid by VC to AC were not deductible. The auditor concluded that AC lacked economic substance, the transactions between AC and VC were not conducted at arm's length rates and they primarily served as a mechanism to shift income from Virginia to State A. The auditor attributed all of the salary earned by the taxpayer from AC to Virginia in the nonresident apportionment factor. In addition, the auditor found that the dividends paid by VC to be excessive because the dividends increased significantly from taxable years prior to those at issue. The auditor determined that the sole purpose for the increase was to avoid Virginia tax.

The taxpayer contested the assessments, asserting that the dividends were issued out of accumulated earnings for federal tax purposes and did not reduce the Virginia tax liability of VC. In addition, the taxpayer contended the consulting fees were legitimate fees paid to the AC for needed consulting services. The Tax Commissioner agreed. First, the Tax Commissioner adjusted the salary the taxpayer attributed to Virginia based on the days worked in Virginia. Based on information provided by the taxpayer, the Tax Commissioner determined that the dividends issued by VC were not Virginia source income for the 2005 through 2007 taxable years as evidence clearly showed the stock was not employed in a business, trade, profession or occupation carried on in Virginia.

10. Domicile and Virginia Source Income. P.D. 09-77 (May 26, 2009). The taxpayers, a husband and wife, changed their domicile from Virginia to State A in April 2004. The taxpayers filed a part-year Virginia individual income tax return for 2004 that reported their change in residence to State A as of May of that year. They did not file returns for the 2005 or 2006 taxable years. The husband is the sole shareholder and sole employee of VSC, a Virginia S Corporation. The husband writes and edits textbooks on behalf of VSC. The edited manuscripts are sent electronically to a publisher that prints and sells the textbooks. VSC's income consists of the fees and royalties from the sale of the textbooks. The husband earns a salary from VSC and its income flows through to the taxpayers' income tax return. In September 2004, VSC was merged into a State A S corporation (ASC). VSC filed a pass-through entity return for 2004. The husband reported his salary and flowthrough income from VSC as a Virginia resident through April 2004 on the taxpayers' individual return. VSC did not file pass-through returns for the 2005 and 2006 taxable years.

Under audit, the Tax Department assessed additional tax and interest against the taxpayers for the 2004 through 2006 taxable years. The auditor found that the taxpayers spent a considerable amount of time in Virginia after they moved to State A and concluded based on a
hunch that the husband performed services as an employee of VSC and ASC in Virginia. The taxpayers contested the assessments, asserting that VSC lacked nexus with Virginia after the taxpayers moved to State A, ASC has neither nexus nor income from Virginia sources, and the husband did not earn any of his salary in Virginia after April 2004.

The Tax Commissioner found that the auditor had no evidence that the taxpayer worked in Virginia and that he properly reported his income. She also found that the VSC had nexus in Virginia until it merged into ASC in September 2004. She required VSC to file an amended return based on this date and abated the 2005 and 2006 assessments.

11. **Capital Gain.** P.D. 09-78 (May 26, 2009). In April 2004, the taxpayers, a husband and wife, abandoned their Virginia residency and established residence in State A. The husband was the sole shareholder of an S corporation (Corporation A) located in State A. In September 2004, Corporation A sold its assets and realized a capital gain through the resulting distribution. The taxpayers filed a part-year Virginia individual income tax return for the 2004 taxable year and attributed all of the gain to State A. The taxpayers were audited and the auditor attributed a portion of the gain to Virginia in proportion to the number of days the taxpayers resided in Virginia. The taxpayers contested the assessment, asserting that because the sale occurred after they moved to State A, no part of the gain should be included in Virginia taxable income. They argued they were not required to prorate the income from the gain from the sale of Corporation A because there was a clearly defined cut-off of activity. The Tax Commissioner agreed and abated the assessment as documentation was provided clearly specifying when the capital gain from sale of Corporation A's assets occurred. Based on this documentation, the taxpayers received the gain after they moved to State A and the capital gain was attributed to State A.

12. **Pension Income.** P.D. 09-79 (May 26, 2009). The taxpayers, a husband and wife, were residents of Virginia for the taxable year at issue. The husband, a retired state employee of New York, received pension distributions from the New York state retirement system. The taxpayers did not include the distribution as part of their Virginia taxable income because they believed the husband's pension income was exempt from state taxation as contributions were subject to taxation. The Tax Department audited the taxpayers' 2005 Virginia income tax return and adjusted their Virginia taxable income to include the husband's pension distribution, resulting in the assessment of additional tax. The taxpayers contend that the distributions from the New York pension are exempt from taxation. The Tax Commissioner upheld the assessment as taxpayers did not add their contributions to FAGI for NY tax purposes. Thus, the contributions were not taxed and the distributions are taxable by the taxpayers state of residency.

13. **Domicile and Part-Year Residency.** P.D. 09-80 (May 26, 2009). The taxpayer did not file a 2005 Virginia income tax return and was assessed individual income tax for the 2005 taxable year. In June 2005, the taxpayer ceased renting a Virginia residence and commenced renting a residence in State A after he accepted a position for employment there. The taxpayer registered his car in State A, but kept a valid Virginia driver's license. The taxpayer appeals the assessment and states he changed his Virginia domicile to State A in May 2005. He moved back to Virginia in March 2006. The taxpayer contends that in 2005 the
majority of his income was earned in State A, and he paid income tax on this income in State A. The Tax Commissioner agreed that the taxpayer abandoned his domicile in May 2005. However, he was required to file a part-year return by the Tax Commissioner.

14. **Statute of Limitations.** P.D. 09-85 (May 28, 2009). In April 2008, the taxpayer filed Virginia individual income tax returns for the 2003 through 2007 taxable years. The Tax Department processed the returns for the 2004 through 2007 taxable years and issued the appropriate refunds. The refund claimed on the 2003 return was not issued because the return was not filed within the applicable statute of limitations. The taxpayer requested that the Department reconsider its position and issue the refund claimed on the 2003 taxable year return. The Tax Commissioner denied the taxpayer’s request as she did not have the authority to extend the statute of limitations.

15. **Domicile.** P.D. 09-86 (May 28, 2009). The taxpayers, a husband and wife, moved to State A in 2004 where they purchased a home and began operating a business. They failed to surrender their Virginia driver's licenses when they moved to State A and continued to own an automobile registered in Virginia. The taxpayers also maintained their residence in Virginia. Under audit, the Department determined the taxpayers were domiciliary residents of Virginia for the 2005 taxable year and assessed additional tax. The taxpayers contended that they took sufficient steps to abandon their Virginia domicile in 2004 such as establishing a permanent place of abode and operating a business in State A. The taxpayers stated that this business required them to work roughly ten hours a day, seven days a week. The Tax Commissioner examined the facts and circumstances and determined that the taxpayers abandoned their Virginia domicile and thus abated the assessment.

16. **Deadline to File Administrative Appeal.** P.D. 09-87 (May 28, 2009). The taxpayer did not file Virginia income tax returns for the taxable years at issue. Under audit, the Tax Department determined the taxpayer had income subject to Virginia income tax for the 1985, 1988, 1993 and 1998 taxable years and issued assessments for tax, penalty and interest. The taxpayer contests the assessments, asserting he was not a resident of Virginia. The Tax Commissioner denied his appeal as he failed to file an administrative appeal within 90 days of the date of the assessments.

17. **Statute of Limitations.** P.D. 09-88 (May 28, 2009). The taxpayer timely filed her 2000 Virginia individual income tax return, but failed to timely file Virginia individual income tax returns for the 2001 through 2004 taxable years. In late August 2007, she filed an amended 2000 return and original returns for 2001 through 2004. The 2003 return reported an overpayment that she requested be credited on her 2004 tax. The Tax Department disallowed the overpayment credit claimed on the 2003 return because the statute of limitations for claiming a refund or overpayment credit had expired. An assessment of tax, addition to tax, and interest was issued for the 2004 taxable year. The taxpayer contended that she filed her returns late because she was waiting for pass-through entities to finalize their financial information. She stated the required information was received in August 2007, and she immediately filed the appropriate returns. The Taxpayer requested that the assessment be abated because the returns were filed in good faith when the pass-through entities finalized their financial information. The Tax Commissioner denied the request as Virginia Code sec. 58.1-499(A) provides that no refund
may be paid if written application is not received within three years from the last day prescribed by law for the timely filing of the return.

18. **Statute of Limitations.** P.D. 09-89 (May 28, 2009). The taxpayers, a husband and a wife, made an early withdrawal from the husband's retirement plan in early 2004. The plan erroneously issued a federal information return (1099-R) reporting the distribution in 2003. The taxpayers reported the income on their 2003 federal and Virginia income tax returns. The plan issued a corrected 1099-R and the Internal Revenue Service (IRS) issued an assessment for the 2004 taxable year. In October 2006, the taxpayers amended their 2003 federal income tax return in order to offset the 2004 liability. In January 2008, the taxpayers filed an amended Virginia individual income tax return for the 2004 taxable year. The Tax Department processed the return and issued an assessment. In April 2008, the taxpayers filed an amended 2003 Virginia individual income tax return, requesting that the overpayment be applied to the 2004 underpayment. The Tax Department determined that the amended 2003 return was filed after the statute of limitations period expired and denied the taxpayers' request. The taxpayers acknowledge that they filed beyond the statute of limitations to request a refund, but appealed the denial of the credit of the 2003 overpayment against the 2004 assessment contending that they paid the appropriate amount of tax. The Tax Commissioner denied the taxpayers' request for the abatement of the 2004 assessment as she is not empowered to waive the statute of limitations period in this situation.

19. **Domicile and Actual Residency.** P.D. 09-95 (June 11, 2009). In June 1999, while Virginia residents, the taxpayers purchased a hotel incorporated as an S Corporation in State A. They moved into the hotel and began running it full time soon thereafter. In May 2000, the taxpayers purchased a residence in State A. The husband acquired a State A driver's license and registered to vote in 2001. The wife acquired a State A driver's license and registered to vote in State A in August 2008. The taxpayers' primary vehicles, an automobile and a motorcycle were registered in State A for the taxable years at issue. In addition, the taxpayers continued to own two residences, two commercial buildings and land in Virginia. They own a dump truck, an antique car and several small trailers that are registered in Virginia. The wife maintained a Virginia driver's license, renewing it as late as January 2008. The taxpayers filed Virginia nonresident individual income tax returns for the taxable years at issue. Under audit, the Department determined the taxpayers were actual and domiciliary residents of Virginia for the 2005 through 2007 taxable years and assessed additional tax and interest. The taxpayers contested the assessment, asserting they were neither domiciliary nor actual residents of Virginia.

The Tax Commissioner determined that the husband changed his domicile to State A before 2005. The strongest evidence against the wife that would indicate the intent to maintain a Virginia domicile is her renewal of a Virginia driver's license. However, she recently relinquished the license. In addition, the preponderance of evidence clearly showed that she moved to State A and took sufficient actions to establish a domiciliary residence there well before the 2005 taxable year.

The taxpayers state they spent 120 days in Virginia in 2005, 90 days in 2006, and 170 days in 2007. The Tax Department's auditor determined the taxpayers were in Virginia for 274 days in 2005, and 306 days in 2006. The auditor reported that the Department's computation is
based on the information and documentation provided by the taxpayers. The Tax Commissioner examined the same information and determined that the documentation supports the taxpayers' position that they were not present in Virginia for more than 183 days in each year. The assessments were abated.

20. **Pass-Through Income.** P.D. 09-103 (June 24, 2009). The taxpayer, a resident of State A, received income from a Virginia limited liability company (VALLC), and a Virginia S Corporation (VASC) for the taxable years at issue. Upon audit, the Tax Department determined that the taxpayer had Virginia source income and assessed additional tax. The taxpayer contended he is not liable for Virginia income tax because he is not a Virginia resident. (The taxpayer did not raise any due process issues regarding the assessment.) The Tax Commissioner determined that the assessment was correct as the taxpayer had Virginia source income.

21. **Section 179 Deduction.** P.D. 09-104 (June 24, 2009). The taxpayers, a husband and wife, filed a joint Virginia income tax return and itemized their deductions for the taxable year at issue. The taxpayers placed office furniture and equipment into service for their businesses in April 2004 and elected to expense the cost in the first year pursuant to Internal Revenue Code (IRC) section 179. In 2004, the taxpayers reported an additional 30% depreciation allowance on their 2004 Virginia itemized deductions that they did not claim on their federal return. The taxpayers' 2004 Virginia return was audited and the itemized deductions were adjusted to reflect the itemized deductions reported on their federal return. The taxpayers contested the adjustment, contending that under the federal Job Creation and Worker Assistance Act of 2002 (JCWAA), they were entitled to claim an additional 30% depreciation allowance. Based on the information provided, the taxpayers placed business property in service in April 2004 and deducted the full cost of the property on their federal income tax return under IRC sec. 179. As the taxpayers were not entitled to a double deduction on their Virginia return, the assessment was upheld.

22. **Combat Pay.** P.D. 09-105 (June 24, 2009). The taxpayers, a husband and wife, are residents of Virginia. They claimed a subtraction on their 2005 Virginia individual income tax return for military wages resulting from combat duty. The Tax Department disallowed the subtraction for combat duty pay on the basis that the combat duty pay was not included in the husband's federal adjusted gross income. The taxpayers appealed the assessment, asserting the military wages are eligible for the subtraction. The Tax Commissioner upheld the assessment. Combat duty pay of enlisted military personnel is not included in the taxpayers' FAGI. Thus, it would not eligible for a Virginia subtraction and is only available for officers whose eligible military pay is partially included in FAGI.

23. **Extended Duty Pay.** P.D. 09-106 (June 24, 2009). The taxpayers, a husband and a wife, are residents of Virginia. They claimed a subtraction on their 2005 Virginia individual income tax return for military wages resulting from extended active duty. The Department disallowed the subtraction for combat duty pay and adjusted the subtraction for extended active duty pay on the 2005 Virginia return, resulting in the assessment of additional tax and interest. The taxpayers appealed the assessment, asserting that the military wages at issue are exempt from Virginia income tax. The Tax Commissioner upheld the
assessment. Combat duty pay of enlisted military personnel is not included in the taxpayers' FAGI. Thus, it would not eligible for a Virginia subtraction and is only available for officers whose eligible military pay is partially included in FAGI.

To the extent included in FAGI, Virginia Code section 58.1-322(C)(23) provides military service personnel with a subtraction for up to $15,000 of military basic pay received during a taxable year, provided they are on extended active duty for a period in excess of 90 days. The subtraction is reduced when the amount of military basic pay received by the taxpayer exceeds $15,000 and is fully phased out when basic military pay reaches $30,000. The taxpayers claimed a military pay subtraction in the amount of $15,000. A review of the tax return showed that the husband's military pay exceeded $15,000. Under audit, the Tax Department auditor reduced the taxpayers' subtraction by the amount that the husband's military pay exceeded $15,000. The Tax Commissioner determined that the adjustment to the taxpayers' military pay subtraction is in accordance with Va. Code § 58.1-322 C 23 and is correct.

24. **Domicile.** P.D. 09-107 (June 24, 2009). The Tax Department obtained information from the Internal Revenue Service (IRS) indicating the taxpayer received third-party annual information returns at an address in Virginia. In addition, the taxpayer purchased a home in Virginia in 1998, obtained a Virginia driver's license in 2002, and registered an automobile in Virginia. As a result, the Tax Department determined the taxpayer was a domiciliary resident of Virginia, and an assessment was issued for the 2004 taxable year. The Taxpayer contested the assessment, asserting that he was an actual resident of Country A and a domiciliary resident of State A during 2004. The taxpayer submitted that he purchased the house in Virginia and one in another state as vacation homes and provided records to indicate these houses were used for vacation purposes only. The automobile registered in Virginia was also used only during visits to the house in Virginia. The taxpayer also claimed that he obtained the Virginia driver's license while on vacation in Virginia. He chose to obtain a Virginia license rather than return to State A to renew that state's license as a matter of convenience. The taxpayer was employed by a State A employer, to whose location he consistently returned when in the United States on business. He has continued to maintain a permanent place of abode, automobile registrations, voting residence, and a driver's license in State A. The Tax Commissioner determined that the taxpayer did not establish domicile in Virginia in 2002 and remained a domiciliary resident of State A in 2004.

25. **Above The Line Audit: Exclusion of the Gain from the Sale of a Principal Residence.** P.D. 09-110 (July 16, 2009). In July 1988, the taxpayers purchased a residence in Virginia where they commenced to reside on a full time basis. The taxpayers purchased a residence in State A in February 2003. They changed their domiciliary residence from Virginia to State A In March 2003. The taxpayers sold their State A residence in April 2005, and purchased another home in State A that month. The taxpayers then sold their Virginia residence in September 2005. The taxpayers excluded the capital gain from the sale of their Virginia home on their 2005 federal income tax return pursuant to Internal Revenue Code (IRC) section 121. The Tax Department disallowed the exclusion on the basis that the State A residence was the taxpayers' principal residence subject to the IRC section 121 exclusion. The taxpayers appealed the disallowance of the exclusion and contend both the Virginia and State A
residences qualified as principal residences, and they were entitled to exclude the capital gain from either sale.

The Tax Commissioner determined that the taxpayers were entitled to and properly excluded the capital gain from the sale of their Virginia home on their 2005 federal income tax return pursuant to IRC section 121. IRC section 121 provides that gross income does not include gain realized from the sale or exchange of a taxpayer's principal residence. A principal residence will qualify for the exclusion so long as it has been used as such for an aggregated period of at least two years during the five-year period ending on the date of the sale or exchange. In most cases, the exclusion can only be used for the gain on a principal residence once every two years. When a taxpayer has more than one sale of a principal residence in a two-year period, the residence that the taxpayer uses a majority of the time during the year ordinarily will be considered the taxpayer's principal residence. However, IRC section 121(f) permits the taxpayer to make an election not to have the exclusion apply to a gain on the sale of a principal residence. The taxpayers used their Virginia residence as a principal residence from September 2000 through March 2003, an aggregated period of two years and 5 months. The taxpayers used their original State A home as their primary residence from March 2003 through April 2005, an aggregated period of two years and one month. As such, each residence qualified as a principal residence, and the taxpayers could choose which gain to exclude pursuant to IRC § 121(f). In this case, the taxpayers chose to exclude the gain from the sale of the Virginia residence. Query: As this matter was an “above the line” audit, one must wonder whether the auditor bothered to read the Internal Revenue Code?

26. Domicile. P.D. 09-111 (July 16, 2009). The taxpayer was a resident of Virginia at the beginning of 2005. In 2005, the taxpayer and his partners purchased four residences in State A. According to an affidavit, the taxpayer moved into one of the State A residences in July 2005. Shortly thereafter, he opened a post office box in State A. The taxpayer surrendered his Virginia driver's license and voter registration and acquired a State A driver's license and registered to vote in State A in December 2005. The taxpayer set up accounts with utilities in State A for the State A properties. In January 2006, the taxpayer resigned from the board of a Virginia charity. The taxpayer had three vehicles registered in Virginia. He registered one of the vehicles in State A in December 2006 and another one in April 2007. The third vehicle has been continuously registered in Virginia. The taxpayer sold his Virginia residence in August 2007. The taxpayer filed a Virginia part-year resident income tax return reporting his change of domicile to State A in July 2005. He filed a nonresident Virginia income tax return for 2006. Upon audit, the Department determined the taxpayer was a resident of Virginia for 2005 and 2006 and assessed additional tax. The taxpayer contended that he changed his domicile from Virginia to State A in July 2005.

The Tax Department gives more weight to a taxpayer's declared intent attached to an affirmative event for determining the exact date of separation from Virginia. The taxpayer declared his intent on his 2005 part-year return and moved to a State A residence in July 2005. Following his move, the Taxpayer obtained a State A driver's license and surrendered his Virginia license. The Tax Commissioner reviewed these facts and determined that the taxpayer successfully abandoned his Virginia domicile and became a domiciliary resident of State A in July 2005.
27. **Amended Return: Change in Other State Tax Liability.** P.D. 09-112 (July 16, 2009). The taxpayers, a husband and wife, were residents of State A. In 1990, the husband retired from a corporation operating in State A. The retirement agreement granted the husband a ten-year payout as part of his retirement, which was to be treated as compensation. In 1991, the taxpayers moved to Virginia. They filed Virginia resident and State A nonresident returns that reported the retirement payouts as income. The taxpayers claimed a credit for income tax paid to State A on their Virginia returns. In 1997, the husband's former employer was purchased by another corporation through a stock acquisition. The acquiring corporation voided the ten-year retirement payout plan and a lump-sum payment was made to the husband. Subsequent to the merger, a review of the payout plan and lump-sum payments by the Internal Revenue Service (IRS) resulted in a closing agreement. Under the closing agreement, payments made prior to 1997 and the 1997 lump-sum payment were treated as dividends and a capital gain, respectively. Pursuant to the closing agreement, the taxpayers amended their 1994 through 1996 Virginia and State A income tax returns and paid the additional tax and interest due to Virginia. For the 1997 taxable year, the taxpayer's reported all their income as income from Virginia sources and claimed no credit for tax paid to State A. State A audited the taxpayer for the 1997 taxable year and issued an assessment. The audit concluded that State A was not subject to the closing agreement and determined that the lump-sum payment received in 1997 was compensation subject to State A income tax. After a prolonged appeal process, the taxpayers accepted an offer from State A on October 25, 2006, and agreed to reclassify a portion of the income as a lump-sum payment as compensation, interest and gains from State A sources. The taxpayers filed an amended 1997 Virginia income tax return on October 11, 2007, claiming a credit for tax paid to other states pursuant to the agreement made with State A. The taxpayers request that the Department accept this return as timely filed and issue a refund.

The Tax Commissioner accepted the taxpayers' return as she concluded that the taxpayers correctly filed amended Virginia income tax returns in accordance with the IRS agreement. Furthermore, the credit for taxes paid to State A was allowed as the lump-sum payments were treated as capital gains under the IRS agreement. Capital Gains are eligible for Virginia’s out-of-state tax credit.

28. **Above The Line Audit: Hobby Loss Rules.** P.D. 09-122 (August 7, 2009). The taxpayers, a husband and wife, are Virginia residents. They purchased several plots of residential land on which they built homes. They also purchased several different condominium units. The taxpayers intended to either sell or rent the residences. The wife is a licensed realtor. She has a business license in the locality in which she operates and keeps separate books and records of her real estate activities. The taxpayers have advertised their residences in several local magazines, in brochures, flyers and through open houses. In addition, the taxpayers spent approximately 25 hours per week engaged in the real estate activities. During the taxable years at issue, the taxpayers incurred significant expenses stemming from building and renovation, marketing and mortgage interest, which they reported on their federal Schedule C to their tax return. The resulting losses offset the taxpayers' salary and investment income, as well as any income generated by the properties themselves. Under audit, the Tax Department concluded that the taxpayers' real estate activities were not engaged in for profit. As a result, the auditor limited deductions claimed on the Schedule C to equal the income generated
by the properties. This resulted in assessments of additional tax and interest. The taxpayers appealed the assessments and contend that their real estate activities were engaged in to make a profit and that they were entitled to deduct all expenses incurred from their real estate operations.

Treas. Reg. section 1-183-2(b) identifies nine factors that should be taken into account when determining whether an activity has a profit motive: 1) The manner in which the taxpayer carries on the activity; 2) the expertise of the taxpayer or his advisors; 3) the time and effort expended by the taxpayer in carrying on the activity; 4) expectation that assets used in the activity may appreciate in value; 5) the success of the taxpayer in carrying on other similar or dissimilar activities; 6) the taxpayer's history of income or losses with respect to the activity; 7) the amount of occasional profits, if any, which are earned; 8) the financial status of the taxpayer; and 9) elements of personal pleasure or recreation. The taxpayers provided significant documentation concerning their activities with regard to their real estate activities. The auditor concluded that the taxpayers did not meet some of the factors used to determine if an activity is conducted with a profit motive. The auditor also determined the taxpayers did not spend enough time conducting the activity.

The Tax Commissioner examined the facts and determined that the clear preponderance of the evidence supported a finding that the taxpayers did conduct their Schedule C business for profit. Editorial Note: This ruling might be the most egregious example of an auditor who wanted to issue an assessment despite the severe weight of the facts and the law against him.

29. **Domicile.** P.D. 09-123 (August 1, 2009). The taxpayer resided in Country A since 1989. He had no permanent place of abode or automobiles registered in Virginia during the taxable years at issue. Information obtained from the Internal Revenue Service, however, showed the taxpayer used a Virginia address to receive third-party information returns for the taxable years at issue. Under investigation, the auditor found that the taxpayer had obtained a Virginia driver's license in 2001 and regularly spent time in Virginia. The auditor requested that the taxpayer file Virginia income tax returns or provide evidence as to why he was not required to file for the taxable years at issue. Assessments were issued when sufficient evidence was not provided. The taxpayer asserts that he was not a resident of Virginia, had no place of abode in Virginia and had no income from Virginia sources and requested abatement of the assessments. The Tax Commissioner determined that the taxpayer did not establish a domicile in Virginia during the taxable year 2001, was not a domiciliary resident for the taxable years at issue, and abated the assessments. Note: Apparently, receiving IRS documents at a Virginia address and holding a Virginia driver's license is sufficient in the auditor's eyes to establish a Virginia domicile.

30. **Combat Pay.** P.D. 09-124 (August 7, 2009). The taxpayer is a resident of Virginia who was on active duty in a combat zone during the 2005 taxable year. He claimed a subtraction on his 2005 Virginia individual income tax return for military wages resulting from combat duty or extended active duty. The Tax Department disallowed the subtractions for combat duty pay on the 2005 Virginia return. The taxpayer appealed the assessment, asserting that a portion of the military wages at issue is exempt from Virginia tax. After a review of the assessment, the taxpayer conceded that a portion of the amount claimed as a subtraction on the 2005 return was not included in FAGI. He did contend, however, that an additional portion of
the income, received for qualifying service, was included on his Form W-2 as taxable wages because it exceeded the maximum amount excludible by the Internal Revenue Service. Based on the documentation provided, the Tax Commissioner determined that the taxpayer is eligible for a subtraction for compensation for active duty service in a combat zone or a qualified hazardous duty area, as set forth therein, and adjusted his return to allow the qualifying portion of the subtraction.

31. Disability Income Subtraction. P.D. 09-125 (August 7, 2009). The taxpayer filed a Virginia income tax return for the 2004 taxable year, on which he claimed a subtraction for disability income. The Tax Department determined that the income in question did not qualify as disability income for purposes of the Virginia subtraction because it was provided by an employer provided plan. The taxpayer contended the subtraction of disability income is correct and requests abatement of the assessment. Virginia Code section 58.1-322(C)(4)(b) provides an individual income tax subtraction for up to $20,000 of disability income as defined under Internal Revenue Code (IRC) section 22(c)(2)(B)(iii). The income at issue was received from the Virginia Retirement System (VRS). According to the income reporting statement issued by VRS, the income qualified as disability income under IRC section 72. Also, the documentation presented indicates that the income qualified for the credit under IRC section 22(c)(2)(B)(iii). Accordingly, the Tax Commissioner determined that the disability income the taxpayer received from VRS for the 2004 taxable year is eligible for the subtraction under in Virginia Code section 58.1-332(C)(4)(b).

32. Domicile. P.D. 09-128 (September 8, 2009). The taxpayer moved from State A to Country A in 2000 for employment purposes. He took sufficient steps to abandon his State A domicile and acquire a Country A domicile in 2000. He did have federal tax information mailed to a Virginia residence. The taxpayer stated he used his sister's address to receive mail because the mail service is poor in Country A. The taxpayer did travel into the United States for 16 days, part of which was spent in Virginia visiting his sister. According to the taxpayer, he found it convenient to have federal tax information to be sent to the Virginia address. In addition, the taxpayer obtained a Virginia driver's license in March 2003. The taxpayer stated he acquired the Virginia driver's license as a convenience for when he visits the United States. Under audit, the Tax Department determined that the taxpayer was a domiciliary resident of Virginia in 2004, and issued an assessment for tax and interest. The taxpayer contested the assessment, asserting he was not a resident of Virginia. The Tax Commissioner determined that the evidence overwhelmingly shows that the taxpayer did not abandon his domiciliary resident in Country A for the 2004 taxable year. Thus, even though he obtained a Virginia driver's license, this evidence alone was not sufficient to show he established a Virginia domicile in 2004. Accordingly, the assessment was abated.

33. Actual Residency. P.D. 09-129 (September 8, 2009). The taxpayers, a husband and wife, are domiciliary residents of State A who spent time in Virginia during 2006. They filed a joint 2006 nonresident Virginia income tax return. Under audit, the Tax Department determined that the taxpayers were actual residents of Virginia and assessed additional tax and interest. The taxpayers conceded that the wife was an actual resident in 2006, but contend that the husband was not an actual resident. They contended that the methodology used by the auditor to determine the number of days in Virginia failed to consider that the husband and the
wife were not present in the same state for every day during the 2006 taxable year. The Tax Commissioner determined that sufficient evidence was provided to demonstrate that the husband spent less than 183 days in Virginia in 2006. The Tax Department's auditor used the husband's calendar of days in Virginia in combination with credit card statements to calculate that the husband spent more than 183 days in Virginia. Evidence provided to the Tax Commissioner indicated the taxpayers shared one credit card account under the husband's name. They also provided evidence and documentation showing that the wife was in Virginia while the husband remained in State A for almost all of the contested days during 2006.

34. **Actual Residency.** P.D. 09-130 (September 8, 2009): The taxpayer is a domiciliary resident of State A and filed nonresident Virginia income tax returns for the taxable years at issue. The taxpayer is the CEO of a Virginia Corporation, owns several investment properties in Virginia, and maintains residences in both State A and Virginia. He travels extensively on behalf of his business and spends significant amounts of time at both his residences. The taxpayer was audited for the 2005 through 2007 taxable years. The auditor determined that the taxpayer was an actual resident of Virginia and assessed additional tax and interest. The auditor determined that the taxpayer spent more than 183 days in Virginia based, in part, on a credit card statement. The taxpayer appealed and contended that he did not spend 183 days in Virginia during any of the taxable years at issue. The taxpayer provided evidence demonstrating that the credit card account was also used by employees of the taxpayer's Virginia business and by at least one family member in Virginia. The Tax Commissioner determined that evidence refuted the auditor's assertion that the taxpayer was in Virginia on the contested days during 2005, 2006, and 2007. The assessments were abated.

35. **Domicile.** P.D. 09-131 (September 8, 2009): The taxpayer filed Virginia nonresident individual income tax returns for the 2004 through 2006 taxable years to report income earned while working for his employer in Virginia. The taxpayer maintained a home in State A where his spouse lived, a State A driver's license, and an automobile registered in State A. He was also registered to vote in State A. The Tax Department obtained information from the Internal Revenue Service (IRS) indicating that the taxpayer received third-party annual information returns at an address in Virginia. In addition, the taxpayer had purchased a town home in Virginia and obtained a Virginia driver's license in 2002. Because the taxpayer spent more time in Virginia than State A for the taxable years at issue, the Tax Department's auditor concluded that the taxpayer was a domiciliary resident of Virginia, and issued assessments. The taxpayer appealed the assessments, contending that, although he performed work for his employer in Virginia, he remained a domiciliary resident of State A. The Tax Commissioner abated the assessment. She determined that the taxpayer did not establish a Virginia domicile and was a domiciliary resident of State A. Note: The auditor based his assessment on the fact that the taxpayer spent more days in Virginia than State A. Did the auditor create this rule out of thin air???

36. **Domicile.** P.D. 09-132 (September 8, 2009): Prior to 2004, the taxpayer was a Virginia domiciliary resident who owned and operated several businesses in Virginia. In 2003, the taxpayer retired from his businesses. He divested himself of a portion of his business interests, but maintained a 5% ownership of a personal service business and 50% ownership of a real estate rental business. After purchasing a townhouse in State A, the taxpayer moved to State
A, acquired a State A driver's license, and registered to vote there in August 2003. Soon thereafter, the taxpayer purchased an automobile and registered it in State A. In 2004, the taxpayer purchased an automobile to be registered and garaged in Virginia. This vehicle was used primarily by the taxpayer when he visited Virginia. He purchased another automobile, registered and garaged it in Virginia in 2005. This vehicle has primarily been used by the taxpayer's son. The taxpayer also joined a country club in State A in 2005, and he resigned his membership in a Virginia country club in 2006. Also in 2006, the taxpayer joined a State A chapter of a nonprofit organization that provides free counseling to small businesses.

The taxpayer did not sell his home in Virginia and continued to use it when he made trips to Virginia. The records show that the taxpayer spent less than 183 days in Virginia during the 2005 and 2006 taxable years, primarily visiting with friends and family. The majority of the taxpayer's time was spent in State A where a number of his family live. Because the Virginia businesses are pass-through entities, the taxpayer filed nonresident individual income tax returns for the taxable years at issue. Under review, the Tax Department determined that the taxpayer did not abandon his Virginia domicile and assessments were issued. The auditor's conclusion was based on the fact that the taxpayer continued to own businesses and a permanent place of abode in Virginia, did not surrender his Virginia driver's license when he moved to State A, and renewed his Virginia driver's license in 2007. The taxpayer contested the assessments, maintaining that he successfully changed his domicile to State A in 2004. The Tax Commissioner weighed the evidence and determined that the taxpayer successfully changed in his domicile to State A at the beginning of 2004 and was not a domiciliary resident of Virginia for the 2004 through 2006 taxable years.

37. Domicile. P.D. 09-133 (September 8, 2009). The taxpayers, a husband and a wife, moved from State A in 2000 when the husband was transferred to Virginia by his employer. In July 2006, the husband was transferred back to State A. The husband rented an apartment for 11 months and purchased a home in State A. He also obtained a driver's license, registered a motor vehicle and registered to vote in State A. The wife remained in Virginia so their children could finish their education. The children received in-state tuition at public universities in Virginia, however the wife signed the applications for in-state tuition. The taxpayers also owned several motor vehicles registered in Virginia that were used by the wife and the children. Under the audit, the Tax Department determined the husband was a domiciliary resident of Virginia for the 2006 taxable year and assessed additional tax. The taxpayers appealed contending that the husband took sufficient steps to change his domicile to State A in 2006. The Tax Commissioner determined that the husband took sufficient steps to abandon his Virginia domicile.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.
IV. RETAIL SALES AND USE TAXES

A. 2009 Legislation

1. Nonprofit Exemption. House Bill 2330 (Chapter 106) and Senate Bill 1222 (Chapter 526) modify the criteria for nonprofit organizations to receive an exemption from the Retail Sales and Use Tax by requiring that nonprofit organizations with gross annual revenues in the previous year of at least $750,000 provide a financial review performed by an independent certified public accountant. Currently, nonprofit entities with gross annual revenues in the previous year of $1 million or greater are required to provide a full financial audit performed by an independent certified public accountant, while nonprofit entities with gross annual revenues between $750,000 and $1 million in the previous year are given the choice of providing a full financial audit or a financial review, both of which must be performed by an independent certified public accountant. In addition, the Tax Department is given the discretion to determine whether nonprofit entities with gross annual revenues in the previous year of at least $1 million must provide a full financial audit or a financial review in order to qualify for exemption.

2. Fabrication of Animal Meat, Grains, and Other Food. House Bill 2360 (Chapter 36) and Senate Bill 944 (Chapter 833) create an exemption from sales and use tax for the fabrication of animal meat, grains, vegetables, or other foodstuffs when the purchaser (i) supplies the foodstuffs and they are consumed by the purchaser or his family, (ii) is an organization exempt from taxation under § 501 (c) (3) or (c) (4) of the Internal Revenue Code, or (iii) donates the foodstuffs to an organization exempt from taxation under § 501 (c) (3) or (c) (4) of the Internal Revenue Code.

3. Data Center Exemption. Senate Bill 944 (Chapter 833) created a new exemption for computer equipment purchased or leased for the processing, storage, retrieval, or communication of data provided that such computer equipment is purchased or leased for use in a data center that (a) is located in a Virginia locality, (b) results in a new capital investment on or after July 1, 2009 of at least $150 million, and (c) results in the creation on or after July 1, 2009 of at least 50 new jobs associated with the operation or maintenance of the data center provided that such jobs pay at least one and one half times the prevailing average wage in that locality.

B. Recent Court Decisions

There are no recent court decisions to report.

C. Current Virginia Tax Commissioner Rulings

1. Hotels and REITS. P.D. 09-2 (February 4, 2009). A hotel owner, operates a real estate investment trust ("REIT") with a business structure involving multiple legal entities and intercompany transactions. Generally, the hotels, the land, real property and all tangible furniture and fixtures are owned within one legal entity (the "Lessor"). The Lessor will lease the hotel, including the realty, furniture and fixtures, for one lump sum rental charge, to a separate subsidiary (the "Lessee") for the purpose of profiting from the hotel operations.
Because the hotel owner is a REIT, the value of the lease payment associated with the tangible personal property does not exceed 15% of the total value. The generic lease agreement states that rent is a lump sum charge for the rental and includes a base rent charge and a percentage of revenue components (collectively referred to as "rent"). The Tax Commissioner assumed that the lease stream occurs between separate respected entities for federal tax purposes (as opposed to disregarded entities) and will be respected as separate legal entities for sales and use tax purposes. Additionally, the Tax Commissioner assumed that the lease stream is documented by intercompany invoices, lease agreements, and journal entries with consideration passing. The hotel owner requested a ruling regarding the application of the retail sales and use tax.

The Tax Commissioner ruled that the lease of tangible personal property which is included in the lease payments is subject to sales and use tax. The Tax Commissioner noted that the Lessor is in the business of making leases of hotels, including the land, real property, and all tangible personal property and fixtures. The lease of the real property however is not subject to sales and use tax. To determine how much of the lease is subject to sales and use tax, the dealer (or lessor) must provide a breakdown of the value of tangible personal property versus the value of the real property included in the lease. If the dealer is not able to provide such a breakdown and no other evidence is available, the tax will apply to the entire lease payment. Once the breakdown is provided, sales tax should be charged on the portion of the lease payment determined by applying an allocation percentage based on the original cost price of the tangible personal property over the total original cost price of tangible personal property, real property and fixtures.

2. Direct Mail Advertising. P.D. 09-3 (February 4, 2009). A taxpayer requested a ruling concerning the sales and use tax implications of its operations. The taxpayer, located in another state, prepares direct mail advertising materials ("materials") for its customers. The materials are sent FOB shipping point from a location outside of Virginia. Some of the materials may be delivered from a non-Virginia post office to residents in Virginia. The taxpayer's customers take title and possession of the materials at the taxpayer's dock outside of Virginia. Risk of loss passes to the customers prior to transfer of possession of the materials to the U.S. Postal Service. The Tax Commissioner determined that the taxpayer is not liable to collect Virginia sales tax as all of its sales occur outside of Virginia.

3. Durable Medical Equipment Exemption: Cosmetic Implants. P.D. 09-4 (February 4, 2009) and P.D. 09-40 (April 27, 2009). A taxpayer requested a ruling as to whether its sales of an injectable implant is exempt from sales tax. The taxpayer is a manufacturer of a permanent aesthetic injectable implant for the treatment of facial wrinkles. The injectable implant is injected into the smile lines around the mouth to smooth the wrinkles, is only obtained via prescription, and is injected as an outpatient procedure by trained physicians.

Virginia Code sec. 58.1-609.10(10) provides an exemption for "prosthetic devices and . . . other durable medical equipment and devices, and related parts and supplies specifically designed for those products . . . when such items or parts are purchased by or on behalf of an individual for use by such individual." Prosthetic devices are defined in Title 23 of the Virginia Administrative Code 10-210-940 to mean "devices which replace a missing part or function of the body and shall include any supplies physically connected to such devices." The Tax
Commissioner determined that the injectable implant does not qualify for the exemption as the implant does not replace a missing part of a person’s body.

4. **Durable Medical Equipment Exemption: Knee Joint Devices.** P.D. 09-6 (February 4, 2009). The taxpayer operates as a medical practice that provides treatment for arthritis and rheumatic diseases. The taxpayer was audited and assessed with sales tax on bulk purchases of knee joint injected viscosupplementation devices, splints and other durable medical equipment. The taxpayer argued that the bulk purchases of knee injected devices, splints, and other durable medical equipment qualify for exemption when the sale of such items is for use by individual patients under prescription of a physician. In addition, the taxpayer contested the penalty assessed on the contested items.

The taxpayer asserts that it should not have been assessed tax on the knee joint injected viscosupplementation devices contending that the devices are considered drugs by physicians and Medicare and exempt under Virginia Code sec. 58.1-609.10(9). However according to the FDA guidelines, the knee joint injected viscosupplementation devices are classified as medical devices. Based on this classification, the Tax Commissioner determined that the exemption for medicines and drugs does not apply to the purchase of these devices by the taxpayer. As this was the first audit of the taxpayer in which the taxability of the knee joint injected viscosupplementation devices was examined, the Tax Commissioner waived the compliance and amnesty penalties assessed on the tax due for these devices.

For the splints, braces, and ankle locks, the taxpayer argued that they should be exempt under the durable medical equipment exemption. However the Tax Commissioner noted that the taxpayer purchased these items in bulk and not for a specific patient. Items purchased in bulk are ineligible for the exemption per 23 VAC 10-210-2060(B). Based on the regulation, the Tax Commissioner upheld the assessment.

5. **Reconsideration: Sales to a Real Property Contractor.** P.D. 09-7 (February 4, 2009). The taxpayer appealed an assessment of uncollected sales tax on sales made to a real property construction company. The Tax Commissioner upheld the assessment and the taxpayer requested a reconsideration. The reconsideration is based on 23 VAC 10-210-410(A), which states, "If a supplier of a contractor doing work in Virginia does not collect the Virginia tax from the contractor, the contractor will be liable for the use tax on his purchases from the supplier." The taxpayer contended that it has no sales tax liability because the contractor is liable for payment of the use tax on its untaxed purchases based on the regulation. The Tax Commissioner denied the taxpayer’s request citing 23 VAC 10-210-410(A) and Virginia Code sec. 58.1-625 which require taxpayers to collect sales tax from contractors and hold dealers liable for uncollected sales tax.

6. **Fabrication.** P.D. 09-15 (February 4, 2009). A taxpayer was assessed with unpaid use tax on its purchase of a service to cut bricks. The taxpayer provided the bricks to a third party business cut the bricks to the taxpayer’s specifications. The bricks were returned to the taxpayer and used to construct arches for real property construction jobs. The Tax Department audited the taxpayer and treated the third party’s charges to cut the bricks as taxable fabrication labor. The taxpayer appeal and maintained that the cutting of bricks does not change
the state or form of the bricks and was not fabrication. The Tax Commissioner disagreed. Title 23 VAC 10-210-560(A) defines fabrication as "[a]n operation which changes the form or state of tangible personal property." Based on this definition, the Tax Commissioner determined that cutting bricks meets the definition of fabrication and upheld the assessment.

7. **Museum Exhibits.** P.D. 09-16 (February 4, 2009). The taxpayer contracts with museums, visitor centers and similar establishments to design, fabricate and install exhibits and the display structures for the exhibits. The taxpayer also designs, fabricates and installs trade show exhibits. The taxpayer's exhibit services include scenic and art production, construction and fabrication, audio-visual systems engineering, multimedia development and artifact mounting. In addition, the taxpayer fabricates and sells custom furniture, graphics and signs. Many of the taxpayer's customers are not located in Virginia. The taxpayer was audited and treated as a real property contractor for much of the fabrication and installation work performed for its customers. The taxpayer appealed the assessment and argued that it was not a real property contractor but rather a dealer of tangible personal property.

The Tax Commissioner cited to *Danville Holding Corp. v. Clement*, 178 Va. 223, 232, 16 S.E.2d 345, 349 (1941), which provides three factors for determining whether property used in connection with realty is a fixture. The three factors are: "(1) Annexation of the chattel to the realty, actual or constructive; (2) Its adaptation to the use or purpose to which that part of the realty to which it is connected is appropriated; and (3) The intention of the owner of the chattel to make it a permanent addition to the freehold." In this case, the Court noted that "[t]he intention of the party making the annexation is the paramount and controlling consideration." When trying to determine if the museum exhibit are real property or tangible personal property, the Tax Commissioner also cited *John Wesley Mullins, et al. v. L.E. Sturgill, et al.*, 192 Va. 653, 66 S.E. 2d 483 (1951), which stated:

in cases of doubt it [the intention of the party making the annexation] has a controlling influence and must be considered. However, in order that a chattel may be converted into a fixture, the intention to make it a permanent accession to the realty must affirmatively and plainly appear; if the matter is left in doubt and uncertainty, the legal qualities of the article are not changed, and it must be deemed a chattel.

In this case, the Tax Commissioner noted that the intent of the parties to make the exhibits purchased from the taxpayer a permanent part of the realty was not affirmatively and plainly apparent. Based on the lack of clarity, the Tax Commissioner determined that the museum exhibits should be treated as tangible personal property, not real property, unless no doubt exists that the item in question was intended to be permanently affixed to the real property. The Tax Commissioner directed the auditor to adjust the audit on this basis.

8. **Agricultural Exemption: Canine Breeder.** P.D. 09-31 (March 31, 2009). The taxpayer is in the business of breeding canines for resale to the pharmaceutical industry. All sales are to companies that provide tax exemption certificates. The majority of the taxpayer's customers request canines that must meet their specific needs (gender, weight, blood type and age). The taxpayer asked if certain purchases (feed, medicines and vaccines) can be purchased
exempt of the retail sales and use tax pursuant to the agricultural exemption provided in Virginia Code sec. 58.1-609.2(1) or any other exemption. The Tax Commissioner determined that the purchases may not be purchased exempt. In order to qualify for the agricultural exemption, two criteria must be met: (1) a farmer must be engaged in the raising of crops, livestock (as defined in Virginia Code sec. 3.2-6500) or other specified farming activities such as quail or worm farming; and (2) exempt purchases must be used by the farmer in agricultural production for market. The Tax Commissioner was not certain if the taxpayer is a farmer. However even if the taxpayer is considered a farmer, it is not engaged in raising crops, livestock (as defined in Virginia Code § 3.2-6500) or the other specified farming activities. In addition, the information provided to the Tax Commissioner indicated that the medicines and vaccines are sold to the taxpayer and not to a veterinarian, as required by the statute to qualify for the exemption.

9. **Food Tax.** P.D. 09-32 (March 31, 2009). The taxpayer operates a restaurant and was assessed tax and interest after the auditor concluded that the taxpayer should have applied the general retail sales and use tax rate to its sales of food rather than the reduced rate. The taxpayer requested a waiver of the tax and interest because it did not charge and collect the general sales tax from its customers. The Tax Commissioner denied the taxpayer's request as the taxpayer is liable for its neglect in failing to collect the proper tax per Virginia Code sec. 58.1-625.

10. **Advertising Exemption.** P.D. 09-33 (March 31, 2009). The taxpayer is an advertising company that provides concept, writing, graphic design, mechanical art, photography and production supervision for generating multimedia vehicles. The taxpayer seeks reconsideration of a prior appeal that determined certain transactions were taxable. The taxpayer argued that a CD presentation and a video testimonial should be exempt from sales tax under the advertising exemption. The Tax Commissioner rejected the request for reconsideration as the taxpayer did not provide sufficient evidence to prove the exemption applies to the specific materials.

11. **Counter-Tops and Manufacturing Exemption.** P.D. 09-34 (March 31, 2009). The taxpayer fabricates counter tops for sale with or without installation. An audit resulted in the assessment of sales tax on under-taxed sales and the assessment of use tax on purchases of various machinery, equipment, supplies and materials. The auditor determined that the taxpayer was principally fabricating for its use or consumption in real property construction contracts. Also the taxpayer was denied the industrial manufacturing exemption for machinery, tools and equipment used directly to fabricate its stone counter tops. The taxpayer appealed and argued that that such determination is incorrect because its primary business is the sale of tangible personal property and, thus, it should be entitled to the industrial manufacturing exemption.

The Tax Commissioner denied the taxpayer's appeal. The Tax Commissioner cited to *Danville Holding Corp. v. Clement*, 178 Va. 223, 232, 16 S.E.2d 345, 349 (1941), which provides three factors for determining whether property used in connection with realty is a fixture. The three factors are: "(1) Annexation of the chattel to the realty, actual or constructive; (2) Its adaptation to the use or purpose to which that part of the realty to which it is connected is appropriated; and (3) The intention of the owner of the chattel to make it a permanent addition to
the freehold." In this case, the Court noted that "[t]he intention of the party making the annexation is the paramount and controlling consideration." In this case, the Tax Commissioner determined that the countertops are real property as (1) they are attached to the permanent cabinets by sealants and caulking and thus annexed to the realty; (2) they are adapted to the use of the dwelling to which it is annexed and are essential to the purpose for which the dwelling was acquired and used; and (3) they are to remain in place for their normal life, subject to the necessity or desire for replacement, maintenance or repair.

The Tax Commissioner also determined that the taxpayer is not eligible to receive the manufacturing exemption. To qualify for the manufacturing exemption, a taxpayer must be an industrial manufacturer. The definition of "manufacturing, processing, refining, or conversion" under Virginia Code sec. 58.1-602 provides:

The determination whether any manufacturing ...activity is industrial in nature shall be made without regard to plant size, existence or size of finished product inventory, degree of mechanization, amount of capital investment, number of employees or other factors relating principally to the size of the business. Further, "industrial in nature" shall include, but not be limited to, those businesses classified in codes 10 through 14 and 20 through 39 published in the Standard Industrial Classification (SIC) Manual for 1972 and any supplements issued thereafter.

The Tax Commissioner determined that the taxpayer was not classified under the correct SIC and NAICS codes and concluded that the taxpayer was not eligible for the exemption. [Query: The Virginia Code clearly states that "'industrial in nature' shall include, but not be limited to ..." certain SIC codes. Despite the underlined language the Tax Department always limits its analysis to the classification of the business. The Tax Commissioner is likely correct in this case, but she is clearly ignoring a portion of the definition in the statute.]

12. Hurricane Preparedness Sales Tax Holiday. P.D. 09-37 (April 21, 2009). This document establishes the guidelines for retailers and consumers regarding Virginia's Hurricane Preparedness Sales Tax Holiday. The sales tax holiday will be a recurring event, beginning each year on May 25 at 12:01 a.m. and ending at 11:59 p.m. on May 31. The holiday will expire in July of 2012.

13. Discount Membership Programs. P.D. 09-43 (April 27, 2009). The taxpayer operates as a retail business that sells beauty products. In the audit, the taxpayer was assessed tax on the sale of discount program memberships. Memberships entitle members to discounts on qualifying purchases. Memberships also entitle members to receive tangible personal property valued at $10 or less during their birthday month. The membership fees were held taxable in the audit because the taxpayer's discount program entitled its members to receive tangible personal property. The taxpayer appealed and contended that the assessment of tax on the discount program charges is erroneous as the use of the membership card is similar to the use of a coupon that provides for a discount on merchandise.
The Tax Commissioner determined that the sale of discount program memberships was subject to the sales tax based on the inclusion of tangible personal property with each membership. This ruling is consistent with prior rulings of the Tax Commissioner and does not add any new analysis except by demonstrating that there is no de minimis exception if any tangible personal property is provided with a membership.

14. **Nexus.** P.D. 09-44 (April 27, 2009). A taxpayer requested a ruling on whether it has nexus for purposes of the sales and use tax. The taxpayer sells storage systems for installation in buildings located in Virginia. The taxpayer is incorporated outside Virginia, maintains no physical presence in Virginia, and does not solicit sales in Virginia with employees or independent representatives. The taxpayer purchases the systems from third-party vendors and that the storage systems are shipped by the vendors directly to the customers or contractors in Virginia. Installation of the storage systems is performed by unrelated third-party contractors. The taxpayer has no ownership interest in any of the installation contractors and that the contractors are independent businesses that have customers other than the taxpayer. The taxpayer provides the installation contractors with quality standards for installation; however, the taxpayer does not provide any supervision over the contractors' work. The Tax Commissioner determined that the activities associated with the sales to the taxpayer's customers do not meet the criteria to qualify for retail sales and use tax nexus in Virginia and the taxpayer is not required to register for the retail sales and use tax in Virginia.

15. **Sign Manufacturer.** P.D. 09-51 (April 27, 2009). A taxpayer, who fabricates, sells and installs signs, was audited by the Department and treated as a real property contractor with respect to its sale and installation of signs for the monthly periods beginning September 2003 and continuing through December 2004. The taxpayer was assessed use tax on its purchase of materials, supplies and equipment used to fabricate and install signs. The taxpayer argued that the signs it sells and installs remain tangible personal property after installation, and the taxpayer should be treated as a retailer rather than a real property contractor. Accordingly, the manufacturing and resale exemptions would then apply to the taxpayer's purchases of equipment and tools used to fabricate the signs and to the materials that become a component part of the signs. The taxpayer denied the appeal. Prior to July 1, 2005, the Tax Department treated all sign manufacturers real property contractors. The Tax Commissioner did not change this position. In addition, real property contractors are not eligible for the manufacturing exemption as they consume the tangible personal property they use. Beginning on July 1, 2005, sign manufacturers are treated as a retailer with respect to its sales and installation of signs.

16. **Government Contractor: Technical Direction Letters.** P.D. 09-52 (April 27, 2009). The taxpayer is a government contractor and was assessed with use tax on purchases of tangible personal property considered by the auditor as used or consumed by the taxpayer in the performance of service contracts with the federal government. The taxpayer appealed contending that the true object test applies to each Technical Direction Letter (TDL) issued pursuant to a federal government service contract. The Tax Commissioner examined the TDLs and determined that it is reasonable to look to the TDLs for applying the true object test. The purpose of a TDL is for the federal government to give technical direction or clarification to the contractor to accomplish work as generally set out in the contract. TDLs and task orders derive
from contracts that are based on estimates of labor and materials and often include a variety of sponsors, i.e., a customer group of federal agencies. Because the contractor does not know exactly who the customer will be or what the customer will specify, this situation makes it impossible to determine the true object of the overall contract with any degree of accuracy.

17. **Party Tent Rentals.** P.D. 09-54 (May 1, 2009). A taxpayer requested a ruling regarding the rental of party tents. The taxpayer rents out party tents and separately states the charges for installation, delivery, fuel, and late fees on the invoice provided to customers. The taxpayer does not collect sales tax on the installation, delivery, fuel and late fees, but charges and collects tax on the rental of the party tents and asks whether this tax treatment is correct. The Tax Commissioner determined that sales tax should not be charged on installation and delivery as those items are exempt when separately stated. If fuel surcharges are added to invoices to account for the cost of fuel incurred while delivering the party tents, such a charge is a transportation charge and exempt of the tax. Conversely, if fuel surcharges are added to the invoice for some purpose not related to transportation or delivery, those charges will be subject to the retail sales and use tax. Lastly, sales tax should be charged on the late fees as no exemption exists and the fees are part of the gross proceeds.

18. **Market Development Fees.** P.D. 09-55 (May 1, 2009). A taxpayer requested a ruling regarding the application of the Retail Sales and Use Tax on a "market development fee." The taxpayer is a roof deck contractor that obtains work by bidding on public projects. The taxpayer buys materials from specific vendors requested by the project architect or engineer. One vendor hired an independent representative to promote its product to architects and engineers. The vendor charges the taxpayer a "market development fee" as a separate line item on each invoice for materials purchased. Currently, the vendor is collecting Retail Sales and Use Tax on this fee from the taxpayer. The Tax Commissioner determined that sales tax should be charged on the market development fee. Under 23 Virginia Administrative Code 10-210-4040, any service included in or in connection with the sale of tangible personal property is considered taxable.

19. **Modular Buildings.** P.D. 09-57 (May 4, 2009). A taxpayer requested a reconsideration of a prior appeal and furnished some specific contract information on particular projects to support its position that the transactions were exempt leases of building units to the federal government. Based on the additional documentation provided, the Tax Commissioner determined that the taxpayer entered into several contracts with the federal government to furnish temporary modular facilities, in which the building units were leased to the government with the expectation that the building units would be removed at the end of the lease term. However even though the documentation provided was not conclusive as to whether the sales constitute mobile offices as defined in Virginia Code section 58.1-2401, the Tax Commissioner determined sale or lease of tangible personal property to the federal government is exempt from the retail sales and use tax pursuant to Virginia Code section 58.1-609.1(4).

20. **Cabinet Merchant.** P.D. 09-60 (May 5, 2009). The taxpayer sells and installs cabinets. As a result of an audit, the taxpayer's classification was changed from contractor to retailer in accordance with the three-prong retailer test set out in Title 23 Virginia Administrative Code (VAC) 10-210-410 G. The taxpayer challenged this classification change
and contended that it does not satisfy the place of business and inventory criteria of the retailer test as it does not maintain a showroom and that it holds materials on site that are dedicated to specific, on-going jobs but does not maintain a general open inventory. The taxpayer contended that it buys cabinet materials on a job-by-job basis.

The Tax Commissioner upheld the assessment. Virginia Code § 58.1-610(D) treats business that sell and install cabinets as retailers, not real property contractors. However Title 23 VAC 10-210-410 G provides an exception to this rule for persons who do not maintain a place of business or an inventory of cabinets. The Tax Commissioner determined that the taxpayer does have a place of business. The evidence provided by the auditor showed that the taxpayer purchased cabinets components in bulk, not on a job-by-job basis as claimed by the taxpayer. The taxpayer submitted no evidence to substantiate its contention of purchasing on a job-by-job basis. The Tax Commissioner upheld the assessment but gave the taxpayer an additional 30 days to provide documentation showing that it purchased cabinets on a job-by-job basis.

21. **Mileage Charges.** P.D. 09-62 (May 13, 2009). The taxpayer sells and leases construction equipment and also services the equipment. Due to the size of the equipment and the expense of moving the equipment, the taxpayer provides on-site field service to its customers. As a result of the Department's audit, assessments were made for certain untaxed fees included on customer invoices. The fees include mileage or zone charges included on customer invoices. The taxpayer appealed and maintained that the untaxed items are exempt.

Virginia Code section 58.1-609.5 3 provides an exemption for separately stated transportation charges. Title 23 of the Virginia Administrative Code 10-210-6000 B defines "transportation charges" as charges for delivery from the seller to the purchaser. Virginia Code section 58.1-609.5 2 exempts from the retail sales and use tax an amount separately charged for labor or services rendered in installing, applying, remodeling or repairing property sold. Virginia Code section 58.1-602 defines "sales price" as "the total amount for which tangible personal property or services are sold, including any services that are a part of the sale . . . without deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, loses or any other expenses whatsoever.

The Tax Commissioner upheld the assessment. It is not clear from the ruling whether the mileage charges related to employee travel for the installation of the equipment or for repair of the equipment. The ruling seems to indicate that the mileage charges related to the repair of the equipment. The Tax Commissioner stated, “Employee travel and accommodation expenses are not deemed part of repair labor charges, as such employee costs are incurred prior to, in preparation of, or after the actual repair labor process. For this reason, and because there is no statutory provision to exempt reimbursable charges for mileage and employee travel and accommodation expenses, such charges are taxable, whether separately stated or not.”

**COMMENT:** The taxpayer in this ruling may have been overly descriptive on its invoices. What if the taxpayer charged one flat fee for repair services that incorporated employee travel for the purpose of the repair?
22. Failure to Collect and Penalties. P.D. 09-72 (May 26, 2009). The taxpayer failed to register to collect sales tax and remit sales tax it collected on the sale of tangible personal property. The taxpayer was assessed with the tax, interest, fraud penalty, and amnesty penalty on applicable periods. The taxpayer appealed claiming that the failure to file was due to an illness. The Tax Commissioner upheld the assessment as the taxpayer was aware of its responsibilities.

23. Manufacturing Exemption. P.D. 09-73 (May 26, 2009). The taxpayer manufactures and sells pre-cast concrete products. The taxpayer was assessed tax, penalty and interest on the purchase of materials, tools, rental equipment and supplies used to erect a structure that houses a bridge crane used in production activities. The taxpayer contested the tax assessed and claims the building is actually an overhead crane structure based on the general definition of overhead cranes as found in the Occupational Safety and Health Standards part 1910.179 and exempt of the tax based on the manufacturing exemption. In addition, the taxpayer was assessed tax on repair parts used for a magnesium chloride tank. The taxpayer claimed the magnesium chloride prevents the employees from breathing air borne particulates. Since the magnesium chloride serves the same purpose as a dust mask that would be exempt by definition as apparel, the taxpayer claimed it is exempt under the safety exemption.

The Tax Commissioner upheld the assessment. The Tax Commissioner determined that the steel beams, steel channels, panels, flat bar, nuts and bolts used in the construction of the structure are taxable. In order for these items to be exempt, they must be a component part of the exempt machinery that is used directly in manufacturing and must not become affixed to realty. Also, the Tax Commissioner determined that the contested magnesium chloride is clearly not "safety apparel" and the exemption for safety apparel is not applicable.

24. Resale and Nonprofit Hospital Exemption. P.D. 09-74 (May 26, 2009). The taxpayer is engaged in sales and services of medical imaging, diagnostic, and therapeutic equipment. The Tax Department's audit discovered that the taxpayer made an exempt sale of a service and supplies contract on equipment that was not supported by a certificate of exemption. The taxpayer contested the tax assessed on the service and supplies contract and claimed the contract qualifies as an exempt sale to a nonprofit hospital and billed through a third party vendor. The taxpayer subsequently obtained a resale certificate of exemption from the third party vendor; however, the auditor disallowed the certificate because it was not sufficient to determine if the sale qualifies for exemption.

The Tax Commissioner upheld the assessment. Under strict scrutiny, the Tax Commissioner examined the resale certificate and denied its use as it could not be determined if the items were purchased for resale. The Tax Commissioner also determined that the contract was with a third party vendor, not the hospital and the nonprofit hospital exemption did not apply.

25. Multiple Exemptions. P.D. 09-75 (May 26, 2009). The taxpayer is a construction and repair contractor. The taxpayer contested seventeen purchases included in the audit. The taxpayer contends that several of these items are exempt from the tax based on the pollution control exemption or the industrial manufacturing exemption. For other items, the
The taxpayer contended that a credit should be granted for Maryland sales tax paid. In addition, the taxpayer contended that an item is exempt because it was used in connection with a tax exempt job, and another transaction was for nontaxable construction services.

The Tax Commissioner upheld the assessment. For the pollution control exemption, the taxpayer did not provide any evidence that the items at issue were certified by the Department of Environmental Quality as pollution control equipment. Absent proof of such required certification, the contested items do not qualify for the certified pollution control equipment exemption. The taxpayer also did not provide any evidence that the items qualified for the manufacturing exemption. The Tax Commissioner also determined that all of the sales were Virginia sales and a credit would not be allowed for erroneously paid Maryland sales tax. Finally, the Tax Commissioner found the rental of equipment was a sale of tangible personal property, not a service, as an operator was not included with the rental.

26. Transportation Charges. P.D. 09-76 (May 26, 2009). The taxpayer manufactures brick. It separately states charges for minimum loads but does not collect sales tax on them. As a result of an audit, the taxpayer was assessed sales tax on minimum load charges on the basis that such charges constitute taxable services in connection with the sale of tangible personal property rather than exempt transportation charges in accordance with Virginia Code sec. 58.1-609.5(3). The taxpayer contended the minimum load charges are exempt transportation charges. A third party trucking company delivers the taxpayer's brick to customers and charges on a full load basis no matter how much is actually carried. The trucking company's charge is normally higher than the freight amount included in the cost of brick prices because of increases in the cost of shipping and fuel. Accordingly, the taxpayer charges a minimum load charge to recover the difference in the actual freight bill and the amount of freight included in the cost of the brick. The Tax Commissioner agreed that the charges are for transportation and that they are exempt as they are separately stated on the invoice. Accordingly, the assessment was abated.

27. Valuation of Property. P.D. 09-82 (May 28, 2009). The taxpayer operates a hotel. An audit showed that the taxpayer was deficient on the remittance of sales tax collected on retail sales and use tax owed on purchases of tangible personal property. The only issue involves the purchase of used furniture in connection with the purchase of a hotel. The Tax Department's auditor assessed use tax based on the value of the furniture, fixtures and equipment ("FFE") as shown in the hotel records as the actual cost. The taxpayer asked the Tax Department to accept a lower estimated value for the FFE. The taxpayer asserted that the FFE was old and in poor condition and no detailed listing of the purchased assets was made because the hotel property was intended to be renovated. Thus, the taxpayer contended the original value assigned the FFE was inflated. The taxpayer also asserted the FFE has a low implied value because the locality-assessed value of the hotel's real property exceeds the purchase price of the hotel's real and personal property. For these reasons, the taxpayer requested a lower value for the FFE using a replacement cost valuation method that takes into account inflation to derive an estimated historical cost. Finally, if the assessment is upheld, the taxpayer believes it will be paying the sales tax twice, once on the inflated value of the old FFE and again on its replacement value.

The Tax Commissioner denied the taxpayer's appeal to use a lower value for the FFE. When title to the used FFE passed to the taxpayer in 2005, the tax applied to the actual cost price.
paid for the FFE at that time. The purchase and sale agreement of the hotel (including furnishings) provided no breakdown of the cost associated with the used FFE. Notwithstanding, the taxpayer determined the cost price of the used FFE was $2,062,500 and listed that amount in its 2006 depreciation schedule as the unadjusted cost or basis of the property. The same FFE amount was used for income tax depreciation purposes in the taxpayer's federal partnership return filed for fiscal year 2005 (and presumably for subsequent filings). The taxpayer did not shown how it arrived at the FFE amount stated in its 2006 depreciation schedule; however, the taxpayer has used that amount as the actual cost price of the property for income tax and financial reporting purposes. The Tax Commissioner also found no basis in the claim of double taxation as the purchase of used FFE in 2005 is totally separate and distinct from the purchase of new FFE in 2007.

28. Delivery of Software. P.D. 09-83 (May 28, 2009). The taxpayer is engaged in software development. An audit resulted in the assessment of sales tax on charges related to the provision of prewritten programs. Because no sales tax was collected on such charges, sales tax was assessed in the audit. The taxpayer contested the sales tax assessed and maintained that the prewritten programs were delivered electronically to the customer, i.e., no tangible medium was used to convey the software program. Based on evidence provided, the Tax Commissioner agreed that the software was delivered electronically. The taxpayer entered into a contract with its customer. On page 13 of the Statement of Work, the contract expressly states the software will be delivered electronically to the customer. The taxpayer also furnished an e-mail that it sent to its customer to further demonstrate that the software files were uploaded to a public file transfer protocol (FTP) server for download by its customer via an FTP website.

29. True Object Test. P.D. 09-84 (May 28, 2009). In July 2002, the taxpayer entered into a subcontract ordering agreement with the Contractor to provide integration and deployment services to customers of the Contractor. Per section C (SOW) of the contract, the taxpayer agrees to furnish all personnel, material, supplies and services required to perform the work identified in accordance with the scope and SOW as specified in each individual delivery order. Specific task descriptions are to be included in each delivery order. The taxpayer was assessed on purchases held in connection with the subcontract. The taxpayer contended that it is engaged in manufacturing custom components for customers of the Contractor. As such, it maintained that the industrial manufacturing exemption provided in Virginia Code section 58.1-609.3(2)(i) applies to the subcontract purchases.

The Tax Commissioner examined the SOW and determined that the nature of the work is not revealed until a delivery order is issued for a specific task. Thus, it is impossible to determine the true object of the overall subcontract based only on the subcontract ordering agreement. For all of these reasons, the Tax Commissioner found that the true object test for the subcontract should apply to the task or delivery order level. With respect to the taxpayer's claim that it is entitled to the industrial manufacturing exemption for custom components under the Subcontract, the information provided was insufficient to justify such a claim. Further, the auditor was never allowed a site tour to observe the taxpayer's operations to note whether such custom assembly process was entitled to the exemption. Ultimately based on the non-manufacturing NAICS classification of the taxpayer, the Tax Commissioner concluded that the
taxpayer's activities should not be classified as "industrial in nature" for purposes of the industrial manufacturing exemption.

30. **Fabrication of Foodstuffs.** P.D. 09-92 (June 9, 2009). The Tax Commissioner issued Tax Bulletin 09-7 with instructions on the implementation of House Bill 2360 and Senate Bill 944 (2009 Acts of Assembly, Chapters 36 and 832), changing the Retail Sales and Use Tax treatment of charges for the fabrication of meats, grains, fruits, vegetables and other foodstuffs.

31. **Federal Contractor.** P.D. 09-97 (June 11, 2009). The taxpayer is a systems integrator that develops and implements systems solutions for agencies of the federal government. The contested purchases relate to the "System." The purchases were made pursuant to a contract ("System Contract") between the taxpayer and the "Federal Agency" regarding the System. The taxpayer contended the contract is for the provision of tangible personal property, and the auditor incorrectly classified it as a services contract. As such, the taxpayer maintained that the purchases at issue should be removed from the audit and the assessment recomputed.

   Based on a review of the contract and statement of work documentation provided, the Tax Commissioner concluded that the System Contract is for the provision of a service to the taxpayer's customer. The statement of work indicates that the contractor (taxpayer) is required to provide support services for the Federal Agency. The taxpayer is also required to provide the services on a continuous, 24 hour, 7 day a week, 365 day a year basis. Additionally, the documentation states that the purpose of the contract is to provide "for the continuity of the mission critical support services ensuring continued operations and maintenance of the" System and other services provided by the Federal Agency.

32. **Sale of Food or the Sale of Tickets to Events That Include Food by Nonprofit Organizations.** P.D. 09-99 (June 23, 2009). The Tax Commissioner issued Tax Bulletin 09-8 with instructions on the implementation of House Bill 1779 that changes the Retail Sales and Use taxation of the sale of (1) food, prepared food and meals ("food") and (2) tickets to events that include the provision of food by certain nonprofit organizations. As a result of this legislation, any nonprofit organization that is eligible to be granted an exemption on its purchases of tangible personal property under Virginia Code sec. 58.1-609.11, and that is otherwise eligible for the occasional sale exemption, may make exempt sales of 1) food and 2) tickets to events that include the provision of food, provided that such sales take place on 23 or fewer occasions in a calendar year.

33. **Agricultural Exemption.** P.D. 09-100 (June 24, 2009). The taxpayer operates a cattle farm and grows hay on the farm to feed the cattle. The Tax Department audited the taxpayer and assessed use tax on various fixed asset and expense purchases made by the farm. The taxpayer is disputing the assessment of the tax on purchases of a tub grinder, excavator, thumb attachment and repair parts for the tub grinder and excavator. The taxpayer maintains that the agricultural exemption in Virginia Code sec. 58.1-609.2 applies to these items.
Written correspondence from the taxpayer's accountant to the taxpayer dated January 15, 2008, and correspondence from the taxpayer to the Tax Department dated February 14, 2008, confirmed that the equipment was used to clean storm damage and make repairs to damaged property and structures on the farm. This correspondence indicated the equipment was used to build and dredge ponds, to make erosion control repairs, to repair fence lines, to construct a stream crossing and similar activities. On appeal, the taxpayer contended that the equipment was used to produce organic materials that were spread on the farm property to enhance the soil. This contention did not persuade the Tax Commissioner that this use of the equipment qualifies for the agricultural exemption. The taxpayer did not demonstrate when or where the organic materials were spread or how the use of the organic materials relates to cattle farming. The Tax Commissioner determined that the subject equipment was used in various taxable activities on the farm and the exemption would not apply. The assessment was upheld.

34. **Agricultural Exemption.** P.D. 09-101 (June 24, 2009). The taxpayer operates a nursery. The Tax Department audited the taxpayer and assessed use tax on the purchase and use of white poly film. The taxpayer argued that the poly film is used during the winter season and is temporarily placed over support structures located in the nursery fields to protect plants from the winter weather. The taxpayer asserted that the poly film qualifies for the agricultural exemption. The auditor held purchases of the poly film taxable on the basis it was a structural construction material. The Tax Commissioner determined that the poly film did not qualify for the agricultural exemption. The poly film is used by the taxpayer to cover propagation houses, which are structures similar to greenhouses that contain plumbing and electrical hookups, ventilation systems and doors. In accordance with Title 23 VAC 10-210-50 A, greenhouses and plastic covered houses do not qualify for the agricultural exemption.

35. **Counter-Tops.** P.D. 09-102 (June 24, 2009). The taxpayer primarily fabricates and sells laminate countertops without installation, and also fabricates and sells artificial stone (solid surface) countertops with installation. An audit showed that the taxpayer is a retailer of laminate countertops and a real property construction contractor of solid surface countertops. While the taxpayer collected sales tax on retail sales of laminate countertops, it failed to pay any tax on the cost price of materials used or consumed in connection with solid surface countertops. Accordingly, the auditor assessed use tax on the solid surface countertops and related materials. The taxpayer took exception to the use tax assessed on the solid surface countertops and related materials. The taxpayer claimed to have no use tax liability because its customers (wholesalers/contractors) charge sales tax on the solid surface countertops sold and installed by the taxpayer. The taxpayer contended that the use tax assessed under these circumstances amounts to double taxation. The taxpayer also contended it was not given prior notice of any policy change, especially since the prior audit did not apply use tax to solid surface materials furnished and installed by the taxpayer. For these reasons, the taxpayer requested abatement of the use tax assessed on the contested items. The Tax Commissioner denied the taxpayer’s appeal. The fact that the taxpayer's customers may have charged and collected the sales tax on the countertops sold and installed by the taxpayer is erroneous and does not relieve the taxpayer of its responsibilities to pay the tax. The Tax Commissioner denied the taxpayer’s claim concerning the prior audit as there was no basis to conclude that the Tax Department accepted the taxpayer's practice of not paying any tax on its costs of solid surface materials that it installed as fixtures in real estate.
36. **Sales Tax Holiday for Clothing and School Supplies Guidelines.** P.D. 09-109 (July 1, 2009). The Tax Commissioner issued guidelines for the sales tax holiday for clothing and school supplies that occurs on the first Friday in August of every year and ends at midnight on the Sunday immediately following.

37. **Delivery Charges, Design Services, and Credit for Taxes Paid.** P.D. 09-113 (July 16, 2009). The taxpayer provides roof truss, floor truss and I-beam systems to the building industry. An audit of the taxpayer for the aforementioned period resulted in an assessment for its failure to charge sales tax on the sale of trusses and design services. The taxpayer claims that the assessment on sales of trusses includes exempt delivery charges. The taxpayer also protests the tax assessed on design services. Furthermore, the taxpayer seeks a credit for sales tax paid to various vendors.

The taxpayer claimed that a $45 shipping charge is included in the lump sum charge for materials on the customer invoice and requested that it be allowed to segregate the exempt shipping charges from the lump sum materials charge. Virginia Code section 58.1-609.5(3) provides that the retail sales and use tax shall not apply to transportation charges separately stated. Despite the code section, the Tax Commissioner allowed a reasonable portion of the lump sum charges to be considered as representing nontaxable delivery charges upon receiving documentation showing what would be a reasonable portion.

Tax was assessed on the total charge for the design and materials used for the construction of the trusses. The taxpayer asserted that the design services should not be subject to the retail sales and use tax and requested that it be allowed to segregate an appropriate design service fee from materials. Virginia Code section 58.1-602 defines "sales price" to mean "the total amount for which tangible personal property or services are sold, including any services that are a part of the sales." The Tax Commissioner denied the taxpayers request and noted that even if the design services were separately stated, they would be taxable. Finally, the taxpayer requested that the Tax Department issue direct refunds of sales and use taxes paid on supplies that are exempt, rather than requiring the taxpayer to seek the refunds from its vendors. Based on the circumstances in this case, the Tax Commissioner allowed credit in the audit for the tax paid to vendors within the statute of limitations established by the filing of this appeal.

38. **Converted Assessment.** P.D. 09-116 (July 31, 2009). The officers of the Corporation consisted of a president, vice president, and secretary. The taxpayers were the Corporation's president and secretary. The Corporation was issued assessments for unpaid sales taxes. When the Corporation failed to pay the tax, interest, and penalty deficiencies, the Tax Department converted the assessments to the taxpayers, pursuant to Va. Code § 58.1-1813. The taxpayers contested these converted assessments, claiming they were not "corporate officers" under Virginia Code section 58.1-1813, as they had no duty to collect and remit the sales taxes and had no knowledge of the unpaid sales taxes prior to December 1, 2006. The taxpayers contended that the Corporation's vice president (who was also the store manager) had such tax reporting and payment responsibilities until November 30, 2006, and he is responsible for the Corporation's failure to remit the sales taxes at issue.
In *Angelson v. Commonwealth of Virginia*, 25 Va. Cir. 319 (City of Richmond, 1991), the court pointed out that four conditions of Virginia Code section 58.1-1813 must be met before a person can be held individually liable for taxes assessed against a corporation. "First, the person must willfully fail to pay, collect, or truthfully account for and pay over a state tax, or willfully attempt in any manner to evade or defeat such tax or its payment. Second, the person must be an officer or employee of the corporation and have a duty to perform the act in respect of which the violation occurs. Third, the person must have (actual) knowledge of the failure or attempt as set out in the statute. And fourth, the person must have authority to prevent such failure or attempt." The court stated that the absence of any one of these conditions prohibits the Department from collecting corporate taxes from an individual.

The Tax Commissioner abated a majority of the assessment. The documentation and facts presented showed that at no time were the taxpayers under a duty to report and pay sales taxes owed prior to December 1, 2006. The taxpayers have also shown that they had no knowledge of the unpaid sales taxes prior to December 1, 2006. Furthermore, the taxpayers did not willfully evade the payment of taxes owed prior to December 1, 2006. The taxpayers were determined to be liable for the unpaid sales taxes for the period of November 2006, because such taxes were not due until December 20, 2006.

39. **Real Property Contractor.** P.D. 09-117 (July 31, 2009). The taxpayer designs, builds and installs audio-visual equipment systems. These systems consist of videoconferencing equipment, projectors, screens, speakers, interactive white boards, and remote control devices. Most of the equipment is typically contained on shelving (a rack) or in a closet in a room. Screens and speakers are generally connected to a wall or a ceiling via brackets. All equipment is installed to be easily removed or relocated. The equipment is merely plugged into the building's existing electrical outlets. Although some of the wiring connecting the components is installed behind the wall or ceiling (approximately 1% of total projects), the taxpayer does no cabling or electrical work that relates to the operation of the building. Rather, such cabling or electrical work is provided by the building's owner or tenant or another contractor. The taxpayer indicated that none of the components of the system become integrated into the real estate and that the wiring may be easily removed. Installations are made in corporate office buildings, government office buildings, museums, universities and schools. The customer may be either a contractor involved in the construction or renovation of the building or an owner or tenant of the facility that engages the taxpayer directly for the work. The taxpayer has historically treated itself as a retailer and now wishes to confirm the application of the sales tax to its transactions.

Based on the facts presented, the Tax Commissioner found that the audio visual systems sold by the taxpayer with or without installation to the customer constitute retail sales of tangible personal property. In such instances, the taxpayer must charge and collect the sales tax based on the total charge for the sale of the audio visual systems. Separately stated installation charges are not subject to the tax.

40. **Sampling and Public Service Exemption.** P.D. 09-118 (July 31, 2009). The taxpayer is in the business of selling communications equipment and was assessed with additional sales and use tax. The taxpayer contended that the sampling methodology used in the
audit resulted in an inaccurate liability. The taxpayer further stated that the transactions included in the sample are related to the repealed public service corporation exemption. The taxpayer contended that it was not notified by its customers that the exemption had been repealed and that the exemption certificates provided by its customers were no longer valid. The Tax Commissioner determined that the sample methodology used in the audit was proper and that the taxpayer's contention that its customers did not make it aware of the repeal of the public service exemption does not warrant waiving any portion of the audit assessment.

41. **Freight-In Charges.** P.D. 09-119 (August 7, 2009). The taxpayers were assessed tax on freight-in charges related to retail property sold by the taxpayers. The auditor taxed these charges because no evidence was provided to indicate the computation of sales prices and whether freight-in costs were included in such computation. The taxpayer maintained that it previously explained to the Tax Department's audit staff how the freight-in costs are built into its overall pricing structure. Freight costs are capitalized in the general ledger by recording journal entries to the merchandise inventory account and the freight-in cost of goods sold account by brand and division. These costs along with handling costs and others are included in determining markups on the property held for sale. Furthermore, the taxpayer indicated that freight-in charges were not separately stated on sales invoices and that sales tax was charged and collected on the full sales price of the property sold. For all of these reasons, the taxpayer contended that the tax assessed on the freight-in charges is erroneous and should be abated. The Tax Commissioner determined that use tax was erroneously assessed on the contested freight-in charges. The facts presented established that the freight-in charges were not separately stated on the sales invoice to retail customers, and thus were not exempted from imposition of the sales tax. Sales tax was ultimately collected on the cost associated with the freight-in charges. While freight-in costs become part of the property for sale at retail, such costs are taxable as part of the retail sales price of property.

42. **Exemption Certificates.** P.D. 09-120 (August 7, 2009). The taxpayer is a retail farm cooperative. As a result of the Tax Department's audit of the taxpayer's locations, the auditor assessed tax on untaxed sales of rodenticides, fencing, horse feed, and related agricultural supplies. The taxpayer contested the audit results, stating the identified sales are not taxable because it accepted exemption certificates in good faith. The Tax Commissioner determined that the taxpayer accepted completed certificates of exemption (Form ST-18) from farmers indicating the rodenticides, horse feed and related supplies would be used in agricultural production and agreed to remove the sales of these items from the audit.

43. **Controlled Drugs.** P.D. 09-127 (August 24, 2009). The taxpayer operates as a medical practice offering medical services to its patients. The taxpayer was audited and assessed tax on bulk purchases of the contraceptive products Mirena and Implanon. Mirena is an intrauterine device (IUD) that slowly releases a chemical agent levonorgestrel into the body that causes contraceptive effects. Implanon is a subdermal implant device that releases the medication etonogestrel into the body for the same purpose. The auditor assessed tax on the purchases of these drugs. The taxpayer contested the assessment of the tax to these purchases on the basis that they are classified as prescription drugs by the United States Food and Drug Administration (FDA) and Schedule VI controlled drugs under the Virginia Drug Control Act. Based on these authorities, the taxpayer claims that Mirena and Implanon are exempt of the tax
in accordance with Virginia Code section 58.1-609.10(9). Virginia Code section 58.1-609.10(9) provides an exemption from the retail sales and use tax for "[m]edicines [and] drugs . . . dispensed by or sold on prescriptions or work orders of . . . licensed physicians . . . [and] controlled drugs purchased for use by a licensed physician . . . ." The Tax Commissioner determined that Mirena and Implanon qualify for exemption under Virginia Code section 58.1-609.10(9) as controlled drugs purchased for use in the taxpayer's professional practice as they are classified by the FDA as prescription drugs.

44. **Manufacturing Exemption.** P.D. 09-134 (September 8, 2009). The taxpayer is an industrial processor of laundry. At issue is the tax assessed on the taxpayer's purchase of a wastewater heat recovery system. The heat recovery system moves process wastewater through tubes (or plates) of the heat exchanger in a flow direction that is opposite the fresh water on the outside of the tubes in the shell. The shell and tube type heat exchanger reclaims heat from the hot wastewater to preheat incoming fresh water. The fresh water is then heated to a higher second temperature by a boiler for use in the processing equipment. The taxpayer claims that the equipment is an integral part of its manufacturing process and is exempt: from the tax pursuant to Title 23 of the Virginia Administrative Code (VAC) 10-210-920.

Virginia Code section 58.1-609.3(8) exempts from the retail sales and use tax:

Tangible personal property including machinery and tools, repair parts or replacements thereof, and supplies and materials used directly in maintaining and preparing textile products for rental or leasing by an industrial processor engaged in the commercial leasing or renting of laundered textile products.

Title 23 VAC 10 210 920 B 2 defines the term "used directly" as it relates to industrial manufacturing and processing as follows:

The term "used directly" refers to those activities that are an integral part of the production of a product, including all steps of an integrated manufacturing process, but not including incidental activities such as general maintenance, management, management, and administration.

The boiler that heats incoming water for use in the taxpayer's laundry process enjoys the industrial processing exemption. The heat recovery system serves the same purpose because it is used to preheat such water, which in turn is used directly in the processing equipment. Therefore, the Tax Commissioner determined that the purchase of the heat recovery system qualifies for the manufacturing exemption.

45. **Government Contractor.** P.D. 09-135 (September 8, 2009). The taxpayer is a manufacturer of specialty electrical and mechanical products. At issue in this audit are various pieces of hardware and other tangible personal property produced for and/or delivered to the federal government for use in the government's research and development program. The products in question are fabricated and/or acquired based on the government's specifications, and installed in federal government research and development facilities. The Tax Department's auditor determined that the true object of the government's contract with the taxpayer was for the
provision of services based on the operational role indicated in the contract. The taxpayer was assessed consumer use tax on all of the direct material costs associated with the contract. The taxpayer appealed contending that the true object of the contract was for the production and sale of tangible personal property to the government and any services provided (such as design, engineering, fabrication, installation, repair and maintenance) were entirely ancillary to the sale of the tangible personal property. The Tax Commissioner examined the contract and determined that that the true object of the contract is for the sale of tangible personal property. There was no evidence in the contract of the taxpayer leasing or renting any of the contested equipment with operators. In addition, the contract indicated that all of the contested equipment was sold to the federal government and remained under the government's control after transfer.

46. Research and Development Exemption and Modification of Prewritten Software. P.D. 09-136 (September 8, 2009). The taxpayer is a private, nonprofit organization that assists certain United States government agencies in identifying, acquiring, and deploying cutting edge technologies. In addition to delivering technology solutions to its customers, the taxpayer's business plan includes investing in businesses, universities and research labs that produce technologies with potential capabilities to benefit the government agencies. The taxpayer then assists the businesses and organizations it invests in with the development of these technologies. The taxpayer contests the assessment of use tax on purchases from fifteen vendors with which the taxpayer was engaged in investment and product development activities.

   The taxpayer identifies and tests software and other products obtained from potential vendors to determine if the products meet the needs of the taxpayer's customers. If a product is approved by the taxpayer and its customer, the vendors perform the actual product development function by modifying and changing the product based on the taxpayer's test results and specifications. The development process continues as different versions of the modified product are provided to the taxpayer for further testing. This process continues until the final product is accepted or rejected by the taxpayer and its customer. The taxpayer does not perform software programming or engage in the modification of products, but rather the vendors perform these activities. The taxpayer also uses subcontractors to beta test the products provided by vendors to determine whether the criteria of a predetermined problem set are met. The Tax Commissioner determined that the taxpayer manages the research and development process rather than conducting the research and development itself and that managing a research and development process does not qualify for the exemption.

   Virginia Code section 58.1-609.5(6) provides an exemption for "[a]n amount separately charged for labor or services rendered in connection with the modification of prewritten programs as defined in § 58.1-602." The taxpayer initially purchased prewritten programs and then contracted with vendors to develop the products. The vendors issued progress billings to the taxpayer for the subsequent modifications made to the software. The Tax Commissioner removed these billings from the audit.

47. Energy Star and Watersense Sales Tax Holiday Guidelines. P.D. 09-137 (September 10, 2009). The Tax Commissioner issued guidelines for the Energy Star and Watersense Sales Tax Holiday that begins at 12:01 a.m. on the Friday before the second Monday in October of every year and ends at midnight on the Monday immediately following.
D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

V. PROPERTY (AD VALOREM) TAXES

A. 2009 Legislation

1. Pollution Control Equipment. House Bill 2084 (Chapter 671) exempts certain pollution control equipment and facilities from local real and personal property taxes. Currently, pollution control equipment is only exempt from local real and personal property taxes by local ordinance. This legislation is effective for tax years beginning on or after January 1, 2011.

2. Agricultural Use Assessments. House Bill 2098 (Chapter 800) provides that real property that otherwise qualifies for agricultural, horticultural, forest or open-space use assessment will not be disqualified because a portion of such property is being used for a different purpose pursuant to a special use permit or as otherwise allowed by zoning. The portion of the property being used for a different purpose will be deemed a separate piece of property for purposes of assessment. The presence of utility lines, zoning designations, and special use permits will not be considered in determining whether the property is devoted to agricultural, horticultural, forest or open-space use. This legislation is effective on July 1, 2009.

3. Sale of Delinquent Property. House Bill 2651 (Chapter 682) relieves a deed of trust creditor from the requirement of filing a claim with the circuit court within 90 days after notice of judicial proceedings instituted by the locality to have tax delinquent property sold to pay the delinquent taxes in order to be entitled to any proceeds from the sale. This legislation is effective on July 1, 2009.

4. Energy Efficient Buildings. Senate Bill 1004 (Chapter 512) adds architects to the list of professionals that are authorized to certify that a building qualifies as an energy efficient building for local Real Property Tax purposes.

B. Recent Court Decisions

1. Virginia Baptist Homes, Inc., et al. v. Botetourt County, 276 Va. 656; 668 S.E.2d 119 (October 31, 2008). The Virginia Supreme Court determined that a retirement community operated by Virginia Baptist Homes ("VBH") was exempt from local property taxes.

Botetourt County challenged the exemption of property owned by VBH on the basis that the property does not satisfy the statutory requirements to be exempt. The property in question was acquired by VBH in 1998. VBH operated a continuing care facility on the property. All residents of the facility pay 100% of the cost of their care. Care is not provided at a reduced charge for the indigent and the aged. However, VBH's plans contemplate "subsidies" for needy folks once the facility meets its financing requirements and charitable funds developed. Lack of
current subsidized care is simply a question of timing, not purpose or desire. Religious services are occasionally held at the facility but are led by visiting clergy of varying backgrounds. VBH claimed the property was exempt as VBH is a religious and benevolent organization.

To be exempt from property taxation, the property must be used on a nonprofit basis and exclusively for religious or benevolent purposes. The Circuit Court said that VBH’s 501(c)(3) exemption satisfied the nonprofit requirement. However, the Circuit Court decided that the property was not used for religious or benevolent purposes. The lack of regular religious services led the Court to find that the facility had no religious purpose. In the context of property tax exemptions, the Court defined benevolent as “Philanthropic; humane; having a desire or purpose to do good to men; intended for conferring the benefits, rather than for gain or profit.” Based on this definition, the Circuit Court concluded that because VBH did not provide care to the financially needy, it was not benevolent as thus the property was not exempt from property taxation.

The Virginia Supreme Court disagreed with the Circuit Court’s conclusion. VBH was designated by the General Assembly as a religious and benevolent organization under Virginia Code section 58.1-3650.33. Based on this designation, the Supreme Court determined that the General Assembly had already declared VBH a religious and benevolent organization and there should be no question about its activities in this respect. Rather the Supreme Court said that the only question to be answered was whether VBH operated the retirement community on a nonprofit basis. Neither the record nor the trial court’s finding lends any support to the contention that VBH was not operated on a nonprofit basis. Furthermore, the County did not assign any error to the lack of a finding that VBH was not operated on a nonprofit basis. The Supreme Court overturned the Circuit Court’s decision.

2. West Creek Associates, LLC, et al. v. County Of Goochland, 276 Va. 393; 665 S.E.2d 834 (September 12, 2008). The Virginia Supreme Court ruled that when a locality determines the fair market value of a parcel of property, the presumption of correctness will not be rebutted based solely on a prior sale of the parcel in which the parcel was a small part of a bulk land purchase.

In this case, 144 separate limited liability companies purchased approximately 2,500 acres of real estate located in the West Creek Business Park in Goochland County. Each limited liability company was conveyed only a small portion of the acreage, but the total purchase price for the 144 separate parcels comprising the 2,500 acres was approximately 34.1 million dollars. Prior to this sale, the County had assessed the 2,500 acres as 20 separate parcels having a total assessed value of 54.8 million dollars. In 2001, the County conducted its quadrennial reassessment of real property pursuant to Virginia Code section 58.1-3252. In that reassessment, the County assessed the 2,500 acres as 144 separate parcels, reflecting the 144 recorded deeds conveying various acreages to the 144 limited liability companies. Forty parcels were assessed a value of $35,000 per acre. Most of the remaining parcels were assessed at $75,000 per acre. The total 2001 assessed value of the 144 parcels was 105.4 million dollars.

West Creek Associates claimed that the assessed value substantially exceeded the property’s fair market value and challenged the assessment in the Goochland County Circuit
Court. After presenting its case, the County moved to strike the evidence contending that West Creek Associates had failed to establish a sufficient record from which the circuit court could conclude that the County had assessed the relevant parcels in violation of Virginia Code section 58.1-3984. The County argued that West Creek Associates proved only how the appraiser valued the parcels but did not establish what the County’s Board of Assessors did with the information provided by the appraiser. In addition, the County argued that West Creek Associates did not show what information the Board of Equalization considered in making the adjustments to the assessments set by the Board of Assessors. The Circuit Court granted the County’s motion to strike the evidence in regard to the parcels valued at $35,000. The motion was granted on the basis that West Creek Associates presented no evidence as to the manner in which the County arrived at the assessment of $35,000 per acre for those parcels nor any evidence from which it could infer the methodology used. In regard to the remaining parcels, the Circuit Court held that the taxpayers had not provided sufficient evidence to substantiate their position on the fair market value of the remaining parcels at issue.

West Creek Associates appealed the Circuit Court’s decision to the Virginia Supreme Court. The Virginia Supreme Court determined that the Circuit Court had improperly granted the County’s motion to strike the evidence as to the parcels valued at $35,000. The Supreme Court stated that it has, “never explicitly held that manifest error cannot be established simply by evidence showing that real property is assessed at more than its fair market value.” In the opinion, the Supreme Court cited several cases where manifest error was demonstrated by presenting evidence that the real property was assessed with a value higher than the fair market value.

For the remaining parcels, the Virginia Supreme Court determined that West Creek Associates had not presented credible evidence of fair market value with regard to the contested assessments on the parcels. West Creek Associates’ contention was that the bulk sale price demonstrated fair market value. The Supreme Court disagreed and stated that a sale price of real property is merely one of the factors to be taken into consideration when determining whether such property has been assessed at more than fair market value. The sale price is accorded substantial weight but it is not conclusive evidence of a property’s fair market value. Accordingly, West Creek Associates did not carry its burden of showing that the parcels are assessed at more than fair market value and West Creek Associates’ evidence did not rebut the presumption of correctness afforded the assessments.

C. Recent Virginia Tax Commissioner Rulings

No rulings in this area were released.

D. Opinions of the Attorney General

1. General Reassessment. OAG No. 09-008 (March 19, 2009). The Dinwiddie County Attorney asked whether a county board of supervisors may prevent an assessor for a general reassessment from complying with Virginia Code sec. 58.1-3300, which governs reassessment records, on the sole basis that the board of supervisors disagrees with the results of such general reassessment. The Attorney General opined that a county board of
supervisors may not prevent a statutorily appointed professional assessor for a general reassessment from complying with Virginia Code sec. 58.1-3300 on the sole basis that the board disagrees with the results of such reassessment. Applying Dillon’s Rule, the Attorney General stated:

The General Assembly has not authorized a county to appoint an assessor to begin to undertake the general reassessment process and then prevent such assessor from complying with the requirements of § 58.1-3300 because the county’s board of supervisors disagrees with the reassessment results. Prior opinions of the Attorney General similarly conclude that a board of supervisors has no power to change the assessment of real property as ascertained by the assessor during a general reassessment and has no authority to raise or lower the ratio of assessment of real property.

2. **Holding Companies and Property Exempted for Religious Purposes.** OAG No. 09-044 (August 3, 2009). Senator Ken Cuccinelli asked whether certain real property and improvements used and occupied by the NorthStar Church Network (“NorthStar”) qualify for exemption from local taxation under Virginia Code section 58.1-3606(A)(5). He also asked whether a nonprofit property holding company that is organized for religious purposes retains the same property tax exemption as its sole member, an incorporated church. NorthStar is a Southern Baptist association of church congregations in Northern Virginia connected to both the state and national Southern Baptist conventions. The NorthStar Foundation ("Foundation") owns property in fee simple that NorthStar exclusively uses and operates for religious purposes. NorthStar leases the property and exclusively operates and occupies the property as a campus ministry. The Foundation is an entity whose sole purpose is to provide real estate and other support activities to member congregations and NorthStar. The Foundation has no other purpose or activities and is operated solely on a not-for-profit, charitable basis. Further, the sole member of the Foundation, which is a religious nonprofit property holding company, is NorthStar. The Attorney General opined that the certain real property and improvements used and occupied by NorthStar do qualify for exemption from local taxation under section 58.1-3606(A)(5). Furthermore, the nonprofit property holding company of its sole member church would retain the same property tax exemption as the church itself.

3. **Boat Piers.** OAG No. 09-042 (August 27, 2009). The Dinwiddie County Commissioner of Revenue asked whether a boat pier may be assessed and taxed separately from the adjoining land of such private landowner. The Attorney General opined that the pier may be assessed and taxed separately from the adjoining land of such private landowner.

VI. **PROCEDURAL**

A. **2009 Legislation**

1. **Power of Attorney:** Senate Bill 905 (Chapter 503) requires the Tax Department to provide a copy of any written correspondence, documentation, or other written materials that relate to a tax matter for which a taxpayer has filed a power of attorney to the person named as power of attorney. The copy is required to be furnished to the person named as
power of attorney at the same time the information is provided to the taxpayer and under the same delivery method used. This bill is effective on July 1, 2010.

2. Federal Refund Setoff for Local Taxes. House Bill 1830 (Chapter 787) allows local governments to collect past due local debts from federal income tax refunds. This legislation will be effective on the effective date of federal legislation enacted by the United States Congress allowing such debt to be offset against federal income tax refunds.

B. Recent Court Decisions
No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings
No rulings of the Virginia Tax Commissioner have been released.

D. Opinions of the Attorney General
No recent opinions of the Attorney General have been released.

VII. BUSINESS LICENSE TAXES

A. 2009 Legislation

1. Green Roof Incentives. Senate Bill 1058 (Chapter 604) and House Bill 1975 (Chapter 17) authorize localities to grant incentives and provide regulatory flexibility to encourage the use of green roofs, which may include reducing permit fees and gross receipts taxes on green roof contractors and streamlining the approval process for building permits.

B. Recent Court Decisions

1. City of Lynchburg v. English Construction Company, Inc. et al., 277 Va. 574 (2009). The Supreme Court of Virginia determined that the City of Lynchburg could not include in its measure of taxable gross receipts a taxpayer’s gross receipts generated, but not taxed, by other Virginia localities. English Construction Company, Inc. and W. C. English, Inc. (collectively referred to as “English”) are construction contractors that have a principal place of business in the City of Lynchburg (“Lynchburg”). English also maintains definite places of business in other localities. The City argued that it may assess gross receipts under Virginia Code section 58.1-3715(A) that are not taxed by the other localities since English has its principal place of business in Lynchburg. Accordingly, Lynchburg assessed English with its Business, Professional, and Occupation License (“BPOL”) tax on all of the gross receipts English received from projects in other localities but were not subjected to a BPOL tax in such other localities. English initiated its lawsuit challenging Lynchburg’s assessment taxes on its BPOL receipts received, but not taxed, in these other localities. English maintains that Lynchburg has no authority to tax such receipts.
The City of Lynchburg Circuit Court held there is no express authority for Lynchburg to tax the gross receipts English earned from other localities where English maintained a definite place of business but the gross receipts were not subjected to the BPOL tax by such other localities and held that Lynchburg’s assessments for such taxes are invalid and abated. Lynchburg appealed the Circuit Court’s decision to the Supreme Court of Virginia.

The Supreme Court of Virginia agreed with the Lynchburg Circuit Court that the Virginia Code did not provide Lynchburg with any authority to tax English’s gross receipts earned in localities where English maintained a definite place of business. The Supreme Court stated that a local governing body must have clear statutory authority to impose a tax. In this case, Virginia Code sec. 58.1-3703.1(A)(3) specifies as a general rule for BPOL purposes that gross receipts to be included in the taxable measure are only those attributable to the exercise of a privilege subject to licensure at a definite place of business within Lynchburg. Furthermore, Virginia Code sec. 58.1-3715 contains no language granting Lynchburg the authority to levy a tax on gross receipts from services performed by a contractor in other localities in which he has a definite place of business. Lynchburg sought such authority by implication. The Supreme Court refused to recognize any authority to impose the tax by implication and noted that Lynchburg’s interpretation of the Virginia Code renders parts of the Code meaningless and ignores the clear legislative intent underlying the General Assembly’s 1996 revision of the business license tax laws.

C. Recent Virginia Tax Commissioner Rulings

1. Petroleum Products Advisory Opinion. P.D. 09-1 (January 20, 2009). The taxpayer is a wholesale marketer of petroleum products, supplying products to consumers and resellers in the eastern half of the United States. The taxpayer purchases its products from petroleum suppliers and has them sent through third party owned interstate pipelines to various terminals located in Virginia, three of which are owned by the taxpayer. The taxpayer maintains its only office in the City, where it obtained a business license and paid the BPOL tax based on purchases. The purchases reported by the taxpayer included purchases from supply terminals located outside the City, but delivered to customers within the City. The taxpayer filed a refund claim for taxes paid on the purchases from the terminal located outside the City. In order to resolve the claim, the City and the taxpayer agreed to request an advisory opinion from the Tax Department.

The Tax Commissioner addressed four questions in the advisory opinion.

1) The Tax Commissioner determined that a locality cannot assess a BPOL tax on a wholesaler if the definite place of business of the goods or wares delivered is outside of the locality, even if the wholesaler has a definite place of business in the locality. Wholesale purchases cannot be "thrown back" to the locality even if the purchases are not subject to tax in a different locality.

2) A definite place of business must be located at the point of delivery to customers within a locality. The location of the customer has no bearing on situs of a wholesaler's purchases.
3) When the taxpayer purchases wholesale product from third party owned terminals, offloads this product onto common carrier or taxpayer owned transportation, and delivers directly to the taxpayer's wholesale customers, the locality where the third party terminal was located could not tax the taxpayer because the taxpayer did not have a definite place of business in that locality.

4) If the taxpayer offloads wholesale product stored on an interim basis at the taxpayer's tank farm located in the City and delivers to wholesale customers in destination states where the taxpayer files state income or income like tax returns, the taxpayer would be able to deduct the cost of the purchases from the City's tax base under Virginia Code sec. 58.1-3732(B)(2). A deduction would not be permitted for costs of purchases sold to customers from such states that pick up the petroleum at the tank farm in the City.

2. **Cellular Phone Services.** P.D. 09-13 (February 4, 2009). The City audited a cellular phone company (the “taxpayer”) and assessed the taxpayer with BPOL tax for cellular service provided to its customers. The taxpayer leases seven towers within the City and owns a kiosk located in the City that sells cell phones and its cellular services. The taxpayer appealed the assessment to the Tax Commissioner arguing that it was not a telephone company under the City's ordinances and did not have a definite place of business in the City. The Tax Commissioner determined that the taxpayer was not a telephone company as the City's ordinances were written for land-based services, not cellular services. However, the Tax Commissioner determined that the kiosk was a definite place of business in the City. As the cellular service was directed and controlled from the taxpayer’s headquarters outside of the City, gross receipts from the provision of the service were sitused outside of the City. The taxpayer’s sales of phones and accessories was sitused to the City and the taxpayer was determined to be subject to the BPOL tax as a retailer on those receipts.

3. **Staffing Firm.** P.D. 09-29 (March 30, 2009). The taxpayer is a staffing firm whose professional workers include independent contractors that are issued a Form 1099, employees that are issued a Form 1099, and employees that are issued a Form W-2. The taxpayer requested an opinion to how it should determine the basis of its gross receipts for BPOL tax purposes. The Tax Commissioner cited Virginia Code sec. 58.1-3732.4(A) which provides that the gross receipts of a staffing firm do not include employee benefits paid to a contract employee "for the period of time that the contract employee is actually employed for the use of the client company pursuant to the terms of a PEO services contract or temporary help services contract.” The term "employee benefits" is defined by the statute to include "wages, salaries, payroll taxes, payroll deductions, worker's compensation costs, benefits, and similar expenses.”

The Tax Commissioner determined that the benefits paid to the taxpayer's employees that receive a Form W-2 and employees treated as nonemployees who are issued a Form 1099 would not be included in the taxpayer's gross receipts. However, benefits paid to independent contractors that receive a Form 1099 are not the type of benefits that would qualify for the exclusion under Virginia Code sec. 58.1-3732.4 according to the Tax Commissioner. These benefits could only be excluded if the taxpayer can demonstrate that the classification of the independent contractors is erroneous or inapplicable under Title 23 VAC 10-500-130.
4. Alternative Treatment For a Broker. P.D. 09-48 (April 27, 2009). A taxpayer is a registered security and commodity broker/dealer with a definite place of business in the City. The taxpayer utilizes a network of independent representatives to provide investment advice and financial services. These representatives are responsible for obtaining a BPOL license in the locality where they operate. Sales proceeds from the investment products, including a fee, are remitted to the taxpayer by a client. The taxpayer retains a portion of the fee and remits the remainder as a commission to the independent representative that made the sale. The City and the taxpayer jointly requested a ruling. For BPOL tax purposes, the taxpayer asserted that it should be assessed only upon those receipts attributed to the portion of the fee it keeps and not the gross commission from a transaction to eliminate double taxation among localities similar to how real estate brokers are treated. The City averred that the taxpayer's gross receipts should include the entire fee.

The Tax Commissioner agreed with the City. Virginia Code sec. 58.1-3732.2 allows real estate brokers to exclude desk fees and overhead costs from its gross receipts if its agent: (1) receives full commission from a sale minus adjustment for the business license tax paid by the broker, and (2) pays the broker a desk fee. This exclusion is strictly limited to real estate brokers. The Tax Commissioner also determined that the taxpayer did not participate in an agency relationship that would allow it to exclude certain amounts from gross receipts. To have an agency relationship, (1) there must be a contractual relationship between a taxpayer and both the client and the contracted third party; (2) the taxpayer cannot commingle its funds with all other sources; it must have a separate accounting system or a fiduciary account where the pass through receipts are recorded; and (3) the taxpayer does not report these "pass through costs" on its federal income tax return.

5. Principal Contractor. P.D. 09-53 (May 1, 2009). A corporation entered into a contract with the federal government to provide research and development services. The corporation subcontracted out a portion of this research and development work to the taxpayer. The taxpayer was originally licensed as a professional service. In October 2007, the taxpayer contacted the county and provided a schedule of revised gross receipts. In addition, the taxpayer requested that they be reclassified as a business service and be taxed at the reduced BPOL tax rate for certain federal contractors under Virginia Code section 58.1-3706(D)(1) on gross receipts earned through their contract with the corporation. The county determined that the taxpayer should be classified as a business service but did not qualify for the reduced rate imposed on eligible federal contractors. The county reclassified the taxpayer as a business service provider and adjusted the taxpayer's BPOL liability in accordance with the revised gross receipts. The taxpayer contends that although it was not a prime contractor, it was a principal contractor as specified in Virginia Code section 58.1-3706(D)(1).

Virginia Code section 58.1-3706(D)(1) provides a separate BPOL classification for:

Any person, firm, or corporation designated as the principal or prime contractor receiving identifiable federal appropriations for research and development services as defined in § 31.205-18 (a) of the Federal Acquisition Regulation in the areas of (i) computer and electronic systems, (ii) computer software, (iii) applied
sciences, (iv) economic and social sciences, and (v) electronic and physical sciences...

The Tax Commissioner determined that the taxpayer was not a principal contractor as it was a subcontractor for the corporation. A "principal contractor" is not defined by federal or Virginia statutes. In order to receive the special BPOL research and development classification, a contractor must be designated a prime or principal contractor. The contract between the corporation and the taxpayer indicated that the taxpayer is designated a subcontractor. The Tax Commissioner found that nothing in the contract indicated that the taxpayer is designated as either a principal or prime contractor and the taxpayer did not provide any evidence to show it is a principal contractor under federal statutes or regulations. Furthermore, Virginia Code section 58.1-3706(D)(1) requires that the contractor performing the specified research and development must receive "identifiable federal appropriations." The taxpayer was compensated by the corporation for its work as a subcontractor and did not receive an identifiable federal appropriation.

6. Deduction for Out of State Receipts. P.D. 09-56 (May 4, 2009). The taxpayer, a multinational corporation, maintains several offices throughout the world, including one in the County. The taxpayer provides investment consulting, performance reporting, and research to nonprofit institutions and private clients. It also serves several foundations, museums, hospitals, and various pension, agency and government funds. taxpayer employees travel to client sites to perform their services. In filing its BPOL returns, the taxpayer concluded that it was impossible or impractical to determine the situs of its gross receipts under the general situs rules and apportioned its gross receipts based on payroll. The taxpayer calculated gross receipts by subtracting from its total world wide gross receipts those gross receipts generated from each state in which it filed an income tax return and multiplied the net total by the percentage of its Virginia payroll to total payroll. The County audited the taxpayer for the tax years at issue and disallowed the subtraction for the gross receipts attributed to states in which the taxpayer filed income tax returns. As a result, the County and assessed the taxpayer additional BPOL tax. The taxpayer appealed the assessments to the County, contending it was not permitted a deduction for gross receipts attributable to business conducted in other states. In its final local determination, the County upheld the audit assessment, concluding that the taxpayer's method for determining gross receipts attributable to the office in the County was flawed. The taxpayer appealed the County's final determination to the Tax Commissioner, claiming it has been denied the deduction for gross receipts attributable to business conducted in other states or foreign countries.

The Tax Commissioner determined that the general payroll apportionment formula captures only the relationship between the taxpayer's payroll and the percentage of gross receipts apportioned to the County. This formula may not completely capture those gross receipts subject to an income or income-like tax in other states for which the taxpayer is entitled to a deduction as provided for in Virginia Code section 58.1-3732(B)(2). The burden of proof is upon the taxpayer to demonstrate that the formula assigns less than the full value of the receipts in other states or foreign countries for which it is entitled a deduction. If a taxpayer demonstrates a difference between the two, it is entitled to deduct the difference from its taxable gross receipts in the County. The Tax Commissioner ruled that the County correctly applied the payroll
apportionment method in determining gross receipts sitused to the taxpayer's definite place of business within its jurisdiction. However the taxpayer may be entitled to a deduction for gross receipts attributable to business conducted in another state of foreign country if it can demonstrate that the general payroll apportionment formula assigns less than the full value of the receipts in other states or foreign countries. The taxpayer was given 45 days to furnish the County with the information and upon receipt of adequate information from the taxpayer, the County was instructed to make appropriate adjustments to the taxpayer's BPOL tax assessment for the tax years at issue.

7. **Affiliated Group.** P.D. 09-63 (May 13, 2009). A taxpayer owns 100% of Corp1 and Corp2 and 50% of Corp3. Corp1 owns 98.787% of Corp4, which in turn owns the other 50% of Corp3. None of the entities have issued non-voting stock. The taxpayer asked whether these corporations constitute an affiliated group for BPOL tax purposes and whether the receipts earned by Corp2 from Corp3 would be considered exempt intercompany receipts between members of an affiliated group. The Tax Commissioner determined that Corp2 and Corp3 are members of an affiliated group, the gross receipts Corp2 receives from Corp3 for leasing employees would be excluded from receipts subject to BPOL tax.

Pursuant to Title 23 of the Virginia Administrative Code (VAC) 10-500-10 and Va. Code § 58.1-3700.1, a chain of entities may be considered as members of an affiliated group if:

1. ownership interests possessing at least 80% of the voting power of all classes of ownership interests and at least 80% of each class of the nonvoting interests of each of the entities subject to inclusion, except the common parent entity, is owned directly by one or more of the other entities in the chain of entities; and

2. the common parent entity directly holds at least 80% of the voting power of all classes of ownership interests and at least 80% of each class of the nonvoting ownership interest of at least one of the other entities in the chain.

8. **Food Service Programs.** P.D. 09-93 (June 11, 2009). The taxpayer operated food service programs at College A, College B, and Installation A. The County conducted a business license tax audit and changed the business classification of these facilities from restaurants to "professional and specialized occupations." Such business services are taxed at a higher rate than businesses making retail sales, including restaurants. The taxpayer appealed the reclassifications to the County. The County issued a final determination upholding the change in classification. In its determination, the County, citing Public Document (P.D.) 98-188 (11/10/1998) in support of the change, concluded that the true object of the contracts between the taxpayer and the owners of the food service facilities at issue was the management of food service operations. The taxpayer appealed the final local determination to the Tax Commissioner asserting, that it runs all levels of the food service operations resulting in retail sales.
College A

During the tax years at issue, the taxpayer was contracted to operate and manage the food services program at designated facilities on College A's campus. Although not specifically addressed, it appears that, on occasion, the taxpayer made retail sales to students, faculty, staff, employees, visitors, and guests invited to College A, who were not covered by the contract.

College B

College B retained the taxpayer to manage and operate a food service program for its students, faculty, staff, employees, visitors, and invited guests. The contract grants the taxpayer the authority to act as an agent for College B in the management of the food service operation. The contract also provided for a retail sales program at several locations on College B's campus. The taxpayer charged individual patrons directly for meals provided under this program. In addition, catering functions were included under the retail sales program. The taxpayer was responsible for collecting charges for College B sponsored catered functions. Under the contract, College B received a commission on sales under the retail sales program. Sales made under these provisions of the contract meet the definition of a retail sale.

Installation A

The taxpayer was under contract to provide all management, personnel, supervision, subsistence, and other items and services connected with performing a food service program at various installations for a branch of the United States military. Based on the contract, the branch of the United States military was the taxpayer's customer, not the individuals who consumed the meals provided at Installation A. As such, the taxpayer was not selling meals to the United States military. Instead, the meals were provided as part of a business service and assessed accordingly.

The Tax Commissioner determined that the food service program provided at Installation A was properly classified as a professional and specialized occupation under the County's ordinance. The assessments issued to the taxpayer for Installation A for the 2003 through 2007 tax years were upheld. Further, the evidence indicated that the taxpayer's businesses conducted at College A and College B were properly classified by the County as a professional and specialized occupation. However, the taxpayer is also making retail sales from these locations. Accordingly, the case was be returned to the County to determine if retail business activities conducted at College A and College B could have operated independently from the food service program.

9. Manufacturing. P.D. 09-94 (June 11, 2009). The taxpayer produces both framed and unframed colored prints and paintings that are sold at wholesale. The taxpayer does not engage in retail sales. A portion of the taxpayer's products are unframed and packed in circular cardboard tubes. The remainder of the products is placed in metal or wood frames that are produced by the taxpayer. Frames are produced by cutting supplies of wood, metal and glass to required lengths and specifications, and then combining the wood, metal, and glass with glue and fasteners to produce the finished frame in which the print or painting is placed. The taxpayer
produces its decorative art prints and framed wall decor through two different processes: (1) the hand-painted reproduction process, and (2) the color print process.

A hand-painted reproduction is produced by designing a master print and using the taxpayer's industrial printing equipment to produce multiple black and white paper base guides or blueprints. The taxpayer's employees then apply paints and ink by hand to produce the product. Employees produce the hand-painted reproductions using a process to apply one color to multiple base guides, then switching to apply an alternate color that is applied to multiple paper base guides, and repeating until the reproduction is fully produced. The product is dried and then either packaged and shipped as an unframed product, or framed and shipped. In approximately 50% of the hand-painted reproductions, the taxpayer applies secondary finishes such as gold leafing, texturing and aging chemicals prior to the shipping process.

A color print is produced by inserting specialized print stock paper into the taxpayer's digital and industrial printing equipment, which apply toners, color inks and chemicals to specialized stock paper to produce the color print product prior to framing and shipping.

During 2005, the taxpayer opened a definite place of business in the County. Upon its move, the taxpayer submitted an application for a business license and described its business as a manufacturer. The County investigated the taxpayer and classified it as a wholesale merchant. The taxpayer paid the BPOL and BTPP taxes for the years at issue and appealed its classification as a wholesale merchant to the County. In its final determination, the County determined that the taxpayer's processes were not manufacturing and the taxpayer was properly classified as a wholesale merchant. The taxpayer appealed to the Tax Commissioner, requesting that it be classified as a manufacturer exempt from the BPOL tax and subject to the machinery and tools tax rather than the BTPP tax.

The BPOL statutes do not define the term "manufacturer" for purposes of the local business license tax. However, the Supreme Court of Virginia has developed a test involving three essential elements in determining whether a manufacturing activity is being undertaken. These elements are: (1) original material, referred to as raw material; (2) a process whereby the original material is changed; and (3) a resulting product, which by reason of being subject to such processing, is different from the original material. County of Chesterfield v. BBC Brown Boveri, 238 Va. 64 (1989). In summary, for BPOL tax purposes, a manufacturer means one engaged in a processing activity whereby the original materials are transformed into a product that is substantially different in character from the original materials.

With regard to the hand-painted reproduction process, a master blueprint is printed out and filled in by hand with ink and paint. The original materials (paper, paint and ink) are combined to produce an original product. As such, the Tax Commissioner determined that the hand-painted reproduction process meets the three-pronged test in BBC Brown Boveri. In addition, approximately 50% of the hand-painted prints require the additional steps of adding gold leafing, texturing and aging. In the color print process, the color print is produced by inserting specialized print stock paper into the taxpayer's digital and industrial printing equipment, which apply toners, color inks and chemicals to specialized stock paper to produce the color print product. The Tax Commissioner also determined that the color print process meets the three-pronged test in BBC Brown Boveri. Finally, the taxpayer's framing process goes
well beyond the simple assembling of pre-made frame parts. It involves the cutting of wood, metal and glass to required lengths and specifications, and then combining the wood, metal, and glass with glue and fasteners to produce a finished frame. Such a process satisfies the three-part test as enumerated by BBC Brown Boveri in that it changes raw materials through a process that results in a substantially new product. Thus, the Tax Commissioner determined that the taxpayer is a manufacturer for the tax years at issue and is exempt from the BPOL tax on sales at wholesale from the place of manufacture. The Tax Commissioner also found that the taxpayer, as a manufacturer, is subject to the machinery and tools tax on equipment used in its manufacturing processes, and property not used in the manufacturing process is exempt from local property taxation.

10. **Dual Classification.** P.D. 09-139 (September 21, 2009). The Company has a definite place of business in a locality that imposes a BPOL tax. The Company has two aspects to its business: (1) an interior decoration department, and (2) a framing department. The Company provides design, consultation and similar services to its customers. When the Company provides solely design, consulting or other services it charges an hourly rate for such services. Provision of services generates less than 1% of the Company’s annual gross receipts. The Company's store displays furniture and furnishings for sale and delivery to customers. Customers can also order items through catalogs and procure installation and upholstery services from a third-party source. All fabrication and upholstery services are connected with merchandise purchased from the Company. The Company coordinates all of these purchases, buying the merchandise and the fabrication services for resale to the customer. Design services with respect to any of the furniture and furnishings purchased from or through the Company are provided at no charge. The goods and services are purchased at wholesale prices and are marked up and resold to its customers at a retail price. These activities produce 60 to 65% of the Company's gross receipts annually. The Company also provides custom framing for various pictures and works of art. Typically, the art is brought in by customers. The Company will help a customer select the molding, mat board, glass, and other components and custom builds a frame for the picture. The charge for tree framing is inclusive of all design services and labor required to make the frame. The framing activities produce 35 to 40% of the Company's gross receipts annually. The Company requested a ruling that it should properly be classified as a retail merchant for BPOL tax purpose. The Company also requested that the Tax Department rule that the de minimis amount of revenues attributable to separately billed interior design services does not require it to obtain a separate business license. The Tax Commissioner discussed the various rules in the ruling but ultimately said that it is the responsibility of local taxing officials to make such determinations after examining the facts and circumstances.

**D. Opinions of the Attorney General**

1. **Alternative Situs for Business Vehicles.** OAG No. 08-086 (January 26, 2009). The Arlington County Commissioner of Revenue asked whether the alternative situs provision of Virginia Code sec. 58.1-3511(A)(ii) is mandatory or creates a voluntary taxpayer election. The Attorney General opined that the alternate situs provision is mandatory. Virginia Code sec. 58.1-3511(A)(ii) provides that
if the owner of a business files a return pursuant to § 58.1-3518 for any vehicle with a weight of 10,000 pounds or less registered in Virginia and used in the business with the locality from which the use of such vehicle is directed or controlled and in which the owner's business has a definite place of business, as defined in § 58.1-3700.1, the situs for such vehicles shall be such locality, provided such owner has sufficient evidence that he has paid the personal property tax on the business vehicles to such locality. [Emphasis added.]

The Attorney General stated that the language in the statute is clear and unambiguous. The statutory language mandates that the situs for business vehicles with a weight of 10,000 pounds or less registered in Virginia and used in a business shall be the jurisdiction in which the owner of such business: (1) is required to file a tangible personal property tax return for any vehicle used in the business, and (2) has a definite place of business from which the use of the business vehicle is directed or controlled.

2. Nonprofit Charitable Organization's Wholly Owned, For-Profit Subsidiary. OAG No. 09-043 (August 24, 2009). The Commissioner of Revenue of Roanoke County asked whether a nonprofit charitable organization's exemption from the BPOL tax also applies to the nonprofit charitable organization's wholly owned, for-profit subsidiary. Section 58.1-3703(C)(18)(a) exempts from BPOL taxation the receipts of "charitable nonprofit organization[s]," that are "described in [IRC] § 501 (c) (3) and to which contributions are deductible by the contributor under [IRC] § 170." The Attorney General found no authority to support the proposition that a separate and taxable corporation that is wholly owned by a charitable nonprofit organization is entitled to the same treatment for purposes of BPOL taxes as is its parent organization.

VIII. TANGIBLE PERSONAL PROPERTY AND MACHINERY AND TOOLS TAXES

A. 2009 Legislation

1. Tangible Personal Property Tax: Electric Vehicles. House Bill 2592 (Chapter 44) creates a separate classification for local property tax purposes for motor vehicles powered solely by electricity. This legislation is effective on July 1, 2009.

2. Machinery and Tools Tax: Separate Classification for Precision Investment Castings Equipment. Senate Bill 1315 (Chapter 528) creates a separate classification for local machinery and tools tax purposes for machinery and tools used directly in the manufacture of precision investment castings.

B. Recent Court Decisions

1. Chesterfield County v. Palace Laundry, Inc. d/b/a/ Linens of the Week, 276 Va. 494; 666 S.E.2d 371 (September 12, 2008). The Virginia Supreme Court held that a business that provides linens to customers does not qualify for the exemption for a processing business from the local business tangible personal property tax.
Linens of the Week ("LOW") provides linens to customers in a laundered and finished condition. The linens are all owned by LOW. LOW was assessed with unpaid business tangible personal property tax by Chesterfield County. LOW argued that it was a laundry business under Virginia Code section 58.1-1101(A) or 58.1-3507 and exempt from the business tangible personal property tax. In the alternative, LOW argued that it was an exempt processing business under Virginia Code section 58.1-3507. LOW appealed the assessment to the Tax Commissioner who found that LOW was not a laundry business, but was a processing business. Chesterfield County filed suit seeking to overturn the Tax Commissioner's ruling with respect to the ruling that LOW was a processing business. LOW countersued seeking to overturn the Tax Commissioner's ruling with respect to the ruling that LOW was not a laundry business.

The Court first examined whether LOW was a laundry business. The Virginia Code does not define a laundry business. When a term is not defined in the Code, the term is given its plain meaning. In the Tax Commissioner's ruling, the Tax Commissioner looked to the North American Industrial Classification System ("NAICS") for a definition of a laundry business. The NAICS specifically excluded linen services as a laundry business and defined linen services separately. The Court found this definition persuasive. In addition, the Circuit Court noted that LOW is not required to launder its linens by agreement with its customers. It is only required to provide clean linens to its customers. LOW also does not launder linens owned by others. For these reasons, the Court concluded that LOW is not a laundry business.

Next the Circuit Court examined if LOW was a processing business. A processing business is not defined for business tangible personal property tax purposes, but it is defined for sales and use tax purposes. The Supreme Court of Virginia has defined processing as taking a raw material and treating it to render it more marketable or useful. The Circuit Court held that when LOW buys new linens, the linens are not rendered more useful or marketable than when they were originally acquired. For this reason, the Circuit Court found that LOW was also not a processing business.

The Virginia Supreme Court reviewed the Circuit Court's decision regarding whether LOW is a processing business. The Supreme Court agreed with the Circuit Court that LOW is not a processing business. The Supreme Court stated that cleaning and maintaining rental property does not transform a rental business into a processing business. Furthermore, processing is not LOW's business. LOW is a linen supply business that rents linens to its customers. The maintenance and cleaning of its rental property is merely an activity ancillary to LOW's linen supply business.

C. Recent Virginia Tax Commissioner Rulings

1. Business Tangible Personal Property Tax: Single Member LLC and Mining. P.D. 09-22 (February 6, 2009). The taxpayer is in the business of natural gas exploration and extraction. The taxpayer wholly owns a limited liability company (LLC). The LLC owns an aircraft used by the taxpayer's employees to fly to areas in which the taxpayer owns natural gas wells and other business locations. The LLC has no other property and has no payroll or other expenses. All of the aircraft's operational and maintenance expenses are paid by the taxpayer. The aircraft is never used to transport natural gas. The aircraft is housed in a
hanger located at an airport in the County. The taxpayer raised three questions concerning the application of the BTPP tax to the aircraft.

**Is natural gas exploration and extraction considered mining for purposes of the BTPP tax?**

The Tax Commissioner determined that the extraction of natural gas is included in the term "mining" for the purposes of Virginia Code sec. 58.1-1101(A)(2). This conclusion is based on Black's Law Dictionary’s definition of "mining" as "[t]he process of extracting ore or mineral from the ground; the working of a mine... [t]his term also encompasses oil and gas drilling." Also in George M. Warren, et al. v. Clinchfield Coal Corporation, 166 Va. 524, 186 S.E. 20 (1936), the Virginia Supreme Court held that the term "mineral" includes all petroleum, oil, and gas.

**Is the aircraft, as used by the taxpayer, subject to the Machinery & Tools tax?**

The aircraft is used to transport its employees to and from the taxpayer's various facilities and other business locations. The Tax Commissioner determined that unless an aircraft owned by a mining company is used to transport any of the materials that were mined, it is highly unlikely that it could be classified as property subject to the M&T Tax. In this case, the airplane would not be considered to be machinery and tools subject to local taxation.

**Does the LLC's ownership of the aircraft affect the aircraft's classification for BTPP purposes?**

In a change to a prior ruling, the Tax Commissioner determined that the exemption provided for manufacturers in Virginia Code sec. 58.1-1101(A)(2) does not extend to separate legal entities that perform no manufacturing activities. However in P.D. 07-191, the Tax Commissioner determined that a wholly-owned corporate affiliate of a taxpayer that held a certificate of incorporation from the State Corporation Commission and has its own FEIN for federal income tax purposes was considered to be a separate taxable entity from the other members of its corporate family and not part of a vertically integrated manufacturing company for BTPP tax purposes. **Query:** If the exemption for manufacturers does not extend to separate legal entities that perform no manufacturing activities, why did the Tax Commissioner bother discussing vertical integration, the SCC certificate of incorporation and the affiliates FEIN if those facts made no difference in the outcome? P.D. 07-191 is very misleading to similarly situated manufacturing companies.

2. **Machinery and Tools Tax: Lack of Evidence.** P.D. 09-70 (May 15, 2009). The taxpayer operated a manufacturing facility in the County for more than 30 years. Much of the equipment in the facility is more than 15 years old and lacks the efficiency of newer machinery. In addition, demand for the product manufactured at the facility is declining as a more efficient product gradually takes over the market. For the 2008 tax year, the taxpayer used an alternative method in determining the value of its machinery and tools. The County revised the assessment using its statutory method of valuation. The taxpayer appealed to the County, which upheld the assessment in its final determination. The taxpayer appealed the County's final local determination, asserting that the County's method of valuation does not reflect the actual
fair market value of the machinery and tools. The Tax Commissioner denied the taxpayer's appeal as it did not provide any evidence of its assertions.


IX. MISCELLANEOUS TAXES

A. 2009 Legislation

1. Minimum Taxes: Senate Bill 946 (Chapter 152) and House Bill 2378 (Chapter 37) subject all telecommunications companies, regardless of the type of business entity, to the greater of either the Corporate Income Tax or a minimum tax. On September 12, 2008, in Virginia Cellular, LLC. v. Virginia Department of Taxation, the Virginia Supreme Court ruled that the Virginia Telecommunications Companies Minimum Tax did not apply to non-corporate companies. The bill also continues the application of the Virginia Minimum Tax on Certain Electric Suppliers to non-corporate entities. The provisions of the bill applying the Virginia Telecommunications Companies Minimum Tax and the Virginia Minimum Tax on Certain Electric Suppliers are retroactive, effective for taxable years beginning on and after January 1, 2004.

2. Local Meals Tax and County Food and Beverage Tax: New Exemptions. House Bill 2059 (Chapter 415) creates new exemptions from the local meals tax and county food and beverage tax including food, beverages and meals:
   i) sold by restaurants to employees as part of their compensation;
   ii) sold by schools to their students or employees;
   iii) sold by hospitals and extended care facilities to patients;
   iv) sold by day care centers;
   v) sold by homes for the aged, infirm, handicapped, battered women, narcotic addicts, or alcoholics;
   vi) sold by age-restricted apartment complexes or residences when included in rental fees;
   vii) when used or consumed and paid for by the Commonwealth, any political subdivision of the Commonwealth, or the United States;
   viii) provided by a public or private nonprofit charitable organization to elderly, infirm, blind, handicapped, or needy persons; and
   ix) provided by private establishments that contract with the appropriate agency to elderly, infirm, blind, handicapped, or needy persons.

This legislation also expands the local meals tax exemptions to include meals sold by: i) volunteer fire departments and rescue squads, and nonprofit churches and organizations on an occasional basis; and ii) churches to their members. This legislation expands the county food and beverage tax exemptions to food and beverages sold by volunteer fire departments and rescue squads, and nonprofit churches and organizations on an occasional basis to provide that such sales may not occur more than 3 times per calendar year. Food and beverages sold by churches to their members are already exempt from the county food and beverage tax.
3. **Daily Rental Property Tax.** House Bill 2472 (Chapter 480) and Senate Bill 1419 (Chapter 692) remove the Daily Rental Property Tax as a component of the Merchants' Capital Tax and make it a separate freestanding tax, renamed the Short-Term Rental Property Tax. The criteria for a taxpayer to be deemed as engaged in a short-term rental business are expanded and the Short-Term Rental Property Tax rate for certain heavy equipment rental property. This legislation also exempts short-term rental property on which the Short-Term Rental Property Tax is imposed from the Business Tangible Personal Property Tax.

4. **License Tax on Insurance Companies: Extension of Retaliatory Tax Credit.** Senate Bill 1246 (Chapter 567) extends the carry forward period from 5 to 10 taxable years for the credit allowed against the premiums tax imposed on insurance companies for retaliatory costs paid by certain Virginia insurance companies to other states. The extension is allowed for any credit claimed prior to or after January 1, 2009.

5. **Alternate Fuel Tax Exemption for Agricultural Operations.** Senate Bill 1358 (Chapter 530) exempts from the alternative fuel tax any alternative fuel produced by the owner or lessee of an agricultural operation and used (i) exclusively for farm use by the owner or lessee or (ii) in any motor vehicles operated by the producer of such fuel.

6. **Recordation Tax Exemption for Habitat for Humanity.** Senate Bill 1309 (Chapter 574) exempts from the recordation tax deeds and deeds of trust recorded in connection with the efforts of Habitat for Humanity and similar charitable organizations in Virginia that build low-cost housing for people who could not otherwise afford a house.

**B. Recent Court Decisions**

1. **Virginia Cellular LLC v. Virginia Department of Taxation,** 276 Va. 486; 666 S.E.2d 374 (September 12, 2008). The Virginia Supreme Court ruled that pass-through entities are not subject to the Virginia Minimum Tax on Telecommunications Companies. Virginia Cellular, a telecommunications company formed as a LLC, challenged the imposition of the minimum tax on pass-through entities. The Virginia Supreme Court examined the statute imposing the minimum tax and other corporate income tax statutes that proscribe the treatment of pass-through entities. The Court agreed that the General Assembly imposed the minimum tax only on corporations. Furthermore, 23 VAC 10-120-89 which imposes the minimum tax on all telecommunications companies, corporations, and pass-through tax entities was determined to be invalid.

**C. Recent Virginia Tax Commissioner Rulings**

1. **Fiduciary Income Tax: Land Preservation Credit.** P.D. 09-19 (February 4, 2009). The owners of a farm who wish to place an open space easement on their land requested a ruling regarding the applicability of the land preservation credit. The farm is owned by two trusts. The first trust owns 30 percent of the farm and is a revocable trust for Federal income tax purposes. All of the transactions occurring in this trust are reported by the grantor on her personal income tax return. The second trust owns 70 percent of the farm and is an
irrevocable non-grantor trust. The non-grantor trust is a taxpaying entity that files its own tax return each year. The same person is trustee for both estates. The non-grantor trust is not entitled to a charitable deduction under Internal Revenue Code ("IRC") sec. 170. The owners asked whether a non-grantor trust is a "landowner/taxpayer" for the purposes of Virginia Code sec. 58.1-512; whether the contribution must meet the requirements of IRC sec. 170; and whether the credit may be claimed against a fiduciary income tax liability.

The Tax Commissioner determined that non-grantor trusts are "taxpayers" for purposes of the credit as it is subject to taxation in Virginia. Although the non-grantor trust is not entitled to a charitable deduction under IRC sec. 170, the contribution need only meet the conditions to qualify for the federal deduction. The fact that a non-grantor trust may not be entitled to receive a deduction will not prevent a non-grantor trust from receiving the credit. Lastly, the Tax Commissioner determined that the credit may be claimed against fiduciary income tax liability despite conflicting code provisions. The Virginia Code states that the credit can be claimed against individual income taxes (Virginia Code sec. 58.1-320) and corporate incomes taxes (Virginia Code sec. 58.1-400); however, other sections of the statute (Virginia Code sec. 58.1-512(C) and 58.1-513(B)) suggest that the credit may also be claimed against a fiduciary income tax liability. The Tax Commissioner stated that these other provisions would not have been included in the statute had the General Assembly not intended the credit to be claimed against fiduciary income tax.

2. Pass-Through Entity Withholding Tax: Single Member LLC and U.S. Virgin Islands Resident. P.D. 09-20 (February 4, 2009). A taxpayer requested a ruling on whether a single member LLC and a resident of the U.S. Virgin Islands are subject to the pass-through entity withholding tax. The Tax Commissioner previously determined in P.D. 07-150 (September 21, 2007) that single member LLCs are not subject to the pass-through entity withholding tax. This determination was reaffirmed. As U.S. Virgin Island residents are not subject to federal income taxes, the Tax Commissioner determined that their income is also not subject to the pass-through entity withholding tax.

3. Minimum Taxes. P.D. 09-27 (March 11, 2009). The Tax Commissioner issued Virginia Tax Bulletin 09-2 to inform taxpayers who requested a refund of telecommunications minimum taxes based on the Virginia Cellular LLC v. Virginia Department of Taxation decision that their refund requests have been denied as a result of the enactment of Senate Bill 946 (Chapter 152) and House Bill 2378 (Chapter 37).

4. Aircraft Sales and Use Tax: Leases. P.D. 09-38 (April 27, 2009). A taxpayer requested a ruling regarding the taxability of lease arrangements for aircraft it owns. The facts are as follows: The taxpayer acquired an aircraft in another state for subsequent lease to a corporation under a ten-year lease agreement. The lessee will make annual lease payments to the taxpayer over the ten-year term. The lessee anticipates subleasing the aircraft to a prospective third party that will hangar and operate the aircraft in Virginia. The prospective sublease will be for a term not to exceed thirty months. Under the terms of the sublease, the customer will make monthly lease payments and also pay a monthly variable rent per flight hour. The taxpayer asked whether the lease payments are subject to aircraft sales and use tax and whether the taxpayer qualifies as a dealer.
The Tax Commissioner determined that the lease payments under the lease and sublease do not constitute sales as the value of the lease payments does not exceed 80% of the value of the aircraft. Because the leases are not considered sales, the taxpayer can elect to remit tax in one of two ways. It can (i) pay the aircraft sales and use tax on two percent of the purchase price of the aircraft or two percent of the current market value of the aircraft licensed in Virginia six months or more after its acquisition or (ii) remit the tax to the Tax Department on two percent of the gross proceeds of the lease payments received from the sublease. Lastly, the Tax Commissioner determined that the taxpayer is a dealer. Title 23 of the Virginia Administrative Code (VAC) 10-220-5 defines "dealer" to mean, "any person the Tax Commissioner finds to be in the regular business of selling aircraft and who owns five or more aircraft at anytime during the calendar year which are held for resale or used for compensation."

5. **Aircraft Sales and Use Tax: Qualified Exchange Accommodation Agreement.** P.D. 09-39 (April 27, 2009). A taxpayer requested a ruling from the Tax Commissioner regarding how the aircraft sales and use tax will apply to a series of transactions. In the facts submitted to the Tax Commissioner, the taxpayer will loan an LLC funds to acquire a replacement aircraft from an unrelated seller located in another state. The aircraft obtained by the LLC will be immediately transported to Virginia, where the LLC will apply to the Department of Aviation for and obtain a license to operate the aircraft. The LLC will lease the replacement aircraft to the taxpayer for a term not to exceed 180 days.

Subsequently, the taxpayer will transfer the relinquished aircraft to a third party buyer using a Qualified Intermediary pursuant to an Exchange Contract. The Qualified Intermediary will hold the proceeds from the sale of the relinquished aircraft. After the reverse exchange transaction is completed, all of the membership interest in the LLC will be transferred to the taxpayer through the Qualified Intermediary. The taxpayer will pay for the LLC interest using: (a) proceeds held by the Qualified Intermediary from the sale of the relinquished aircraft and (b) an additional payment equal to the difference between the outstanding note balance from the acquisition of the replacement aircraft and the payment from the Qualified Intermediary on the sale of the relinquished aircraft.

The Tax Commissioner determined that the LLC will be subject to the aircraft sales and use tax on its initial purchase of the aircraft. The lease payment will not be subject to the tax as the payment do not equal or exceed eighty percent of the value of the aircraft. The Tax Commissioner could not determine whether the aircraft sales and use tax would apply to the sale of the relinquished aircraft to a third party because the application of the tax will depend on whether the aircraft is subject to licensing with the Department of Aviation. The sale of the LLC interests will also not be subject to the aircraft sales and use tax. Title 23 VAC 10-220-5 3 states that the term "sale" does not include "[a]ny transfer of ownership or possession which is part of the sale of all or substantially all the assets of a business. The exemption applies only to aircraft upon which Virginia aircraft sales and use tax has been paid upon acquisition . . . " As the tax will have been paid on the acquisition of the aircraft, the Tax Commissioner determined that this exemption will apply.
6. **Pass-Through Entity Withholding Tax.** P.D. 09-59 (May 1, 2009). A partnership has both Virginia source income and non-Virginia source income earned from pass-through entities engaged in residential and commercial real estate rental activities. All of the partnership's limited partners are nonresident individuals or nonresident fiduciaries. Several of the limited partners are residents of California and the District of Colombia. These partners claim a credit on their Virginia Nonresident Income Tax Return for taxes paid to their respective states of residence. The partnership states that this credit has historically been equal to the Virginia tax liability. In light of the fact that these nonresident limited partners are not required to pay any tax to Virginia, the partnership asked whether the pass-through entity withholding tax is required to be paid on behalf of a taxpayer whose credit for taxes paid to other states is sufficient to offset all Virginia income tax attributable to the shares of income distributed by a pass-through entity.

The Tax Commissioner determined that the credit for taxes paid to the District of Colombia will generally be sufficient to cover the full Virginia liability because their current tax rates are higher than Virginia's current tax rate. However, a credit from California will only sometimes be sufficient because California currently has tax rates that are higher and lower than Virginia's current tax rate, depending on the amount of taxable income. An exception is allowed for individuals whose credit for taxes paid to other states is sufficient to offset all Virginia income tax attributable to the shares of income distributed by the PTE by P.D. 07-150. Based on the exemption in no withholding will be required for those limited partners of the partnership whose credit is sufficient to offset their Virginia tax liability, i.e., only the D.C. residents.

7. **Recordation Tax: Increase in Line of Credit.** P.D. 09-65 (May 13, 2009). A taxpayer requested a ruling on two different fact scenarios where a debtor refinanced his mortgage and received an increased line of credit. For each scenario, the taxpayer requested a ruling that only the increased credit line above the amount of the original mortgage would be subject to recordation tax. The Tax Commissioner agreed. Virginia Code section 58.1-803(D) exempts from the recordation tax refinanced deeds of trust and mortgages where the purpose of the refinancing is to modify the terms of an existing debt with the same lender. Under this section, the recordation tax is imposed only on that portion of the amount of the bond or other obligation secured that is included to the amount of the existing debt secured by a deed of trust or mortgage on which the tax has been paid.

8. **Cigarette Tax: Stamping Agent.** P.D. 09-69 (May 13, 2009). The Stamping Agent is a corporation that plans to apply for a Virginia stamping agent permit. Once it has obtained the Virginia permit, the Stamping Agent plans to purchase cigarettes directly from the manufacturer and have them shipped to the Affixer. The Stamping Agent would purchase the Virginia revenue stamps and transfer possession of the stamps to the Affixer as a contract agent of the Stamping Agent. The Affixer would apply the stamps to the Stamping Agent's cigarettes on a contract basis and transport the cigarettes to retail stores in the Commonwealth. The Stamping Agent requested a ruling regarding the legality of this arrangement. The Tax Commissioner approved this arrangement and reminded the Stamping Agent that it is still responsible for following all statutory requirements imposed on licensed stamping agents.
9. Digital Media Fee: Collecting on Behalf of Others. P.D. 09-114 (July 16, 2009). The Content Provider provides movies, games and basic cable programming to guests in hotels, motels and other temporary lodging facilities in Virginia through the television sets located in guest rooms. While the basic cable programming is provided to guests free of charge, the movies and games ("digital media") are only available to guests for a separate charge. Although the charge is set by the Content Provider, it is billed to and collected from guests by the lodging facility on the bill with other charges related to the stay. The Content Provider invoices lodging facilities on a monthly basis for the digital media sold to guests in the previous month. The lodging facility remits the invoiced amount to the Content Provider after retaining a commission. The Content Provider requests a ruling allowing it to voluntarily register to collect and remit the Digital Media Fee on behalf of certain lodging facilities. The Tax Commissioner granted this request and stated that this arrangement will not affect the calculation of the tax in any way.

D. Opinions of the Attorney General

1. Original Cost. OAG No.08-109 (February 25, 2009). Senator Emmett Hanger asked what is the meaning of the term “original cost” as it is used in Virginia Code sec. 58.1-3503(A)(17). Virginia Code sec. 58.1-3503(A)(17) provides:

A. Tangible personal property is classified for valuation purposes according to the following separate categories which are not to be considered separate classes for the rate purposes:

   17. All tangible personal property employed in a trade or business other than that described in subdivisions 1 through 16 of this subsection, which shall be valued by means of a percentage or percentages of original cost.

Senator Hanger suggested that the original cost of personal property employed in a trade or business could be defined as either the price paid for the personal property when it originally was purchased from a manufacturer or dealer or the price paid by a subsequent purchaser. Senator Hanger also observed that Virginia Code sec. 58.1-3503(A)(17) does not define “original cost.”

The Attorney General opined that the meaning of the term “original cost” is the cost of the personal property employed in a trade or business paid by the owner who first purchased the personal property from either a manufacturer or dealer. In effect if a business purchases a piece of used equipment, the equipment’s value will be based on its cost when it was purchased new by the original owner, not the cost to the current owner who purchased the equipment used. This opinion will also likely prevent business from using a sales-leaseback transaction to reduce the value of their equipment. Many business have considered selling their equipment to a capital firm at an appraised price of its current value and leasing the equipment as a method of reducing their basis for business tangible personal property tax purposes. The issuance of this opinion likely means that Virginia localities will not recognize the new appraised value in such a transaction for business tangible personal property tax purposes.