Hot Topics in Virginia Taxation - The Present and the Future?

Craig D. Bell
William L.S. Rowe

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HOT TOPICS IN VIRGINIA TAXATION

The Present and the Future?


Craig D. Bell
McGuireWoods LLP
901 East Cary Street
Richmond, Virginia 23219
cdbell@mcguirewoods.com
Telephone: (804) 775-1179
Facsimile: (804) 698-2160

William L.S. Rowe
Hunton & Williams
951 E. Byrd Street
Richmond, Virginia 23219
wrowe@hunton.com
Telephone: (804)788-8410
Facsimile: (804)788-8218

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A discussion of 2008 tax legislation, recent court decisions, Tax Department rulings, and opinions of the Virginia Attorney General.

I. CORPORATE INCOME TAX

A. 2008 Legislation

1. Fixed Date Conformity. HB 912 (Chapter 1) and SB 582 (Chapter 2) amend Virginia Code section 58.1-301(B) to conform the State Tax Code with the federal Internal Revenue Code as it existed on December 31, 2007, for individual and corporate income tax purposes. Virginia continues, however, to disallow the federal bonus depreciation deduction and the five year net operating loss carryback period for state tax purposes. The new conforming date enables the state to adopt the federal amendments made by The Small Business and Work Opportunity Tax Act of 2007; House Resolution 4118, which excludes income received from Virginia Tech University out of amounts transferred from the Hokie Spirit Memorial Fund if such amounts were paid on account of the tragic event on April 16, 2007; and the Tax Mortgage Forgiveness Debt Relief Act of 2007. This legislation contained an emergency clause and was effective upon the Governor’s approval.

2. Biodiesel and Green Diesel Fuels Producers Income Tax Credit. HB 139 (Chapter 482) allows an income tax credit to biodiesel and green diesel fuels producers in Virginia who produce up to two million gallons of biodiesel or green diesel fuels a year. The amount of the credit is $0.01 per gallon but no more than $5,000 annually for taxable years beginning on and after January 1, 2008.

3. Exemption for Launch Services and Payload. HB 238 (Chapter 211) and SB 286 (Chapter 149) grant an income tax exemption for income resulting from the sale of launch services to space flight participants or launch services intended to provide individuals the training or experience of a launch, without performing an actual launch. The legislation also grants an income tax exemption for any gain recognized as a result of resupply services contracts for delivering payload entered into with the Commercial Orbital Transportation Services division of the National Aeronautics and Space Administration or other space flight entity. This legislation is effective for taxable years beginning on or after January 1, 2009.

4. Study: single sales factor. HJR 177 and SJR 101 establish a joint subcommittee to study the benefits of adopting a single sales factor to apportion the income of multistate corporations for purposes of the corporation income tax. The subcommittee has formally met one time with the next session scheduled for September 30, 2008.
B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Nexus, Consolidated Return, and Alternative Method of Apportionment. P.D. 08-6 (January 11, 2008). The taxpayer filed a consolidated Virginia corporate income tax return with a number of its affiliates for the taxable years at issue. In addition, the three subsidiaries of the taxpayer, Corporation A, Corporation B, and Corporation C, filed separate Virginia corporate income tax returns for the taxable years at issue. Under audit, the Department made adjustments to consolidate Corporation A, Corporation B, and Corporation C with the taxpayer and its affiliates, resulting in the assessment of additional corporate income tax. The taxpayer contested the assessment and contended that Corporation A, Corporation B, and Corporation C lacked nexus with Virginia for income tax purposes. The taxpayer also requests permission to use an alternative method of allocation and apportionment if it is found that Corporation A, Corporation B, and Corporation C must be included in the Virginia consolidated return.

Pursuant to Va. Code § 58.1-442, an affiliated group of corporations may elect to file a consolidated Virginia income tax return. If such an election is made, 23 VAC 10-120-322 provides that, once an election to file a consolidated return is made, a related corporation must be included in the Virginia consolidated return unless it is exempt from Virginia income tax under Public Law (P.L.) 86-272 or not subject to Virginia income tax if separate returns were to be filed, or using different taxable years. The Tax Commissioner determined that Corporations A, B, and C should be included in the consolidated return if they are subject to Virginia income tax. After analyzing each subsidiary, the Tax Commissioner determined that Corporations A and C had no property or payroll in Virginia and were not subject to Virginia income tax. Corporation B had an office with employees in Virginia. The taxpayer argued that the office was ancillary to solicitation and protected under P.L. 86-272. The Tax Commissioner ruled that owning or leasing real property exceeds the protection afforded by P.L. 86-272. In addition, the activity in Virginia was not de minimis. Finally, the Tax Commissioner denied the taxpayer’s request for an alternative method of apportionment as the taxpayer did not demonstrate that the statutory method is unconstitutional or inapplicable.

2. Fixed Date Conformity Tax Bulletin. P.D. 08-14 (February 6, 2008). The Tax Commissioner issued Virginia Tax Bulletin 08-1 to provide instructions to taxpayer for complying with HB 912 and SB 582 which update Virginia’s date of conformity with the Internal Revenue Code.

3. Intangible Holding Company. P.D. 08-34 (April 4, 2008). The taxpayer appealed an assessment of corporate income taxes after the auditor determined that transactions between the taxpayer and its intangible holding company (the “IHC”) caused income reported to Virginia to be reflected improperly. The taxpayer and its affiliates reported net operating losses for the taxable years at issue. The taxpayer’s
records indicated that the consolidated Virginia returns reported net operating losses to Virginia almost every year since the inception of the IHC and it never paid Virginia corporate income tax (a span of more than 15 years). The records also showed the taxpayer would have had positive Virginia taxable income for almost every taxable year if it were not paying royalties and interest to IHC. The taxpayer argued that the royalty fees and interest charged by IHC were deductible for federal income tax purposes and were specifically structured by its CPA firm to fall within the range of arm's length rates permissible under Internal Revenue Code § 482.

The Tax Commissioner denied the appeal. The Tax Commissioner determined that the IHC lacked economic substance. The IHC’s officers received no compensation from the IHC and two of the three officers were employees of the taxpayer. The overall payroll of the IHC was minimal and it shared “office space” along with numerous unrelated parties. The IHC did conduct limited activities. However, the Tax Commissioner determined that the overall expenses incurred were minimal in comparison to the revenue generated from the license agreements. Also, the taxpayer conducted essential corporate functions for IHC for which it was not compensated during the taxable years at issue.

In addition, the Tax Commissioner found that the taxpayer failed to substantiate that the royalty rates charged for the use of the trademarks were reflective of fair market value. The taxpayer did not incur a credit risk from the intercompany loans from the IHC. Despite the fact that the loans had a market rate of interest, the purpose of the loans was to distort Virginia income.

4. **Nexus.** P.D. 08-63 (May 19, 2008). The taxpayer, headquartered outside of Virginia, is in the business of issuing credit cards. It is a member of a group of related entities, several of which are subject to income tax in Virginia. The taxpayer does not own or lease property in Virginia and does not have any employees or agents in Virginia. The taxpayer markets credit cards in Virginia by mail, telephone and internet advertising. The mailings originate from locations outside Virginia, and neither the taxpayer nor its related entities operate a call center in Virginia. The taxpayer derives more than 70% of its gross income from interest and fees to process credit card transactions. The taxpayer is contemplating engaging in activities within Virginia that will require it to begin filing Virginia income tax returns in the near future and requests a ruling on whether it has had nexus in Virginia for purposes of the corporate income tax for previous taxable years.

The Tax Commissioner determined that as the taxpayer had neither property nor payroll in Virginia and as a financial corporation all of its sales would be allocated outside of Virginia based on cost of performance, it would not have a positive apportionment factor and no corporate income tax liability for prior years.

5. **Allocation of Sales.** P.D. 08-137 (July 30, 2008). The taxpayer, headquartered in State A, operates a social networking website that connects friends, coworkers, neighbors, and individuals with common interests. Subscribers are not
charged a fee for this service. Instead, the taxpayer generates revenue through delivering relevant on-line advertisements to targeted subscribers. Almost all the taxpayer's employees administer and operate the business from its facility in State A. The taxpayer also has sales representatives located in other states, but none in Virginia. The social networking website resides on servers, most of which are located in State A. Some of the servers are located in Virginia. Advertisements are loaded onto servers by employees in State A for delivery to subscribers. The taxpayer requested a ruling regarding the proper method to allocate revenue for purposes of the Virginia sales factor.

The Tax Commissioner opined that the ruling will depend on whether the greater portion of the income producing activity for the fees from advertising stored on the Virginia servers occurred in Virginia or another state. The taxpayer would have to determine the costs associated with loading and storing the advertising on the Virginia server for a given taxable year. The computation of such costs might include the percentage of space and time the advertising was on the Virginia servers. Costs in Virginia for a particular advertising fee would also include a portion of the costs for maintaining the social networking website on Virginia servers.

The Tax Commissioner concluded that the taxpayer should develop a method for determining the income producing activities associated with revenue. Even if it is determined that none of the advertising fees should be included in the numerator of the Virginia sales factor at this time, the location of the income producing activities may change in the future as the business environment changes.

6. Federal Instrumentality. P.D. 08-138 (July 30, 2008). The Board is a federal instrumentality created for the purpose of providing professional investment management of various trusts and operating funds. The Board operates as a trust forming part of a pension, profit-sharing, or stock bonus plan qualified under Internal Revenue Code (IRC) § 401(c) that is exempt from federal income taxation under IRC § 501(a). The IRS determined that income earned by the Board and its pass-through entities’ income is exempt because it is derived in the exercise of an essential governmental function. The Board requested that the Tax Department rule that the income is not subject to Virginia corporate income tax because the income is derived from an essential governmental function. The Tax Commissioner determined that because the Board is exempt from federal taxation, the income would not be subject to income tax in Virginia.

7. Nexus. P.D. 08-139 (July 30, 2008). Corporation A is a corporation not domiciled in Virginia, but subject to Virginia corporate income tax. It produces and sells tangible personal property that it sells nationwide. It wholly owns Corporation B, which in turn wholly owns Corporation C. Corporation A generates accounts receivable from the sale of its property. It sells the receivables to Corporation B for a discount. Corporation B, in turn, sells the receivables to Corporation C.

Corporation A borrows money from banks that use the receivables owned by Corporation C as collateral. Corporation A services the receivables on behalf of Corporation C for an administrative fee. Receivable payments are typically sent
electronically to a Corporation C collection account, but are occasionally sent to lock boxes located outside of Virginia. Corporation A's collection officers occasionally travel to Virginia to service receivables. While in Virginia, Corporation A collection officers engage in sales promotion on behalf of Corporation A, the periodic review of existing customers' credit worthiness, and the discussion of delinquent accounts.

Corporation B has no employees, property, and the only income is the proceeds from the sale of the receivables. Corporation C has no employees or property other than the receivables and the lease of the lock boxes. Corporation C's only income is the proceeds from the gain from the collection of the receivables and the administrative fees paid by Corporation A. Corporation C is the lessee of the lock boxes. A ruling was requested as to whether Corporation B and Corporation C are subject to Virginia corporate income tax.

The Tax Commissioner ruled that Corporation B would not be subject to Virginia income tax. Corporation B's activities are limited to purchasing Corporation A's receivables and immediately selling them to Corporation C. Corporation B's income is limited to the net proceeds from the resale of the receivables to Corporation C. Corporation B lacks any connections with Virginia that would create nexus for income tax purposes. In addition, Corporation B does not have any positive apportionment factors. Finally, the Tax Commissioner determined that Corporation C would not have a positive sales factor and no income from Virginia sources. Therefore, it would not be subject to Virginia income tax even if it did have nexus.

8. **P.L. 86-272. P.D. 08-142 (July 30, 2008).** The taxpayer is an out of state corporation that manufactures and sells medications for animals. The taxpayer employs several sales representatives, a district manager and a veterinarian, all of whom reside and work out of their homes in Virginia. The sales representatives solicit sales of the taxpayer's medications at veterinary clinics. The sales representatives distribute samples to current and prospective customers without charge. The District Manager works out of his home and solicits sales by visiting veterinary clinics. The manager recruits, hires, trains, defines and assigns the responsibilities of the sales representatives, who report to the manager. The manager also participates in sales and marketing campaigns.

The veterinarian provides technical training and sales support, which include providing information to customers regarding the application possible interactions and dosing instructions of the product. The veterinarian conducts product demonstrations and answers questions for current and prospective customers. The veterinarian also participates in trade shows, veterinary conferences, and veterinary school meetings. The taxpayer was audited by the Tax Department and assessed with corporate income tax. The auditor concluded that the taxpayer had nexus with Virginia because the employees' activities in Virginia exceeded the solicitation of sales and that the taxpayer had property in Virginia. The taxpayer appealed and contended that the employees' activities are either directly related to the solicitation of sales or are ancillary to the solicitation process and have no independent business purpose apart from their connection to the soliciting of
orders. In addition, the taxpayer argued that providing company automobiles and computers to its employees merely facilitates sales solicitation.

The Tax Commissioner denied the taxpayer's appeal. The Tax Commissioner concluded that the taxpayer performed activities that are non ancillary to the solicitation of sales. In addition, these activities constituted a continuous pattern of enterprise, which is not de minimis and cannot be considered a trivial addition to the taxpayer's business conducted on in Virginia. On this basis, the assessment was upheld.

9. Land Preservation Tax Credit. P.D. 08-159 (August 30, 2008). The taxpayer files a Virginia consolidated income tax return with 12 affiliated corporations. Each of the 13 members of the affiliated group plans to acquire $100,000 worth of Land Preservation Tax Credits to be claimed against the group's consolidated tax liability. The taxpayer anticipates that the consolidated income tax liability for the group will exceed $1.3 million. The taxpayer requested a ruling as to whether the Credit limitation in Va. Code § 58.1-512 is the aggregated total of each member of the group holding a credit or each affiliates tax computed on a separate return basis. The Tax Commissioner determined that each individual member of an affiliated group of corporations included in a consolidated corporate income tax return may claim up to $100,000 regardless of its contribution to the total tax liability. In the case of the taxpayer, each of the 13 members of the affiliated group holding Credits could claim up to $100,000 worth of the Credit against the group's consolidated tax liability. If all 13 affiliates are holding Credits, up to $1.3 million could be claimed on the consolidated income tax return.

10. Nexus Via Deliveries and Services Performed By An Affiliate. P.D. 08-168 (September 11, 2008). The taxpayer requested a ruling on whether it has nexus with Virginia for corporate income tax purposes. The taxpayer, a corporation headquartered outside Virginia, makes sales into Virginia through mail order and via the Internet. The taxpayer does not have property or employees in Virginia. Orders are received and approved or rejected outside Virginia. The taxpayer is registered to collect and remit Virginia sales and use tax. The products are shipped to customers via common carrier or third party contract carriers. The contract carriers are independent contractors that make deliveries for multiple principals. When delivering goods for the taxpayer, the contract carriers may, in some cases, unpack a purchased item at a customer's home, provide minor set up, inspect the product, and remove packing materials.

The taxpayer is related to an entity (Stores), a corporation headquartered outside Virginia, that has retail stores located in Virginia that sell many of the same products as the taxpayer. On occasion, as a service to Stores' customers, a retail store may allow returns of items purchased from the taxpayer. The taxpayer's website does not advertise that returns are accepted at retail stores, and instead instructs them to ship such merchandise directly to its distribution center located outside Virginia.
The Tax Commissioner determined that the taxpayer has nexus with Virginia for corporate income tax purposes. The Tax Commissioner noted that Stores' arrangement with the taxpayer is consistent with many retail sellers that sell both through mail order or Internet businesses, and brick and mortar locations. In addition, the taxpayer benefits from Stores' policy even if its website does not advertise that merchandise may be returned to Stores' locations. Stores also provides an additional service not provided to unrelated third parties. Stores provides a local shipping point for the taxpayer's returned merchandise not carried in the retail store. Stores does not provide similar services to unrelated third parties. Based on these facts, the Tax Commissioner concluded that Stores' return policy, when conducted in Virginia on behalf of the taxpayer, would exceed the protection of P.L. 86-272.

The Tax Commissioner also determined that the taxpayer may have corporate income tax nexus based on the activities of the contract carrier. The contract carriers unpack merchandise, provide minor setup services, inspect purchased property for quality and damage, and remove packaging materials. The Tax Commissioner stated that these activities could be considered to go beyond the making of sales in Virginia. For example, consideration would have to be given to whether unpacking and setting up the product is necessary to complete the sale, the complexity of the setup procedures, the extent of the inspection process, and the ability of the customer to dispose of the packing materials. Consideration may also be given to rates charged by the contract carriers for deliveries, including product setup versus rates for delivery only. If the activities of the contract carriers go beyond the making of sales, such activities could exceed the protection afforded the taxpayer under P.L. 86272.

11. **Texas Margin Tax.** P.D. 08-169 (September 11, 2008). A taxpayer requested a ruling as to whether the Texas Business Margin Tax is required to be added back under Virginia Code section 58.1-402(B)(4). For purposes of computing the Virginia taxable income of a corporation, Virginia Code section 58.1-402(B)(4) provides an addition to federal taxable income for the "amount of any net income taxes and other taxes, including franchise and excise taxes, which are based on, measured by, or computed with reference to net income, imposed by the Commonwealth or any other taxing jurisdiction, to the extent deducted in determining federal taxable income." The Tax Commissioner determined that the Texas Business Margin Tax is not a tax based on, measured by, or computed with reference to net income. Therefore, the tax is not required to be added back under Virginia Code section 58.1-402(B)(4) when computing Virginia taxable income.

12. **Employee Present in Virginia.** P.D. 08-176 (September 18, 2008). The taxpayer, a limited liability company (LLC) taxed at the entity level, has corporate headquarters located outside of Virginia. It has no sales or property in Virginia. One of its officers, however, resides in Virginia and works out of his residence. His job responsibilities do not include the solicitation of sales. The taxpayer withholds Virginia income tax from this employee. The taxpayer filed Virginia corporate income tax returns for the 2005 and 2006 taxable year and paid Virginia income tax. The taxpayer requested
a refund of Virginia income tax paid for these years as it contends it does not have Virginia source income.

The Tax Commissioner denied the taxpayer's refund request. The Tax Commissioner stated that the existence of one employee residing and working in Virginia creates a positive payroll factor. A positive payroll factor indicates that the taxpayer had Virginia source income for the taxable years at issue and is subject to Virginia's corporate income tax.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

II. INDIVIDUAL INCOME TAX

A. 2008 Legislation

1. Filing of Tax Returns. HB 678 (Chapter 217) requires large income tax return preparers to file returns electronically unless the return includes attachments or schedules that cannot be accepted through electronic means. Currently, large income tax preparers have the option of filing returns electronically or using 2D bar-coded paper returns. This legislation would not change a provision in current law that would allow the Tax Commissioner to waive the requirement to file electronically. This legislation is effective for taxable years beginning on or after January 1, 2008.

2. Land Preservation Credit Confidentiality. HB 662 (Chapter 785) includes as a confidential tax document any document that is required to be filed with the Department of Conservation and Recreation under the land preservation tax credit program. This legislation took effect on July 1, 2008.

3. Land Preservation Tax Credits. HB 849 (Chapter 549) makes several changes in order to simplify the administration of the Land Preservation Tax Credit. First, it allows the Tax Department to disclose certain information related to adjustments of transferred credits and related assessments to both the transferor and transferee. Second, it allows the donor and any transferors and transferees of the credit to file an administrative appeal when there is a modification to the credit, even if they have not received an assessment. The Tax Department would have the discretion to permit the joinder of a party or consolidate appeals filed by different taxpayers if the interest of the party or the applications involve adjustments to credits arising from the same transaction or occurrence, provided that no interests were prejudiced and the joinder or consolidation advanced administrative economy. Finally, because most large donations involve the use of pass-through entities, several procedures similar to those used by the Internal Revenue Service pursuant to the Tax Equity and Fiscal Responsibility Act (TEFRA) are adopted. The statute of limitations would be extended for pass-through entities when a pass-through entity is being audited, and the Tax Department would be required to send notice of certain administrative proceedings to the owners of the pass-through entity. The provisions of this legislation are applicable to disclosures made in the course of assessing
tax on or after July 1, 2008, and to administrative proceedings pending on or filed after July 1, 2008.

4. **Neighborhood Assistance Act Tax Credits.** HB 680 (Chapter 585) provides that, for both business firms and individuals, the credit amount would be forty percent of the value of the donation. This legislation also provides that the value of a motor vehicle donated by a business firm would be the value as determined for federal income tax purposes. In addition, an individual that makes a contribution to a Neighborhood Assistance Act Tax Credit program is allowed to claim a tax credit for the donation even if the donation has been claimed as a deduction for federal income tax purposes. Finally, this legislation allows a business firm that pledged a donation in writing on or before January 1, 2006, to a neighborhood organization to be eligible to receive a tax credit that is equal to 45 percent of the value of the donation. The donation must be made on or before January 1, 2013 in order to qualify. This legislation took effect on July 1, 2008.

5. **Neighborhood Assistance Act Tax Credits.** SB 700 (Chapter 463) Changes the Neighborhood Assistance Act tax credit program by allowing individuals to receive tax credits for donations of marketable securities.

6. **Riparian Waterway Tax Credit.** HB 1309 (Chapter 449) adds an "individual's grantor trust" to the definition of "individual" and changes the term "taxpayer" to individual. This will allow an individual's grantor trust to benefit from the tax credit when the property is held in the trust's name. This legislation took effect on July 1, 2008.

B. **Recent Court Decisions**

There are no recent court decisions to report.

C. **Recent Virginia Tax Commissioner Rulings**

1. **Converted Assessment.** P.D. 08-7 (January 11, 2008). The corporation was assessed withholding taxes, penalties, and interest for the periods January through December 2002 and October through December 2004. When the corporation did not pay the assessments, the liability was converted to the corporate officers, pursuant to Va. Code § 58.1-1813. The taxpayer contested the penalty, asserting that the Corporation's president was the responsible officer. In a prior determination, P.D. 07-29 (4/9/2007), the Tax Commissioner found that the taxpayer signed checks to pay Virginia withholding tax for other periods, had the authority to make disbursements from the Corporation's bank account, and was responsible for all day-to-day operations of the Corporation. Based on these findings the Tax Commissioner upheld the penalty assessed against the taxpayer. The taxpayer requested a reconsideration of the Tax Commissioner's determination contending that evidence has come to light that the president of the Corporation had specifically dictated that corporate debt be paid, rather than tax liability, because the president had personally guaranteed the corporate debt.
The Tax Commissioner again denied the taxpayer's appeal as the taxpayer did not produce any objective evidence to affirm these assertions. In addition, the assertions do not absolve the taxpayer from being a corporate officer as defined in Va. Code § 58.1-1813.

2. Part-Year Resident Proration. P.D. 08-8 (January 11, 2008). In April 2004, the taxpayers abandoned their Virginia residency and established residence in State A. The husband was the sole shareholder of an S corporation located in State A. In September 2004, the S Corporation 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 that the taxpayers resided in Virginia. The taxpayers contested the assessment, asserting that the gain should be attributed to State A because the gain occurred while they were residents of State A.

Based on P.D. 95-184 (7/14/1995), a part-year resident must determine income from a pass-through entity attributable to the period of Virginia residency by prorating the income in accordance with the number of days he was a resident of Virginia during the taxable year. A part-year resident is not entitled to a credit for taxes paid to another state with respect to income from a pass-through entity that has been excluded from Virginia source income pursuant to this policy. In the instant case, the sale of assets by the S corporation resulted in income subject to proration as determined in P.D. 95-184. The taxpayer argued that P.D. 95-184 states the proration of distributions method applies if there is a "clearly defined cut-off of activity." The taxpayers asserted that because the sale occurred after they moved to State A, no part of the gain should be included in Virginia taxable income.

The Tax Commissioner determined that the sale of assets by the S corporation resulted in income subject to proration as determined in P.D. 95-184. In the 1995 ruling, the fact that the taxpayers moved to Virginia had no bearing on when the activity of the S Corporation was cut off. A new S corporation was then started in Virginia. Because an S corporation ceased operations in the other state and a new corporation was started in Virginia, a clear cut-off of activity occurred that limited the proration periods. No proration applied only because the taxpayers moved to Virginia on the date that the clear cut-off of activity occurred. In the taxpayer's case, no such clear cutoff of the S corporation's activity occurred. The taxpayers merely moved from Virginia to State A. The S corporation remained in operation for the entire year.

3. Equity and Subordinated Debt Investments Tax Credit. P.D. 08-11 (January 11, 2008). The taxpayer plans to issue a subordinated debt that will be convertible into equity of the corporation. The convertible notes would be due and payable within two years after issuance. They also stipulate a mandatory conversion to equity when certain investment targets are met. The equity would be converted to common stock. The taxpayer requested a ruling as to whether the convertible notes
would be qualified investments for purposes of the Credit, and if not, whether the equity would qualify when the notes are converted.

The Tax Commissioner determined that because the notes are required to be either converted or redeemed within two years of the date of issuance, the convertible notes would not qualify for the credit. In addition, the equity resulting from the conversion of notes would not qualify for the credit. The taxpayer's investors are making a cash investment in a convertible note. Because cash was not directly invested in a qualified equity or subordinated debt, the taxpayer's investors would not be considered to have made a qualified investment.

4. **Domicile.** P.D. 08-31 (April 2, 2008). The taxpayer and his wife were Virginia residents through the 2001 taxable year. In January 2002, the Taxpayer accepted a position with a corporation located in Country A. The contract was for a period of approximately 10 years until the taxpayer's 60th birthday, which was the age of mandatory retirement. The taxpayer leased a townhouse in Country A and invested money in furnishing the Country A townhouse. The taxpayer did not obtain a Country A driver's license. In 2004, the taxpayer took a position with a corporation located in Country B after the corporation in Country A was reorganized, and his job responsibilities were diminished. The employment contract with the Country B corporation was for an indefinite time period. The taxpayer leased a residence for a three-year period. He incurred expenses to refurnish the Country B residence. The taxpayer did obtain a Country B driver's license. In June 2006, the taxpayer's employment with the Country B company was terminated and he was hired by a corporation located in Country C. He obtained a Country C driver's license. The taxpayer purchased and registered a car in Country C. The Taxpayer continues to live and work in Country C.

During the years at issue, the taxpayer paid Country A income tax even though he resided in Country B and Country C. In January 2005, the taxpayer commenced proceedings to become a citizen of Country A. In March 2007, the taxpayer became a citizen of Country A. During the taxable years at issue, the taxpayer's wife continued to reside in Virginia. The wife maintained joint custody of her child with her ex-husband, who also resided in Virginia. In August 2003, the Virginia home that the taxpayer and his wife jointly owned was deeded to a trust in which the Taxpayer and his wife were the trustees. The wife was the sole beneficiary of the trust. Mortgage interest was deducted on the taxpayer's joint federal income tax return. The taxpayer also maintained a Virginia driver's license that was renewed in 2006. The taxpayer jointly owned a vehicle with his wife that was registered and garaged in Virginia. The taxpayer's third-party information returns were sent to the Virginia address. The taxpayer claimed a foreign tax credit on his federal income tax return as a United States citizen. The taxpayer was registered to vote and did vote in a Virginia local primary in June 2006 when back in Virginia visiting his wife. The taxpayer contends that he intended to move to Country A permanently, and only moved to Country B and Country C to pursue job opportunities. The taxpayer avers that his wife remained in Virginia because she had joint custody of her daughter with her ex-husband. As such, the taxpayer contends that he successfully terminated his Virginia
domicile in 2002 when he accepted employment in Country A that required him to move to Country A.

The Tax Commissioner agreed that the taxpayer abandoned his Virginia domicile and established a domicile in Country A. The facts provided with this case were very extensive. The facts clearly demonstrated that the taxpayer changed domicile even though he voted in Virginia and renewed his Virginia driver’s license. Voting and driver’s licenses are probably among the largest factors to be considered when determining domicile. As shown in this ruling, they can be overcome.

5. Domicile. P.D. 08-38 (April 10, 2008). In November 2003, the taxpayer moved from Virginia to a leased apartment in State A. In State A she held a full-time job while taking classes at night. She maintained a Virginia driver’s license until October 2005, when she obtained a State A driver’s license. During the time she resided in State A, she leased a vehicle. In July 2007, she resigned from her job in State A and moved to her parent’s home in Virginia. During the time she resided in State A, her information returns were sent to the residence owned by her parents. The taxpayer did not file a Virginia income tax return for the 2004 taxable year. Under audit, the Tax Department determined that she was a Virginia resident and assessed Virginia income tax. The taxpayer contends that she was a resident of State A during 2004.

The Tax Commissioner examined the facts and agreed that the taxpayer was a resident of State A during 2004. The Tax Commissioner determined that the taxpayer maintained no permanent place of abode in Virginia, spent very little time in Virginia, established residency connections outside Virginia by leasing an apartment and leasing vehicles in State A. While the taxpayer did maintain a Virginia driver’s license during the taxable year at issue, she eventually relinquished it and obtained a State A license. The taxpayer did not renew her Virginia’s driver license while she resided in State A.

6. Innocent Spouse. P.D. 08-44 (April 17, 2008). The taxpayers (a husband and wife) filed joint Virginia income tax returns reporting tax overpayments for the taxable years at issue. The Tax Department used the refunds to offset tax liabilities resulting from penalties assessed under Va. Code § 58.1-1813 against the husband for liabilities accrued by two businesses from 1989 through 1994. The wife did not file joint returns with her spouse during the 1989 through 1994 taxable years as she was not married to her husband during the years that the husband’s tax liability was accrued. The wife requested a refund of her refund as an innocent spouse. While the Virginia does not conform to federal innocent spouse relief, the Tax Department has a policy not to hold one spouse liable for past tax liabilities of the other spouse accrued in years before a return was jointly filed. Accordingly, the Tax Commissioner determined that the wife is entitled to a refund of the tax overpayment stemming from her income accrued during the 2004 and 2006 taxable years.

7. S Corporation Income. P.D. 08-45 (April 17, 2008). For the 2003 taxable year, an S corporation properly filed corporate income tax returns as a Subchapter S Corporation with both the Internal Revenue Service and the Tax Department. The S
corporation subsequently 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 taxpayer is a shareholder in the S corporation. The taxpayer, a
nonresident, did not file a Virginia nonresident individual income tax return for the 2003
taxable year. Under audit, the Tax Department issued a tax assessment based on income
passed through from the S corporation. The taxpayer appealed the assessment arguing
that the tax was paid by the S corporation. The Tax Commissioner rejected the
taxpayer’s appeal. The S corporation’s amended return was not proper as Virginia
conforms to the IRS treatment of S corporations. Accordingly, the taxpayer should have
filed a nonresident return and reported his share of the S corporation’s income. Also, the
S corporation could not file an amended return for a refund of the tax paid with the first
amended return as the statute of limitations had expired.

8. **Low-Income Subtraction: Foundation Employee.** P.D. 08-47
(April 17, 2008). The taxpayer, an employee of an unnamed Foundation, inquired
whether he is eligible for the low-income subtraction granted to federal and state
employees. The Tax Commissioner examined the provisions in the Code of Virginia and
determined that the Foundation qualifies as a state agency for purposes of the subtraction.

9. **Land Preservation Credit: Cap Amount.** P.D. 08-49 (April 28,
2008). The Tax Commissioner issued Tax Bulletin 08-7 announcing that the cap for the
Land Preservation Income Tax Credit increased to $102,287,000 for calendar year 2008.

10. **Part-Year Return.** P.D. 08-51 (April 30, 2008). The taxpayer is a
foreign service officer who did not spend anytime in Virginia in 2005. Prior to 2005,
Virginia was the taxpayer’s domicile. The taxpayer’s family changed their domicile to
another state in May 2005. The Tax Department assessed the taxpayer with unpaid
individual income taxes on the income he earned in 2005. The taxpayer disputed the
assessment and argued that he was not a Virginia domiciliary resident in 2005. The Tax
Commissioner did not address the taxpayer’s domicile but ruled that he is required to file
a part-year resident return with Virginia for the period of January 2005 through May
2005.

11. **Domicile.** P.D. 08-56 (April 30, 2008). Prior to 1999 the
taxpayers resided in Virginia and owned a second residence in another state. The
taxpayers moved to the other state in 1999. In 2000 the taxpayers relinquished their
Virginia driver's licenses and acquired driver's licenses in the other state. They registered
their cars and registered to vote in the other state. The taxpayers also continued to own a
home in Virginia. The taxpayers continued to have their federal returns and other
financial information sent to the Virginia address. The taxpayers maintained that they
frequently travel between Virginia and State A and believe the mail delivery at their
Virginia address is more secure. In addition, the taxpayer's adult children live near the
Virginia residence and pick up their mail. For the 2003 taxable year, the taxpayers filed a
State A income tax return, but did not file a Virginia income tax return.
The Tax Department received information from the Internal Revenue Service that tax documents for the 2003 taxable year were sent to the taxpayers at a Virginia address. The Department requested additional information from the taxpayers in order to determine their residence for that taxable year. The taxpayers did not respond to the information requests. As such, the taxpayer was assessed an individual income tax liability as a nonfiler for the 2003 taxable year. The taxpayers appealed the assessment. With no discussion of the facts, the Tax Commissioner determined that the taxpayers abandoned their Virginia domicile prior to 2003 and abated the assessment.

12. **Signing Bonus.** P.D. 08-61 (May 19, 2008). In June 2006, the taxpayer signed a contract with a Major League Baseball team. Pursuant to this contract, the taxpayer was offered a signing bonus paid in two installments, one in 2006 and one in 2007. At the time of the signing, the taxpayer was sent to a location outside Virginia for a brief instructional period, and then assigned to a minor league team operating in Virginia. In July 2006, the taxpayer was reassigned to another minor league team located outside Virginia. In 2006, the taxpayer's W-2 statement issued by the Virginia minor league team reported the Taxpayer's 2006 bonus installment as Virginia source income. The taxpayer filed a nonresident Virginia individual income tax return that reported the signing bonus as Virginia source income in the return's apportionment factor and subtracted the signing bonus. The Tax Department audited the taxpayer and disallowed the subtraction, resulting in the taxpayer's refund being reduced. The taxpayer contends that none of the signing bonus should be subject to Virginia income tax and requests that the entire refund claimed on his return be allowed.

The Virginia taxable income of a nonresident is defined under Virginia Code section 58.1-325 as "an amount bearing the same proportion to his Virginia taxable income, computed as though he were a resident, as the net amount of his income, gain, loss and deductions from Virginia sources bears to the net amount of his income, gain, loss and deductions from all sources." No subtraction is allowed for signing bonuses. The Tax Commissioner determined that the disallowance of the subtraction for the signing bonus was correct. However as the signing bonus was not Virginia source income as the taxpayer was a resident of another state when he earned the bonus, the Tax Commissioner allowed to taxpayer to file an amended return to treat the signing bonus as non-Virginia source income to correct the nonresident apportionment factor to remove the signing bonus from income from Virginia sources.

13. **Land Preservation Credit: Donation of Easement by an Estate.** P.D. 08-66 (May 19, 2008). The executors of an estate donated a conservation easement in a certain parcel of land that had been owned by the decedent and had been specifically devised to the beneficiary by the decedent's will. The beneficiary, as the sole devisee of the land upon which the easement was granted, gave his written consent to the donation by signing the deed conveying the easement individually as an additional grantor, in addition to signing in his capacity as one of the executors. A ruling is requested as to whether the Virginia land preservation tax credit can be claimed by the estate or the beneficiary.
The Tax Commissioner determined that the issue is whether the land was owned by the estate or the beneficiary on the date that the deed conveying the easement was executed. In Virginia title to real estate devised by will passes directly to the devisee, although the personal representative of the estate may have the power to sell the real estate and thereby divest the devisee of title. The personal representative has no interest in land devised to others unless he exercises his power to sell. The Tax Commissioner determined that title to the land in question vested in the beneficiary upon the decedent's death, and any subsequent taxable events related to that land are reportable by the beneficiary. Therefore, the Virginia land preservation tax credit is allowable to the beneficiary if he satisfies all of the requirements set forth in Virginia Code section 58.1-512, and the beneficiary is the holder of any allowable but unused credits for purposes of transferring such credits.

14. **Domicile.** P.D. 08-69 (May 22, 2008). Prior to 2001 the taxpayer and his wife resided in Virginia. In February 2001 the taxpayer accepted a position with a corporation located in another state. Pursuant to this job, the taxpayer leased a residence in the other state. However, the taxpayer continued to jointly own a home in Virginia where his wife lived during 2004. The taxpayer maintained his Virginia driver's license and renewed it twice after moving from Virginia. In addition, the taxpayer was registered to vote in Virginia and had three vehicles registered in his name in Virginia. The taxpayer was assessed with income tax for the 2004 taxable year. The taxpayer appealed.

The Tax Commissioner determined that the taxpayer failed to abandon his Virginia domicile. The taxpayer performed two actions consistent with changing his domicile. He accepted a full-time, permanent position with a company located in another state and leased a residence there. The taxpayer also performed numerous actions that are consistent with maintaining a Virginia domicile. The taxpayer maintained a Virginia driver's license during the taxable year at issue and renewed it twice after leaving Virginia. His cars were registered in Virginia, and he jointly owned a residence with his wife in Virginia. He was registered to vote in Virginia and his informational returns were sent to Virginia residence.

15. **Out of State Tax Credit.** P.D. 08-70 (May 22, 2008). The taxpayers, a husband and wife, are Virginia residents who received income from a jointly owned partnership (the "Partnership") located in another state. The taxpayers filed a State A individual income tax return for the 2005 taxable year and paid the resulting State A income tax liability during 2006. On their 2006 Virginia individual income tax return, the taxpayers claimed a credit for taxes paid to other states for the amount of the 2005 income tax liability in the other state paid in 2006. The Tax Department disallowed the out-of-state tax credit because the Partnership's income was not subject to income taxation by both State A and Virginia for the 2005 taxable year and reduced the taxpayers' refund. The Taxpayers contested this adjustment to their refund, asserting that as cash basis taxpayers they should be entitled to an out-of-state tax credit for taxes paid to the other state during 2006. The Tax Commissioner denied the refund request and
noted that the taxpayers may file an amended return for 2005 to claim the credit for the taxes paid on the partnership income.

16. Foreign Source Income Subtraction. P.D. 08-102 and 08-109 (June 18, 2008 and June 20, 2008). The taxpayers claimed a foreign source income subtraction for foreign source income that was passed through to the taxpayers by an S corporation. This subtraction was disallowed by the Tax Department as the foreign source income subtraction for individuals was repealed in 2003. The taxpayers argued they are allowed a subtraction of the S corporation's foreign source income and sought a ruling as to whether they may subtract foreign source income that flowed through from an S corporation. The Tax Commissioner determined that individuals are not allowed to subtract foreign source income in determining Virginia taxable income as the subtraction for individuals was repealed in 2003.

17. Foreign Source Income Subtraction. P.D. 08-103 (June 18, 2008). The taxpayer subtracted income earned from Canada and Germany on his 2006 individual income tax return. The Tax Department disallowed the subtraction and issued an assessment. The taxpayer appealed the assessment, contending that the income was taxable in the respective foreign countries under federal tax treaties and Virginia's taxation of such income constitutes prohibited double taxation. The Tax Commissioner denied the taxpayer's appeal as the tax treaties with Canada and Germany do not restrict state income taxes.

18. Virginia Source Income and Due Process. P.D. 08-123 (June 26, 2008). The taxpayer, a nonresident, held a 13% limited partnership interest in a Virginia limited partnership (VLP). VLP was formed by the taxpayer's parents as a family limited partnership to shift wealth to the taxpayer and her siblings. During the 2004 taxable year, the taxpayer's father and brother, both Virginia residents, were VLP's general partners. VLP's primarily asset holdings include savings accounts, certificates of deposit, stocks, bonds, a passive overriding royalty interest, and holdings in publicly traded partnerships as a limited partner. VLP also owned two plots of unimproved land located in Virginia and some coins that were kept in a Virginia vault. In addition, VLP held a minority interest in two limited liability companies. Both LLCs owned unimproved tracts of land in Virginia.

The taxpayer filed a Virginia nonresident individual income tax return but did not report any income generated by VLP as Virginia source income. Upon audit, the Tax Department concluded that all of VLP's income was Virginia source income and issued an assessment. The taxpayer paid the assessment and filed an administrative appeal contending that the Department improperly classified the income as Virginia source income on her nonresident return and questioned whether the Virginia has sufficient due process to tax her.

The Tax Commissioner determined that VLP had Virginia source income. VLP was a limited partnership located in and operating in Virginia. VLP received income from its various investments. No evidence was provided to indicate that VLP operated in
any state other than Virginia. Accordingly, the Tax Commissioner found that all of VLP’s income resulted from a business, trade, profession or occupation carried on in Virginia for the taxable year at issue.

The Tax Commissioner also found that Virginia possesses sufficient due process. According to the Tax Commissioner, “The construction of the federal and Virginia tax statutes allows partners to pay income tax on behalf of the partnership. It follows then that, because items of income, gain, loss or deduction retain their character as they pass-through to a taxable entity, the attributes and activities of a partnership that make it subject to Virginia tax inure with such items as they are passed through to the partners. It is not a matter of whether the income is subject to tax, but who is paying the tax. In the case of a nonresident partner, the Department is merely exerting its authority to tax the income of partnership operating within its jurisdiction. Thus, the Department’s assessment of additional tax against the Taxpayer is permissible under the Due Process Clause.”

Comment: The Tax Commissioner did not acknowledge the Circuit Court of the City of Richmond’s holding in DiBelardino v. Commonwealth of Virginia, Department of Taxation; Dutton v. Commonwealth of Virginia, Department of Taxation, Case Nos. CL06-5696 and CL06-6291 (Cir. Ct. June 22, 2007)(City of Richmond). In this case, the Court held that income passed through to a nonresident taxpayer from an out-of-state limited liability company that operates in Virginia is not subject to the individual income tax if the taxpayer does not have the requisite minimum contacts with Virginia. The Tax Department strongly disagrees with the Court’s decision is would like to re-litigate the due process issue.

19. Domicile. P.D. 08-125 (June 26, 2008). The taxpayer resided in several foreign countries since 1995 pursuant to his job requirements. In January 2003, the taxpayer purchased residential property in Virginia. According to the taxpayer, the Virginia property was purchased for investment purposes. However, the taxpayer’s parents resided in the residence without paying rent. The parents did pay for utilities and maintenance connected with the home. The taxpayer did not use the Virginia house as a personal residence. The taxpayer’s federal tax information returns were sent to this address. As the taxpayer traveled into Virginia during the year to visit his parents, he found it convenient to have federal tax information to be sent to the Virginia address. The taxpayer has subsequently arranged to have the federal information returns sent directly to his Country A address. In July 2004, the taxpayer acquired a Virginia driver’s license. The taxpayer surrendered the license in December 2007 after being contacted by the Tax Department.

Based on preponderance of evidence, the Tax Commissioner determined that the taxpayer was neither a domiciliary nor an actual resident of Virginia for the 2004 taxable year and abated the assessment. In her reasoning, the Tax Commissioner stated that the taxpayer spent very little time in Virginia, established residency in Country A with his wife and children, and was employed outside of Virginia. The Tax Commissioner also noted further steps taken by the taxpayer to reduce his connections with Virginia.
20. **Military Pension.** P.D. 08-140 (July 30, 2008). The taxpayer was a domiciliary resident of another state and an actual resident of Virginia. The taxpayer filed Virginia resident individual income tax returns for the 2004 and 2005 taxable years and claimed a subtraction for his pension from the military. The Tax Department disallowed the subtraction and assessed additional tax. The taxpayer appealed the assessment contending that his pension is not subject to Virginia tax. Virginia Code section 58.1-322(C)(19) provides a subtraction for income received from certain retirement and pension plans, "the contributions to which were deductible from the taxpayer's federal adjusted gross income, but only to the extent the contributions to such plan or program were subject to taxation under the income tax in another state." The taxpayer's state of domicile only taxes individual income to the extent of stock dividends and bond interest. As the taxpayer's military retirement contributions were not subject to tax in another state, the Tax Commissioner denied the appeal.

21. **Virginia Source Income and Financial Corporations.** P.D. 08-143 (July 30, 2008). The taxpayer, a nonresident of Virginia, owns a 50% share of an S Corporation (S) that is incorporated in Virginia. S operates out of another state where its president resides. S holds cash, investment securities and a 25% interest in a limited partnership (LP). S has no real or tangible property within or without Virginia and has no payroll. All investment transactions are made through an investment advisor located in outside of Virginia. The LP holds cash and one parcel of undeveloped real estate located in Virginia. In 2003 and 2004, S filed Virginia returns and issued a K-1 to the taxpayer. The taxpayer did not file a Virginia individual income tax return for the taxable years at issue. The Tax Department concluded that S's income was Virginia source income and issued tax assessments to the taxpayer.

The taxpayer appealed the assessment contending that S's income is not Virginia source income subject to tax to nonresidents. The Tax Commissioner determined that because S derived all of its income from investment activities during the 2003 and 2004 taxable years, it was a "financial corporation" for Virginia income tax purposes. The Tax Commissioner found no evidence that any of the activities performed by S to generate the investment income occurred in Virginia. In addition, LP incurred no costs in Virginia that would have passed through to S. As the cost of performance occurred outside Virginia and all of S's income would be apportioned outside Virginia, S had no income from Virginia sources during the taxable years at issue. The assessment was abated.

22. **Domicile.** P.D. 08-144 (July 30, 2008). The taxpayer and his wife moved to Virginia in January 2002, leased an apartment, obtained Virginia driver's licenses and registered cars in Virginia. In September 2002, the taxpayer obtained employment in and moved to a foreign country. The wife remained at the Virginia address and worked in Virginia. In January 2003, the taxpayer acquired permanent residence status valid through 2017 in the foreign country. In April 2003, the taxpayer purchased a vehicle in the foreign country and obtained a driver's license there. The taxpayer, however, continued to maintain his Virginia driver's license, which he renewed in 2005.
In June 2004 the Taxpayer purchased a residence in the foreign country. In April 2005, the wife moved to Country A to reside with the taxpayer. The taxpayer's adult son continued to live in the Virginia residence. Upon the wife's move, one of the Virginia vehicles was sold and the other was transferred to the son. The Taxpayer spent no days in Virginia during 2004.

In 2004 the taxpayer and his wife filed a joint federal tax return and claimed a foreign tax credit. The wife filed a resident Virginia income tax return for the 2004 taxable year and a part-year Virginia income tax return for the 2005 taxable year. All of the taxpayer's federal information returns for the 2004 taxable year were sent to the Virginia address. In October 2007 the taxpayer and his wife moved back to their Virginia address. Under audit for the 2004 taxable year, the Tax Department determined that the taxpayer was a resident of Virginia and assessed additional tax and interest. The taxpayer appealed the assessment asserting that he was not a Virginia resident.

The Tax Commissioner determined that the taxpayer moved to the foreign country and took sufficient actions to establish a domiciliary residence there. The strongest evidence that would indicate the intent to maintain a Virginia domicile is the renewal of a Virginia driver's license. The Tax Commissioner determined that the Taxpayer successfully abandoned his Virginia domicile and established domicile in the foreign country prior to the 2004 taxable year.


The taxpayers owned a residence in State A where they resided for a portion of the year for purposes of the husband's business. The husband also had a State A driver's license. In June 1999 the wife purchased a residence in Virginia and transferred it to the trustee of a Qualified Personal Residence Trust (QPRT). Upon purchasing the Virginia residence, the taxpayers surrendered their State A driver's licenses and obtained Virginia driver's licenses. The husband renewed his Virginia driver's license in June 2004, and the wife renewed her Virginia driver's license in May 2006. The taxpayers filed 2003 and 2004 Virginia nonresident income tax returns that reported a portion of the husband's salary as Virginia source income. Upon audit, the auditor determined that the taxpayers were Virginia domiciliary residents for the taxable years at issue and issued assessments. The taxpayers appeal the assessments and contend that they never established a Virginia domicile.

The Tax Commissioner determined that the taxpayers have maintained strong ties to Country A by continually maintaining permanent residency, keeping a residence, voting, and maintaining a Country A driver's license. Based on preponderance of
evidence, the Tax Commissioner determined that the taxpayers did not surrender their Country A domicile and establish a Virginia domicile for the 2003 through 2005 taxable years.

24. **Domicile.** P.D. 08-170 (September 11, 2008). The taxpayer leased a residence in Virginia through 1986. At that time he possessed a Virginia driver's license and was registered to vote in Virginia. After 1986, the taxpayer commenced residing in State A and working long term assignments in that state and various foreign countries. He resided briefly in Virginia at his brother's house in 1992 and voted that year in Virginia. The taxpayer continuously renewed his Virginia driver's license 1986 through 2005, the taxable year at issue. In 1994, the taxpayer registered to vote in State A. In 2003, the taxpayer acquired a post office box in Virginia. The taxpayer filed a State A nonresident income tax return for the taxable year at issue. In 2007, the taxpayer began to physically reside in Virginia. In an audit of the taxpayer for the 2005 taxable year, the tax department determined the taxpayer was a resident of Virginia and assessed additional tax and interest. The taxpayer contested the assessment, asserting that he was not a Virginia resident.

The Tax Commissioner determined that the evidence shows that the taxpayer moved to State A and took sufficient actions to establish a domiciliary residence there, despite the renewal of his Virginia driver's license. The taxpayer successfully abandoned his Virginia domicile and established domicile in State A prior to the 2005 taxable year. The assessment was abated.

25. **Temporary Sick Pay.** P.D. 08-171 (September 11, 2008). A permanently disabled taxpayer received a W-2 that reported third-party sick pay as income in 2004. The taxpayer subtracted this income as disability income pursuant to Virginia Code section 58.1-322(C)(4)(b) on his 2004 Virginia income tax return. The Tax Department disallowed this subtraction on the basis that third-party sick pay reported on a Form W-2 is not disability income subject to the subtraction. The taxpayer appealed contending that the income constitutes disability income because he is being compensated due to a permanent disability. The Tax Commissioner denied the taxpayer's appeal. Wages reported on a W-2 are considered temporary sick pay that does not qualify for the subtraction under Virginia Code section 58.1-322(C)(4)(b).

26. **Converted Assessments.** P.D. 08-172 (September 11, 2008). The Tax Department issued assessments against a corporation for failure to remit withholding tax for the periods January 2003 through December 2004. Upon failure to collect the deficiencies from the corporation, the Tax Department assessed the taxpayer penalties in the amount of the taxes, as well as penalties and interest owed by the corporation, pursuant to Virginia Code section 58.1-1813. The taxpayer was the president and CEO of the corporation until 1987, at which time his son succeeded him as president. Although he remained as a director, declining health forced the taxpayer to reduce the amount of time that he worked for the corporation. By 2003, all executive decisions, including financial ones, were made by the taxpayer's son in his capacity as president and treasurer of the corporation. During the taxable periods at issue, the taxpayer came into
the office at most two days a week, and his only job responsibility was to consult on technical issues. The corporation's tax problems were not disclosed to the taxpayer and an affidavit from a long-time employee was submitted supporting the assertion that the taxpayer had a diminishing role in the corporation due to health issues. The assessment was appealed contending that the taxpayer is not a corporate officer as defined in Virginia Code section 58.1-1813 and cannot be held liable for the taxes, penalties and interest assessed to the corporation. Based on the information provided, the Tax Commissioner determined that the taxpayer did not have sufficient knowledge of the failure or attempt to evade taxes, or the authority to prevent such failure or attempt pursuant to Virginia Code section 58.1-1813.

27. **Pension Income.** P.D. 08-173 (September 11, 2008). The taxpayer was a retired employee of another state who received pension distributions from that state's retirement system. The taxpayer moved to Virginia in 2004. The taxpayer subtracted the pension distributions from his Virginia taxable income for the 2004 through 2006 taxable years. The Tax Department disallowed the subtractions and adjusted the taxpayer's Virginia taxable income, resulting in the assessment of additional income tax and interest for the taxable years at issue. The auditor determined there was no basis to subtract the pension distributions when computing Virginia taxable income. The taxpayer appealed contending that Virginia should not tax out-of-state pension income. After dispelling the taxpayer's mostly frivolous arguments, the Tax Commissioner upheld the assessment on the basis that Virginia may tax the income of its residents.

28. **Domicile.** P.D. 08-174 (September 11, 2008). The taxpayer became a Virginia resident in 1992 and registered to vote that same year. She purchased a residence in Virginia in 2001. The taxpayer acquired a Virginia driver's license and registered her car in Virginia. The taxpayer renewed her Virginia driver's license in August 2002 and in June 2007. In 2001, she started a business and rented office space in State A, a neighboring state, and in State B. In June 2005, the taxpayer purchased a residence in State B and moved a portion of her furniture and personal items from her Virginia residence to State B. She also purchased furnishings and appliances in State B for her State B residence. She acquired a State B driver's license and acquired a car that she registered in State B. In October 2005, the taxpayer moved her State B office to a location that was leased for five years. In September 2005, the taxpayer consulted with realtors regarding the sale of her Virginia residence. She listed her home for sale in May 2006. She took her Virginia home off the market in September 2006 to care for a sick parent and used it as a residence when conducting business at her State A office. The taxpayer relisted her house in March 2007 and sold it in October 2007. The taxpayer filed a Virginia part-year return in 2005. In an audit, the Tax Department determined that she had not abandoned her Virginia domicile and assessed additional tax for the 2005 and 2006 taxable years. The taxpayer appealed the assessments.
The Tax Commissioner upheld the assessment. The two facts that led to the upholding of the assessment were the Virginia driver’s license renewal in 2007 and the taxpayer’s use of the Virginia house as a residence after she argued that the abandoned Virginia. While she may have been able to overcome the driver’s license renewal alone, the use of the house as a residence likely tipped the scales against her.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

III. RETAIL SALES AND USE TAXES

A. 2008 Legislation

1. Motor Vehicle Repairs in Certain Localities. HB 361 (Chapter 484) and HB 579 (Chapter 488) repeal the sales and use tax on charges for motor vehicle repair services in the Hampton Roads Transportation Authority and the Northern Virginia Transportation Authority areas. This legislation is effective on July 1, 2008.

2. Communications Sales and Use Tax Distribution. HB 487 (Chapter 25) and SB 262 (Chapter 148) allow Bath County to receive a set percentage of the communication sales and use tax revenues apportioned and distributed monthly to localities, beginning July 1, 2008.

3. Exemption: audio and video works. HB 711 (Chapter 545) changes the sunset from July 1, 2009 to July 1, 2019 for the sales and use tax exemptions for audio and video works.

4. Energy and Water Conservation Products Tax Holiday. HB 1229 (Chapter 554) adds water-efficient products to the products sales tax holiday held during a four-day period in the month of October. This legislation is effective on July 1, 2008.

5. Exemption for Certain Computer Equipment. HB 1388 (Chapter 558) and SB 668 (Chapter 764) create an exemption from the retail sales and use tax for computer equipment used in data centers that are located in a Virginia locality having an unemployment rate above 4.9 % for the calendar quarter ending November 2007 and that meet certain investment and job creation criteria. This legislation is effective on July 1, 2008.

6. Printed Materials. SB 5 (Chapter 138) extends the sunset date from July 1, 2008 to July 1, 2012 for the exemption from sales and use tax for the purchase of printing by advertising businesses when the printed material is distributed outside the Commonwealth.
7. **School Textbooks.** SB 392 (Chapter 569) extends the current sales and use tax exemption on sales of school textbooks to students attending nonprofit colleges and other institutions of learning to students attending for-profit institutions of learning. The legislation has a delayed enactment clause of July 1, 2010.

B. **Recent Court Decisions**

1. **Bloomingdale’s, Inc. v. Virginia Department of Taxation,** At Law No. CL05T00891-00 (Cir. Ct. August 7, 2007) (City of Richmond). Virginia’s Circuit Court for the City of Richmond has held that the sales tax does not apply to sales of tangible personal property at a retail store to be shipped to a location outside of Virginia. The Tax Department filed a petition of appeal with the Virginia Supreme Court, however the Supreme Court denied certiorari on February 22, 2008.

   The taxpayer, Bloomingdale’s, Inc., applied for the correction of an assessment of sales tax made on sales made at its McLean, Virginia store with the City of Richmond Circuit Court. Sales tax was assessed by the Virginia Department of Taxation on numerous transactions which can be summarized in five examples.

   **Example #1:** The merchandise was purchased with cash at the McLean store and shipped from a warehouse outside of Virginia to a location in the District of Columbia. The risk of loss remained with Bloomingdale’s until delivery in the District of Columbia. Bloomingdale’s collected and remitted sales tax to the District of Columbia.

   **Example #2:** The merchandise was purchased by credit card from the McLean store by a person who was not present at the store but had a Virginia telephone number. The merchandise was shipped from Virginia to New York with the risk of loss remaining with Bloomingdale’s until delivery in New York. Bloomingdale’s collected and remitted sales tax to New York.

   **Example #3:** The merchandise was purchased by credit card from the McLean store by a person who was not present at the store but had a Virginia telephone number. The merchandise was shipped from Virginia to North Carolina with the risk of loss remaining with Bloomingdale’s until delivery in North Carolina. No sales tax was collected or remitted as Bloomingdale’s is not registered to collect sales tax in North Carolina.

   **Example #4:** The merchandise was purchased by credit card from the McLean store by a person who was not present at the store but had a Virginia telephone number. The merchandise was shipped from Virginia to Florida with the risk of loss remaining with Bloomingdale’s until delivery in Florida. Bloomingdale’s collected and remitted sales tax to Florida.
Example #5: The merchandise was purchased by credit card from the McLean store by a person who was present at the store. The merchandise was shipped from Virginia to Massachusetts with the risk of loss remaining with Bloomingdale’s until delivery in Massachusetts. Bloomingdale’s collected and remitted sales tax to Massachusetts.

The Tax Department assessed sales tax on these transactions based on Title 23 of the Virginia Administrative Code section 10-210-680. This section states:

“If a resident or nonresident buys a gift in Virginia and requests the seller to ship or mail such gift to another person, the purchaser is deemed to receive title to the gift at the time of purchase and the transaction is therefore taxable in Virginia. The location of the recipient of the gift has no bearing upon the taxability of the transaction; therefore, even if the recipient is located outside Virginia the sale is not a sale in interstate commerce.”

Furthermore, Title 23 of the Virginia Administrative Code section 10-210-780 interprets the interstate commerce exemption. This regulation applies the exemption only in cases where the tangible personal property is delivered outside of Virginia to the purchaser.

The Court examined the statute that imposes the sales tax, Virginia Code section 58.1-603, to determine whether the tax applied to these transactions. Virginia Code section 58.1-603 imposes the sales tax “upon every person who engages in the business of selling at retail or distributing tangible personal property in this Commonwealth . . .” on “the gross sales price of each item or article of tangible personal property when sold at retail or distributed in this Commonwealth.” To be a “sale” under Virginia Code section 58.1-602, there must be a transfer of title or possession.

In its argument that the transactions were subject to Virginia sales tax, the Tax Department argued that the parties to each sale are the purchaser and Bloomingdale’s, not the recipient and Bloomingdale’s. Furthermore when the customer paid for the items and instructs Bloomingdale’s to ship the item by common carrier, the sale was complete and the customer had constructive possession of the item from the point of sale. According to the Tax Department, a taxable event (the sale) had occurred. The Court disagreed.

In each of the five example transactions, the Court ruled that there was no transfer of title or possession of the merchandise in Virginia. The Court observed that under Virginia Code section 8.2-401(2) title to the merchandise did not pass until the delivery of such good was complete. This statute states, “title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. . .” In addition, the Court noted that Bloomingdale’s retains the risk of loss on the merchandise during delivery. As title to the merchandise did not pass in Virginia, and in one example the merchandise was never present in Virginia, the Court ruled that the sales tax does not apply to the disputed transactions. Also, sections 10-210-
680 and 10-210-730 of Title 23 of the Virginia Administrative Code were ruled to be not in conformity with the Code of Virginia.

C. Current Virginia Tax Commissioner Rulings

1. Hotel Rooms, Admission Tickets, and Sod. P.D. 08-4 (January 7, 2008). The taxpayer contested an assessment of sales tax on amusement park tickets sold as part of a package with room accommodations and an assessment of sales tax on sod purchased and installed at the taxpayer's golf course by an out-of-state landscaping contractor. An affiliated entity of the taxpayer sold vacation packages that included admission tickets to the affiliate's amusement parks and accommodations at one of 40 local hotels. The affiliate entered into contracts with local hotels for the sale of hotel reservations. Pursuant to the contracts, the affiliate had the right to purchase hotel reservations and to sell the reservations to its customers. The taxpayer collected the total price for the vacation package from the customers at the time of the booking. The taxpayer remitted the amount collected less a commission for its services to the hotel. The taxpayer collected the applicable taxes from the customer at the time of booking and remits those amounts to the hotels.

The taxpayer was solely responsible for handling the admission ticket portion of the vacation package and collects all payments from the customer for the tickets. The taxpayer purchased the tickets from the affiliate and collects a small commission for the services it provides in selling the tickets. In addition to the vacation packages, the taxpayer entered into a contract with an out-of-state landscaping contractor in which the contractor agreed to provide various landscaping services including the installation of sod. Under the agreement, the taxpayer paid a lump sum payment to the contractor, which included "all applicable sales and/or use taxes."

Title 23 VAC 10-210-730 C provides that "[a]ny additional charges made in connection with the rental of a room or other lodging or accommodations are deemed to be a part of the charge for the room and are subject to the tax. For example, additional charges for movies, local telephone calls and similar services are subject to the tax. Toll charges for long-distance telephone calls are not subject to the tax." The Tax Commissioner examined the charges for admission tickets and determined that the admission tickets are not an integral element of the taxable transaction because the rates for the accommodations and the admission tickets are set independently from one another. Accordingly, the Tax Commissioner determined that the charges for the admission tickets are not taxable.

With regard to the sod, the taxpayer contracted for the installation of sod at its golf course. The sod was purchased by the landscape contractor from an out-of-state vendor. The vendor billed the landscape contractor and shipped the sod to the taxpayer. The vendor charged the landscape contractor 5% sales tax on the purchase. The vendor is a registered Virginia dealer. Based on these facts, the Tax Commissioner determined that the taxpayer is not liable for the sales tax on the purchase of the sod. The facts and discussion concerning this sod were not detailed.
2. **Sampling and Exemption Certificates.** P.D. 08-9 (January 11, 2008). The taxpayer operates a hardware store, an industrial parts store and a rental center at four locations in Virginia. The audit of the taxpayer's sales and use tax records resulted in the assessment of sales tax on untaxed retail sales of various materials, equipment and supplies for which an exemption certificate was obtained. The taxpayer contests all of the sales tax assessed. The taxpayer maintained that the contested sales should not be included in the audit because it acted properly in accordance with the law and regulations in accepting exemption certificates. In addition, the taxpayer contends that the use of sampling as an audit methodology is improper and invalid in the absence of statutory or regulatory authority.

The Tax Commissioner denied the taxpayer's appeal. The Tax Commissioner stated that the sampling technique is valid under Virginia law. In addition, the Tax Commissioner could not find cause to conduct a detailed audit or use another audit methodology to review the taxpayer's records. The taxpayer acceptance of exemption certificates was not reasonable as a number of exemption certificates accepted by the taxpayer were incomplete and outdated. In many instances the property sold was not of the same class as that identified on the certificates. For example, a Manufacturing Exemption Certificate (Form ST-11) was accepted by the taxpayer for the exempt sale of roll bath tissues and orange cleaner, and the Agricultural Exemption Certificate (Form ST-18) was accepted for the exempt sale of drainer opener, a plunger and a toolbox.

3. **Sampling.** P.D. 08-16 (February 29, 2008). The taxpayer was audited and assessed with unremitted sales tax. The taxpayer appealed the assessment and argued that the sample should not have included a particular large sale. The Tax Commissioner denied the appeal as the taxpayer failed to show that the transaction is isolated in nature and not a normal part of the taxpayer's operation.

4. **Downloaded Software.** P.D. 08-17 (February 29, 2008). As a result of a Tax Department audit, the taxpayer was assessed tax on the untaxed purchase of software. The taxpayer contended that the software package was downloaded electronically from the vendor. The vendor who downloaded the applications and upgrades remotely performed all installations and upgrades by logging directly into the taxpayer's server. In addition, all documentation related to the software package was electronically mailed to the taxpayer. The taxpayer provided email between representatives of the taxpayer and the vendor to support its position. The email indicates the software was downloaded electronically via the vendor logging directly into the taxpayer's server. In addition, other upgrades, including those related to reports, indexes and client programs were downloaded electronically. The Tax Commissioner found this evidence sufficient and abated the assessment.

5. **Electronic Exemption Certificates.** P.D. 08-18 (February 29, 2008). A taxpayer requested a ruling as to whether an electronic exemption certificate created for administrative ease would be allowed in Virginia. The Tax Commissioner determined that the exemption certificate in electronic format does not capture the
required information or statements provided on the Virginia resale Form ST-10 and is not acceptable in its present form.

6. Packaging and Interstate Commerce Exemption. P.D. 08-26 (March 20, 2008). The taxpayer is engaged in packaging services and provides bagging and bulk containerization of grain and feed products for the export market. As a part of its service, the taxpayer arranges for trucks to bring empty cargo ship containers, owned by steamship lines, to the taxpayer's facilities. The grain and feed products are placed in bags or other containers and loaded into the cargo ship containers by the taxpayer. The taxpayer was assessed use tax on the purchase of the bags, pallets and other container materials purchased by the taxpayer for use in providing its service. The taxpayer contended that the bags and other container materials are exempt from retail sales and use tax pursuant to the foreign and interstate commerce exemption.

The Tax Commissioner disagreed and upheld the assessment. The interstate commerce exemption only applies to sales of tangible personal property. The taxpayer does not sell tangible personal property, it sells services. For the packaging exemption to apply, the packaging materials must be resold to customers. In the case of the taxpayer, the packaging materials are not resold.

7. Durable Medical Equipment. P.D. 08-28 (April 2, 2008). The taxpayer sells various medical products for use by cardiologists and radiologists and requested a ruling on the application of the retail sales and use tax to the products. Virginia Code section 58.1-609.10.10 provides an exemption for "[w]heelchairs and parts therefor, braces, crutches, prosthetic devices, orthopedic appliances, catheters, urinary accessories, 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. Durable medical equipment is equipment that (i) can withstand repeated use, (ii) is primarily and customarily used to serve a medical purpose, (iii) generally is not useful to a person in the absence of illness or injury, and (iv) is appropriate for use in the home." In order to qualify as exempt durable medical equipment, the product must meet the four criteria provided above and the product must be purchased by or on behalf of an individual for use by such individual. The fact that an item is purchased from a medical equipment supply store or is purchased on a physician's prescription is not dispositive of its exempt status. The Tax Commissioner opined that the various products related to or used with a catheter or dispensed by prescription are exempt from sales tax. The majority of the taxable products were not exempt as they were not appropriate for home use.

8. Lack of Documentation and Amnesty Penalty. P.D. 08-29 (April 2, 2008). The taxpayer operates hair salons in Virginia and throughout the United States and abroad. The taxpayer was assessed tax, compliance penalty, amnesty penalty and interest on fixed asset and expense purchases. The taxpayer contested a number of transactions and provided a schedule itemizing the disputed items that it believes should be removed from the audit. The taxpayer indicated that supporting documentation is available, but did not provide any documentation. In addition, the taxpayer claimed
that the assessment of amnesty penalty in this case is without any statutory support and should be abated.

The Tax Commissioner denied the appeal as the taxpayer did not provide any documentation. The taxpayer argued eight separate issues but offered no substantiation for any of its arguments. The Tax Commissioner could not remove any of the items without documentation. It is not clear in the ruling whether the Tax Department contacted the taxpayer to request the documentation before issuing the ruling.

Finally, the taxpayer argued that because the assessment was issued after the conclusion of the Amnesty period, the penalty was inappropriate as it could not participate in amnesty. The Tax Commissioner disagreed and noted that Virginia Code section 58.1-1840.1 was available to nonfilers and those who underreported their tax.

9. **Lease of Compressors and Corporate Reorganization.** P.D. 08-35 (April 10, 2008). The taxpayer is engaged in the business of engineering and assembly of natural gas compressors for sale and for use in providing compression of natural gas to its customers. The taxpayer is in the process of reorganizing its business in a tax-free reorganization for federal income tax purposes. The taxpayer will form three new limited liability partnerships that will be disregarded entities under Treasury Regulation § 301.7701-3(b). Compressors currently under lease/rental agreements in Virginia will remain in force subsequent to the transfer of ownership to the partnerships under the reorganization. The taxpayer asked whether the transfer of the compressors to the partnerships is subject to Virginia sales and use tax or whether the resale exemption would apply.

The taxpayer also plans to restructure its current contract for the lease of compressors to a contract or for the provision of compressor services. The taxpayer asked whether the Tax Department will treat the revised Master Services Agreement as the provision of a nontaxable service or the lease/rental of tangible personal property for purposes of the Virginia sales and use tax.

The Tax Commissioner determined that the transfer of the compressors to the partnerships will qualify for an occasional sale and be exempt from sales and use tax as reorganizations are specifically included in the definition of an occasional sale. The Tax Commissioner also determined that when a customer leases a compressor from the taxpayer, the true object of the transaction is the sale of tangible personal property. There was no indication in the ruling that the compressors were leased with an operator. Finally, the gross proceeds from the lease of a compressor will be subject to the sales tax.

10. **Employee Meals and Prior Audit Advice.** P.D. 08-36 (April 10, 2008). The taxpayer established a meal program that allows its employees to obtain meals free of charge. Under audit, the taxpayer was held taxable on 35% of the gross sales price with regard to the meals provided to its employees free of charge. The Taxpayer contends that based on its volume of sales, it should be classified as a food service operator and that it properly applied the exemption to the meals at issue. The
Taxpayer also contends that it relied upon guidance provided in a prior audit. The Tax Commissioner determined that under Virginia law, only meals provided to restaurant employees as part of their wages are exempt from sales tax. Meals provided to all other employees are subject to sales tax. However, the taxpayer provided proof to the Tax Commissioner of the guidance from the prior audit. Based on the prior guidance, the Tax Commissioner agreed to abate the assessment but required the taxpayer to pay sales tax on all future meals provided to non-restaurant employees.

11. **Charges In Addition to Lodging.** P.D. 08-37 (April 10, 2008). The taxpayer operates a real estate company specializing in vacation rental management for beach homes in Virginia. The taxpayer was audited by the Tax Department and was assessed on separately stated charges for travel protection insurance. Services sold in connection with accommodations are taxable as part of the charge for the room. In this case, the Tax Commissioner determined that the travel protection insurance charges at issue were not part of the accommodations offered to the guests. The taxpayer did not hold out to its customers that the charge for furnishing accommodations includes travel protection insurance. In each instance, the customer had a choice as to whether or not to purchase the travel protection insurance. If the customer elected to purchase the insurance, then the customer was billed an additional charge. Furthermore, the taxpayer was not a contracting party to the insurance transaction. The insurance contracts exist between the guest and the insurance provider. The Tax Commissioner removed the insurance charges from the audit.

12. **Use of Forklifts.** P.D. 08-39 (April 15, 2008). The taxpayer, a lumber manufacturer, was audited by the Tax Department and assessed use tax on two forklifts. The taxpayer asserted that the forklifts qualify for the manufacturing exemption because the preponderance of their use is in the taxpayer's exempt manufacturing process. Based on information provided by the taxpayer, one of the forklifts was used 100% of the time in the manufacturing process. The other forklift was used 40% of the time in the manufacturing process, 40% of the time in a taxable use, and 20% of the time in the "yard." The Tax Commissioner determined that the activities in the yard occur prior to the completion of production and are an integral part of the manufacturing process. As both forklifts are used in an exempt function more than 50% of the time, the Tax Commissioner removed the forklifts from the audit.

13. **Reconsideration: Assessment Based on Information from Alcoholic Beverage Control.** P.D. 08-41 (April 17, 2008). The taxpayer requested a reconsideration of a prior ruling in which the Tax Commissioner upheld an assessment of sales taxes based on data provided by the Virginia Department of Alcoholic Beverage Control. The taxpayer believes that the prior estimated unpaid sales taxes were too high and offered supplier invoices and a Mixed Beverage Annual Review (MBAR) report as evidence. The Tax Commissioner determined that the supplier invoices were insufficient as there was no way of verifying that the purchase invoices provided are a complete record of the Taxpayer's food purchases for the period in question. The Tax Commissioner also reviewed the MBAR reports and noted that the ABC had already
determined that the taxpayer failed to file complete and accurate MBAR reports. The Tax Commissioner declined to reverse the previous ruling.

14. **Nexus and Uncollected Tax.** P.D. 08-42 (April 17, 2008). The taxpayer is a modular home manufacturer located outside Virginia. The taxpayer had voluntarily registered to collect the Virginia retail sales tax beginning February 2005. The taxpayer actively solicited in Virginia and made retail sales to Virginia customers beginning in October 2003. Accordingly, the taxpayer was assessed sales tax on all sales transactions made prior to its registration. The taxpayer disputes the entire assessment and contends that its Virginia customers should be liable for collecting and remitting the sales tax.

The Tax Commissioner examined the facts and determined that taxpayer had one or more salesmen in Virginia soliciting business by actively traveling throughout Virginia to set up new accounts and working with customers. One of those salespersons lived in Virginia and called upon Virginia businesses on behalf of the taxpayer during the period in question. Based on this information the Tax Commissioner found sufficient nexus with the taxpayer and the taxpayer should have been registered for the collection of the Virginia retail sales and use tax prior to February 2005. Despite this finding, the Tax Commissioner allowed a credit "if the taxpayer is able to furnish sufficient evidence [within 60 days] that its Virginia customers (i) remitted the consumer use tax to the Virginia Department of Taxation with respect to any of the modular home sales held in this audit, or (ii) resold the modular sections without installation to another dealer or contractor." Absent any further evidence, the Tax Commissioner upheld the assessment.

15. **Internet/Computer Jukeboxes.** P.D. 08-43 (April 17, 2008). The taxpayer requested a ruling on the sales tax consequences of certain song downloading options it sells with its digital jukeboxes. The Tax Commissioner ruled that the downloading options are provided independent of the sale of the jukeboxes or other tangible personal property and are not taxable sales. However, the taxpayer also offers support services that include 24-hour technical telephone support, exchanges of damaged or defective parts, software upgrades in both tangible and intangible formats and on-site field service technicians. The Tax Commissioner determined that these support services are a maintenance contract for the provision of services and tangible personal property. The Tax Commissioner ruled that one-half of the total charge for telephone support billed by the taxpayer to the operators is subject to the sales and use tax.

16. **Nonprofit Exemption: Nursing Homes.** P.D. 08-48 (April 2, 2008). The taxpayer requested a ruling on whether nursing homes are required to be licensed by the Virginia Department of Social Services to receive the new nonprofit sales and use tax exemption offered under Virginia Code section 58.1-609.11. To receive an exemption under this section, an organization must: 1) be exempt under either § 501(c)(3) or § 501(c)(4) of the Internal Revenue Code; or 2) have annual gross receipts of less than $5,000. In addition, the organization must: 3) comply with applicable state solicitation laws; 4) maintain annual general administrative costs that do not exceed 40%; and 5) conduct a full financial audit if the organization's gross annual revenue was $1 million or
more in the previous year. If the entity's gross annual revenues fell between $750,000 and $1 million in the previous year, the entity may choose between a full financial audit and a financial review, both of which must be performed by an independent certified public accountant. The Tax Commissioner determined that if the taxpayer meets all the requirements enumerated under Virginia Code section 58.1-609.11, it will receive the broader exemption available to all nonprofit entities that meet the enumerated criteria, without regard to what license the nonprofit entity holds.

17. Hurricane Preparedness Sales Tax Holiday. P.D. 08-50 (April 25, 2008). 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.

18. Transportation and Delivery Charges. P.D. 08-53 (April 30, 2008). The taxpayer was assessed with additional sales tax. The taxpayer contests tax assessed on three types of charges: fuel surcharge, offloading, and demurrage. The taxpayer argued that these separately stated charges are part of the separately stated transportation charge which is exempt pursuant to Virginia Code section 58.1-609.5(3). The Tax Commissioner examined the three disputed charges. The fuel surcharge was determined to account for the high cost of fuel incurred while delivering the product and is calculated based on a percentage of the freight charge. As this is a transportation charge, the tax assessed on the fuel surcharges were abated. Offloading charges are for the removal of the product from the Taxpayer's trucks at the customer job site. Demurrage charges are for the driver's wait time when the driver has reached the delivery destination but offloading is delayed by the customer. As both offloading and demurrage charges are classified as handling which is specifically excluded from the exemption for transportation charges, the Tax Commissioner upheld this portion of the assessment.

19. Sales to Motor Vehicle Refinishers and Body Shops. P.D. 08-54 (April 30, 2008). The taxpayer was audited for the period of June 2002 through September 2005. The taxpayer was assessed with sales tax on untaxed retail sales of paint, thinner and other refinishing materials, equipment, and shop supplies to motor vehicle refinishers and body shops for which exemption certificates were obtained.

Prior to July 1, 2005, motor vehicle refinishers and body shops are the consumers of any paints and other materials applied to motor vehicles, whether for a repair or replacement. Effective on and after July 1, 2005, the definition of "retail sale" under Virginia Code section 58.1-602 was expanded to specifically include "the separately stated charge made for automotive refinish repair materials that are permanently applied to or affixed to a motor vehicle during its repair." Therefore, a motor vehicle refinisher must charge and collect the sales tax on the total amount charged for paint, thinner and filler but it may buy such items exempt of the tax under a resale exemption certificate, Form ST-10.
Despite the policy prior to July 1, 2005, the Tax Commissioner abated the sales tax assessed against the taxpayer for all sales for which the taxpayer obtained resale exemption certificates. These sales were removed from the assessment as "There is no indication in the facts presented that such resale certification was otherwise specified on any purchase order." The Tax Commissioner upheld the assessment related to two sales for which the taxpayer obtained resale certificates a year after the sales. The taxpayer did not prove that the two sales qualify for the resale exemption.

20. **Research and Development Exemption.** P.D. 08-58 (May 19, 2008). The taxpayer is an aerospace and defense contractor specializing in the design, development and manufacturing of missile and space propulsion systems. The taxpayer is contesting the application of tax to the purchase of a digital fuel valve, insulation rings, and casting tooling. The taxpayer contends that the research and development exemption applies to the purchase of these items. The taxpayer contends that the purchases were made pursuant to independent research and development projects entirely funded by the taxpayer.

Virginia Code section 58.1-609.3(5) provides that the retail sales and use tax does not apply to "[t]angible personal property purchased for use or consumption directly and exclusively in basic research or research and development in the experimental or laboratory sense." The Tax Commissioner determined that the fuel valve and insulation rings were used during the testing of missiles in the research and development phase and removed the purchases from the audit. The casting tooling is used by the taxpayer to cast experimental rocket motors for testing. The Tax Commissioner determined that the casting tooling is also used directly in research and development.

21. **Donated Flower Bulbs.** P.D. 08-59 (May 19, 2008). The taxpayer purchases flower bulbs for resale. When the bulbs are no longer viable enough to be sold, the taxpayer donates the bulbs to charitable organizations. The taxpayer was previously audited by the department and held taxable on the donated bulbs. The taxpayer requests a ruling regarding the application of tax on the donated bulbs. The Tax Commissioner ruled that donated bulbs are subject to the use tax when purchased with a resale exemption.

Title 23 Virginia Administrative Code 10-210-490 states, "Any person who withdraws any item of tangible personal property for his own use from an inventory on which no tax has been paid must report tax on the cost of all property withdrawn for purposes other than sale. For example, a retailer who purchases an inventory of clothing exempt from the tax for the purposes of resale, and who withdraws an item from such inventory for personal use, gift or donation, must report tax on the cost price of such item unless such gift or donation is otherwise exempt."

22. **Industrial Manufacturing Exemption.** P.D. 08-60 (May 19, 2008). The taxpayer provides screen printing and embroidery of apparel for sale mainly to end users. The taxpayer's customers include churches, school organizations and other nonprofit organizations. The taxpayer contested the tax assessed to purchases of
equipment used in its business operation. The taxpayer maintained that such equipment qualifies for the industrial manufacturing exemption. The Tax Commissioner upheld the assessment as the taxpayer's customers were "end users" of its products. The production activities of industrial manufacturers are usually carried on for the wholesale market or to order for industrial users, rather than for direct sale to domestic consumers. Furthermore, the taxpayer's business did not fall within the SIC codes that are industrial in nature as required by Virginia Code section 58.1-602.

23. **Sales of Ethanol.** P.D. 08-65 (May 19, 2008). The taxpayer purchases fuel grade ethanol from Virginia suppliers for resale to motor fuel retailers and wholesalers. The ethanol sold by the Taxpayer is blended with gasoline by its customers and is subsequently subject to the Fuels Tax administered by the Department of Motor Vehicles. The taxpayer has not registered with the Tax Department for a sales tax account in Virginia and does not have a certificate of registration as it does not sell any products at retail. The taxpayer requested a ruling that it may purchase ethanol exempt from the Retail Sales and Use Tax under the Retail Sales and Use Tax exemption for fuels subject to the Fuels Tax. A new supplier of ethanol to the taxpayer asserted that the ethanol is subject to the Retail Sales and Use Tax unless purchased using a resale exemption certificate, and the supplier will not accept a certificate of exemption from the taxpayer without a certificate of registration number for the taxpayer.

The Tax Commissioner determined that because the taxpayer's customers will pay the Fuels Tax on the fuel grade ethanol when it is blended with a motor fuel, the fuel grade ethanol is subject to the Fuels Tax. Accordingly, purchases of fuel grade ethanol by the taxpayer are exempt from the Retail Sales and Use Tax under Virginia Code section 58.1-609.1(1).

24. **Trip and Road Service Call Charges and Six Year Audit.** P.D. 08-67 (May 22, 2008). The taxpayer is a real property contractor specializing in excavation and the preparation of land for building sites. The Tax Department audited the taxpayer's prior six years as the taxpayer never filed consumer use tax returns or paid the consumer use tax on its purchases. The taxpayer contended that the audit should be limited to three years. The auditor also assessed sales tax on trip and road service call charges in connection with vendor service call repairs on the taxpayer's vehicles. The taxpayer contends that the audit erroneously taxes separately stated labor and service charges. The taxpayer paid the assessment and requested a refund.

The Tax Commissioner determined that the six year audit period was proper. The Taxpayer paid the assessment and requested a refund.
25. **Manufacturing Exemption.** P.D. 08-71 (May 29, 2008). The taxpayer requested a redetermination of a prior unidentified appeal. The taxpayer produces prototype cellular phones and printed circuit boards. The taxpayer argued that its activities do not represent preproduction activities as concluded in the prior determination. Instead, the taxpayer contended that the manufacturing exemption applies to the production of the prototypes because a tangible personal product was produced for sale or resale, and because the production process was industrial in nature. The taxpayer stated that the facility where the prototypes are produced and the facility where the mass production of the final product is completed are separate legal entities. The taxpayer contended that the customer contracted with the taxpayer for the production of the prototypes and that the prototypes were the final product presented to the customer. To prove this assertion, the taxpayer provided a copy of the Specific Supply Agreement entered into with its customer.

Title 23 VAC 10-210-920 A provides that "for a business to obtain the [manufacturing] exemption, it first must be manufacturing or processing products for sale or resale and secondly, such production must be industrial in nature." The Tax Commissioner reviewed the facts and determined that the manufacturing of the prototype cellular phones and the printed circuit boards meets the test to qualify for the manufacturing exemption.

26. **Sample Dispute and Fixed Assets.** P.D. 08-73 (June 6, 2008). The taxpayer was audited by the Tax Department and assessed use tax on various untaxed purchases. The taxpayer maintained that the expense purchases sample used in the audit is invalid and that certain purchases in the sample are not taxable. The taxpayer also maintained that the invoice dates of certain fixed asset transactions occur before the start of the audit period and that these transactions are barred from assessment under the statute of limitations. Finally, the taxpayer requested a ruling from the Tax Department concerning the inclusion of sales taxes erroneously paid to vendors in the computation of the alternative method for computing use tax compliance.

**Sample**

The taxpayer argued that because the entire population of purchase invoices for the sample period was examined but only specific purchase accounts were used to compute and project the error factor, the error factor used to project the expense purchases sample was too high. The Tax Commissioner ruled that with regard to audit sampling, a taxpayer must demonstrate that a sample used in an audit is not representative of the audit period or that it is flawed in some other manner to invalidate the sample. The Tax Commissioner determined that the taxpayer failed to prove that the sample used by the auditor was invalid.
Fixed Assets

A prior ruling (P.D. 97-265) dealt with a taxpayer that was assessed use tax on fixed assets purchased outside the audit period but booked in the taxpayer's accounting system during the period covered by the audit. The Tax Department ruled that the assets should be removed from the audit because the taxpayer became liable for the tax based on the date the assets were purchased. However, the ruling also states that the Tax Department can examine fixed asset transactions booked subsequent to the end of the audit period to ensure that the tax has been paid on all fixed assets purchased during the period of audit. Based on this ruling, the Tax Commissioner agreed to remove the fixed assets purchased by the taxpayer outside the audit period only if the Tax Department's auditor examines the taxpayer's fixed asset records for asset acquisitions made prior to the end of the audit period but booked after the audit period.

Compliance Penalty

During the audit, the taxpayer submitted to the auditor a refund claim for sales and use taxes erroneously paid on purchases made from some of its vendors during the audit period. The auditor indicated that the erroneously paid taxes could not be included in the calculation of the alternative method for computing compliance penalty. The taxpayer argued that the erroneously paid taxes should be included in the calculation of the compliance penalty. Because erroneous payments of sales and use taxes constitute payments that are not legally due to the Commonwealth of Virginia, the Tax Commissioner determined that erroneously paid sales and use taxes should not be included in the computation of sales and use tax compliance.

27. Shipping and Handling Charges. P.D. 08-74 (June 6, 2008). The taxpayer was audited by the Tax Department and assessed use tax on combined shipping and handling charges billed on purchases from various vendors. The taxpayer provided documentation obtained from several vendors that showed a breakdown of the shipping and handling components of the charges at issue. Other vendors provided statements that the shipping and handling charge is actually a shipping charge only. The Tax Commissioner adjusted the audit to remove the separately stated shipping charges and the charges related to the vendor statements.

28. Event Tickets with Catered Meal. P.D. 08-76 (June 6, 2008). The taxpayer, a nonprofit membership corporation, was assessed tax and interest on the sale of event tickets to members that include catered meals. The taxpayer contested the assessment on the basis that the primary purpose of the events is not the provision of a catered meal, but rather for entertainment or business purposes. In addition, the taxpayer claimed that it paid tax to its vendors for the taxable goods and services purchased for such events.
Title 23 VAC 10-210-30 addresses admissions and states:

The tax does not apply to sales of tickets, fees, charges, or voluntary contributions for admissions to places of amusement, entertainment, exhibition, display, or athletic contests, nor to charges made for participation in games or amusement activities. However "cover charges" or "minimum charges" which include the provision of or the entitlement to food, drinks, or other tangible property constitute a sale of property and are subject to the tax.

The Tax Commissioner determined that the fact that the primary purpose of the events may not be the catered meal does not alter the fact that the ticket price includes the provision of a taxable meal. Based on the regulation, the auditor was correct in assessing the tax to the sale of tickets that include the provision of catered meals.

While the taxpayer claimed that it paid the sales tax to vendors for the taxable goods and services purchased for the contested sales of tickets to the above events, the taxpayer did not provide any documentation to the Tax Commissioner to substantiate its claim. However the Tax Commissioner stated, “For purposes of this audit only, if the Taxpayer can produce documentation that the tax was paid on goods and services provided in connection with the events, I will allow credit in the audit for the tax paid. The credit will be limited to the amount of the assessed tax. Absent such evidence, there is no basis to revise the Department's audit.”

29. **Sample.** P.D. 08-77 (June 6, 2008). In a prior determination letter, the Tax Department found that the sample and extrapolation methods were properly applied. The taxpayer requested a reconsideration and stated that the initial appeal letter provided incomplete facts. The taxpayer agreed to the results of the extrapolation for 2003 through 2004, but contended that the error factor should not be applied to periods before 2003 due to a change in purchasing habits. The Tax Commissioner disagreed and concluded that an adjustment of the extrapolation and error factor was not warranted. The taxpayer acknowledged that purchases were incorrectly exempted from retail sales and use tax beginning in 2003; therefore, it is likely that similar errors were made in the collection and remittance of the sales and use tax for periods prior to 2003.

30. **Prescription Drug Exemption.** P.D. 08-78 (June 6, 2008). The taxpayer operates a for-profit outpatient center dedicated to cardiac services. An audit resulted in the assessment of tax on prescription drugs used in the provision of cardiac services. The taxpayer appealed the tax on the prescription drugs Definity, Atropine, Dobutamine and Adenosine as these drugs are used to enhance the image production of echocardiograms and in cardiac stress testing. Each drug is ordered in bulk and used on an as-needed basis. The taxpayer states the drugs are dispensed on a physician’s order when needed for a specific patient.
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, optometrist, licensed nurse practitioner, or licensed physician assistant in his professional practice." In prior rulings, the Tax Commissioner held that when an invoice includes a licensed physician as purchaser, the invoice is sufficient to document that the purchase is by a physician for use in his practice. Also, when an invoice includes a federal Drug Enforcement Agency (DEA) number, the use of a DEA number is synonymous with the naming of a physician. Based on this policy, the Tax Commissioner removed items from the audit where a physician or DEA number was included on the invoice.

31. Sales of IV Medication and Provision of Services. P.D. 08-79 (June 6, 2008). The taxpayer maintains a pharmacy and provides intravenous (IV) medications and medical products pursuant to physicians' prescriptions. The IV medications and medical products are sold to customers for administration in the home. The reimbursement contracts entered into between the taxpayer and the insurance providers set out payments to the Pharmacy for the IV medications and medical products, as well as, payment for services billed by an affiliated home health care entity that is not operated by the taxpayer. Payments are provided on a per diem basis. Because a single contract provides payment for the services, IV medications and medical products, the auditor concluded that the taxpayer is a service provider with regard to the operation of the Pharmacy. Based on this conclusion, the auditor assessed the tax on the taxpayer's purchases of IV medications, pumps and other medical supplies sold by the Pharmacy. The taxpayer argued that the auditor erroneously concluded that the inclusion of the Pharmacy and the Affiliate in the same reimbursement contract implies that the Pharmacy is rendering medical services. The taxpayer asserted that the Pharmacy does not employ physicians or nurses and does not provide medical or nursing services. Instead, the Pharmacy sells medications pursuant to physicians prescriptions to customers who self administer the medications.

The Tax Commissioner reviewed contract documents provided by the taxpayer which include a rate schedule for combined home health and home infusion services. This schedule includes pricing to cover IV medications, supplies, nursing services and pharmaceutical support services. The Pharmacy has charges listed for injectible home infusion medications. The Affiliate is listed separately and has charges listed for home infusion and physical therapy. Because the Pharmacy and the Affiliate are separate legal entities, the Tax Commissioner determined that the entities cannot be held responsible for the services and products provided by the other for purposes of the sales and use tax. Therefore, the Tax Commissioner removed the disputed items from the audit.

32. True Object Test: Equestrian Packages. P.D. 08-90 (June 18, 2008). The taxpayer operates an equestrian retreat that offers daily equestrian excursions and overnight packages that include accommodations, meals, horseback riding, and other activities. The taxpayer was audited and assessed tax on the lump sum charge for equestrian packages that include meals and lodging. The taxpayer contests the tax and
contends that it provides a horseback riding service. The Tax Commissioner determined that the true object of the transaction, in this instance, is the provision of a service. The taxpayer is deemed to provide a nontaxable service and is not required to collect the tax on the equestrian packages. Accordingly, the tax assessed to the sale of equestrian packages was removed from the assessment.

33. Shop Supply Charges. P.D. 08-91 (June 18, 2008). The taxpayer is engaged in the sale and repair of heavy trucks. For repair work, the taxpayer pays the tax on purchases of shop supplies used in the performance of its repair services. The taxpayer bills its customer a lump sum charge to recover its costs of the shop supplies. The lump sum charge for the shop supplies is based on a percentage of the labor charges billed on the customer's repair invoice. The auditor assessed sales tax on revenues generated from the shop supply charges that exceed the taxpayer's shop supplies cost. The Tax Commissioner reviewed the taxpayer's invoices and noted that the miscellaneous shop supply charge is listed separately on the customer repair invoice and represents nontransferable shop supplies used in performing the taxpayer's repair work. Based on the invoices, the Tax Commissioner determined that a sale as defined in Va. Code § 58.1-602 has not taken place because there is no transfer of tangible personal property from the taxpayer and the customer on the shop supplies.

34. Underreported Alcohol Sales. P.D. 08-92 (June 18, 2008). The taxpayer operates a restaurant. The taxpayer was assessed tax, penalty and interest for underreported sales of alcoholic beverages based on a meals tax audit performed by the locality for the period December 2001 through December 2005. The taxpayer appealed contending that the audit conducted by the locality is flawed and does not accurately reflect the taxpayer's gross receipts. The Tax Commissioner found no basis for adjusting the Department's assessment. The taxpayer did not provide sufficient evidence to refute the validity of the sales figures computed by the meals tax audit.

35. Transportation Charges. P.D. 08-93 (June 18, 2008). The taxpayer is a manufacturer of log homes. The taxpayer and its customers enter into contracts for the purchase, ordering and delivery of log homes to the customers' designated site. As a result of the Department's audit, the taxpayer was assessed tax on charges resulting from a Change In Delivery Date addendum to the original contract. If a customer wants to change the delivery date of their log home, the taxpayer creates a Change In Delivery Date Addendum to the original contract. The addendum lists a delivery date change charge schedule that is based on the number of days prior to the original delivery date the customer requests the change. The charges are to compensate the taxpayer for the additional administrative time and effort involved in rescheduling the delivery of a log home. The taxpayer maintained that the Change In Delivery Date addendum charges are transportation charges and separately stated for each log home.

Based on the taxpayer's description of the charges in its appeal letter, the Tax Commissioner did not agree that the charges at issue represent transportation or delivery charges. The change in delivery date charge is an addendum to the original contract for purchase of the log home. The charge is not for transportation, but rather compensation
for additional administrative time and effort. Therefore, the change in delivery date charge is considered part of the sale price of the log home.

36. **Lump Sum Repair Charges.** P.D. 08-84 (June 18, 2008). The taxpayer provides servicing and repair of medical instruments and equipment for hospitals and healthcare facilities. As a result of the Department's audit, the taxpayer was assessed tax on a lump sum charge billed to customers for the repair labor and parts associated with the medical instruments and equipment. The taxpayer's invoices include a standard calculation of 20% of the total invoice amount for parts and other supplies. The taxpayer issued corrected invoices showing separately stated repair labor and parts charges. For this reason, the taxpayer requested that the tax assessed on the repair labor charges be abated.

   The taxpayer billed a lump sum charge for the repair parts and services provided to its customers. Based on the definition of sales price in Virginia statutes, the Tax Commissioner determined that the auditor correctly held the total charge taxable. However as this was a first generation audit of the taxpayer, the Tax Commissioner agreed to remove the tax associated with the repair labor charges from the assessment upon the auditor's verification that the taxpayer has issued corrected invoices to its customers that separate the charges for repair labor and parts.

37. **Financing Charges.** P.D. 08-95 (June 18, 2008). The taxpayer provides underground and overhead utility services for the utility industry. During the audit period, the taxpayer purchased construction equipment from a vendor. The taxpayer financed the construction equipment for a period of 36 months. The vendor's invoice lists a low rate program fee on each invoice. Under audit, the auditor concluded that the fee is a handling charge and assessed use tax. The taxpayer contended that the low rate program fees listed on the invoices are interest charges and provided additional documentation in the form of finance contracts to support its contention that the interest charges are not subject to retail sales and use tax.

   Virginia Code section 58.1-602 excludes from the definition of "sales price" the following charges: "finance charges, carrying, service charges or interest from credit extended on sales of tangible personal property under conditional sales contracts or other conditional contracts providing for deferred payments on the purchase price." Based on a review of the invoices and finance contracts, the Tax Commissioner determined that the charges listed as low rate program fees represent interest charges in connection with the financing of the construction equipment and removed them from the audit.

38. **Government Sales and Manufacturing Exemption.** P.D. 08-97 (June 18, 2008). The taxpayer is a machine shop that primarily fabricates ornamental articles of tangible personal property on a job shop basis. An audit resulted in the assessment of sales tax on untaxed fabrication charges and fabricated articles of tangible personal property. In addition, use tax was assessed on untaxed purchases of tangible personal property used or consumed in the taxpayer's business. The taxpayer appealed
contending that certain sales for government projects are exempt transactions and certain purchases qualify for the industrial manufacturing exemption.

The Tax Commissioner reviewed the government sales and determined that the sales were made to a real estate contractor. As Title 23 of the Virginia Administrative Code (VAC) 10-210-410(A) provides that no sale to a contractor is exempt on the ground that the other party to the contract is a government agency, these sales were not removed from the audit. The Tax Commissioner found basis for treating the taxpayer as a manufacturer and that the contested purchases qualify for the industrial manufacturing exemption as machine shops are listed as manufacturers in the SIC and NAICS codes.

39. **Sale of Counter Tops.** P.D. 08-98 (June 18, 2008). The taxpayer fabricates counter tops for installation on kitchen and bathroom cabinetry and treats itself as a retailer with respect to the collection and payment of the sales and use tax. The Tax Department's auditor determined that the taxpayer is a real property contractor of counter tops and assessed consumer use tax on all purchases of materials, supplies, equipment and software used or consumed in the taxpayer's business. The taxpayer argued that it should be treated as a retailer in accordance with subsection G of Title 23 of the Virginia Administrative Code (VAC) 10-210-410. The taxpayer contended that it satisfies the definition of retailer by installing counter tops and maintaining a wholesale place of business and an inventory of counter top materials. The taxpayer also contended that counter tops are like or comparable to cabinets, which are specifically subject to this regulation. As a retailer of counter tops, the taxpayer asserted that it should not be denied the manufacturing exemption. For these reasons, the taxpayer contended that the assessment is erroneous, unfair and contrary to the taxpayer's original registration.

The Tax Commissioner declined to treat the taxpayer as a retailer as counter tops are not comparable to cabinets or any of the other items listed in 23 VAC 10-210-410. Cabinets generally are enclosures with doors, shelving and compartments and, therefore, are not akin to counter tops that are generally flat surfaces similar to table tops. Although a cabinet may aid in supporting a counter top, a counter top is clearly not an enclosure of any sort. The Tax Commissioner also added that treatment of the taxpayer as a retailer for the audit period would not be beneficial to the taxpayer. Potentially, the liability from an audit as a retailer would exceed the current liability derived as a contractor. Three sales invoices furnished by the auditor show that the taxpayer charged sales tax on counter top materials, sinks and faucets but exempted lump-sum charges for fabrication and installation labor and exempted charges for edging and cutouts in the counter top materials (basically, fabrication charges) where sales tax should have been charged. In a retail transaction, fabrication labor is fully taxable based on the fabrication regulation at Title 23 VAC 10-210-560. If it were possible to treat the taxpayer as a retailer of counter tops that are furnished and installed, it would still be liable for the uncollected sales tax on fabrication charges, including all lump-sum charges for fabrication and installation.

40. **“Self-Assessing” Customers and Location of Sale.** P.D. 08-99 (June 18, 2008). The taxpayer produces large format printing and displays. An audit by the Department resulted in the assessment of tax on untaxed sales. The taxpayer
contended that the error rate calculated for the sample resulted in a larger taxable sales amount than the amount of sales actually deducted on its sales tax returns as non-taxable. The taxpayer asserted that the sample contained a disproportionate number of transactions for which its customers self-assessed tax. As a result, the sample is distorted. In order for an audit sample to be adjusted, the taxpayer must demonstrate that the sample is flawed. The Tax Commissioner determined that sales to customers who self-assessed tax is not sufficient justification for making an adjustment to an audit sample.

The taxpayer also contended that its records show a larger amount of sales going into Virginia than the sales on which its customer remitted use tax. The taxpayer asserted that the differences represent shipments to its customer's distribution center in Virginia which sends products to its stores in several states outside Virginia where the customer pays use tax to the Tax Department based on the stores that actually receive and use the tangible personal property at issue. The taxpayer contended that because these items were not used in Virginia, they should not be taxable in Virginia. The Tax Commissioner disagreed. In this instance, the taxpayer’s customers make use of the property purchased from the taxpayer in Virginia by directing the taxpayer to ship the property to its distribution centers in Virginia. As this constitutes a first use of the property in Virginia, a taxable event occurs in Virginia even if the property is subsequently delivered outside the state.

41. **Catalog Stands.** P.D. 08-100 (June 18, 2008). In a prior determination letter, the Tax Commissioner denied the taxpayer an exemption from the retail sales and use tax for the purchase of a catalog stand. The taxpayer provided a picture of a catalog stand and requested that the determination with respect to the catalog stand be overturned. Based on the information provided, the Tax Commissioner determined that the taxpayer's catalogs do not require the support of the catalog stand to be displayed. Unlike certain point-of-purchase displays, the catalogs can be displayed without means of support. The catalogs are bound and do not have to be secured to the catalog stand for support while being displayed. In order for the exemption to apply, the display (i.e., the catalog stand) must provide support for the printed materials.

42. **Advertising Exemption.** P.D. 08-101 (June 18, 2008). The taxpayer is an advertising company that provides concept, writing, graphic design, mechanical art, photography and production supervision for generating multimedia vehicles. After an audit, the taxpayer was assessed with additional sales and use tax. The taxpayer argued that certain purchases are exempt as the advertising exemption applies.

Title 23 of the Virginia Administrative Code (VAC) 10-210-41(B) interprets the advertising exemption and provides that “Advertising businesses are engaged in providing professional services and are the users and consumers of all tangible personal property purchased for use in such business .... In addition, the tax applies to all purchases by an advertising business of concept, writing, graphic design, mechanical art, photography, etc .... not made pursuant to development of a specific advertising campaign. For example, if an advertising business purchases scenic photographs of
Virginia for possible use in future advertising campaigns, the purchase of such photographs will be subject to the tax.”

The Tax Commissioner declined to remove a multimedia CD presentation from the audit as there was no evidence that it was used to deliver information to the general public. The Tax Commissioner also declined to remove charges for shooting and editing of a video testimonial and purchases of photography as the taxpayer did not provide any evidence demonstrating that the video is part of a specific advertising campaign.

43. **Modular Homes.** P.D. 08-105 and 08-106 (June 20, 2008). A taxpayer posed twelve different scenarios on sales and use tax responsibilities involving the sale of modular homes and as asked numerous questions concerning sales tax registration, payment, and computation of the tax. The Tax Commissioner responded by issuing a ruling that addressed each scenario by opining on which party is responsible for paying Virginia sales and use tax and answered all of the questions.

44. **Intracompany Sales and Other Issues.** P.D. 08-110 (June 20, 2008). The taxpayer appealed an assessment of sales taxes on numerous items. After receiving sufficient documentation, the Tax Commissioner removed numerous items related to service contracts, sales upon which a resale exemption was obtained by the taxpayer at the time of sale, purchases of high speed copiers, and purchases of items for resale. The Tax Commissioner did not remove items related to an intracompany transfer as argued by the taxpayer as the documentation provided by the taxpayer did not show that the sale was an intracompany transfer. Finally, the Tax Commissioner lowered the interest rate from the large corporate underpayment rate to the standard interest rate.

45. **Virginia Petroleum Storage Tank Fee.** P.D. 08-111 (June 26, 2008). The taxpayer sold off road fuels that are subject to the retail sales and use tax and added the Virginia Petroleum Storage Tank Fee used for the cleanup of leaking storage tanks. The taxpayer charged sales tax on the off road fuels but did not charge the tax on the fee. The auditor assessed sales tax on the fee and the taxpayer appealed, arguing that the fee is part of the Virginia Excise Tax on fuels and not subject to the sales tax. The Tax Commissioner determined that the fee is not part of the Virginia Excise Tax. Instead, the fee is imposed by the Department of Environmental Quality and not specifically set out as a tax on the sale of motor fuels or as an element of the excise tax. Accordingly, the fee is part of the sales price and sales tax should be charged on that amount.

46. **Insufficient Documentation.** P.D. 08-112, 08-113, and 08-114 (June 26, 2008). The taxpayer sells food and other items. The taxpayer was assessed additional sales and use tax and appealed the assessment arguing that the sales tax was correctly calculated, use tax had been paid on the assessed purchases by the taxpayer, or sales were made to exempt universities. The majority of the assessment was upheld as the Tax Commissioner reviewed the worksheets used to calculate the taxpayer’s sales tax returns. The taxpayer did not provide any documentation to support its assertions and a review of the worksheets also did not support the assertions.
Furthermore, food sold to an exempt entity such as a government is taxable. In most cases, food sold to a government will not be consumed by the government. Instead, it will be consumed by an individual.

47. **Direct Pay Permit.** P.D. 08-115 (June 26, 2008). The taxpayer was assessed with sales tax on three sales in which the customers provided direct payment permits for the purchase of catered meals. The taxpayer appealed. The Tax Commissioner reviewed the direct pay permit and noted that the form appears to restrict purchases by the permit holder to tangible personal property. However, the wording of the permit provides that its issuance is subject to the limitations, terms and conditions set out in under Virginia Code section 58.1-624. The statute provides that a permit holder shall remit the tax on all sales, distributions, leases, storage of tangible personal property, and sales of taxable services directly to the Tax Commissioner. Based on the language contained in the statute, the Tax Commissioner removed the sales to these customers from the assessment.

48. **Sales to the U.S. Government.** P.D. 08-116 (June 26, 2008). The taxpayer has entered into a contract with the U.S. Government to provide engineering, fabrication, transporting, installation and fine-tuning of all interpretive exhibits, exhibit lighting, audio-visual equipment and associated items for a museum. The government provided an exemption certificate to the taxpayer, indicating that tangible personal property purchased for use or consumption by the United States is exempt from the Virginia retail sales and use tax. The taxpayer requested a ruling on its sales and use tax responsibilities. The Tax Commissioner responded with broad guidelines. If the contract is for the provision of a service or is a contract with respect to real estate, the taxpayer must pay sales tax on its purchases of tangible personal property that it will consume under the contract. If the contract is for the provision of tangible personal property, the taxpayer may purchase the tangible personal property exempt from sales tax under a resale exemption and sell the property to the government exempt of tax. Also, the taxpayer may purchase property exempt from sales tax if it is a purchasing agent of the government. To be a purchasing agent, the credit of the government must be directly bound on the taxpayer’s purchases.

49. **Overpayment Credits and Brochures.** P.D. 08-117 (June 26, 2008). The taxpayer contended that it made overpayments of use tax during the period January 2004 through June 2005. The taxpayer took credits for these overpayments on its sales tax returns filed for the periods December 2006 through May 2007 by reducing its gross sales amounts on its returns by the amount of the overpayments. The taxpayer did not account for the overpayment credits on the return as required. Because the taxpayer did not follow these procedures in accounting for the overpayments on its returns, the credits were not allowed in the audit for the period at issue. The taxpayer appealed the disallowance of the credits. Despite the incorrect method the taxpayer utilized, the Tax Commissioner ruled that the taxpayer must demonstrate that the tax was paid to the Tax Department. The Tax Commissioner provided the taxpayer with the opportunity to submit documentation supporting its contention that the disallowed credits reported on
the returns outside the audit period should have been allowed in the audit and returned the audit to the audit staff.

The taxpayer was also assessed with use tax on its brochures. The taxpayer mails the brochures to independent agents throughout the country to provide sales incentives information. The brochures provide information regarding the various conventions around the world that the agents can attend if their sales volumes reach a certain level. The taxpayer contended that the brochures were stored in the Commonwealth for less than twelve months before being distributed outside the Commonwealth. The taxpayer appealed the assessment contending that the brochures are exempt meeting and convention promotional materials. The Tax Commissioner disagreed. Exempt promotional material promotional material does not include internal administrative items under Virginia Code section 58.1-609(6)(4) and 23 VAC 10-210-3010(A). The Tax Commissioner determined that the brochures were for internal use by the taxpayer to disseminate information to its agents about incentives for achieving sales goals and about conventions available for attendance by the agents. On this basis the Tax Commissioner upheld the assessment for this portion of the audit.

50. Occasional Sale. P.D. 08-118 (June 26, 2008). The taxpayer operated a chiropractic practice and a medical practice and was assessed sales tax on the sale of medical equipment to a physician made in connection with the sale of the medical practice. The taxpayer appealed contending that the sale of the medical practice was the result of a reorganization, and the sale of medical equipment qualifies as an exempt occasional sale. The Tax Commissioner disagreed. To be considered an occasional sale the taxpayer must sell all or substantially all the assets of any business, the transfer of assets must qualify for nonrecognition of income under § 351 of the Internal Revenue Code, or must be the sale of a division engaged in totally separate and distinct activities based on such considerations as separate books which are separately maintained, separate bank accounts, separation of fixed assets, separation of employees and the flow of economic advantage from one division of the organization to another.

Following the sale the Taxpayer remained in business, operating as a chiropractor. Additionally, the Taxpayer did not provide any documentation demonstrating that a substantial portion of the assets of the practices transferred when the medical practice was sold qualifies for § 351 nonrecognition or that any of the requirements for a sale of a division were satisfied. Accordingly, the Tax Commissioner upheld the assessment.

51. Real Property Contractor – HVAC. P.D. 08-120 (June 26, 2008). The taxpayer furnishes and installs residential heating, ventilation, and air conditioning (HVAC) equipment. The taxpayer was assessed use tax on untaxed purchases of tangible personal property, and sales tax on certain sales of installed equipment for which sales tax was separately charged and collected but not remitted to the Tax Department. The taxpayer protested requesting a resale exemption for its HVAC purchases and a tax credit against the sales tax assessed. In addition, the taxpayer requested an adjustment to the audit for any sales tax erroneously collected if it can prove that it refunded such tax to its customers.
The Tax Commissioner denied the taxpayer’s appeal. In a prior audit, the taxpayer made the same errors by not paying use tax on its purchases and charging sales tax. In the first audit, the taxpayer was given prospective compliance to allow the taxpayer to correct its compliance for the future. However, the taxpayer continued to separately charge and collect sales tax with respect to certain installed HVAC equipment. The Tax Commissioner declined to grant a resale exemption to the taxpayer and decided that the credit requested by the taxpayer was not warranted because the taxpayer failed to abide by the verbal and written instructions provided as a result of the prior audit. The Tax Commissioner granted the taxpayer’s request for an adjustment subject to verification by the Department’s auditor that refunds were issued to customers. The refunds of erroneously collected sales tax will lower the assessment dollar for dollar but may only apply to the sales tax portion of the assessment and any adjustment cannot exceed the sales tax assessment amount.

52. **Intangible Software.** P.D. 08-122 (June 26, 2008). The taxpayer was assessed sales tax on software leases. The taxpayer contended that these leases were exempt pursuant to the exemption for custom programs. The taxpayer never received the software in any tangible form. The Tax Commissioner determined that the software did not qualify for the exemption for custom software as the vendor retained rights in the lease agreement to sell the same software to other customers. However as the software was intangible, it was not subject to sales tax and the Tax Commissioner abated the assessment.

53. **True Object Test and Training.** P.D. 08-128 (July 29, 2008). The taxpayer was assessed sales tax on its rental of laser eye correction equipment and training services. The taxpayer contested the assessment arguing that both were the provision of a service. With the lease of the equipment, personnel employed by the vendor was provided to the taxpayer to monitor the equipment. However as the taxpayer actually operated the equipment, the Tax Commissioner determined that the provision of monitoring personnel was secondary to the lease of the equipment and held that the lease was subject to sales tax. The Tax Commissioner also examined the sales contract to determine if the training was optional and separate from the sale as the taxpayer argued. The Tax Commissioner determined that the training was required under the contract and therefore part of the sales price of the equipment and taxable.

54. **Shipping and Handling and Resale Exemption.** P.D. 08-129 (July 30, 2008). The taxpayer was assessed sales tax on shipping and handling charges and leases sold for resale. The taxpayer did not separately state the shipping and handling charges on its customer’s incomes but did not charge sales tax on this amount. The Tax Commissioner determined that because the shipping and handling charges were not separately states, the charges were part of the sales price and subject to sales tax. The taxpayer provided resale certificates on certain sales upon which sales tax was assessed. The Tax Commissioner could not verify that the resale exemption was proper as there were no matching invoices. The Tax Commissioner permitted the taxpayer to submit the
proper invoices within 30 days to remove the sales tax assessed for these items from the audit.

55. Converted Assessment. P.D. 08-130 (July 30, 2008). A taxpayer was a limited partner in a partnership that owned and operated a hotel. The taxpayer was assessed with sales tax that was not paid by the partnership. The taxpayer appealed the converted assessment arguing that the partnership should be assessed, not him. The taxpayer made statements to the Tax Commissioner about working toward making the hotel a profitable business which showed that the taxpayer had knowledge of the partnership’s business operations. The taxpayer was the only partner listed in the Tax Department’s accounting records for the partnership. The Tax Commissioner determined that the taxpayer had the authority to prevent the failure to file sales tax returns. Accordingly, the taxpayer was a "corporate, partnership or limited liability officer" as defined in Va. Code § 58.1-1813, and that the assessment was properly converted.

56. Automotive Repair Parts and Out of State Sellers. P.D. 08-131 (July 30, 2008). The taxpayer paid sales tax on repair parts it purchased from vendors and did not charge its customers sales tax on the repair parts. The taxpayer also purchased other items from out of state sellers and did not pay sales tax on these items. (The nature of these items is not disclosed.) The taxpayer was assessed with uncharged sales tax on the sale of repair parts to its customers and use tax on its purchases from out of state vendors.

The taxpayer appealed the assessment arguing that his treatment of the repair parts was proper and the out of state sellers were in error by not charging sales tax. The Tax Commissioner denied the appeal. Under Title 23 VAC 10-210-3050(A), sales tax should be charged on the price of repairs including labor. The taxpayer should have purchased the parts under a resale exemption and charged its customers with sales tax. (There is no mention of a credit for sales tax erroneously paid by the taxpayer.) Also, it was not clear to the Tax Commissioner that the out of state sellers were required to collect Virginia sales tax. As such, the taxpayer should have paid use tax on its purchases.

57. Intangible Software. P.D. 08-132 (July 30, 2008). The taxpayer appealed an assessment on its purchase of software. The taxpayer claimed that the software was delivered electronically and provided the sale contract as proof. The Tax Commissioner determined that the contract did not state how the software was delivered. Based on lack of evidence, the assessment was upheld.

58. Internet Service Provider Exemption. P.D. 08-133 (July 30, 2008). The taxpayer provides Internet services to its customers offering email services, content, and the Internet as part of a package of services sold to end-user subscribers. It was not clear to the auditor whether the taxpayer offered proprietary content which is required to qualify for the Internet service provider exemption. Accordingly, the taxpayer was assessed tax on purchases of computer hardware and software, servers, hosting equipment, and distribution equipment used to provide Internet services to end users.
The Tax Commissioner abated the assessment as the Tax Department's Audit Supervisor was given temporary access to the subscriber's access-only web pages, which show that the taxpayer's subscribers have the ability to post news, reviews, and articles on any topic and to participate in on-line journals (user blogs). The Tax Commissioner determined that this embedded information becomes the proprietary content of the taxpayer. Because the taxpayer provides access to this proprietary content, it was sufficient to qualify for the ISP exemption.

59. Custom Intangible Software. P.D. 08-134 (July 30, 2008). The taxpayer appealed an assessment of sales tax on its purchase of software. The taxpayer claimed that software was exempt as custom software and delivered electronically. The Tax Commissioner denied the appeal as evidence was located that the software was developed for the "federal procurement community" and not solely for the taxpayer. Furthermore, the taxpayer did not provide evidence that the software was delivered electronically.

60. Inoperable Aircraft. P.D. 08-148 and P.D. 08-149 (July 30, 2008). The taxpayer contested an assessment of retail sales and use tax on its purchase of inoperable aircraft used to train students to repair aircraft. As Virginia Code sections 58.1-1502 and 58.1-1506 subject the sale of inoperable aircraft and aircraft kits to the aircraft sales and use tax and not to the retail sales and use tax, the Tax Commissioner abated the assessment.

61. Digital-to-Analog Converter Box Coupon Program. P.D. 08-150 (February 29, 2008). A ruling was requested on whether a retailer should charge sales on the full sales price of digital-to-analog converter boxes when presented with a $40 government coupon. The Tax Commissioner determined that sales tax should be charged on the full amount as the vendor will receive the full sales price for the box with $40 coming from the federal government and the remainder received from the customer.

62. Energy Star and Watersense Sales Tax Holiday Guidelines and Rules. P.D. 08-151 (August 27, 2008). This document establishes the guidelines for retailers and consumers regarding Virginia's Energy Star and Watersense Sales Tax Holiday. The sales tax holiday will be a recurring event, beginning at 12:01 a.m. on the Friday before the second Monday in October of every year and ending at midnight on the Monday immediately following. The holiday will expire in July of 2012.

63. Real Property Contracts. P.D. 08-154 (August 29, 2008). The taxpayer was assessed with use tax on tangible personal property it incorporated into real property for government entities. In addition, the taxpayer inquired about whether it could claim a bad debts credit on certain transactions, the temporary storage exemption, and credit for taxes paid to other states. The Tax Commissioner denied the taxpayer appeal of the use tax assessed as the government exemption does not extend to real property contractors performing work for a government entity. In addition, the taxpayer could not claim a bad debt credit on certain transactions as it had never collected or
remitted any sales tax on the transaction. The temporary storage exemption was inapplicable as it only applies to property stored in Virginia to be used in exempt real property construction. Finally, the credit for taxes paid to other states only applies to taxes paid to another state from which the property was purchased, or if the tax was legitimately imposed because of a taxable use in another state prior to the delivery and use of the property in Virginia.

64. Manufacturing Exemption and Pollution Control Exemption. P.D. 08-155 (August 29, 2008). The taxpayer manufactures and sells kitchen cabinets. The taxpayer contested five groups of items held in the audit as taxable purchases. The taxpayer maintained that four of these items qualify for the industrial manufacturing exemption and the fifth qualified for the pollution control exemption. The first items assessed were forklifts used to move products from the production line to a staging area. The taxpayer claimed that the forklifts were also used to move products in between processes but presented no evidence to backup this assertion. Without any evidence that such forklifts were used predominantly within the manufacturing process, these items remained in the audit. The Tax Commissioner removed a knife grinder used to shape cabinets. The Tax Commissioner did not remove bar coding equipment to track products or a shipping label maker as these items are used in an administrative function, not manufacturing. Finally, the equipment used by the taxpayer for removing sawdust from the air does not qualify for the pollution control exemption as it did not have the proper Department of Environmental Quality certification.

65. Temporary Storage Exemption. P.D. 08-156 (August 29, 2008). The taxpayer, an electrical contractor, contested consumer use tax assessed on construction materials temporarily stored in Virginia and subsequently incorporated into real property projects at various U.S. embassies throughout the world. The taxpayer contended that these materials qualify for the temporary storage exemption. The Tax Commissioner determined that although the foreign country imposed a VAT tax on the value added to the work, the materials could have been purchased exempt in the foreign country. On this basis, the Tax Commissioner agreed that the exemption applies and abated the assessment.

66. Sale of Food to Nonprofit Organizations. P.D. 08-157 (August 29, 2008). The taxpayer contracts to sell hot and cold bulk foods to private schools, church affiliated schools and day care providers most of which are exempt from income tax under Internal Revenue Code § 501(c)(3). The Tax Department assessed retail sales tax on untaxed sales of food to customers that had claimed various exemptions from the sales and use tax. The auditor determined that the taxpayer was operating as a caterer and treated the disputed transactions as sales of taxable services. Exemption certificates taken from many customers were not considered valid because the exemptions claimed were applicable to purchases of tangible personal property but not to services.

The Tax Commissioner determined that the sales of food were sales of tangible personal property, not services. The food sold by the taxpayer is not served to the persons consuming the food but is placed under the care and supervision of the school or
day care that purchases the food. The school or daycare is then responsible for providing the food in the form of individual meals to the children or students under their care. The Tax Commissioner removed items from the audit where a valid resale exemption certificate was given to the taxpayer.

67. **Financing Transactions.** P.D. 08-163 (August 29, 2008). The taxpayer leases property to customers and also provides financing to its customers. In the audit the taxpayer was assessed for sales tax on both lease and financing transactions. The taxpayer appealed and argued that the financing transactions constitute nontaxable loans of money rather than sales or leases of tangible personal property. The taxpayer also contended that the financing transactions are negotiated separately from the leasing transactions and are not related to the leasing transactions.

The Tax Commissioner determined that the financing transactions constitute a loan between the Taxpayer and its customer and is not subject to the tax, even though embodied in the same document with a lease. The lease transaction and the finance transaction are two separate transactions that are not related to one another. Accordingly, the proceeds received as a result of the financing transaction are not considered gross proceeds because they are not related to or associated with the leasing of tangible personal property as contemplated in Va. Code §§ 58.1-603 and 58.1-602 and Title 23 VAC 10-210-840.

68. **Information Technology Services.** P.D. 08-164 (August 29, 2008). The taxpayer is an information technology consulting services firm that performed defense related contracts primarily for the federal government. It was assessed sales tax on a multitude of issues. The Tax Commissioner removed many of the items based on evidence provided by the taxpayer. One contract upon which sales tax was assessed was discussed in this appeal.

The contract is for the taxpayer to "design, develop, deploy, and operate a system" for a weather program. The contract requires the taxpayer to perform a number of services during each phase of the contract, to include telecommunications services, hardware maintenance and logistics support services, software maintenance and support, and other services. The system is a high-speed computer and communications network utilized by the taxpayer's customer. The system allows the customer's forecasters to deliver more accurate and timely weather warnings and forecasts. The customer's forecasters actively use the system as a part of their job responsibilities. The taxpayer does not actively operate the system as part of its responsibilities under the contract. Rather, the taxpayer provides troubleshooting services to the customer and ensures proper maintenance of the system. The Tax Commissioner reviewed the contract and determined that the true object of the contract is for the provision of a tangible computer system. Accordingly, purchases of tangible personal property that were transferred to the government agency pursuant to this contract were removed from the audit.
69. **Nexus and Broadcast Equipment.** P.D. 08-167 (September 11, 2008). A taxpayer requested a ruling on whether sales and use tax applies to the sale of certain broadcasting equipment, software and related services. The taxpayer is an out-of-state corporation that provides broadcast computer equipment (servers) and software used to transmit data via television. The products are sold to public radio and television broadcasting stations and to nonprofit public broadcasting stations in the United States. In connection with its server sales, the taxpayer also provides installation, customer support, training services, and repair and maintenance services. The taxpayer does not maintain a home office in Virginia, nor does it employ Virginia residents for sales or active solicitation. Instead the taxpayer uses traveling sales representatives that solicit sales to Virginia based customers and provide installation and maintenance services to these customers.

Virginia Code section 58.1-612(C) provides in part that a dealer shall be deemed to have sufficient activity or nexus in Virginia if the dealer solicits business in Virginia by employees, independent contractors, agents or other representatives. Based on the facts presented, the Tax Commissioner determined that the taxpayer has nexus with Virginia and must register to collect and remit the sales and use tax.

The broadcasting exemption under Virginia Code section 58.1-609.6(2) is limited to equipment used for transmitting, not programming or program preparation. The Tax Commissioner determined that to the extent the servers are used directly in broadcasting a signal over the airwaves to viewers, the purchase of the servers will receive the broadcast exemption. However because these servers are also used to edit and store content, they are used in a taxable manner. Therefore the Tax Commissioner determined that a proration of taxable use versus exempt use must be established and the sales tax should be applied to the taxable portion of the sales price. [Query: Unless a taxpayer knows the server will be used solely for one of the two functions, how will the taxpayer know how to prorate the sales price between taxable and exempt uses before the taxpayer even begins to use the server?]

Finally, the services will be taxable if they are included or sold in connection with the taxable sale of tangible personal property unless specifically exempted by statute. If the tax on the sale of equipment must be prorated, then the tax on the services will also follow the same tax proration. When services are sold independent of any sale of tangible personal property, the charges for such services are not taxable in accordance with Virginia Code section 58.1-609.5(1).

70. **Delivery and Service Charges.** P.D. 08-177 (September 18, 2008). The taxpayer sells modular homes at retail to contractors that perform the installations. The taxpayer contests the assessment of sales tax on carrier maintenance fees and contends that such fees should be considered part of the exempt delivery charges. The taxpayer also contests the tax assessed on factory trim out (FTO) fees and contends that such fees are exempt installation labor charges. The FTO fees involve on-site labor to complete the trim work after the modular sections have been affixed to a permanent foundation by the purchaser of the modular building sections. Trim work involves the
installation of baseboard, crown molding, stairs and fascia after the individual units are joined together by the contractor.

The Tax Commissioner upheld the tax on carrier maintenance fees. The separately stated transportation charge exemption is applicable only to the act of delivery and does not include maintenance charges that are indirectly related to the act of delivery. The Tax Commissioner did, however, remove the FTO charges from the assessment. The Tax Commissioner determined that the FTO charges constitute a nontaxable installation charge as such charges incurred are in connection with the installation of products regarding real property contracts.

71. Internet Based Services. P.D. 08-178 (September 22, 2008). The taxpayer licenses interactive web-based training and educational services (e-Learning). In connection with the e-Learning services, the taxpayer requested a ruling on whether it has a responsibility to collect and remit sales tax as a result of doing business in Virginia. The Tax Commissioner opined that as long as there is no provision of tangible personal property such as e-Learning software conveyed in a tangible format (via tape, diskette, etc.), the transaction is not taxable.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

IV. PROPERTY (AD VALOREM) TAXES

A. 2008 Legislation

1. Energy Efficient Buildings. HB 239 (Chapter 288) and SB 174 (Chapter 401) expand the category of energy-efficient buildings that may be classified as a separate class of real property for tax purposes to include buildings that meet performance guidelines or standards under the Green Globes Building Rating System of the Green Building Initiative, Leadership in Energy and Environmental Design Green Building Rating System, EarthCraft House program, or Energy Star program. This legislation took effect on July 1, 2008.

2. Public Service Corporations and Electric Suppliers. HB 1123 (Chapter 642) provides that the additional real property tax authorized to be imposed on commercial property by the localities in the Hampton Roads Transportation Authority shall not be imposed on property of a public service corporation or electric supplier unless a final certificate of occupancy for a commercial or industrial use has been issued and remains in effect. This legislation took effect on July 1, 2008.

3. Qualifications of assessors and appraisers. HB 314 (Chapter 540) provides for the Department of Taxation to establish a certification program for all supervisors, assessors, and appraisers contracted to perform assessments or general reassessments of real property. This legislation took effect on July 1, 2008.
B. Recent Court Decisions

1. **Botetourt County v. Virginia Baptist Homes, Inc.**, Civil Action No CL06000061-00, Botetourt County Circuit Court (June 6, 2007). Botetourt County challenged the exemption of property owned by Virginia Baptist Homes ("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 Circuit Court’s decision to link benevolence to the financial condition of the property is troubling. First, the Circuit Court ignored parts of the very definition of benevolence it cited. It is arguable that the mere operation of the continuing care facility is humane and has the purpose of doing good for others. How does the fact that the residents pay for their care change this fact? There is nothing in the opinion that suggests that the VBH ran the facility in the pursuit of a profit. Should VBH have offered a reduced cost and run a deficit at the facility? If the property is not exempt today, will the property be exempt once the subsidized care begins? What if VBH increased the costs of its care to its non-needy resident to allow the admittance of the more needy as a reduced cost? Such a plan could arguably dissuade non-needy patients from choosing this facility which could lead to the closing of the facility. VBH appealed this opinion to the Virginia Supreme Court and certiorari was granted. Arguments will be heard in the Fall of 2008 and a decision should be delivered by the conclusion of 2008.

2. **West Creek Associates, LLC, et al. v. County Of Goochland**, Record No. 071411, Supreme Court of Virginia (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.
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. Rollback Taxes and Rezoning. Op. Atty. Gen. Va. No. 04-045 (August 5, 2008). The Commissioner of the Revenue for Spotsylvania County requested an opinion on (1) whether a parcel must be removed from the land use taxation program and assessed roll-back taxes when the parcel is rezoned at the owner's request to industrial use, and the owner fails to report a change in the actual use to the commissioner of the revenue; (2) whether agricultural real property that was rezoned to a more intensive use, but which has been returned to use as a commercial farm for a period of three years, must be rezoned to a less intensive use before it is eligible for use taxation and assessment; and (3) whether real property with intensive zoning may qualify for land use taxation and assessment if its zoning has not changed, but is being commercially farmed or used as forest and has never received land use taxation.

The Attorney General opined that (1) real property must be removed from the land use program and roll-back taxes assessed when such property is rezoned to a more intensive use at the owner's request; (2) agricultural real property, which has been rezoned at the owner's request to a more intensive use, removed from the land use program, and assessed roll-back taxes subsequently must be rezoned to a less intensive use before it can be eligible to receive land use taxation again; and (3) real property with intensive zoning may qualify for land use assessment and taxation if the local assessing official determines that it is real estate devoted to agricultural, horticultural, forest, or open space use as set forth in § 58.1-3230.

V. PROCEDURAL

A. 2008 Legislation

Virginia did not pass any legislation in 2008 to address general procedural matters.

B. Recent Court Decisions

No recent court decisions.
C. Recent Virginia Tax Commissioner Rulings

1. Timely Filed Return. P.D. 08-52 (April 30, 2008). The Tax Department determined that the taxpayer filed the corporate return after expiration of a filing extension. An assessment was issued for the late filing penalty, the addition to tax for underpayment of estimated income tax penalty, and accrued interest. The taxpayer appealed the assessment and provided proof that the return was postmarked on the date the return was due. The Tax Commissioner abated the late filing penalty as well as the addition to tax for underpayment of estimated income tax penalty and accrued interest associated with the late filing penalty.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

VI. BUSINESS LICENSE TAXES

A. 2008 Legislation

Virginia did not pass any legislation in 2008 to address business license taxes.

B. Recent Court Decisions

1. English Construction Company, Inc. v. City of Lynchburg and W. C. English, Inc. v. City of Lynchburg (Va. Ctr. Ct., March 12, 2008)(Lynchburg City)(unpublished decision). The Circuit Court for the City of Lynchburg held 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 maintains 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 circuit court, after noting that English had the burden to show that Lynchburg's assessments are invalid, carried its burden. The trial court stated that Lynchburg had no express statutory authority to support the challenged assessments.
The circuit court principally relied on Virginia Code sections 58.1-3703.1(A)(3) and 58.1-3715 to reach its decision. Virginia Code section 58.1-3703.1(A)(3)(a) provides that:

The gross receipts for a contractor shall be attributed to a definite place of business at which his services are performed or if his services are not performed at any definite place of business, then the definite place of business from which his services are directed or controlled, unless the contractor is subject to the provisions of section 58.1-3715.

Section 58.1-3715 provides that although a contractor is obligated to procure a license in the jurisdiction where its principal offices are located, it may also be required to obtain a license in another jurisdiction if its business in that jurisdiction exceeds $25,000. In that situation, the other “county, city or town may require of such contractor a local license, and the amount of business done in such other county, city or town in which a license tax is paid may be deducted by the contractor from the gross revenue reported to the county, city or town in which the principal office or any branch office of the contractor is located.”

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.

C. Recent Virginia Tax Commissioner Rulings

1. **Nonprofit Organizations.** P.D. 08-12 (January 11, 2008). A taxpayer requested a ruling as to whether certain day-care centers qualify for the BPOL tax exemption permitted for gross receipts of certain charitable nonprofit organizations. The first scenario involves a church (Church A) affiliated in good standing with a national church organization that obtained an income tax exemption from the Internal Revenue Service (IRS). The exemption covers all the affiliated local churches in good standing with the national church. Church A operates a day-care center (DCA) at a facility located away from the main church building. Church A and DCA share the same bank account for depositing receipts and paying expenses. Some donations to Church A are used to fund DCA. Church A and DCA use the same federal employer identification number (FEIN) to file payroll returns. The equipment utilized by DCA is owned by Church A. In the other scenario, a church (Church B), which is a member of a national church organization granted an exemption from federal income tax, operates a day-care center (DCB) located at Church B’s facility. DCB has a separate checking account from Church B. Church B and DCB use separate FEINs for purposes of filing federal withholding taxes. In its application for its FEIN, DCB represented itself as a "church/church-controlled organization." DCB does not have an official document from the IRS to support its claim that it is exempt from federal income tax as a charitable and
or nonprofit organization. Church B does exercise oversight of DCB's operations and provides funding.

The Tax Commissioner determined that Church A, as long as it can satisfy the locality that DCA furthers the church's exempt purpose under IRC § 501(c)(3), should be exempt from BPOL taxation. The fact that Church A has a certification from the IRS through its national organization should be considered strong evidence that it meets the requirements of the BPOL tax exemption for charitable nonprofit organizations. In the second scenario involving DCB, a determination must be made as to the degree to which it is connected with and controlled by Church B and whether or not it is engaged in carrying out the functions of a church, including ministration of sacerdotal functions (furtherance of the church's exempt purpose or ministry) and conducting religious worship. What is included in the conduct of religious worship or the ministration of sacerdotal functions will depend on the tenets and practices of a particular church.

2. Telephone Company. P.D. 08-21 (February 29, 2008). The taxpayer is a limited liability company that provides wireless telephone service through an agreement with a separate entity that is authorized by the Federal Communications Commission (the "FCC") to provide commercial mobile telephone service to its customers. The taxpayer itself is not authorized by the FCC to provide such service to its customers, nor does it hold a certificate of convenience and necessity from the State Corporation Commission (the "SCC"). The taxpayer classified itself as engaged in two separate business activities for purposes of the BPOL tax: a business service providing wireless communications, and a retail sales business operating sales outlet stores. The City changed the taxpayer's self-classifications to the single classification of a public service, or telephone company. This reclassification by the City changed the rate of assessment applied to the taxpayer's gross receipts from $.36 per $100 (business service) and $.20 per $100 (retail sales) to 3% (public service company under the grandfather clause). The City assessed the taxpayer with additional BPOL taxes. The taxpayer appealed the City's determination. The City asserts it properly reclassified the taxpayer as a telephone company, that it had the statutory authority to apply a grandfathered tax rate of 3% to the gross receipts of telephone companies and that as a telephone company, the taxpayer could not segregate its retail sales activities from its primary purpose.

The Tax Commissioner ruled that the taxpayer is a telephone company as its affiliated entity is authorized by the FCC to provide telephone service and the taxpayer uses this license in its business. However, the grandfathered rate of 3% does not apply to the taxpayer. For the 3% rate to apply, the taxpayer must provide landline service, not wireless service. As such, the appropriate rate for the taxpayer is ½ of 1%.

3. Separate Businesses. P.D. 08-40 (April 17, 2008). The taxpayer is a certified interior designer and holds itself out as an interior design service in the telephone directory. In addition to an office located in the City, the taxpayer has a small showroom (roughly 400 square feet) for display of household furnishings and a supply of various catalogs from which customers can order furniture and other furnishings. The City contends that the taxpayer holds itself out as providing interior design services and
should be classified as a business service for purposes of the BPOL tax and assessed the taxpayer's gross receipts at the business services rate. The taxpayer disputes the City's classification, contending that it is engaged in two separate businesses: that of providing design consulting services, and the retail sales of furniture ordered by its clients for which the taxpayer collects and remits the state and local sales tax to the state.

The Tax Commissioner reviewed the evidence and determined that the taxpayer did not provide the City with sufficient information to prove the existence of the separate and substantial retail sales activities. The Tax Commissioner remanded this case back to the City with the instruction to reconsider the taxpayer's appeal.

4. Federal Instrumentality. P.D. 08-81 (June 6, 2008). The taxpayer administers the federal Medicare Part B program in Virginia under a contract with the United States Department of Health and Human Services (DHHS). The County classified the taxpayer as a business service for BPOL tax purposes, and assessed the taxpayer accordingly. The taxpayer protests the classification and assessment, claiming that it is an instrumentality of the federal government exempt from state and local taxation.

The Tax Commissioner examined federal statutes and case law and determined that the taxpayer is an instrumentality of the federal government. "As a contracted carrier for the federal Medicaid Part B program, the Taxpayer's primary function is to receive, disburse and account for federal funds used for making payments for services furnished by eligible Medicare providers. This function includes the responsibility of determining reasonable charges with respect to services rendered by eligible providers. The Taxpayer also serves as a channel of communication between DHHS and eligible providers. Contracted carriers are the sole instruments used to implement the Medicare Part B plan. As such, carriers like the Taxpayer are so "intimately connected" with the performance of the federal government's duty to implement the law that they cannot be subject to state or local taxation."

5. Nonprofit Organization. P.D. 08-82 (June 6, 2008). Two separate nonprofit entities, A and B, held SCC certificates as the statutorily mandated underground utility notification centers for the state. Each company was assigned a specific geographic area within the state and each contracted with independent vendors who conducted daily notification operations. Both were exempt from tax pursuant to Internal Revenue Code (IRC) §§ 501 (a) and 501(c)(6). In 2001, A and B decided to consolidate their operations and provide one notification center to serve the entire state. While waiting the SCC's approval of the merger and certification of the new notification center, A and B formed the taxpayer to manage the overall operations of the two certificated entities. A and B each had a 50% interest in the Taxpayer.

For federal income tax purposes, A and B continued to exist until 2004. The taxpayer was organized as a limited liability company (LLC) that elected to be treated as a pass-through entity for federal and state income tax purposes. The taxpayer provided utility protection services on behalf of A and B. A and B merged. On April 1, 2003, the
SCC issued a Certificate of Incorporation to the new corporation and gave its final approval to the merger of A and B, creating the corporation effective April 1, 2004. The SCC certificated the corporation as the sole notification center for underground utilities in Virginia. The taxpayer was dissolved at the same time, and the Corporation absorbed all of taxpayer's functions. The Corporation was been granted tax-exempt status under the provisions of IRC §§ 501 (a) and 501(c)(6).

Under audit, the City determined that the taxpayer was subject to BPOL licensure and issued tax assessments for 2002 through 2004. For BPOL tax purposes, the City recognized A and B as tax-exempt entities under the provisions of IRC § 501(c)(6) prior to 2002 and subsequently recognized the Corporation as a tax-exempt entity after it was certificated by the SCC in 2004. The taxpayer appealed the assessments to the City, arguing that the tax-exempt status enjoyed by the two single entities A and B, and later by the Corporation, should also apply to the taxpayer because of its relationship with the entities. The City denied the taxpayer's application, concluding that the taxpayer was formed to provide call center services to A and B. Both A and B had previously engaged separate vendors or independent contractors to provide the call center services. The City maintained that as an independent contractor, the taxpayer was performing the same service as the vendors and therefore was subject to the BPOL tax in license tax years 2002 through 2004. The Tax Commissioner determined that the taxpayer was created for the purpose of accomplishing the goals of nonprofits A and B and therefore should be treated as such by the City.

6. **Appealable Events and Situs of Gross Receipts.** P.D. 08-83 (June 6, 2008). The taxpayer is a publisher that provides information services to the construction and architectural industries. All corporate decisions, including the development of new enterprises, are made at the taxpayer's corporate headquarters in another state or one of its regional offices. The general subscription service that the taxpayer offers to all of its subscribers includes access to one of more than 100 facilities called "Plan Rooms" that are located throughout the country. Plan Rooms are equipped with a kiosk computer that provides subscription customers with access to their individual customer accounts. Using their own log-on identification, subscribers may access their accounts and use an application that provides information on other taxpayer services. Only subscribers are permitted use of the Plan Rooms. There is no provision in the standard contract providing for use of a Plan Room, and in fact, the taxpayer may, and has, closed Plan Rooms without notification to its customers.

The Plan Room in the County was staffed by a single employee whose primary purpose was to provide customer service. This employee did not engage in the sale of materials. All sales inquiries were referred to the taxpayer's corporate offices in another state. There was no publishing or information generation work conducted at the Plan Room. The Plan Room was available to subscribers on a continuous basis and, therefore, the taxpayer did have a definite place of business in the County. Under audit, the County requested information concerning gross receipts generated at the Plan Room located in the County. When the taxpayer did not provide the requested information, the County issued statutory assessments for the 2002 through 2006 tax years. The taxpayer contested
the assessments on the grounds that its activity in the County was ancillary to its actual business as a provider of marketing information services, all of which were generated outside the state of Virginia. In its response to the taxpayer’s appeal, the County asserted that neither the County nor the Tax Commissioner had jurisdiction to consider the taxpayer’s appeal.

The Tax Commissioner determined that a statutory assessment is an appealable event. Under Virginia Code section 58.1-3703.1(A)(5)(f), an appealable event includes "an assessment of a local license tax when no return has been filled by the taxpayer." The Tax Commissioner also determined that the actual information services provided by the taxpayer were performed in jurisdictions outside Virginia and directed or controlled from a place of business outside Virginia. For this reason, none of the gross receipts generated from these services were attributable to the taxpayer's office in the County. Finally, the Tax Commissioner determined that Plan Rooms are an ancillary service to the taxpayer’s customers, not a separate business. The service provided by taxpayer's Plan Room in the County was not included in its contract with its subscribers. Furthermore, the Plan Room would not exist independently of the principal business. Rather, the taxpayer offers a supplemental service via the plan rooms that make its general business more attractive to the consumer (subscriber). The actual provision of the information services and the sales services were directed and controlled from the taxpayer’s offices in State A.

7. Situs of Gross Receipts. P.D. 08-84 (June 6, 2008). The taxpayer is a provider of television cable service to residents of the City and nearby counties. Its local headquarters is in the County. The taxpayer's management personnel, customer service call center, principal sales office, marketing personnel, technical support personnel, and transmission and satellite equipment are all located at its facility in the County. The taxpayer also has an office in the City that provides customer service including accepting, initiating and processing orders for new services, cancellations, upgrades and downgrades; receiving payments on accounts; distributing or exchanging converter boxes, cables, and other equipment; and taking orders for repair services. Additionally, the studio at the office in the City provides public access to cable transmission for purposes of broadcasting local programming. Transmission equipment for local government access is also located at this office.

The taxpayer has a franchise agreement with the City, under which it pays an annual fee based on a percentage of its gross revenues from its business in the City. Additionally, the City imposes a BPOL tax on the taxpayer. The franchise agreement stipulates that the taxpayer keep complete and accurate books of account and records of its business in the City at the office located in the City. For BPOL tax purposes, the City assessed the taxpayer's business in the City as a business service. The taxpayer contested the assessments, contending that the functions of the office in the City are ancillary to the functions of the main operation of the headquarters office in the County. The taxpayer asked for a full refund of BPOL taxes it paid in tax year 2003, and asked that the assessments made in 2004 and 2005 be abated.
The Tax Commissioner determined that while the taxpayer's headquarters is in the County, the taxpayer also has a definite place of business in the City that provides direct services to customers. Therefore, the receipts attributed to services performed at the definite place of business in the City must be sourced to the City. The franchise agreement grants the taxpayer the "right and the authority to engage in the business of operating and providing cable services" in the City. In accordance with the agreement, the taxpayer installs, constructs, repairs, replaces, and maintains property necessary to operate the cable system in the City. To the extent that these services are performed at the office in the City, the Tax Commissioner ruled that gross receipts associated with these services would be sitused to the City and subject to BPOL tax.

8. Situs of Gross Receipts. P.D. 08-86 (June 6, 2008). The taxpayer, a multinational corporation, maintains offices throughout the world, including one in the County. The taxpayer provides a broad range of technical, professional, and construction services to industrial, commercial and governmental clients, drawing upon the particular expertise of employees situated at its various offices, depending upon the nature of the project. On each project, the taxpayer segregates gross receipts attributable to services performed by each office. The County audited the taxpayer for the tax years at issue and assessed additional BPOL tax. The taxpayer appealed the assessments to the County. In its final local determination, the County upheld the audit assessment, which was based on the sales factor from the taxpayer's Virginia corporate income tax returns, allowing for deductions for gross receipts attributed to other localities where the taxpayer had paid a business license tax. The County also determined that the taxpayer was not entitled to deductions for business conducted in other states because the services were performed in the County.

The Tax Commissioner noted that the Virginia income tax sales factor is an unreliable measure of gross receipts for purposes of the BPOL tax and ordered the County to recalculate the taxpayer's gross receipts. As for the deduction for business conducted in other states, the Tax Commissioner determined that the taxpayer properly computed its out-of-state deduction on its original returns. The County asserted that the out-of-state deduction is not available for services performed in the County on out-of-state projects because such services were actually performed at a definite place of business in the County. In the case of business services, the proper measure of the out-of-state deduction is based on gross receipts, or revenues derived from customers located in a state or country other than Virginia. Accordingly, in those instances in which a taxpayer has a definite place of business in Virginia and does business in other states where it is liable for income tax, and files a tax return in those states, a deduction is allowed for the receipts derived from customers located in those states. This deduction is allowed even if a taxpayer does not have a definite place of business in those states or services are directed or controlled in those states.

9. Determination of Gross Receipts. P.D. 08-124 (June 26, 2008). The taxpayer is a travel agency with three locations in the County. The taxpayer makes reservations through travel vendors on behalf of its clients. The taxpayer's clients make payments directly to the travel vendor for travel services. Upon receipt of a client's
payment, the travel vendor pays the taxpayer a commission. The County issued BPOL tax assessments to the taxpayer based on the financial information obtained from the taxpayer that included both the travel services and the commissions. The taxpayer appealed the assessment and presented internal operating statements to demonstrate the actual amount of commission revenue that it received. In its final determination, the County made adjustments to the audit assessment based on these documents, but determined that the information was insufficient to adjust the gross receipts for some travel carrier vendors (railroads, ferry companies, cruise companies, steamship lines, etc.) and other travel related services (hotels, motels, car rental, etc.). The taxpayer appealed the final local determination to the Tax Department.

The taxpayer argued that receipts (commissions) that are "grossed up" for purposes of presenting "gross sales" on its financial statements should have no bearing on its actual gross receipts that can be taxed for BPOL purposes. Instead, the taxpayer provided federal tax information and audited financial statements to document its gross receipts.

The Tax Commissioner determined that although federal tax information and audited financial statements can be helpful in determining gross receipts, they usually provide insufficient detail when a taxpayer has multiple locations or operates in multiple localities and states. The taxpayer also provided a number of other records and logs to support its claim. The Tax Commissioner noted that the County gave this information due consideration and made adjustments where warranted. When logs and ledgers are inconclusive, a taxpayer may have to provide invoice records, paid receipts, bank statements, deposit slips and other similar documentation in order to prove what it actually received. Since the taxpayer did not provide this documentation, the Tax Commissioner upheld the assessment.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.

VII. TANGIBLE PERSONAL PROPERTY AND MACHINERY AND TOOLS TAXES

A. 2008 Legislation

1. Tangible Personal Property Tax Classification. HB 625 (Chapter 26) and SB 192 (Chapter 94) extend the sunset date from June 30, 2009 to June 30, 2019 for a separate classification for personal property tax rate purposes, for personal property used in manufacturing, testing, or operating satellites within a Multicounty Transportation Improvement District.

2. Tangible Personal Property Tax; Separate Classification For Low-Speed Vehicles. SB 195 (Chapter 143) creates a separate classification for local taxation purposes for low-speed vehicles, which are defined as four-wheeled electrically powered
vehicles with a maximum speed greater than 20 miles per hour but not greater than 25 miles per hour that comply with federal safety standards. This legislation took effect on July 1, 2008.

B. Recent Court Decisions

1. Chesterfield County v. Palace Laundry, Inc. d/b/a/ Linens of the Week. Virginia Supreme Court, Record No. 071290 (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 not a processing business. LOW countersued seeking to overturn the Tax Commissioner's ruling with respect to the ruling that LOW was a processing 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


2. Machinery and Tools Tax: Jurisdiction, Packaging Equipment, Engineering-Related Costs, Vendor Support Costs, and Costs For Equipment Modification and Refurbishment. P.D. 08-30 (April 2, 2008). The taxpayer is a manufacturer of food products. The taxpayer filed an application for review and amended returns for its 2001 through 2004 assessments with the County's commissioner of the revenue in November 2004. In its final determination the County agreed to portions of the amended returns and refunded assessments on certain property, but declined to refund all the M&T tax requested by the taxpayer. The taxpayer appealed a number of adjustments the County made to its amended returns. Specifically, the taxpayer's appeal addressed the County's decision to assess certain packaging assets, engineering-related costs, vendor support costs and the costs for equipment modification and refurbishment.

The taxpayer filed its original appeal to the County for tax years 2001 and 2002. When the County received the taxpayer's initial amended return for the 2001 and 2002 tax years, it responded with requests for additional information, toured the plant, and examined the property at issue. The final local determination granted relief on some of the equipment changing the original assessments. The Tax Commissioner considered this to be a new assessment for purposes of Virginia Code section 58.1-3983.1. Therefore, the Tax Commissioner had jurisdiction to hear the appeal.

The Tax Commissioner found that the machinery used in the initial packaging of the food products was used in manufacturing. Machinery used to package the products for shipping was not used in manufacturing. As such, the machinery that packages products for shipping is not subject to the M&T tax.

Design and engineering were integral parts of the taxpayer's manufacturing activity, and that work was properly classified as manufacturing by the locality. Accordingly, the Tax Commissioner found that machinery and tools used in the engineering process are directly used in the manufacture of the food product, and are subject to local M&T taxation.

Vendor support costs consist primarily of vendor oversight when a new piece of machinery is installed. As installation costs have traditionally been regarded as part of the costs of business tangible personal property, or in this instance, part of machinery and
tools, the Tax Commissioner would not segregate these costs from the "original cost" used as the basis for calculating the M&T tax. However, assets associated with training, are not directly involved in the manufacture of the food products, and therefore should be intangible capital for purposes of the M&T tax. Finally, the Tax Commissioner stated that when machinery is refurbished, it is the Commissioner of Revenue's responsibility to determine the fair market value.

3. **Business Tangible Personal Property: Manufacturer.** P.D. 08-80 (June 6, 2008). The taxpayer processes chicken and poultry and manufactures soybean meal and oil and animal feed. Only the taxpayer's division that manufactures soybean meal and oil has situs in the City. The City classified the taxpayer as a wholesaler engaged in some manufacturing and assessed the taxpayer's tangible personal property as a wholesale merchant. The taxpayer contested the assessment, arguing that its activity in the City was substantial enough to warrant its classification as a manufacturer for local tax purposes.

The Virginia Supreme Court developed a test involving three essential elements to determine whether 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. See Solite Corp. v. County of King George, 220 Va. 661; County of Chesterfield v. BBC Brown Boveri, 238 Va. 64 (1989).

For local tax purposes, a manufacturer is 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. It does not matter whether the transformation is a step in getting the product ready for market or it is a complete process. What matters for purposes of local taxation is whether the transformation of the material takes place in the locality. In this case, the Tax Commissioner determined that the transformation of soybeans into oils and feed does take place at the taxpayer's facilities in the City. As these activities constitute manufacturing, the taxpayer is not subject to the tangible personal property tax and the machinery and tools used in these activities are subject to the City's M&T tax.

4. **Machinery & Tools Tax: Classification as Machinery and Tools.** P.D. 08-85 (June 6, 2008). The taxpayer is a manufacturer of pressure-sensitive carton sealing tape and pallet stretch wrap. In its original appeal to the County, the taxpayer asserted that it had erroneously over-reported certain assets by including start up costs, scrap metal inventory, repair costs, and computer hardware and software. The taxpayer filed an amended return that included adjustments for all of these costs and reflected a refund due to the taxpayer. The County found that the computer and software assets were used directly in the manufacturing process and, therefore, were subject to the M&T tax. Upon reconciling the taxpayer's federal tax returns with its M&T returns, the auditor found that the "value originally reported is consistent with the amounts shown on the federal depreciation schedule to Form 1120, which is the proper basis for assessment." The County issued an assessment that did not reflect the taxpayer's adjustments for
inventory associated with start-up costs, cost of repairs or the computer equipment. The taxpayer appealed the final local determination.

**Start Up Costs**

The taxpayer contended that certain costs, such as taxes, associated with the installation and start-up of various manufacturing lines were applied to the original cost of such lines and asked that these be excluded from the original cost used as the basis for the M&T tax assessment. The Tax Commissioner disagreed and did not grant the adjustment as the original capitalized cost of business tangible property generally refers to the cost of property, including all costs associated with putting the property in use.

**Scrap Metal Inventory**

The taxpayer stated that it incorrectly included the capitalized cost of scrap manufacturing inventory used in test runs of the machinery in its reporting of original capitalized costs. The taxpayer stated that these materials were "improperly reported as capital asset additions on the tangible personal property reports." The taxpayer listed these materials as assets and they were included as machinery on the taxpayer's federal Form 1120. The County stated that because these items were included on the taxpayer's federal tax returns as capitalized costs, and there was no documentation showing these materials were inventory, it had to rely on the taxpayer's reporting on its federal income tax return.

The Tax Commissioner determined that the County properly included these costs in the value of the machinery for purposes of determining M&T tax. Capitalized cost of machinery includes all costs associated with putting the property in use. In this case, the test runs were necessary to get the machinery in proper working condition for producing marketable products. The raw materials inventory used in the test runs did not become part of the finished products inventory. Rather, the materials were discarded after testing was complete. The costs associated with these test runs, including raw materials inventory, were properly included in the basis of the machinery asset's capitalized cost.

**Repair Costs**

The repair costs at issue were costs that the taxpayer added to the value of its machinery. Therefore, the Tax Commissioner presumed that these costs were considered to be major repairs and modifications and properly included in the basis for determining the M&T tax. The Tax Commissioner noted that the evidence provided did not clearly indicate when the repairs occurred, or whether they increased the value of the machinery. As the burden to show that these costs should not be included in the taxable basis rests with the taxpayer, it was incumbent upon the taxpayer to prove to the satisfaction of the local commissioner of the revenue that the repairs should not be included.
Computer Hardware And Software

Upon audit, it was found that the computer hardware and software assets were directly used in the manufacturing process, and therefore were properly classified as machinery and tools. The Tax Commissioner determined that the evidence furnished by the taxpayer was not sufficient to prove this classification is erroneous.

5. Machinery & Tools Tax: Classification as Machinery and Tools. P.D. 08-88 (June 16, 2008). In 1999 the taxpayer acquired a manufacturing facility in the City. The taxpayer filed amended M&T tax returns with the City for tax years 2001 and 2002. According to the taxpayer, some of the machinery and tools originally reported for taxation had been decommissioned or had never been installed. The taxpayer's amended returns also removed assets that should have been considered intangible and not subject to local taxation. In its final determination, the City agreed to portions of the amended returns and refunded the associated tax but declined to refund the entire amount reflected on the amended returns. The taxpayer appealed a number of adjustments the City made to its amended returns.

As the taxpayer is a manufacturer, the Tax Commissioner found that the taxpayer's pollution control equipment was not used directly in the manufacturing process. Therefore, the equipment was found to be intangible in accordance with Va. Code § 58.1-1101 and subject to state taxation only.

A storage racking system was used to (1) hold raw materials to be used in the manufacturing process, and (2) store finished products ready for shipping. While both goods are kept in separate bins and never commingled, they nonetheless are stored in the same racking system. The taxpayer argued that a certain percentage of the racking system should be exempt from the M&T tax because it is used for finished goods storage. In a prior ruling, the Tax Commissioner determined that if a substantial portion of the machinery's use was devoted to the manufacturing process, it was subject to the M&T tax. Based on the information provided, the Tax Commissioner determined that the storage racking system was properly classified by the City as machinery and tools for purposes of the M&T tax.

The taxpayer had two vacuums bag sealers on line that were used to bundle and seal the manufactured products for shipment. One sealer was found to be exempt from the M&T tax by the City and the other was not. As a part of the shipping process, both sealers are considered as intangible property of manufacturers and therefore, exempt from the M&T tax.

Autopackers were originally reported on the taxpayer's tangible personal property tax returns. The taxpayer provided the City and the Department with an affidavit concerning the location of the autopackers in dispute. The affidavit states that six autopackers were never operational, and that several of the autopackers, having been transferred from other plants were actually stored at an offsite location. The City did not regard the affidavit as sufficient evidence to demonstrate that the autopackers were never
used in the taxpayer's facility in the City. However, the Tax Commissioner believed the affidavit represents a good faith effort on the part of the taxpayer to confirm its contention that this machinery, having never been installed, should in fact not be included in the taxpayer's M&T tax assessment.

The amended returns identified four molds used in the manufacturing process that were replaced between 1994 and 2000. These molds, which remained at the facility, and the replacement molds were included on the original M&T tax returns filed by the former owner of the facility. The City denied the taxpayer's request for refund of taxes paid on these molds, maintaining the preparer of the M&T tax returns should have readily recognized these items as non-operating or idle equipment. The Tax Commissioner noted that the City determined that equipment on two manufacturing lines became idle in 2000 and 2001 based on the taxpayer's operations log. Using established policy, the City refunded tax paid for 2002 on the equipment that became idle in 2000. Based on the information, the Tax Commissioner determined that the molds at issue would have been considered idle either during 2001 or 2002 and should not be subject to the M&T tax.

With regard to some of the equipment that was either idle or never installed, the City denied the taxpayer's request for refunds. The City asserted that the personnel in charge of preparing the returns would have easily identified the items at issue. As such, the City determined that it could not exonerate the return preparer of the responsibility to file accurate returns. Virginia Code sections 58.1-3980 and 58.1-3983.1 permit taxpayers to appeal assessments of local business taxes made by local taxing authorities. These sections put no limits on the reasons or rationale for making a request for refund. The Tax Commissioner determined that no evidence was provided that would indicate the taxpayer or its predecessor willfully over reported the amount of property on M&T tax returns. The Tax Commissioner also noted that the City granted relief on some items but not others and found no basis in the City's position denying the refunds on the basis that the return preparer should have known at the time the original returns were filed which equipment was idle or never installed.

VIII. MISCELLANEOUS TAXES

A. 2008 Legislation

1. Arlington County Transient Occupancy Tax. HB 787 (Chapter 30) and SB 462 (Chapter 153) extend the sunset date from January 1, 2009 to January 1, 2012 for Arlington County’s additional transient occupancy tax of one-fourth of one percent.

2. Transient Occupancy Tax: Designation of Revenue. HB 1453 (Chapter 230) allows all 34 counties listed in the statute to impose up to a 5% transient occupancy tax with any excess over 2% to be designated and spent solely for tourism and travel, marketing of tourism, or initiatives that, as determined after consulting the local tourism industry organizations, attract travelers to the locality. Under current law, 15 of the counties were not required to consult with local tourism industry organizations. This legislation took effect on July 1, 2008.
3. **Transient Occupancy Tax: Historic Triangle Area.** SB 770 (Chapter 839) makes changes to the Williamsburg Area Destination Marketing Committee which is responsible for administering the local transient occupancy tax for the Historic Triangle area. The legislation also provides for the Greater Williamsburg Chamber and Tourism Alliance to serve as the fiscal agent for the Committee. This legislation took effect on July 1, 2008.

4. **Delinquent Local Taxes; Lists by Treasurer.** HB 869 (Chapter 550) adds uncollected balances of personal property taxes on certain vehicles to the list of delinquent taxes maintained by the Treasurer that must be furnished to the local governing body on request, and for which the Treasurer shall be given credit for the amount of such taxes. This legislation took effect on July 1, 2008.

5. **Additional Withholding Exemptions Repealed.** HB 1261 (Chapter 228) repeals provisions that have never been implemented allowing additional withholding exemptions.

**B. Recent Court Decisions**

1. **Virginia Cellular LLC v. Virginia Department of Taxation.** Record No. 071895, Supreme Court of Virginia (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. **Communications Sales and Use Tax.** P.D. 08-2 (January 7, 2008).

The taxpayer is a telecommunications reseller and utilizes certain landline services and facilities supplied by a third party to transmit calls placed by foreign offshore call centers to residents of Virginia and nationwide. The taxpayer also, through the resale of landline services and facilities, transmits calls that originate in Virginia and nationwide to foreign offshore call centers. In both scenarios, the taxpayer’s customer is the foreign offshore call center and not the individual placing or accepting the phone call. The third party bills the taxpayer for the use of its landline services and facilities and charges tax and surcharges on Virginia calls. The taxpayer neither has a physical presence in Virginia nor does it have any customers within Virginia. The taxpayer requested a ruling as to whether the service transactions detailed above are taxable.
The Tax Commissioner opined that the taxpayer does not have corporate income tax nexus nor is it a dealer for retail sales and use tax purposes. As the taxpayer is a telecommunications reseller, its sales are exempt from the communications sales and use tax. The Tax Commissioner opined that the taxpayer must provide an exemption certificate to the third party to utilize the resale exemption.

2. **Unconstitutional Transportation Authority.** P.D. 08-15 (February 27, 2008). The Tax Commissioner issued Tax Bulletin 08-2 to inform taxpayers of the Virginia Supreme Court’s decision that the provisions of House Bill 3202 (Acts of Assembly 2007, Chapter 896) allowing the Northern Virginia Transportation Authority and the Hampton Roads Transportation Authority to impose the Motor Vehicle Repair Labor and Services Sales and Use Tax (“Repair Tax”) and the Hampton Roads Transportation Authority to impose the Motor Vehicle Fuel Sales Tax were unconstitutional. Accordingly, the Motor Vehicle Fuel Sales Tax in the Hampton Roads Transportation Authority and the Repair Tax in both Authorities are null and void. The Motor Vehicle Fuel Sales Tax imposed in the Northern Virginia Transportation District and in the member localities of the Potomac and Rappahannock Transportation Commission is not affected by this ruling as this tax was not imposed by the respective authorities.

3. **Unconstitutional Motor Vehicle Repair Labor Tax.** P.D. 08-20 (February 29, 2008) and P.D. 08-24 (March 13, 2008). The Tax Commissioner issued Tax Bulletins 08-3 and 08-4 to instruct motor vehicle repair dealers to stop collecting the Motor Vehicle Repair Labor and Services Sales and Use Tax in Northern Virginia and Hampton Roads.

4. **Motor Vehicle Repair Labor Tax.** P.D. 08-27 (March 25, 2008). The Tax Commissioner directed all dealers who collected sales tax in Northern Virginia on motor vehicle repair labor to remit all tax collected to the Tax Department by May 6, 2008. A refund process will be implemented.

5. **Communications Sales and Use Tax: Content Services.** P.D. 08-64 (May 19, 2008). The taxpayer provided traditional long distance telecommunication services to its customers. The services are sold on a per minute basis and may be paid for on either a prepaid or post-paid basis. The taxpayer also plans to offer its customers access to audio-visual content ("content services") via cellular telephones. The content services include news, songs, ring-tones, sports live video, sports scores, astrology, stock information, recipes, travelogue, short stories, exam results, reality shows, and humorous content. The customer will dial a toll free number and enter an authentication code to access the content services. The customer will be charged on a per minute basis for listening to or viewing the content services. There will also be an additional fixed charge to download the content services for future use and reuse. The content services may be paid for on either a prepaid or post paid basis. The taxpayer requested a ruling regarding the application of the Communications Sales and Use Tax to these transactions.
The Tax Commissioner determined that if the content services offered by the taxpayer that are downloaded by the consumer for future use and reuse constitute digital property delivered electronically, they would not be subject to the Communications Sales and Use Tax. Digital products delivered electronically, such as software, downloaded music, ring tones and reading materials are specifically excluded from the Communications Sales and Use Tax under Virginia Code section 58.1-648(C). Digital products delivered electronically do not include any products that require continued payments from the purchaser or products that are sold without the right of permanent use granted by the seller.

6. **Recordation Tax: Refinancing.** P.D. 08-122 (June 26, 2008). The taxpayer refinanced a deed of trust and paid recordation tax on the refinancing. The deed of trust was subsequently assigned to the Lender. The taxpayer again refinanced the deed of trust with the Lender. The title company that closed the second loan required that recordation tax be paid for recording the entire refinanced deed of trust. The taxpayer argued that the refinancing should be exempt from the recordation tax on the amount of the original debt because she is refinancing through the Lender to whom she is making mortgage payments. The loan closer contends that the refinancing was not with the original lender or assignee because no assignment was recorded with the County. The Tax Commissioner agreed with the taxpayer as all the exemption requires is the refinancing occur with the mortgage company that holds the deed of trust.

7. **Withholding Tax: Successor Liability.** P.D. 08-141 (July 30, 2008). The taxpayer was assessed with withholding tax on its failure to withhold income tax from employees. The owners of the taxpayer appealed the assessment arguing that the failure occurred prior to its purchase of the business. The Tax Commissioner denied the appeal stating that the taxpayer is responsible for the liabilities of the business.

8. **Cigarette Tax: Classification as a Manufacturer of Cigarettes.** P.D. 08-146 (July 30, 2008). The taxpayer, a New Jersey corporation, sold unstamped cigarettes within Virginia. The taxpayer does not manufacture cigarettes directly and is not a successor of another entity that qualified as a tobacco product manufacturer. The Tax Department notified the taxpayer that this sale of unstamped cigarettes was a violation of Virginia law and that the taxpayer must affix Virginia Cigarette Tax Stamps to any packs of cigarettes being shipped to customers within Virginia. The Taxpayer argued that it should be treated as a manufacturer under Va. Code § 58.1-1012(B), instead of as a wholesale dealer under Va. Code § 58.1-1012(A), and therefore allowed to ship unstamped cigarettes into the Commonwealth. The taxpayer can be a manufacturer for the purposes of Va. Code § 58.1-1012(B) if it is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States. The taxpayer did not provide any evidence of this fact but was allowed to submit documentation in an effort to meet this statutory classification.
9. Pass-Through Entity Withholding Tax. P.D. 08-147 (July 30, 2008). The taxpayer requested a ruling on whether a pass-through entity with two members, both of which are C corporations, must pay the new withholding tax regarding these corporate members. The members have historically remitted quarterly estimated payments to Virginia and filed corporate income tax returns with Virginia. The Tax Commissioner ruled that if the C corporation members do not have their commercial domiciles in Virginia, the pass-through entity will be responsible for paying the withholding tax if the pass-through entity has taxable income for the taxable year that is derived from or connected with Virginia sources and at least some of that income is allocated to the C corporation members.

10. Minimum Tax on Telecommunications Companies: Internet Tax Freedom Act. P.D. 08-166 (August 29, 2008). A taxpayer requested a ruling on how the Internet Tax Freedom Act Amendments Act of 2007 affects the Commonwealth of Virginia’s state taxes on telecommunications services purchased by Internet Service Providers. The Tax Commissioner opined consistent with previous rulings which stated, “[R]evenue generated from providing Internet service would be included in the gross receipts of a company meeting the definition of a telecommunications company in Code of Virginia Sec. 58.1-400.1. The definition of gross receipts includes "all revenue." There is no special provision in the Code of Virginia or any of the corresponding regulations which would serve to exclude the revenue for providing Internet service.” The Tax Commissioner also noted that this issue is currently the subject of litigation before the State Corporation Commission.

D. Opinions of the Attorney General

No recent opinions of the Attorney General have been released.