2013

Recent Developments in Virginia Taxation

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RECENT DEVELOPMENTS IN VIRGINIA TAXATION[1]

A Discussion of Tax Legislation, Recent Court Decisions, Tax Department Rulings, and Opinions of the Attorney General from October 1, 2012 Through October 1, 2013

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A discussion of Virginia tax legislation, court decisions, Tax Commissioner rulings, and Attorney General opinions from October 1, 2012 through October 1, 2013.

I. CORPORATE INCOME TAX

A. 2013 Legislation

1. Port Volume Increase Tax Credit. House Bill 1824 (Chapter 774) allows agricultural entities, manufacturing-related entities, and mineral and gas entities to claim the Port Volume Increase Tax Credit. Under current law, the credit may be claimed only by taxpayers engaged in the manufacturing of goods or the distribution of manufactured goods. This legislation is effective for taxable years beginning on or after January 1, 2013.

2. Worker Retraining Tax Credit. House Bill 1923 (Chapter 294) increases the Worker Retraining Tax Credit for eligible worker retraining courses taken by qualified employees at private schools from a maximum of $100 per year per qualified employee to $200 per year per qualified employee, or $300 per year per qualified employee if the worker retraining includes retraining in a STEM or STEAM discipline including, but not limited to industry-recognized credentials, certificates, and certifications. This legislation also adds a sunset date to the Worker Retraining Tax Credit, which would allow taxpayers to claim the tax credit for taxable years beginning on and after January 1, 1999, but prior to January 1, 2018. This legislation is effective for taxable years beginning on or after January 1, 2013.

3. Tax Credit for Participating Landlords. House Bill 2059 (Chapter 23) and Senate Bill 932 (Chapter 374) reduce from $450,000 to $250,000 the amount of income tax credits that may be issued each fiscal year by the Department of Housing and Community Development to landlords participating in housing choice voucher programs. This legislation is effective on July 1, 2013.

4. Federal Conformity. House Bill 2150 (Chapter 4) and Senate Bill 1241 (Chapter 693) advance Virginia's date of conformity to the Internal Revenue Code from December 31, 2011 to January 2, 2013. This legislation conforms Virginia's tax code to a 2010 federal law that temporarily increased the federal earned income tax credit (EITC) for Taxable Year 2012 and the American Taxpayer Relief Act of 2012. Congress enacted the American Taxpayer Relief Act of 2012 which extended several federal tax provisions that were scheduled to expire. This act extended the enhanced EITC to taxable years ending before Taxable Year 2018. This act also extended certain federal income tax rates, tax credits, AMT provisions, estate tax provisions, provisions of the federal research and experimentation tax credit, and certain itemized and above-the-line deductions for individuals. This legislation is effective on February 15, 2013.

5. Obsolete Tax Credits. Senate Bill 1296 (Chapter 657) deems tax credits that have not been claimed by any taxpayer during the five preceding calendar years obsolete and precludes the Tax Department from authorizing taxpayers to claim such tax credits except as

expressly authorized by the General Assembly. The lawful carryover or transfer of a tax credit previously authorized by the Tax Department is not affected. According to the Tax Department's fiscal impact statement, the Day-Care Facility Investment Credit and the Tax Credit for Certain Employers Hiring Recipients of Temporary Assistance to Needy Families were not claimed during Fiscal Years 2010 through 2012. Also, the Green Job Creation Tax Credit, which became available in Taxable Year 2010, was not claimed in Fiscal Years 2011 or 2012. This legislation is effective on July 1, 2013.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Nexus. P.D. 12-168 (October 23, 2012). Corporation A is a manufacturer jointly owned, 80% by a related entity (Corporation B) and 20% by a common parent corporation. Both Corporation B and the common parent are headquartered outside Virginia. Corporation A's sole facility is located in Virginia. Corporation A sells its finished products exclusively to Corporation B for distribution throughout the United States. Corporation B takes title to the goods at the end of the manufacturing process in Virginia. The finished goods remain at Corporation A's manufacturing facility for three to seven days until they are shipped by common carrier to Corporation B's customers located outside of Virginia. Corporation B does not have any facilities or employees in Virginia. All orders for finished goods are received at Corporation B's headquarters. Corporation B does not pay rent or a storage fee for the temporary storage of its inventory pending transport. At the time the title is transferred, both Corporation A and Corporation B know the customer's name and the destination of the shipments. The cost of labor for preparing the products for shipping is borne by Corporation A. Corporation B bears the cost of shipping. A ruling was requested as to whether Corporation B has nexus for Virginia corporate income tax purposes. The Tax Commissioner determined that Corporation B has nexus in Virginia as it has finished goods that are present in Virginia. **Planning opportunity:** Corporation B can avoid Virginia income tax by not taking title to the finished goods.

2. P.L. 86-272. P.D. 12-192 (November 29, 2012). The taxpayer, a partnership located in another state, is a developer and manufacturer of prescription drugs. Both of the taxpayer's general partner and limited partner are related corporations. The taxpayer markets its products in Virginia through sales personnel, product approval representatives, and medical science liaisons located both within and without the Commonwealth. The taxpayer also has contracts with an unrelated third party located in Virginia that conducts clinical trials on drug products in Virginia. The taxpayer requested a ruling as to whether it has nexus for Virginia income tax purposes.

The Tax Commissioner opined that the taxpayer likely has nexus due to the medical science liaisons. Federal law (Public Law (P.L.) 86-272) controls this determination. The taxpayer's salespersons solicit sales directly to hospitals, home care pharmacies, wholesalers, standard pharmacies, and chain drug stores. They also promote or detail products indirectly with doctors through presentations, literature, and samples. Product approval representatives work with state agencies and insurance companies in order to get the taxpayer's products approved for coverage under both private and public healthcare plans (*i.e.*, Medicaid and Medicare). Before promoting a product to physicians and the general public, the taxpayer seeks approval for inclusion of its pharmaceutical products by states and insurance companies. As for the contract with the third party, the question as to whether the taxpayer is subject to Virginia tax on its income rests on whether or not the research organization located in Virginia is an independent contractor. The Tax Commissioner stated that the taxpayer will have to evaluate its relationship with the research organization in order to determine if it meets the definition of an independent contractor under P.L. 86-272.

The job description provided for the medical science liaison, however, includes a number of duties that are not clearly defined as to how they are ancillary to solicitation. Developing professional relationships with current leaders in academic and clinical medicine, practitioners and healthcare decision makers could be an ancillary activity. However, the Tax Commissioner noted that it could also serve several other business functions. Other activities that the Tax Department could not clearly limit to solicitation activities include communicating with investigators and institutions, maintaining relationships with patient advocacy groups and developing medical and scientific advocates. In addition, the Tax Department identified several activities that it would not consider to be activities ancillary to solicitation. The medical science liaisons are the primary science contact for the taxpayer. While this function could benefit solicitation, it would appear to include activities that would occur during the product manufacturing and testing, as well as, providing expertise in post-sale situations. Furthermore, the Tax Department considers tracking relevant state and federal compliance guidelines and regulations to exceed the protection afforded under P.L. 86-272.

3. <u>Filing Status</u>. P.D. 12-194 (November 30, 2012). Prior to 2005, the taxpayer's subsidiaries that were subject to Virginia income tax filed separate corporate income tax returns. The taxpayer began operating in Virginia during 2005 and filed a combined Virginia corporate income tax return with its affiliates for the taxable year ended December 31, 2005. The Tax Department processed the return and transferred payments made separately by the affiliated entities and changed their filing status. The Tax Department audited the taxpayer and its subsidiaries for the taxable years at issue. One of the adjustments made was to separate the affiliated entities, resulting in assessments against six of the taxpayer's Virginia affiliates. The auditor concluded that the taxpayer had not been granted permission to change its filing status. The taxpayer appealed the audit adjustments contending the Tax Department accepted the 2005 combined return and the taxpayer had requested permission to change its filing status. The Tax Commissioner upheld the assessment as the taxpayer requested permission after the 2005 return was filed. Requests to change filing status must be made prior to filing a return. As the request was made prior to the taxpayer’s 2006 return, the Tax Commissioner granted permission for returns for taxable years 2006 and thereafter.

4. <u>Filing Status</u>. P.D. 12-200 (December 6, 2012). Taxpayer A, headquartered in State A, owns a number of subsidiaries. Two of taxpayer A's subsidiaries (Group A) operated in Virginia. One subsidiary ran an operating facility in Virginia and another subsidiary had an administrative office in Virginia. The members of Group A filed separate Virginia income tax returns. taxpayer B, headquartered in State B, also owns a number of subsidiaries. Ten facilities were operated by taxpayer B's subsidiaries in Virginia. These subsidiaries (Group B) filed a Virginia consolidated income tax return. In November 2010,

taxpayer A acquired taxpayer B and became the parent corporation of the new family of corporations. Immediately prior to the merger, taxpayer B held a less than 40% of the value of the combined corporate assets and netted slightly more than 35% of total revenue of both groups. taxpayer A requested a ruling that the merger meets the standard for eligibility to make a corporate filing status election pursuant to the Tax Department's policy with regard to the merger of equal corporations. In the alternative, taxpayer A requests that it be permitted to change its filing status election from separate to consolidated because of the extraordinary circumstances of this merger. The Tax Commissioner determined that the taxpayer A was not permitted to file a return on a consolidated basis and denied the taxpayer's request to change. The Tax Commissioner did grant permission to file on a combined basis.

5. Barge and Rail Usage Tax Credit Guidelines. P.D. 12-204 (December 7, 2012). The Tax Commissioner issued updated guidelines for the Barge and Rail Usage Tax Credit.

6. International Trade Facility Tax Credit Guidelines. P.D. 12-205 (December 7, 2012). The Tax Commissioner issued updated guidelines for the International Trade Facility Tax Credit.

7. P.L. 86-272. P.D. 12-218 (December 21, 2012). The taxpayer is an out-of-state S corporation that generates Virginia taxable income. It files a unified nonresident return on behalf of its numerous nonresident shareholders. On its 2010 return, the taxpayer subtracted a gain resulting from the distribution of stock of Corporation A to its shareholders. During processing, the Tax Department disallowed the subtraction and reduced the amount of refund claimed by the taxpayer. The taxpayer filed an appeal, contending it did not have a unitary relationship with Corporation A, and its ownership in Corporation A stock was not operational in nature. The taxpayer requested a refund of Virginia income tax paid for the taxable year ended December 31, 2010. The Tax Commissioner denied the refund. The taxpayer was a holding company that held investments in a number of operating entities. Its primary function is to hold and manage these companies in order to provide a return for its shareholders. While they normally own a controlling interest in the entities in which they invest, holding companies are also used to facilitate entity reorganizations and investment transfers. As such, the Tax Department considered the sale of, or distribution of stock to its shareholders to be an activity conducted within the normal operations of a holding company, even if such transactions rarely occur. Thus, the Tax Department determined that it was allowed to tax the income under P.L. 86-272 and U.S. Supreme Court cases. Accordingly, the Tax Commissioner denied the taxpayer's request for a refund.

8. Single Sales Factor Election for Manufacturers Guidelines. P.D. 13-6 (January 7, 2013). The Tax Commissioner issued guidelines for the single sales factor election for manufacturers.

9. Updated Date of Federal Conformity. P.D. 13-19 (February 15, 2013). The Tax Department issued Tax Bulletin 13-3 upon the passage of House Bill 2150 which amended Virginia date of conformity to the terminology of the Internal Revenue Code as of January 2, 2013.

10. Change in Filing Status. P.D. 13-48 (April 5, 2013). Through a series of transactions, A merged with B in January 2010. The shareholders of A and B each received 50% of the stock of the taxpayer. B, based in another state held a marginally higher value of the combined corporate assets prior to the merger, and held a slight edge in total revenue. An officer of A, based in Virginia, was designated as the chairman of the board and chief executive officer of the taxpayer. The taxpayer moved its headquarters to State B. Prior to the merger, A filed a combined Virginia income tax return. Only one of B's subsidiaries (B Sub) was subject to Virginia income tax prior to the transaction. The taxpayer requested a ruling that the merger meets the merger of equals standard for eligibility to make a corporate filing status election. The Tax Commissioner denied the request. The Tax Department will generally not grant permission to change to a consolidated filing status absent extraordinary circumstances. Based on the facts presented, the Tax Commissioner found no extraordinary circumstances exist to warrant granting permission to change to filing on a consolidated basis.

11. Foreign Source Income Subtraction. P.D. 13-121 (July 1, 2013). The taxpayer discovered it had failed to claim a subtraction for foreign source income on its corporate income tax return for the 2008 taxable year. Instead of filing an amended return to claim the subtraction, the taxpayer filed a protective claim for refund pursuant to Va. Code § 58.1-1824. For corporate income tax purposes, Va. Code § 58.1-402(C)(8) provides a subtraction to the extent included in federal taxable income for certain foreign source income. The taxpayer's Form 1118 reports the vast majority of its foreign income resulted from the performance of services. Such income is not generally considered to qualify for Virginia's subtraction unless the services can be classified as "technical fees." The taxpayer did not provide an explanation to the Tax Department of the nature of its income. The Tax Commissioner denied the taxpayer's protective claim for refund as the claim does not include all relevant facts and does not specify the amount of the remedy sought.

12. Research and Development Expenses Tax Credit Fixed Base Percentage. P.D. 13-124 (July 2, 2013). A Company has been in business since 2010 and has been in business in Virginia since 2011. The Company submitted Form RDC, Application for Research and Development Expenses Tax Credit, for Taxable Year 2012. When computing the credit amount, the company calculated its fixed base percentage using its Virginia qualified research and development expenses and total gross receipts for Taxable Years 2010 and 2011, the two prior taxable years when the Company was in business. The Tax Department adjusted the amount of the Company's Research and Development Expenses Tax Credit for Taxable Year 2012 based on the fact that the Company was only in business in Virginia during Taxable Year 2011. The recomputed fixed base percentage used the Company's Virginia qualified research and development expenses and total gross receipts for Taxable Year 2011 only, since this was the only taxable year when the taxpayer was in business in Virginia. The Company appealed and requested clarification regarding the calculation of a company's fixed base percentage for purposes of the Virginia Research and Development Expenses Tax Credit. The Tax Commissioner reversed the adjustment as there is no requirement that the fixed base percentage be applied using only the taxpayer's Virginia qualified research and development expenses and total gross receipts for taxable years in which the taxpayer was in business in Virginia.

13. Distortion of Income Adjustment and Intangible Add-Back. P.D. 13-140 (July 19, 2013). The taxpayer was audited for the 2005 and 2007-2009 taxable years and a

number of adjustments were made. An adjustment was made to disallow deductions for "franchise fees" paid to the Parent for all of the taxable years included in the audit. In addition, the Tax Department limited the amount claimed as an exception to the add-back for intangible expenses by reducing the taxpayer's intercompany royalty expense to correspond to the amount of the Parent's income from intangibles apportioned to the states in which the Parent paid tax and increased the corresponding net add-back of intangible expense. The taxpayer filed an appeal contending the franchise fees for management services provided by the Parent did not distort the taxpayer's Virginia taxable income. The taxpayer also appealed the disallowance of the exception to the add-back asserting that the add-back is permitted by the plain language of the statute and the Parent had a valid business purpose. The Tax Commissioner determined that the franchise fees did not distort the taxpayer's income as the Parent and the intercompany transactions had economic substance. Therefore, the Tax Commissioner analyzed whether the services were provided at fair market value. The taxpayer provided several independent transfer pricing studies. The Tax Commissioner's review of these studies demonstrated that the rates charged for the services performed by the Parent were reasonable when compared with arm's length transactions between unrelated third parties. For this reason, the Tax Commissioner adjusted this portion of the assessment. The Tax Commissioner did not adjust the portion of the assessment related to the intangible expense add-back. The taxpayer argued that 100% of the royalty income was eligible for the "subject to tax" exception. The Tax Commissioner stated that only the "portion" that is taxed in other states after apportionment is eligible for the exception. Also, the taxpayer did not follow the procedures for claiming the valid business purpose exception.

14. Corporation Formed by Exempt Indian Tribe. P.D. 13-151 (August 6, 2013). A federally recognized Indian tribe is generally exempt from federal income taxation. The Tribe formed the taxpayer, a corporation, under its own laws, which it is able to do as a sovereign state. The taxpayer, based in State A, is doing business in Virginia. The taxpayer requested a ruling to confirm that it is not subject to Virginia income tax or required to file a Virginia income tax return. The Tax Commissioner declined to opine in that manner. It was unclear to the Tax Commissioner whether the taxpayer is subject to federal income tax. Therefore, the Tax Commissioner could not issue a ruling advising the taxpayer that it is not subject to Virginia income tax. Accordingly, the taxpayer is considered to be a corporation subject to Virginia income tax and must file returns.

15. Intangible Add-Back. P.D. 13-156 (August 6, 2013). The taxpayer paid factoring fees to IHCB and IHCC. The taxpayer filed Schedule 500AB with its 2006 through 2008 Virginia corporate income tax returns and claimed an exception for 100% of the factoring fees deducted on its federal income tax returns on the grounds that the sale of the receivables to IHC was subject to tax in another state. The taxpayer received an assessment for the "portion" of the fees that were apportioned out of the other state's income tax. The taxpayer appealed contending that the exception allows an exception for 100%. The Tax Commissioner disagreed and upheld the assessment. He determined that the taxpayer qualifies for only a portion of the requested exception.

16. Foreign Source Income Subtraction. P.D. 13-162 (August 13, 2013). The taxpayer filed consolidated Virginia corporate income tax returns for each taxable year at issue. The Tax Department audited the taxpayer for the 2007 through 2010 taxable years and adjusted

the expenses applied to the foreign source income subtraction. Assessments were issued for the 2007 through 2010 taxable years. The taxpayer appealed the auditor's adjustments for the 2008 through 2010 taxable years contending that the Tax Department erroneously reduced the foreign source income subtraction by expenses attributable to both passive and general subpart F and foreign dividend gross-up income. The taxpayer also asserted that the auditor did not use non-allocable expenses attributable to passive activity income in computing the subtractions for the 2007 taxable year and was, therefore, inconsistent in the application of Virginia tax policy. The Tax Commissioner's review of the audit determined that the auditor properly applied expenses to Subpart F income and foreign dividend gross-up income. Accordingly, he denied the taxpayer's request for a refund of income tax paid for the 2008 and 2009 taxable years and the abatement of the 2010 assessment. However, he returned the audit to the audit staff in order to review the 2007 foreign source income subtraction and make any necessary adjustments if the auditor failed to take into account non-allocable expenses attributable to Subpart F dividends and foreign source gross-up in computing the foreign source income subtraction.

17. Intangible Add-Back and Payroll Factor. P.D. 13-165 (August 23, 2013). The taxpayer and several of its affiliates file as part of a combined return for Virginia income tax purposes. For the taxable years at issue, the taxpayer paid royalties to three affiliated entities, IHCA, IHCB, and IHCC. On its income tax returns, the taxpayer listed one state in which the affiliated entities filed income tax returns and claimed an exception for all of the royalty and interest deductions on the grounds that they were subject to tax in another state. On audit, the Department limited the amount claimed as an exception to the add back by reducing it to correspond to the amount of the affiliates' royalty income apportioned to the state in which the affiliates paid tax and increased the corresponding net add back of royalties and interest. The taxpayer filed an appeal contesting the assessments. The taxpayer argued that (1) the full royalty deduction is permitted by the plain language of the statute; (2) the Tax Department's prior rulings misconstrue the add back clause; (3) the Tax Department's policy contradicts its regulations; (4) it followed the Tax Department's return instructions; and (5) the affiliated entities were not sham or shell companies. In addition, the taxpayer asserted that the Virginia add back statute violates the Commerce and Due Process clauses and that the "subject to tax" exception is not limited to separately filed tax returns. The taxpayer also provided evidence that the affiliated entities received royalty income from numerous third parties. Finally, the taxpayer asserted that auditor erroneously eliminated payroll from the payroll factor of several related entities.

The Tax Commissioner adjusted the assessment based on the information provided by the taxpayer. The Tax Commissioner rejected every argument that the "subject to tax" exception applied. However, he examined the evidence provided by the taxpayer and determined that the exception for intangible expenses paid to affiliates who derive at least one-third of its gross revenues from the licensing of intangible property to third parties applies to the fees paid to IHCA and IHCB. Therefore, he adjusted the assessment to allow the exception for those fees. The fees paid to IHCC did not qualify for any exception, so the Tax Commissioner did not adjust the assessment with respect to those fees.

The auditor also removed the payroll factor from the apportionment formula as the taxpayer had no payroll in Virginia. All corporations, with several exceptions for particular industries, are required to use a three-factor formula based on the property, payroll and sales within Virginia, with the sales factor counted twice. The formula is the average of the three factors, except if the denominator of any fraction is zero, then that fraction is not included in the average. See Title 23 VAC 10-120-150(A)(2). However if the numerator is zero but there is a positive denominator, then the fraction is included the average. The Tax Commissioner adjusted the assessment by reinserting the payroll factor into the apportionment formula.

18. Protective Claim Statute of Limitations. P.D. 13-168 (August 29, 2013). In P.D. 12-180, the Tax Department determined the taxpayer had failed to timely amend its protective claim in conjunction with a court case and, therefore, the claims for the 2004 and 2005 taxable years were not filed within the statute of limitations. The taxpayer sought a redetermination contending the 2004 claim was filed with its addendum for the protective claim contemporaneously to the Tax Department's denial of the claim, and the addendum should have been considered as a request for redetermination. In addition, the taxpayer asserts the Tax Department mishandled the filing of the 2005 tax return by accepting the payment of the telecommunications minimum tax without the filing of corporate income tax return. The Tax Commissioner denied the taxpayer's request. The redetermination of the protective claim was denied as it was simply re-arguing the same law. Title 23 of the Virginia Administrative Code (VAC) 10-20-165 F permits taxpayers to request a reconsideration of a determination issued under Va. Code § 58.1-1821 if the facts were originally misstated, the law in effect was changed, the policy was misapplied or new facts were provided. In addition, the Tax Commissioner determined that the 2005 return was not mishandled as no return was filed. The payment was not a substitute for the return.

19. Limited Partnership Interests. P.D. 13-169 (September 6, 2013). The Corporation, commercially domiciled outside Virginia, is exempt from income tax under Internal Revenue Code (IRC) § 501(c)(3). The Trust is a qualified pension trust under IRC § 401(a) for the benefit of employees of the Corporation. Neither entity has physical presence or any other operations in Virginia. Each entity receives alternative investment income from limited partnerships that conduct business in Virginia. The entities own less than 10% limited partnership interests in each of the pass-through entities. To the extent that the entities own interests in the same partnership, the aggregate limited partnership interest is less than 10%. Neither entity is related to the general partners of the limited partnerships. The entities requested a ruling as to Virginia income tax implications of the limited partnership interests held by the Corporation and the Trust. The Tax Commissioner opined that the corporation would have to report the Virginia source income from the LPs, but may not have to incorporate the attributes of the LPs into its own attributes for apportionment purposes.

In Public Document (P.D.) 95-19 (2/13/1995), the Tax Department ruled that a corporate limited partner is generally required to include its proportionate share of the partnership's property, payroll and sales with its own property, payroll and sales for purposes of determining its Virginia apportionment factor. In addition, the Tax Department also set forth a standard, pending the promulgation of regulations, under which no partnership attribution of apportionment factors would be required if (1) a corporation holds a limited partnership; (2) all general partners are unrelated third parties; (3) the combined partnership interests held by the corporation and all related parties constitute 10% or less of the profit and capital interest of the limited partnership; and (4) the structure is not a device primarily designed to avoid Virginia taxation of the limited partnership's income. The Tax Commissioner opined that if these four tests are met, the corporation would not have to incorporate the LPs' attributes. The Tax

Commissioner also opined that this ruling does not apply to trusts. Therefore, the trust would be subject to Virginia income tax if it has Virginia source income. **Comment:** The Tax Commissioner never discussed the 501(c)(3) aspect of the corporation.

20. Nexus. P.D. 13-172 (September 19, 2013). The taxpayer, an entity headquartered outside Virginia, has an employee located in Virginia. The employee travels to consult with customers in the United States. The consulting services include conducting training at customer facilities and the taxpayer's office. The employee also develops test methods from the Virginia office in her home. None of the taxpayer's customers are located in Virginia. The taxpayer acknowledged it will need to withhold Virginia income tax from the employee's compensation. Based on the facts presented, the taxpayer requested a ruling that it does not have nexus with Virginia for purposes of corporate income tax. The Tax Commissioner opined that the taxpayer would have nexus with Virginia as the employee's activities in Virginia are neither related to solicitation or *de minimis* which would afford it protection under P.L. 86-272.

D. Opinions of the Attorney General

No recent opinions.

II. INDIVIDUAL INCOME TAX

A. 2013 Legislation

1. Land Preservation Tax Credit Annual Cap. House Bill 1398 (Governor's signature pending) limits the maximum amount of credits that may be issued in a calendar year to $100 million. This limitation is effective beginning with credits issued in the 2013 calendar year.

2. Long-Term Care Insurance Tax Credit. House Bill 2047 (Governor's signature pending) repeals the Long-Term Care Insurance Tax Credit. This bill also clarifies the law for taxable years on or after January 1, 2014 by completely disallowing the long-term health care insurance premiums deduction if the individual has claimed a federal income tax deduction for such taxable year for long-term health care insurance premiums paid by him. This legislation is effective for taxable years beginning on or after January 1, 2014.

3. Neighborhood Assistance Act and Education Improvement Scholarships Tax Credits. House Bill 1996 (Chapter 716) and Senate Bill 1227 (Chapter 713) make numerous changes to the Neighborhood Assistance Act and Education Improvement Scholarships Tax Credits. Specifically, the amount of Neighborhood Assistance Act Tax Credit and Education Improvement Scholarships Tax Credit that may be issued to an individual during the taxable year are increased from $50,000 to $81,250 and clarifies that the existing $500 minimum donation requirement applies on an individual basis. This legislation clarifies what type of accounting reports must be provided by neighborhood organizations and scholarship foundations.

Tax credits are allowed for donations of marketable securities; the definition of "student" for purposes of qualifying to receive scholarships from scholarship foundations is clarified; the time frame during which scholarship foundations must disburse at least 90 percent of the value of donations for which tax credits were issued is altered from one year from the donation to the 12-month period beginning on June 30 and ending on June 30 of the following year; and the deadlines are clarified for the annual reporting requirements for scholarship foundations, as well as specifying the information that must be reported. The penalty provisions for the failure of a scholarship foundation to meet the requirements by the applicable deadlines are increased.

This legislation extends the expiration dates for the Neighborhood Assistance Act Tax Credit and the Education Improvement Scholarships Tax Credit to July 1, 2028, and January 1, 2028, respectively. The provisions of this legislation amending the minimum donation and establishing a maximum amount of donations made by individuals for which tax credits may be issued under the Neighborhood Assistance Act Tax Credit and Education Improvement Scholarships Tax Credit programs are effective for taxable years beginning on or after January 1, 2013. The remaining provisions of this legislation are effective on July 1, 2013.

4. Investments Eligible for Tax Credits. House Bill 1872 (Chapter 289) allows any investment by a taxpayer that is transacted via an online general solicitation, an online broker, or a funding portal to be eligible for any income tax credit for which it qualifies, such as the equity and subordinated debt tax credit. This legislation is effective on July 1, 2013.

5. Deduction for Life, Medical, and Dental Insurance Premiums. House Bill 2167 (Chapter 88) allows an income tax deduction equal to the amount an individual age 66 or older with earned income of at least $20,000 and federal adjusted gross income not in excess of $30,000 for the year pays annually in premiums for (i) a prepaid funeral insurance policy covering such individual or (ii) medical or dental insurance for any person for whom the individual taxpayer may claim a deduction for such premiums under federal income tax laws. The deduction is not allowed for any portion of such premiums for which the taxpayer has been reimbursed, has claimed a deduction for federal income tax purposes, has claimed another Virginia income tax deduction or subtraction, or has claimed a federal income tax credit or any Virginia income tax credit. This deduction is effective for taxable years beginning on or after January 1, 2013.

6. Deposit of Income Tax Refund into Virginia College Savings Plan. House Bill 2145 (Chapter 28) and Senate Bill 1220 (Chapter 402) allow an individual to designate that his individual income tax refund, or a portion thereof, be deposited into one or more Virginia College Savings Plan accounts. Any taxpayer designating that a refund be deposited into a Virginia College Savings Plan account will, by making such designation, be deemed to authorize the Tax Department to provide all necessary information to the Virginia College Savings Plan. If an individual does not own a Virginia College Savings Plan account, then the amount of the refund will be returned to the individual by the Virginia College Savings Plan. This legislation is effective for taxable years beginning on or after January 1, 2014.

7. Neighborhood Assistance Act Credits. Senate Bill 1009 (Governor's signature pending) makes several changes to the Neighborhood Assistance Act Tax Credit. Specifically, this legislation requires that at least 50 percent of the neighborhood organization's revenues be used to provide services to low-income persons or to eligible students with disabilities; clarifies the type of accounting reports that must be provided by neighborhood organizations; requires a neighborhood organization to be in existence for at least one year prior

to having a proposal for Neighborhood Assistance Act Tax Credits approved by the Department of Social Services ("DSS") or the Department of Education ("DOE"); and, specifies that a neighborhood organization and its affiliates must meet the requirements of the application regulations and guidelines in order for a proposal to be approved.

B. Recent Court Decisions

1. Nathan H. Miller and Kimberly H. Miller v. Virginia Department of Taxation, Case No. CL11001514-00 (October 2, 2012, Rockingham County Circuit Court). On September 30, 2009, the taxpayers filed a 2008 Net Operating Loss Amendment to their 2006 Virginia Income Tax Return. Thereafter, the taxpayers' 2008 Federal Tax Returns were audited by the Internal Revenue Service and their net operating loss was reduced. The taxpayers then submitted a Second Amended Virginia 2006 Tax Return reflecting the revised audited 2008 net operating loss. When the Second Amended Tax Return was processed by the Tax Department, no refund was issued. The taxpayers had claimed credit for taxes paid to Maryland in 2006, and as a result, all taxes paid to Virginia for that year had already been refunded. The taxpayers then requested a ruling from the Tax Commissioner that they be allowed to apply their 2008 net operating loss to their 2007 Virginia Tax Return. The Tax Commissioner issued a ruling denying the request, based upon the conformity of Virginia income tax laws to the Internal Revenue Code pursuant to Va. Code § 58.1-301. The Tax Commissioner found that in accordance with provisions of the Internal Revenue Code, the taxpayers had carried their 2008 net operating loss back to 2006 on their federal return using it to reduce their Adjusted Gross Income. As a result, the taxpayer's 2006 Virginia tax liability was also reduced. Because the entire net operating loss was claimed on the 2006 Federal Tax Return, the taxpayers could not claim the deduction again on their 2007 Federal Tax Return. Accordingly, under the conformity law, there being no independent Virginia provision for claiming net operating loss, the taxpayers were also precluded from claiming the deduction on their 2007 Virginia Return. The Circuit Court upheld this ruling.

2. Forest Lodge, LLC v. Virginia Department of Taxation, Case No. CL11000654-00, Albemarle County Circuit Court). On December 30, 2009, Forest Lodge, LLC conveyed 1,194 acres of real property, referred to as Biscuit Run to the Virginia Department of Conservation and Recreation ("DCR") in a bargain sale transaction pursuant to Internal Revenue Code § 170 for $9.8 million. Forest Lodge subsequently applied for land preservation tax credits ("Credits") based on the value of the donation which was the difference between the consideration of $9.8 million received for the donation and the fair market value of $87.7 million as of December 30, 2009 pursuant to a qualified appraisal submitted by Forest Lodge with its application for the Credits. After a ten month review of the application, the Tax Department issued $11,680,000 in Credits based on the value of the donation but substituted a fair market value of $39 million based on an appraisal obtained by the Tax Department. The Albemarle County Circuit Court determined that the Tax Department's appraisal was erroneous and unsupportable and determined the fair market value of Biscuit Run to be $86.5 million as of the December 30, 2009 valuation date. The court ordered $19 million in additional Credits to be issued based on the difference between the consideration received and $86.5 million.

Background

Forest Lodge acquired Biscuit Run in 2005 at a highly competitive auction for $46.2 million. Biscuit Run is a unique piece of land in Albemarle County. Mainly due to zoning, only 5% of Albemarle County is developable. All but 200 acres of Biscuit Run is within the developable area of Albemarle County. At the time of acquisition, only 1,024 home units could be constructed on Biscuit Run by-right based on its zoning. After its acquisition of Biscuit Run, Forest Lodge received three offers from national home builders to purchase Biscuit Run. Pulte Homes offered $152 million, Newland Communities, LLC offered $120 million, and Entertainment Enterprises, LLC offered $92.8 million plus 25% of the profits of the potential Biscuit Run Development. The three offers had one common feature. The consideration offered was contingent on the rezoning of Biscuit run to allow at least 3,000 units.

Forest Lodge sought to rezone Biscuit Run to Neighborhood Model District zoning. The process of rezoning lasted approximately two years and cost nearly $2 million. The initial rezoning application was rejected by the Albemarle Planning Commission by a vote of 7-0. However, the planning commission ultimately approved the rezoning with proffers attached to the future development. Biscuit Run was rezoned in September 2007 to Neighborhood Model District zoning. This new zoning allowed Forest Lodge to construct a total of 3,000 units on Biscuit Run. After the rezoning, another appraisal was commissioned by a financial institution to determine the highest and best use of Biscuit Run as of October 23, 2007. The appraisal determined the fair market value of Biscuit Run to be $120 million.

For various reasons, none of the three offers closed and Forest Lodge retained Biscuit Run. In mid-2009, the members of Forest Lodge determined that they wished to donate Biscuit Run to the state for the creation of a park in Albemarle County. After negotiations with DCR, Biscuit Run was donated in a bargain sale transaction for $9.8 million on December 30, 2009. Forest Lodge hired Patricia O'Grady Filer, MAI to appraise the value of Biscuit Run as of December 30, 2009, the date of donation, for purposes of applying for Credits. Mrs. Filer valued Biscuit Run at $87.7 million. Mrs. Filer's value was based on the sales comparison approach and the income approach. Mrs. Filer used five comparable sales[2]: the 2005 sale of Biscuit Run, three sales in Culpeper County, and one additional sale in Albemarle County. In the discounted cash flow performed under the income approach by Mrs. Filer, she used a discount rate based on interviews with local developers and the national average and an absorption rate based on Biscuit Run's favorable location.

Even though it was not required to do so, Forest Lodge took one additional step and hired James H. Boykin, Ph.D., MAI to review Mrs. Filer's appraisal. Dr. Boykin requested changes and clarifications to Mrs. Filer's appraisal. Once the changes and clarifications were made to Dr. Boykin's satisfaction, he recommended approval of the appraisal based on the Uniform Standards of Professional Appraisal Practice.

[2] Mrs. Filer subsequently amended her appraisal to add four more comparable sales. The addition of these sales had no effect on the value of Biscuit Run.

Application for Credits

Forest Lodge filed its application for Credits in January 2010. Despite submitting a qualified appraisal and fulfilling every other requirement under Va. Code § 58.1-510 *et seq*., the Tax Department withheld the Credits Forest Lodge applied for. The Tax Department also never concluded that the qualified appraisal was either false or fraudulent. After meetings with representatives of Forest Lodge, the Tax Department ordered its own appraisal of Biscuit Run.

The Tax Department ultimately hired Lawrence Salzman of Salzman Real Estate Services in Richmond to appraise Biscuit Run. Mr. Salzman is a licensed appraiser as well as an attorney and land developer. Mr. Salzman was hired on numerous occasions by the Tax Department to act as counsel in disputes over Credits. Mr. Salzman also reviews appraisals submitted with credit applications on a regular basis for the Tax Department. The services performed by Mr. Salzman were so frequent that the Tax Department supplied Mr. Salzman with his own workspace at the Tax Department, a security badge, and an email address at tax.virginia.gov. Mr. Salzman first reviewed Mrs. Filer's appraisal in his capacity as an advocate/attorney working for the Tax Department to identify any issues or weaknesses in her appraisal. Before Mr. Salzman was hired to perform the independent appraisal sought by the Tax Department, two appraisers located in the Charlottesville Metropolitan Statistical Area (MSA) were contacted to appraise Biscuit Run. Both appraisers declined the engagement. At this juncture, Mr. Salzman and an Assistant Tax Commissioner decided that the Tax Department would hire Mr. Salzman to perform the independent appraisal.

Mr. Salzman delivered an appraisal to the Tax Department in which he determined that the value of Biscuit Run was $39 million as of December 30, 2009. In the appraisal, Mr. Salzman used both the sales comparison approach and the income approach to derive a value of Biscuit Run. In the appraisal, Mr. Salzman used eight comparable sales: the 2005 sale of Biscuit Run, three sales in Chesterfield County, three sales in Henrico County, and one sale in Culpeper County. The determination of the per unit value of the 2005 sale of Biscuit Run was flawed as Mr. Salzman did not use the 2005 zoning of Biscuit Run in his calculation. Instead, he used the figures from the 2007 rezoning of Biscuit Run in his calculation. Other questionable aspects of this appraisal were that Mr. Salzman gave no weight to the three offers to purchase Biscuit Run, the absorption rate used in the discounted cash flow performed under the income approach was based on the number of permits issued for lots in Albemarle instead of the actual number of lots available for sale, and the discount rate used in the same calculation was based on false information given to Mr. Salzman by a representative of a developer. Despite knowledge of these flaws, the Tax Department chose to issue Credits based on Mr. Salzman's valuation.

Appeal

Forest Lodge filed an administrative appeal with the Tax Department for the issuance of the full amount of Credits requested. The Tax Department determined that a second appraisal was needed. After requesting bids on the appraisal, the Tax Department selected Samuel Long of Miller Long and Associates of Roanoke to perform this appraisal. Mr. Long is an appraiser with extensive experience appraising real property located in Southwest Virginia. Prior to this appraisal however, Mr. Long had never appraised any property in Albemarle County and had only appraised one parcel (in Nelson County) in the adjacent counties. On August 4, 2011, Mr.

Long delivered an appraisal to the Tax Department in which he valued Biscuit Run at $32,200,000. Mr. Long made no attempt to interview any representative of Forest Lodge. This neglect led to Mr. Long being unaware of the three offers to purchase Biscuit Run and thus no consideration was given to them. Furthermore, Mr. Long determined the value of Biscuit Run using the sales comparison approach solely. For comparable sales, Mr. Long used five sales from Chesterfield County, one sale from Culpeper County, one sale from Henrico County, one sale from Botetourt County, one sale from Bedford County, and one sale from Orange County.

Forest Lodge acquired a second appraisal of Biscuit Run from Ivo Romenesko, MAI of Appraisal Group, Inc. Mr. Romenesko determined that the fair market value of Biscuit Run as of December 30, 2009 was $86.5 million. Mr. Romenesko arrived at this fair market value using the sales comparison approach and the income approach. For his comparable sales, he used two sales in Albemarle County, one sale in Culpeper County, one sale in Caroline County, one sale in Stafford County, and one offer to purchase a tract of land in Albemarle County. For the discounted cash flow performed under the income approach, Mr. Romenesko conducted a substantial survey of developers local to Albemarle County to determine the proper discount rate. Also, Mr. Romenesko reviewed the permits for units issued in Albemarle County to determine the actual number of lots available for sale as opposed the number of permits issued. This review revealed that less than 200 lots were actually available for sale in Albemarle County as opposed to the 7,000 permits issued by Albemarle County.

After the exchange of additional appraisals, the Tax Department refused to issue additional credits despite the obvious flaws in their appraisals. Forest Lodge filed an Application for Correction of an Erroneous Action with Respect to a Tax Attribute under Va. Code § 58.1-1825 in the Albemarle County Circuit Court. After discovery and several pre-trial motions filed by the Tax Department in an attempt to have the case dismissed, all of which failed, the trial began on April 15, 2013 during which the court heard testimony and received evidence over three days. All four appraisers testified with respect to their appraisals.

After hearing all of the testimony and receiving evidence, the court issued a ruling from the bench in which Judge Paul D. Peatross discussed all four appraisals. Judge Peatross began by discussing the Tax Department’s appraisals. Judge Peatross began by stating that Mr. Long was a competent appraiser, but had no experience in Albemarle County. He was also troubled by the fact that Mr. Long gave no consideration to the offers. Moving to Mr. Salzman, Judge Peatross noted that Mr. Salzman had a conflict by being an attorney and an appraiser and questioned his bias. Furthermore, Judge Peatross stated that he did not understand why Mr. Salzman gave no weight to the offers to purchase Biscuit Run and questioned several decisions made by Mr. Salzman in his appraisal. For Mrs. Filer, Judge Peatross noted there were some understandable criticisms regarding the allocation of her development costs on the income approach. Judge Peatross concurred with Mr. Romenesko’s characterization of Biscuit Run as a valuable piece of property based on several aspects. Ultimately, Judge Peatross focused on the offers and their contingency on rezoning. Judge Peatross found that these offers showed the value of Biscuit Run and its rezoning, which Mr. Salzman and Mr. Long basically ignored. Based on all the information presented, Judge Peatross found Mr. Romenesko’s appraisal of $86.5 million to be the most credible. Accordingly, the Court ordered the Tax Department to issue the additional $19 million of Credits based on this $86.5 million fair market value determination.

C. Recent Virginia Tax Commissioner Rulings

1. Out of State Tax Credit. P.D. 12-156 (October 4, 2012). The taxpayers were residents of California when they sold their ownership interest in a business located in California on the installment basis in 2007, after which they moved to Virginia and became domiciliary residents of Virginia. For the installment payment received in 2010 while residents of Virginia, the taxpayers claimed a credit for taxes paid to California on their 2010 Virginia income tax return. The Tax Department disallowed the credit and issued an assessment. The taxpayers filed an appeal contending California imposed tax on the installment payment received in 2010, and the credit should be allowable by Virginia. The Tax Commissioner upheld the assessment. Virginia Code § 58.1-332 prohibits taxpayer from claiming the credit when the laws of another state, under which the income in question is subject to tax assessment, provide a substantially similar credit to such resident individual. The Tax Commissioner determined that California allowed the taxpayer to claim such a credit.

2. Pass-Through Entity Nexus. P.D. 12-164 (October 18, 2012). The nonresidents each own a pass-through entity (APTE) headquartered outside of Virginia. The APTEs' primary source of income is derived from fees for the nonresident owners' participation in an event. The APTEs also generate income from personal appearances by the nonresident owners and use of the owners' image/name on souvenirs, and product testing. Several of the APTEs also own competition teams that win purse money depending on the results of a competition and sponsorship fees. The operations of the APTE require equipment and a number of employees. The equipment is moved to states in which the competitive sporting events are conducted. In addition to the nonresident owner, the APTE employs administrative assistants, a pilot, driver, and a dozen or more crew members for the team. Most of these employees generally travel to the competitive events. The nonresidents requested a ruling on whether the activities conducted by the APTEs within Virginia are sufficient to establish nexus. The Tax Commissioner determined that the activities are sufficient to establish nexus. The APTEs conduct operations in Virginia as do the nonresident owners. These activities are sufficient to require the APTEs to withhold Virginia income tax from the portion of the nonresident owners' income and from the wages of the employees. Also, the nonresident owners are required to file Virginia income tax returns.

3. Residency. P.D. 12-165 (October 23, 2012). The Tax Department received information from the Internal Revenue Service that tax documents for the 2006 and 2007 taxable years were sent to the taxpayer at a Virginia address. While the taxpayer maintained a permanent place of abode and worked in State A, he also maintained a Virginia residence. The taxpayer returned to his residence regularly and received financial documents at this residence. He also held a Virginia driver's license that was renewed in June 2007 and again in April 2012. The taxpayer also had multiple vehicles registered in Virginia. The Tax Department issued assessments for the years at issue. The taxpayer appealed the assessment contending he was a resident of State A and did not have any income from Virginia sources for the taxable years at issue. The Tax Commissioner upheld the assessment. He determined that while the taxpayer appears to have been an actual resident of State A, he did not abandon his Virginia domicile. In order to change from one legal domicile to another legal domicile, there must be (1) actual abandonment of the old domicile, coupled with an intent not to return to it,

and (2) an acquisition of a new domicile at another place, which must be formed by personal presence and an intent to remain there permanently or indefinitely. The burden of proving that the domicile has been changed lies with the person alleging the change. This ruling is not helpful because there is no indication that Virginia was the "old domicile."

4. Credit for Taxes Paid to Other States. P.D. 12-169 (October 26, 2012). During 2008, the taxpayer, a Virginia resident, worked temporarily for his employer in Maryland. The employer withheld Maryland income tax for the period of time the taxpayer worked in Maryland. In April 2010, the taxpayer filed an amended 2008 Virginia income tax return as a resident claiming a credit for Maryland taxes withheld by his employer. The Tax Department issued a refund based on the taxpayer's claim. Under review, the Tax Department adjusted the credit to reflect the actual amount of tax paid on the Maryland return and issued an assessment. The taxpayer appealed the assessment contending the Tax Department failed to provide timely assistance to his request for information about his filing requirements for 2008. The taxpayer also requested that the Tax Department waive the penalty and interest. The Tax Commissioner upheld the assessment of tax as the taxpayer was refunded all of the taxes paid to Maryland and was not eligible for the credit. On the issue of whether he received proper assistance, it was not clear whether the answers provided to the taxpayer were incorrect as the context of the questions was unknown. Furthermore, all assistance provided to the taxpayer was via telephone call and not in writing. Virginia Code § 58.1-1835 authorizes the Tax Commissioner to abate an assessment or a portion of an assessment that is attributable to erroneous advice furnished to the taxpayer in writing by an employee of the Tax Department acting in his official capacity. The Tax Commissioner did agree to waive the penalty however as the penalty was levied for underpayment of estimated taxes and the employer improperly withheld Maryland taxes causing the underpayment. The Virginia Code does not provide for a waiver of interest.

5. Penalty and Interest Waiver for Victims of Hurricane Sandy. P.D. 12-170 (October 30, 2012). The Tax Commissioner issued Tax Bulletin 12-7 to provide a penalty and interest waiver for victims of Hurricane Sandy whose returns were delayed due to the storm.

6. Prizes. P.D. 12-184 (November 13, 2012). The taxpayer, a Virginia resident, won a sports utility vehicle in a national contest during the 2008 taxable year. She filed her 2008 federal and Virginia income tax returns, but did not report the income from the contest. The taxpayer was audited by the Internal Revenue Service (IRS). As a result of the audit, the taxpayer's federal adjusted gross income (FAGI) was increased to include the market value of the prize winnings. The taxpayer failed to file an amended Virginia income tax return reflecting the IRS adjustment. The IRS notified the Tax Department of the changes in the taxpayer's FAGI, and the Tax Department issued an assessment for additional tax and interest. The taxpayer appealed the assessment contending she was not informed that the prize was taxable. The Tax Commissioner upheld the assessment as IRC § 74(a) includes prizes in gross income.

7. Land Preservation Tax Credit. P.D. 12-190 (November 26, 2012). In December 2008, VLLC conveyed a conservation easement to a donee. Pursuant to the conveyance of the easement, VLLC registered its donation with the Tax Department for purposes of the Land Preservation Tax Credit (the "Credit"). Subsequently, VLLC transferred a portion of the Credit to the taxpayers based on an appraisal submitted with the registration. The taxpayers

claimed the Credit on their 2008 and 2009 Virginia individual income tax returns. Under examination, the Tax Department determined that the appraisal overvalued the easement. VLLC and the Tax Department entered into a settlement agreement that reduced the value of the easement. Based on this agreement, the Tax Department then issued assessments against all taxpayers that received the Credit from VLLC, including the taxpayers. The taxpayers paid the assessments and filed an appeal, contending they should not be penalized because they purchased the Credit in good faith. The Tax Commissioner denied the appeal. The Tax Department may only permit a Credit based on the fair market value of a conservation easement. When a donor and the Tax Department agree on a valuation, Credit holders must address any resulting devaluation of the Credit with the transferors of such Credit. The taxpayers recourse is against VLLC.

8. Domicile. P.D. 12-211 (December 13, 2012). In this reconsideration, the Tax Commissioner reconsidered a prior ruling that determined that the taxpayer did not abandon his Virginia domicile when he moved overseas for work. In the reconsideration, the issue was whether the taxpayer was a resident of Virginia prior to moving overseas. The taxpayer was in Virginia for less than 12 months. In that time, he obtained a Virginia driver's license and used a Virginia mailing address. The taxpayer did not obtain a permanent place of abode or seek employment in Virginia. Prior to coming to Virginia, the taxpayer was a resident of Texas where he was employed. The taxpayer resigned from his Texas employment for personal reasons which was simultaneous with the expiration of his lease on his Texas apartment. On the strength of obtaining a Virginia driver's license, using a Virginia mailing address, and being present in Virginia for less than 12 months, the Tax Commissioner determined that the taxpayer was a Virginia resident despite the lack of a permanent place of abode in Virginia or Virginia employment. **Comment**: Quoting directly from the P.D.:

> "In order to change from one legal domicile to another legal domicile, there must be (1) actual abandonment of the old domicile, coupled with an intent not to return to it, and (2) an acquisition of a new domicile at another place, which must be formed by personal presence and an intent to remain there permanently or indefinitely."

The taxpayer did not obtain a permanent place of abode in Virginia or Virginia employment. There is no dispute about these facts. Where is the intent to permanently or indefinitely remain in Virginia? Yes, the taxpayer obtained a driver's license and used a Virginia mailing address. Do those minimal contacts outweigh the lack of a permanent place of abode in Virginia or Virginia employment?

9. Pass-Through Income and Nonresident Salary. P.D. 12-219 (December 21, 2012). The taxpayers, a husband and wife, were residents of State A. The husband was the majority owner of ALLC, a limited liability corporation located in State A. The husband also held the majority interest in VSC, a Virginia S Corporation. VSC provided financial and retirement services. VSC, ALLC's only client, paid ALLC fees to provide investment and asset management services on behalf of its clients. In 2009, the taxpayers attributed the loss passed through from VSC to Virginia and income passed through from ALLC entirely to State A on their nonresident Virginia income tax return. The taxpayers attributed all of the husband's salary from ALLC to State A on their income tax returns for the taxable years at issue. Under audit, the

Tax Department determined that the transactions occurring between VSC and ALLC were not at an arm's length rate. As a result, the auditor attributed all of the husband's share of ALLC's income to Virginia and issued an assessment. The taxpayer paid the assessments and filed an appeal contending the fees paid to ALLC by VSC were made pursuant to an arm's length arrangement. The Tax Commissioner agreed. The taxpayer presented evidence that VSC has a contract with an unrelated third party to provide investment and asset management services. The documentation provided indicated the fees charged by ALLC for its services are comparable to the unrelated third party provider. Accordingly, the Tax Commissioner determined that the transactions between ALLC and VSC did not create an improper reflection of VSC's Virginia income. However, the Tax Commissioner determined that ALLC had Virginia source income based on the activities of the husband. In 2009, the husband spent 135 days in Virginia. He stated that he worked 74 of those days for VSC and performed no work for ALLC while in Virginia. Because of the nature of the relationship between the husband, VSC, and ALLC, the Tax Commissioner found it doubtful that the husband performed no services on behalf of ALLC while he was in Virginia. Therefore, he attributed some ALLC income to Virginia. The Tax Commissioner also attributed a portion of the husband's salary to Virginia.

10. Age Deduction. P.D. 13-5 (January 10, 2013). In 2007, 2008, 2011 and 2012, the taxpayer, a married citizen of Virginia, cashed United States savings bonds that had reached maturity. Upon reviewing his 2011 Virginia tax return, the taxpayer discovered that the income resulting from his United States savings bonds had not been subtracted from his adjusted federal adjusted gross income ("AFAGI") in computing the Age Deduction. The taxpayer requested a ruling contending that Virginia is taxing tax-exempt income derived from obligations of the United States by failing to remove such income from the calculation of the Age Deduction and that he is entitled to refunds for the 2007, 2008 and 2011 taxable years. The Tax Commissioner disagreed noting that the exempt income was subtracted from the taxpayer's income and the age deduction was a matter of legislative grace. The Tax Commissioner also noted that while acting within their discretion to create deductions with reasonable computations, the Virginia General Assembly clearly excluded Social Security benefits and other benefits subject to taxation under IRC § 86 from AFAGI. If the General Assembly wanted to allow a second deduction for tax-exempt income derived from obligations of the United States, it could have done so, but did not.

11. Land Preservation Tax Credit Annual Limitation. P.D. 13-8 (January 23, 2013). The Tax Department issued Tax Bulletin 13-1 to announce that the annual cap for land preservation tax credits would be $113,909,000 for 2013. However, House Bill 1398 amended the law to limit the annual cap to $100 million annually with no indexing.

12. Penalty Relief for Farmers, Fishermen and Merchant Seamen. P.D. 13-12 (January 31, 2013). The Tax Department followed the IRS and issued Tax Bulletin 13-2 granting relief from the estimated tax underpayment penalty for farmers, fishermen, and merchant seamen unable to file and pay their 2012 taxes by the March 1 deadline.

13. Land Preservation Tax Credit: Credit Claimed by Married Couple. P.D. 13-24 (March 4, 2013). The taxpayers, a husband and wife, claimed $100,000 of Land Preservation Tax Credit (the "Credit") on their joint 2009 Virginia individual income tax return. The Tax Department disallowed $50,000 of the Credit and issued an assessment of tax because

the husband was the only grantor of the conservation easement. The taxpayers paid the assessment and appealed contending they were entitled to claim the entire $100,000 in Credit on their 2009 return because the Credit is marital property. The Tax Commissioner upheld the assessment. Virginia statutes limit the Credit to the donor of the conservation easement or the transferee. Because the husband was listed on the deed of gift of easement, he is considered to be the landowner/taxpayer making the donation. Only the husband was eligible to claim the Credit on the taxpayers' joint 2009 return and the Credit was subject to the $50,000 limitation.

14. Credit for Taxes Paid to Other States. P.D. 13-28 (March 5, 2013). The taxpayers, a husband and wife, filed a Virginia part year return for the 2010 taxable year. The husband was a full year Virginia resident and the wife a part year Virginia resident. The wife lived and worked in State A for a part of the 2010 taxable year. The taxpayers filed a State A income tax return and paid income tax on the wife's wages earned in State A. The taxpayers filed a Virginia income tax return, excluded the wages earned in State A from the Virginia taxable income and claimed a tax credit for the income tax paid to State A. Under audit, the Tax Department disallowed the tax credit and issued an assessment for additional tax and interest. The taxpayers paid the assessment and appealed contending the Tax Department should allow the tax credit because the State A income was subject to Virginia income tax. The Tax Commissioner upheld the assessment. Va. Code § 58.1-303 prohibits part-year residents from claiming any credit against their Virginia tax liability for tax paid to any other state or jurisdiction of residence or domicile for that portion of the taxable year during which they were a resident of such other state or jurisdiction. Under this statute, the taxpayers were not eligible for a credit for taxes paid to State A while the wife was a resident of State A.

15. Land Preservation Credit: Transferee Liability. P.D. 13-29 (March 11, 2013). In December 2008, VLLC conveyed a conservation easement to a donee. Pursuant to the conveyance of the easement, VLLC registered its donation with the Tax Department for purposes of the Land Preservation Tax Credit (the "Credit"). Subsequently, VLLC transferred a portion of the Credit to the taxpayers based on an appraisal submitted with the registration. The taxpayers claimed the Credit on their 2008 Virginia individual income tax return. Under examination, the Tax Department determined that the appraisal overvalued the easement. VLLC and the Tax Department entered into an agreement that reduced the value of the easement. Based on this agreement, the Tax Department then issued assessments against all taxpayers that received the Credit from VLLC, including the taxpayers. The taxpayers filed an appeal contending that VLLC should be held liable for their assessment because the Credit was purchased in good faith and there was an indemnification agreement with VLLC. They asserted that the Tax Department failed to first seek payment of the assessments from the tax matters representative prior to issuing the assessment against the taxpayers. The Tax Commissioner upheld the assessment. Per Va. Code § 58.1-512, the Tax Department may only permit a Credit based on the fair market value of a conservation easement. When a donor and the Tax Department agree on a valuation, Credit holders must address any resulting devaluation of the Credit with the transferors of such Credit. Furthermore, the sales agreement is between VLLC and the taxpayer. The Tax Department was not a party to this agreement. The taxpayer will need to pursue recourse against VLLC. As for the tax matters representative, none was registered from which the Tax Department was required to demand payment per Virginia Code § 58.1-513(F).

16. Domicile. P.D 13-36 (March 18, 2013). After a number of years abroad, the taxpayers, a husband and a wife, moved to Virginia in 2004 when the husband, a foreign service specialist, was assigned to a position in Virginia. They purchased a house and registered motor vehicles in Virginia. The husband registered to vote and obtained a commission as a notary in Virginia. They retained driver's licenses for State A, their domiciliary residence. In 2007, the husband was transferred to an overseas assignment. He surrendered his notary license. The taxpayers also sold their motor vehicles and cancelled their Virginia voting registrations. They converted their Virginia residence into a rental property. The taxpayers filed a Virginia part-year return for 2007 and filed nonresident Virginia returns for 2008 and subsequent taxable years. The husband has been offered a two year assignment back in the United States. If the husband accepts the position, the taxpayers would move back into their Virginia home. The taxpayers requested a ruling as to whether they would be considered Virginia residents for the 2007 through 2012 taxable years if they moved back to Virginia in 2013. The Tax Commissioner opined that based on the information provided by the taxpayers, they have continuously been Virginia domiciliary residents since 2004. The taxpayers stated that their clear intent was to retain domicile in State A, as evidenced by the fact that they held State A driver's licenses. However, the taxpayers established considerably more connections with Virginia than they held with State A during the 2004 through 2007 taxable years. When they moved overseas, they did take substantial steps to abandon their Virginia domicile. They relinquished all of their connections with Virginia except for the house, which they converted to rental property. The taxpayers have made no claim that they established domicile in a foreign country. The question, therefore, hinged on whether the taxpayers' stated intent and State A driver's licenses are sufficient to reestablish domicile in State A. The facts presented to the Tax Commissioner did not clearly indicate a reestablishment of domicile in State A when the taxpayers moved overseas in 2007.

17. Domicile. P.D. 13-43 (March 29, 2013). The taxpayer was assessed with additional Virginia individual income tax after she filed a federal income tax return with a Virginia address and did not respond to Tax Department requests for more information. The taxpayer appealed the assessment and provided evidence that she performed a number of actions to show she established domicile in State A during the taxable year at issue. The taxpayer provided evidence that she obtained employment, filed resident income tax returns, and registered to vote in State A. While the taxpayer used a Virginia address when filing her 2008 federal income tax return, she contends that all 2008 income tax returns were filed after she moved to Virginia in 2009. The Tax Commissioner agreed and abated the assessment. **Query:** If a taxpayer leaves Virginia between the end of the year but before the tax returns for that year are filed, what address are they supposed to use on the return?

18. Converted Assessment. P.D. 13-49 (April 12, 2013). The taxpayer was president of ACP. ACP sold substantially all of its assets to BCP in June 2009. As a result of the transaction, ACP recognized deferred revenues and a gain on the sale of intangible property for the taxable year at issue. ACP filed a 2008 Virginia corporate income tax return but failed to pay the resulting liability. When the Tax Department was unable to collect the corporate income tax assessment from ACP, it converted the assessment to the taxpayer as a responsible officer. The taxpayer appealed the assessment, contending he was not a responsible officer of ACP at the time of the sale or when the liability was recognized. The taxpayer maintained that proceeds from the sale of ACP's assets were not sufficient to pay the corporate tax due. The Tax

Commissioner disagreed and upheld the assessment. In this case, the evidence did not show that ACP was insolvent or in bankruptcy when the transaction took place. The taxpayer indicated that funds were available to pay employees' salaries through the date of the transaction. The taxpayer, as President, negotiated a non-cash sale of specified assets and liabilities of ACP to BCP. The negotiations were conducted with a former officer familiar with ACP's financial situation who had formed BCP for the specific purpose of acquiring ACP. The taxpayer was aware that the sale of ACP would result in a substantial taxable gain, but failed to make a provision for any possible tax liability out of funds remaining in ACP.

19. Disability Subtraction. P.D. 13-50 (April 24, 2013). For the taxable years at issue, the taxpayer filed Virginia individual income tax returns claiming subtractions for disability income. Under review, the Tax Department determined that the taxpayer received income from substantial gainful activity and, therefore, did not qualify for the Virginia subtraction. The taxpayer appealed the assessments contending the income received was treated as disability income under the Civil Service Retirement System (CSRS). The Tax Commissioner disagreed and upheld the assessment. The income in question was eligible for the subtraction. However, a taxpayer must be permanent and totally disabled to claim the subtraction. The Tax Department determined that the taxpayer was not permanently and totally disabled because he engaged in substantial gainful activity during the taxable year at issue. Treas. Reg. § 7.105-2 defines "substantial gainful activity" as "the performance of significant duties over a reasonable period of time in work for remuneration or profit." During the taxable years at issue, the taxpayer was employed in the service industry where he was paid at the minimum wage rate. The nature of his employment required him to perform duties similar to any other employee. The taxpayer was employed on a trial basis by three employers in 2008 and worked in excess of 1200 hours. He was employed in excess of 1700 hours during 2009 and 2010. In accordance with Treas. Reg. § 7.105.2(c), the taxpayer was engaged in part-time employment in a competitive work situation at a rate of pay equal to or greater than minimum wage. Accordingly, the taxpayer was not permanently and totally disabled for the 2008 through 2010 taxable years, and the income at issue does not qualify for the subtraction for disability income under Va. Code § 58.1-322(C)(4)(b).

20. Domicile. P.D. 13-55 (May 1, 2013). A taxpayer, a Virginia resident prior to 2008, was audited by the Tax Department to determine her state of residency for 2008. This ruling had little in the way of facts except:

- The taxpayer moved into a home with her fiancé in State A;
- She used her fiancé's address for federal income tax purposes;
- Her Virginia employer withheld income tax in State A;
- She filed a State A resident income tax return;
- She continued to work in Virginia;
- She owned a motor vehicle registered in Virginia;
- She held a Virginia driver's license that was renewed in October 2008; and,
- When the relationship with her fiancé ended in early 2009, she returned to Virginia.

Based on these limited facts, the Tax Commissioner determined that she did not abandon her Virginia domicile and was a domiciliary resident in 2008.

21. Domicile. P.D. 13-56 (May 1, 2013). The taxpayer and his spouse were Virginia residents in 2007. In 2008, the taxpayer was transferred to Country A for employment purposes. He and his spouse severed all of their Virginia connections with the exception of maintaining Virginia driver's licenses and receiving mail at a Virginia address. The taxpayer registered to vote in State A and claimed State A to be his domicile in 2008. The taxpayer did not make any other connections to State A nor spent any time in State A in 2008 or 2009. The taxpayer was assessed as a Virginia resident with additional Virginia individual income tax for 2008 and 2009. The Tax Commissioner upheld the assessment upon appeal.

22. Converted Assessment. P.D. 13-60 (May 3, 2013). The taxpayer was vice president and secretary of a business operating in Virginia ("VSC"). The taxpayer's spouse was president and treasurer. The Tax Department issued an assessment to VSC for failure to remit withholding tax for the periods January 2009 through December 2009. Upon failure to collect the deficiency from VSC, the Tax Department assessed penalties against VSC officers equal to the amount of the withholding taxes, penalties and interest owed by VSC. The taxpayer appealed the conversion of the assessment contending his functions for VSC were limited to overseeing field operations and he was not personally responsible for the liabilities of VSC, pursuant to Va. Code § 58.1-1813. The Tax Commissioner disagreed and upheld the assessment.

The taxpayer asserted that he had no knowledge that taxes were not being paid until he was contacted by the IRS in 2010. The taxpayer also asserted that the treasurer (his wife!!!!) was the responsible officer. He indicated that she was responsible for keeping the financial records of VSC, paying vendors, and administering payroll. The Tax Department's records indicated that the withholding returns were filed by the treasurer. The treasurer has admitted responsibility but has attested that the taxpayer was aware of the assessments, including a partial payment agreement with the Department with regard to VSC's liability. The treasurer (his wife!!!!) also asserted the taxpayer took all of VSC's assets and client base to another entity when VSC closed in December 2011 instead of using them to raise funds to pay VSC's debts. VSC filed for bankruptcy in May 2012. The Tax Commissioner upheld the assessment as he determined that all attributes of the VSC's income, gain, loss, deduction, or credit pass through to the taxpayer and his wife; therefore, the taxpayer and his wife were not only responsible for the decisions made on behalf of the VSC, they retained all benefits from such decisions. **Comment:** The marital dynamic is the most interesting aspect of this ruling.

23. Domicile. P.D. 13-65 (May 10, 2013). A taxpayer, a Virginia resident prior to 2007, was audited by the Tax Department to determine his state of residency for 2009. According to the ruling, the taxpayer contended he moved to State A during the 2007 through 2011 taxable years to complete a contract assignment and returned to Virginia during the 2011 taxable year. When the contract was completed, the taxpayer returned to Virginia. Among the other facts in this ruling: The taxpayer

- Established a place of abode in State A;
- Had State A income tax withheld from his wages;
- Filed a State A income tax returns as a resident of State A;
- Was transferred to State A to for an employment assignment;
    - The Tax Commissioner determined from evidence that this assignment may have been temporary.
- Received third party information returns at his Virginia residence;

- Contended that his Virginia residence was maintained by a family member;
    - No rental income is reported on his federal income tax return.
- Could move back into this property at any time;
- Had use of the property when he was in Virginia;
- Held a Virginia voter's registration card and participated in the 2008 and 2010 general elections in Virginia;
- Was transferred back to Virginia during the 2010 and 2011 taxable years;
- Continued to register his motor vehicles in Virginia; and,
- Held a Virginia driver's license that was renewed in October 2008.

Based on these facts, the Tax Commissioner concluded that the taxpayer did not abandon his domiciliary residence in Virginia during the 2007 through 2011 taxable years and was a domiciliary resident of Virginia for the taxable years at issue.

24. Itemized Deductions. P.D. 13-72 (May 16, 2013). The taxpayers were residents of Virginia between 1984 and July 1, 2010. During this period, the taxpayers never had a sufficient amount of deductions to itemize for federal income tax purposes and they utilized the standard deduction. On July 1, 2010, the taxpayers purchased a home and established residency in Maryland. The taxpayers then began making Maryland property tax and interest payments. The property taxes and interest derived from the taxpayers' Maryland home were enough for them to elect to itemize deductions on their 2010 federal income tax return. The taxpayers elected to itemize their deductions for federal income tax purposes and filed a Virginia part-year individual income tax return for their time as Virginia residents during the 2010 taxable year. Because the taxpayers elected to itemize on their federal income tax return, they were required to itemize on their Virginia part-year return in lieu of the standard deduction. However, because the property tax and interest payments were made while the taxpayers were residents of Maryland, they had no itemized deductions to claim on their Virginia part-year return. The taxpayers filed a request to claim a prorated standard deduction on their Virginia part-year return. The Tax Commissioner denied the request as Va. Code § 58.1-322(D)(1)(b) allows taxpayers to claim the Virginia standard deduction only if they have not elected to itemize deductions on their federal income tax return.

25. Land Preservation Tax Credit Cap. P.D. 13-74 (May 22, 2013). The Tax Commissioner issued Tax Bulletin 13-6 to announce that 2013 House Bill 1398 (Chapter 798, 2013 Acts of Assembly) limits the aggregate cap to $100 million beginning with the 2013 calendar year.

26. Annual Cap for the Qualified Equity and Subordinated Debt Investments Tax Credit. P.D. 13-75 (May 22, 2013). The Tax Commissioner issued Tax Bulletin 13-7 to announce that House Bill 1500 (Chapter 806, 2013 Acts of Assembly) increased the tax credit limit to $4.5 million for Taxable Year 2013 and to $5 million for Taxable Year 2014.

27. Domicile. P.D. 13-88 (June 10, 2013). A taxpayer was audited by the Tax Department for the 2009 taxable year. The taxpayer filed a 2009 Virginia income tax return. However the Tax Department adjusted the Virginia return based on the federal data and issued an assessment for additional tax and interest. The taxpayer appealed the assessment contending she did not work or reside in Virginia during the 2009 taxable year and the Virginia return was

filed in error. To determine the taxpayer's state of residency, the Tax Commissioner weighed the following facts:

- The taxpayer registered to vote in State A in October 2008;
- She filed her 2009 federal income tax return with a State A address;
- She obtained a State A identification card in July 2009;
- She held her Virginia driver's license until October 2009;
- She filed a 2009 Virginia resident income tax return;
- She had Virginia income tax withheld from her wages during 2009.
- No information was provided that indicated where the taxpayer resided in 2009;
- Her employer was located in State B, which is in commuting distance from either State A or Virginia;
- The employer did not withhold any State A income tax;
- She did not provide any evidence that she filed a State A income tax return; and,
- She provided no documentation that she established a permanent place of abode in either Virginia or State A.

Based on the facts and lack thereof, the Tax Commissioner upheld the assessment and gave the taxpayer an opportunity to submit additional documentation.

28. Domicile. P.D. 13-89 (June 10, 2013). The taxpayers were audited by the Tax Department to determine their state of residency for 2008. The taxpayer's facts as stated in the ruling are:

- The taxpayers moved to Country A so that the husband could pursue an employment opportunity;
- The employer verified that the husband has been employed for an indefinite period of time;
- The taxpayers established a permanent place of abode in Country A;
- The taxpayers continued to own the home in which they resided while they were in Virginia;
- The husband was registered to vote in Virginia and voted in federal elections;
- The husband owned motor vehicles registered in Virginia;
- The taxpayers held Virginia driver's licenses, which were renewed in 2008;
- The taxpayers continued to own a residence in Virginia while they lived in Country A; and,
    - No evidence was provided to indicate that the taxpayers attempted to sell the real estate or convert it into a rental property. The property was available to the taxpayers if and when they chose to return to Virginia. The home was available for the children to reside in when they attended school in Virginia.
- After not filing for a number of years and with no other significant changes to their residency status, the taxpayers filed Virginia income tax returns as residents for the 2010 and 2011 taxable years.
    - The taxpayers claimed that they decided to file Virginia income tax returns in 2010 and 2011 so that they could get in-state tuition rates for their children.

The Tax Commissioner upheld the assessment. He stated that "Representing oneself to be a Virginia resident in order to obtain in-state tuition rates for one's child has been considered evidence of a clear indication of intent to be considered a domiciliary resident of Virginia. The Department considers a taxpayer's continued connections to Virginia for the purposes of taking advantage of favorable Virginia laws in order to gain the benefits of lower costs (*i.e.*, driver's licenses and in-state tuition) available to Virginia residents to be strong intent of a taxpayer's desire to be a domiciliary resident of Virginia."

29. Nonresident Truck Driver. P.D. 13-90 (June 10, 2013). A truck driver (the "taxpayer"), a resident of State A, transported products between destinations in different states as an "over-the-road" (OTR) tractor-trailer driver. He worked as either a company driver or an owner/operator on behalf of one trucking company headquartered in Virginia. As a company driver, he was paid wages reportable on a federal wage and tax statement (Form W-2). As an owner/operator, he reported business income and expenses on Schedule C of Form 1040 as a sole proprietor. The taxpayer requested a ruling that he is not subject to Virginia income tax. The Tax Commissioner opined that Title 49 U.S.C. § 14503(a)(1) exempts the wages he earns from Virginia income tax. Title 49 U.S.C. § 14503(a)(1) prohibits a state from imposing a net income tax on compensation paid by certain motor carriers to an employee for performing transportation services in two or more states when the employee is not a resident of that state. Also, the Tax Commissioner acknowledged that the federal statute defines "employee" to include an independent contractor when operating a commercial motor vehicle. Therefore, the fees received by the taxpayer may also be exempt as they were performed when he was an owner operator. However after citing some inconsistencies, the Tax Commissioner declined to opine on the application of the federal law to those fees.

30. Amended Return Statute of Limitations. P.D. 13-92 (June 10, 2013). In October 2012, the taxpayers filed a Virginia individual income tax return for the 2009 taxable year reporting a tax. The Tax Department processed the return and issued an assessment for the tax due. The taxpayers also filed an amended return for the 2008 taxable year reporting an overpayment of tax and requested that this overpayment be credited to the 2009 taxable year. The Tax Department denied the request to credit the overpayment because the amended return was not filed within the statute of limitations. The taxpayers appealed the denial of the credit requesting that the Tax Department waive the statute of limitations. The Tax Commissioner denied the appeal as has no authority to waive the statute of limitations.

31. Domicile. P.D. 13-93 (June 11, 2013). The taxpayer, originally domiciled in California, is employed as a foreign service officer for the United States. In 2003, the taxpayer moved to Virginia pursuant to a job transfer. He purchased a Virginia home, registered a motor vehicle in Virginia, and obtained a Virginia driver's license. He was registered to vote in California. In 2007, the taxpayer was transferred to Country A. Pursuant to this transfer, he sold his Virginia home and motor vehicle. He, however, retained his Virginia driver's license, which was renewed in March 2007 and September 2012. The taxpayer also married a Virginia resident in December 2008. He was transferred back to the United States and resumed residing in Virginia in August 2009. The taxpayer filed Virginia resident income tax returns during the 2003 through 2007 taxable years. He filed a California part-year return for 2007 and California nonresident returns for 2008 and 2009. The taxpayer did not file returns in Virginia for the 2008 or 2009 taxable years. His spouse filed separate Virginia income tax returns as a resident for each of these taxable years. The taxpayer and his wife filed a joint Virginia resident return for 2010. Under audit, the Tax Department determined that the taxpayer was a Virginia domiciliary

resident during the 2008 taxable year and issued an assessment for individual income tax. The taxpayer appealed the Tax Department's assessment contending he was not a Virginia resident in 2008. The Tax Commissioner considered two issues with this appeal before upholding the assessment. First, he considered whether the taxpayer abandoned his California domicile and established a Virginia domicile in 2003. Citing his purchase of a Virginia residence, register a motor vehicle in Virginia, and obtaining a Virginia driver's license, the Tax Commissioner determined that he was a Virginia domiciliary resident in 2003. The second issue was whether the taxpayer abandoned his Virginia domicile and established a Country A domicile in 2007. While the taxpayer performed actions consistent with abandoning his Virginia domicile, he provided no evidence of establishing a domicile in Country A. For this reason, the assessment was upheld.

32. <u>Amended Return Statute of Limitations</u>. P.D. 13-94. (June 11, 2013). The taxpayers filed a part-year Virginia individual income tax return for the 2008 taxable year on May 22, 2012. The Tax Department processed the return, but denied the refund because the return was not filed within the statute of limitations. The taxpayers filed an appeal contending the return was filed within three years of the extended due date. The Tax Commissioner denied the appeal as the taxpayer must have filed a return before the extended due date to receive an extension. Therefore, the statute of limitations relates back to the original due date.

33. <u>Pension Income</u>. P.D. 13-95 (June 11, 2013). The taxpayers, a husband and wife, were residents of State A. On March 1, 2010, the husband retired from a corporation operating in State A. On March 7, 2010, the taxpayers moved to Virginia and established domicile. A lump sum non-qualified pension distribution was earned and payable to the husband as of the date of his retirement. However, because the retirement election was either not timely received or processed, the distribution was not made until April 2010. The taxpayers filed a 2010 Virginia part-year individual income tax return that attributed the pension distribution to State A. The Tax Department audited the taxpayers' 2010 return and adjusted their Virginia taxable income to include the husband's pension distribution which resulted in the assessment of additional tax. The taxpayers appealed the assessment contending the pension distribution was constructively received prior to the residence change. The Tax Commissioner upheld the assessment. He relied upon Public Law (P.L.) 104-95, codified at Title 4 U.S.C. § 114, which prohibits a state from imposing an income tax on any retirement income received by an individual who is not a resident or domiciliary of that state. Under the Tax Department's interpretation, P.L. 104-95 prohibited the retirement income from being included in FAGI until the taxpayers had actually received the income. The same reasoning would be applied to the concept of constructive receipt for cash basis taxpayers. Because P.L. 104-95 only allows taxpayers to be taxed on retirement income in their state of residency when such income is actually received, the Tax Commissioner concluded that the taxpayers received the nonqualified retirement distribution on or around April 1, 2010 when the taxpayers were residents of Virginia.

34. <u>Domicile</u>. P.D. 13-97 (June 11, 2013). The taxpayer, a domiciliary resident of Virginia, is employed by the United States Department of State. The taxpayer was transferred by his employer to Country A in February 2011. Concurrent with this transfer, the taxpayer performed a number of actions to establish domicile in State A. He obtained a driver's license, registered his motor vehicles, and registered to vote in State A. The taxpayer also argued that he was a State A domiciliary resident and continued to maintain a residence in State

A while he resided in Virginia. The taxpayer also took actions to abandon his connections with Virginia. He canceled his Virginia driver's license and voter registration and moved and registered his motor vehicles in State A. He also abandoned his permanent place of abode in Virginia. The Department of State withheld Virginia income tax from the taxpayer's compensation. The taxpayer filed a Virginia part year return for the period he resided in Virginia and a refund claim for nonresident withholding for the period withholding payments were paid to Virginia after February 2011. The taxpayer filed an appeal contending he changed his domiciliary residence to State A in February 2011. The Tax Commissioner disagreed, denied the refund claim, and upheld the assessment. Citing Coopers Adm'r v. Commonwealth, 121 Va. 338, 93 S.E 680 (1917), in which the Virginia Supreme Court observed that neither physical presence alone, nor expressed intention alone are sufficient to create a legal domicile for taxation purposes, the Tax Commissioner determined that the taxpayer was not a domiciliary resident of State A because he was not physically present there to establish his domicile. Accordingly, the Tax Commissioner determined the taxpayer was a domiciliary resident of Virginia in 2011, denied the claim for nonresident withholding, and issued an assessment for additional tax and interest.

35. Credit for Taxes Paid to Other States. P.D. 13-98 (June 11, 2013). The taxpayer requested a reconsideration of P.D. 12-113. In that ruling, the Tax Commissioner held that the taxpayer had failed to show that she had abandoned her Virginia domicile in 2008, but granted the taxpayer additional time to provide the documentation to support her position. The taxpayer conceded that she did not change her domiciliary residence. However, she asserted that the facts as applied to the 2008 taxable year are the same for 2007 and requested a credit for income tax paid to another state for the 2007 and 2008 taxable years. The Tax Commissioner required the taxpayer to file Virginia individual income tax returns for the 2007 and 2008 taxable years to more accurately reflect her Virginia income tax liability as she had not yet filed those returns.

36. Domicile and Virginia Source Income. P.D. 13-110 (June 20, 2013). The Tax Department received information from the IRS that the taxpayer may have received investment income from rental properties located in Virginia. The Tax Department requested that the taxpayer file the appropriate income tax returns or provide an explanation as to why the income was not taxable. When a response was not received, the Tax Department issued assessments based on the information available. The taxpayer appealed the assessments contending he was a resident of State A and that he had no Virginia source income. The Tax Commissioner denied the appeal and upheld the assessments. The taxpayer provided documentation showing that he established a permanent place of abode and maintained a registered motor vehicle in State A. However, he maintained a Virginia post office box in which he received financial statements for the taxable years at issue. In addition, the taxpayer owned interest in a number of real estate properties in Virginia, one of which is the home of his mother. The taxpayer also has held a Virginia driver's license since 1995 that was renewed in December 2010. With no other information, the Tax Commissioner determined that the taxpayer was a domiciliary resident of Virginia and that he had Virginia source income from the rental properties.

37. Criminal Charges. P.D. 13-111 (June 21, 2013). Pursuant to a criminal investigation, the Tax Department determined that the taxpayers failed to report business and

passive income on their Virginia individual income tax returns for the taxable years at issue. The taxpayers were prosecuted and proffered an Alford plea to one count of filing a false income tax return. Originally, the taxpayers were sentenced to suspended incarceration and restitution equal to the approximate amount of tax and a 100% fraud penalty. The Court subsequently eliminated the penalty portion of the restitution. The Tax Department then issued assessments for the entire Virginia income tax due, plus a 100% fraud penalty and interest. The taxpayers appealed the assessments contending their liability should be limited to the restitution amount ordered by the trial court. The Tax Commissioner disagreed and upheld the assessment citing the principle that criminal and civil sanctions, however, may be imposed for the same offense.

38. Itemized Deductions. P.D. 13-114 (June 26, 2013). The Tax Department adjusted the taxpayers' itemized deductions reported on their 2011 Virginia income tax return resulting in tax due. The taxpayers filed an appeal contending they were entitled to deduct certain amounts the Tax Department disallowed for medical expenses, charitable contributions, and business expenses. The Tax Department requested additional information to substantiate the itemized deductions claimed on the Virginia individual income tax return. The taxpayers provided some information regarding the medical expenses and employee business expenses. The documentation, however, failed to substantiate the itemized deductions claimed on the original return or change the auditor's adjustments. The Tax Commissioner upheld the assessment for this reason.

39. Domicile. P.D. 13-115 (June 26, 2013). The Tax Department received information from the IRS indicating that the taxpayers, a husband and wife, may have been required to file a Virginia income tax return for the 2009 taxable year. A review of the Tax Department's records showed that the taxpayers had not filed a return. Responding to inquiries by the Tax Department, the husband explained that he had lived and worked for a portion of the year in State A. For the remainder of the year, he had lived in State B where he attended school. The Tax Department discovered that the husband had renewed his Virginia driver's license in July 2008. As a result, an assessment was issued to the taxpayers as domiciliary residents of Virginia. The taxpayers appealed the assessment contending they were not residents of Virginia during the taxable year in question. The Tax Commissioner quickly determined that the wife was not a Virginia resident as she only lived in Virginia in 2003 and 2004 to attend graduate school. The husband, however, was born and raised in Virginia and moved to State A after graduating from college. When he moved, he sold his motor vehicle. He did not purchase an automobile because of alternative transportation options were available. His term of employment in State A was not for a fixed term or temporary. He established a permanent place of abode and employment in State A. During that period, he filed State A resident tax returns. However, he committed a cardinal sin of retaining a Virginia driver's license and renewing it in July 2008. He also used his parents' Virginia address for mailing purposes while in law school to ensure that his mail was received promptly. In 2007, the husband moved to State B in 2007 to attend law school. After completing law school, he returned to State A. Based on these overwhelming facts, the Tax Commissioner abated the assessment. **Comment:** It seems that the assessment was issued based on the sole fact that the husband had a Virginia driver's license and every other fact was disregarded including the wife's facts who barely had any connection to Virginia. Allegedly, every assessment is reviewed before it is issued. How did this assessment make it through that review?

40. Out of State Tax Credit. P.D. 13-118 (June 27, 2013). The taxpayer is a domiciliary resident of California. During the 2010 taxable year, the taxpayer resided in Virginia for a part of the year and received business income from Virginia sources. Because the taxpayer remained in Virginia for more than 183 days, she was required to file a Virginia resident income tax return. The taxpayer filed a California individual income tax return and paid income tax on her income as a domiciliary resident. The taxpayer filed a Virginia Form PY 760 and claimed a credit for income tax paid to California. The Tax Department disallowed the credit on the taxpayer's return and issued an assessment for additional tax and interest. The taxpayer appealed the assessment contending she is a dual resident and eligible for a tax credit under Virginia law. The Tax Commissioner determined that he did not have enough information to determine whether the taxpayer is eligible for the credit and gave her 30 days to submit an amended return. When an individual is a domiciliary resident of California, the Tax Department's policy is that California should allow a credit against its tax for the amount of Virginia income tax paid. Because the taxpayer was a domiciliary resident of California, she would not be entitled to a credit for taxes paid to California on her 2010 part-year Virginia return. However, the taxpayer did file income tax returns in a number of states in which she was not a resident during 2010. As such, she may be entitled to an out-of-state credit for taxes paid to those other states if the taxes were incurred on income derived from those states while she was residing in Virginia.

41. Port Volume Increase Tax Credit Guidelines. P.D. 13-123 (July 1, 2013). The Tax Commissioner published guidelines for the port volume increase tax credit. These Guidelines supersede the Port Volume Increase Tax Credit Guidelines that were issued by the Tax Commissioner on March 5, 2012 (Public Document 12-21).

42. Refund Interest. P.D. 13-135 (July 16, 2013). The taxpayer, a resident of State A was not required to file Virginia income tax returns for the 2007 through 2012 taxable years. The former employer, however, withheld Virginia income tax from his retirement pay. Upon discovery of the error, the taxpayer filed Virginia income tax returns requesting a refund of the income tax paid for the taxable years at issue. The Tax Department processed the returns and issued refunds of all income tax paid. The taxpayer requested that interest be issued on the refunds as he contended that the Tax Department should have known that the tax was erroneously withheld and that the Commonwealth had the use of his money. The Tax Commissioner denied his request as Virginia Code § 58.1-1833 does not permit such a payment of interest. The Tax Commissioner also cited the annual number of returns processed and that it is incumbent upon the taxpayer to retain and review suitable records and documents to determine his proper Virginia income tax liability to refute the contention that the Tax Department should have known it was not entitled to the money.

43. Death Benefits Subtraction. P.D. 13-149 (July 31, 2013). The Beneficiary received death benefit payments from annuities following the death of her husband. When the Beneficiary calculated her Virginia taxable income for Taxable Years 2007, 2008, and 2009, she subtracted the death benefit payments from her federal adjusted gross income pursuant to Va. Code § 58.1-322(C)(32) to the extent that such payments were subject to federal income taxation. The Tax Department assessments to the Beneficiary for taxable years 2007, 2008, and 2009 in which it disallowed the Beneficiary's subtraction for death benefit payments for all three taxable years, and assessed additional tax and interest to the Beneficiary. The Tax Department disallowed the Beneficiary's death benefit payment subtractions because such benefits were paid

to her on a monthly basis and not in a lump sum, and the source of the annuity payments was a federal law and not a contract with an insurance company. The taxpayer appealed claiming that the subtraction was proper. The Tax Commissioner disagreed and upheld the assessment. For the subtraction to be allowed, the source of the payment must be an annuity contract between a customer and an insurance company and it must have been awarded to the beneficiary in a lump sum.

44. Maryland Reciprocal Agreement. P.D. 13-150 (August 2, 2013). The taxpayer, a resident of Maryland, was employed in Virginia. The taxpayer also had income from MSC, a Maryland S corporation that operated in Virginia. On her Virginia nonresident income tax return for the 2009 taxable year, the taxpayer allocated wages and ordinary and interest income from MSC to Virginia, but claimed a credit against her Virginia tax liability for taxes paid to Maryland. Under review, the Tax Department disallowed the out-of-state tax credit. In response, the taxpayer submitted an amended return to allocate only her income from MSC to Virginia. The Tax Department rejected the amended return concluding that because the taxpayer had other Virginia source income besides wages, reciprocity did not apply. The taxpayer filed an appeal contending that the reciprocal income tax agreement between Maryland and Virginia exempted the taxpayer's wages from Virginia taxation. The Tax Commissioner agreed. Because the reciprocal agreement between Maryland and Virginia does not permit the Commonwealth from imposing tax on Virginia compensation earned by Maryland residents simply because they have other income (both ordinary and interest) from Virginia sources, the Tax Department erred in denying the taxpayer's amended return.

45. Domicile of Active Duty Military. P.D. 13-161 (August 13, 2013). The taxpayers, a husband and wife, filed a Virginia income tax return as residents for the 2009 taxable year. For the 2011 taxable year, the taxpayers filed a Virginia nonresident return allocating the wife's income to Virginia. Information obtained during the audit of the 2009 return, however, indicated that the husband continued to be a Virginia resident in 2011. As a result, the Tax Department recomputed the taxpayers' Virginia income tax liability and issued an assessment. The taxpayers appealed the assessments contending that the husband was a resident of State A during 2009 and 2011. The Tax Commissioner disagreed and upheld the assessments. The facts in this case were as follows:

- The husband was transferred to a Virginia duty station in 2003;
- The husband purchased a residence in State A in 2005, after he was stationed in Virginia;
- He filed resident State A tax returns jointly, as if each spouse were a State A resident;
    - The taxpayers reported no liability to State A for the taxable years at issue.
- He listed State A as his military "home of record";
- He did not occupy the State A house other than brief stays while visiting his family;
- The house is occupied by several members of his extended family;
- He began filing Virginia income tax returns as a resident for certain taxable years beginning with the 2005 taxable year;
- He also obtained a Virginia driver's license in 2005 and renewed it in 2012; and,
- He registered motor vehicles, registered to vote, and purchased a residence in Virginia.

Also, after being contacted by the Tax Department in 2013, the husband obtained a State A driver's license and voter's registration. The Tax Commissioner gave no weight to these actions with regard to the question of his 2009 and 2011 residencies.

D. Opinions of the Attorney General

No recent opinions.

III. RETAIL SALES AND USE TAXES

A. 2013 Legislation

1. Omnibus Transportation Revenue Bill. House Bill 2313 (Chapter 766) made the following changes to Virginia tax law:

- Increases the sales and use tax statewide by 0.3 percent effective on July 1, 2013;
  - Does not to apply to purchases of food eligible for the reduced tax rate;
- Phases in an increase in the motor vehicle sales tax from 3 percent to a total increase of 4.15 percent by July 1, 2017;
- Imposes the following taxes in the Northern Virginia and Hampton Roads region to fund local and regional transportation projects effective July 1, 2013;
  - Additional state sales and use tax of 0.7 percent in both Northern Virginia and Hampton Roads;
    - Does not to apply to purchases of food eligible for the reduced tax rate;
  - Additional grantor's tax of $0.15 per $100 of valuation in Northern Virginia;
  - Additional transient occupancy tax of 2 percent in Northern Virginia;
  - Additional sales tax of 2.1 percent is imposed on motor vehicle fuels in Hampton Roads;
  - Eliminates the states 17.5 cents per gallon Fuels Tax on gasoline, diesel, and blended fuels beginning July 1, 2013 and replaces it with a tax of 3.5 percent on the wholesale price of gasoline and a 6.0 percent tax on the wholesale price of diesel;
    - If federal legislation authorizing remote sales tax collections is not enacted by January 1, 2015, the wholesale tax on gasoline would increase from 3.5 percent to 5.1 percent;
  - Increases the annual license tax on electric motor vehicles from $50 to $64;
- Requires the Tax Commissioner to comply with legislation enacted by Congress requiring states to simplify the administration of the sales and use tax as a condition to require remote sellers to collect and remit the state and local sales taxes;
  - The Tax Commissioner must take all administrative actions he deems necessary to facilitate the Commonwealth's compliance with the minimum simplification requirements, including but not limited to:
    - (i) providing adequate software and services to remote sellers and single and consolidated providers that identify the applicable state and local sales tax rate to be applied on sales on which the Commonwealth imposes sales and use tax;
    - (ii) providing certification procedures for both single providers and consolidated providers to make software and services available to remote sellers;

    - (iii) ensuring that no more than one audit be performed or required for all state and local taxing jurisdictions within the Commonwealth; and
    - (iv) requiring that no more than one sales and use tax return per month be filed with the Department of Taxation by any remote seller or any single or consolidated provider on behalf of such remote seller.
- Notwithstanding the definitions in Virginia Code § 58.1-601(A) and to the extent that conformity to any remote collection authority legislation enacted by the Congress is required, the words and terms used in Chapter 6 (Retail Sales and Use Tax) of Title 58.1 of the Code of Virginia related to the minimum simplification requirements will have the same meaning as provided in such federal legislation;
- Requires, as authority is granted by any federal legislation, the collection of sales and use tax by any remote seller, or a single or consolidated provider acting on behalf of a remote seller. If the federal legislation has an exemption for sellers whose sales are less than a minimum amount, then in determining such amount, the sales made by certain related parties will be aggregated; and
- Relieves any remote seller, single provider, or consolidated provider who has collected an incorrect amount of sales or use tax from liability for such additional amount, if collection of the improper amount is a result of the remote seller, single provider, or consolidated provider's reasonable reliance upon information provided by the Commonwealth, including, but not limited to, any information obtained from software provided by the Department of Taxation.

2. Entitlement to Certain Sales Tax Revenues for the Town of Wise. House Bill 1785 (Chapter 568) adds the Town of Wise to the list of municipalities eligible to receive certain sales tax revenues generated by qualifying public facilities in their jurisdiction to repay bonds issued to pay the costs of such facilities. This legislation also expands the list of bonds eligible to be repaid from such sales tax revenues to include bonds issued on or after January 1, 2013, but prior to January 1, 2016. This legislation is effective on July 1, 2013.

3. Harvesting Forest Products Exemption. House Bill 2054 (Chapter 223) clarifies that for purposes of the exemption available for machinery, tools, equipment, fuel, energy, and supplies used directly in the harvesting of forest products, the term “harvesting of forest products” includes all operations prior to the transport of the harvested product used for: (i) removing timber or other forest products from the harvesting site; (ii) complying with environmental protection and safety requirements applicable to the harvesting of forest products; (iii) obtaining access to the harvesting site; and (iv) loading cut timber or other forest products onto highway vehicles for transportation to storage or processing facilities. This legislation is effective on July 1, 2013.

4. Exemption for Certain Separately Stated Charges for Rented or Leased Property. House Bill 2236 (Chapter 90) clarifies that the current sales and use tax exemption that applies to separately stated installation, application, remodel and repair charges on property for sale also applies when property is leased or rented. This legislation is effective on July 1, 2013.

5. Pollution Control Exemption Clarification. House Bill 1399 (Chapter 10) clarifies that pollution control equipment certified by the Department of Mines, Minerals and

Energy for coal, oil, and gas production continues to be exempt from the Retail Sales and Use Tax. This legislation is declarative of existing law.

6. Entitlement to Sales and Use Tax Revenues: City of Fredericksburg. Senate Bill 1225 (Chapter 724) adds the City of Fredericksburg to the list of municipalities eligible to receive certain sales tax revenues generated by qualifying public facilities in their jurisdiction to repay bonds issued to pay the costs of such facilities. This legislation also expands the list of bonds eligible to be repaid from such sales tax revenues to include bonds issued on or after January 1, 2013, but prior to July 1, 2017. This legislation is effective on July 1, 013.

7. Hurricane Preparedness Sales Tax Holiday. Senate Bill 766 (Chapter 325) adds gas-powered chainsaws with a selling price of $350 or less and chainsaw accessories to the list of items that qualify for exemption during the sales tax holiday for hurricane preparedness items. This legislation is effective on July 1, 2013.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Energy Star and Watersense Sales Tax Holiday Guidelines. P.D. 12-154 (October 3, 2012). The Tax Commissioner issued guidelines for the Energy Star and Watersense sales tax holiday.

2. Exemption Certificates. P.D. 12-155 (October 4, 2012). A taxpayer appealed an assessment generated from an audit where a number of exemption certificates were denied. The Tax Commissioner adjusted the assessment by: (1) accepting properly completed exemption certificates that were dated prior to the subject transactions; (2) removing a customer's transaction from the sample because the taxpayer was collecting sales tax on the purchases of this customer; and (3) accepting a certificate where the customer listed their FEIN instead of Virginia Tax Account number because the Virginia number included the FEIN. The Tax Commissioner also rejected a number of certificates due to incomplete data on the face of the certificate or for being dated after the transactions.

3. Nexus. P.D. 12-158 (October 5, 2012). The taxpayer sells heavy equipment and repair and replacement parts for the equipment. The taxpayer also rents equipment and performs some repair services. The taxpayer does not own facilities in Virginia and does not employ salespersons that solicit sales in Virginia. The taxpayer was audited by the Tax Department and assessed use tax on untaxed Virginia sales and rental transactions. At the time of the audit, the taxpayer was not registered to collect Virginia sales and use tax on its Virginia sales and rentals. The auditor determined that the taxpayer had nexus with Virginia during the audit period and should have been registered for and collected Virginia use tax on the Virginia sale and rental transactions held taxable in the audit. The taxpayer disputed the entire assessment on the basis that it did not have sufficient nexus with the state of Virginia to require registration for the collection of sales and use taxes. The Tax Commissioner determined that the

taxpayer had nexus with Virginia and was required to collect Virginia sales tax. The taxpayer had nexus by virtue of the fact that it "[o]wns tangible personal property that is rented or leased to a consumer in this Commonwealth, or offers tangible personal property, on approval, to consumers in this Commonwealth." Per Virginia Code § 58.1-612(C)(9), a dealer with such connections has the requisite nexus.

4. Lease Payments. P.D. 12-159 (October 12, 2012). The taxpayer operates a bowling alley. As a result of the Tax Department's audit, the taxpayer was assessed use tax on leased equipment. The equipment was purchased by an affiliate of the taxpayer. The equipment was used by the taxpayer and the taxpayer "reimbursed" the affiliate for the loan payments on the purchase of the equipment. The taxpayer argued the assessed transactions are not lease payments but loan reimbursements. The Tax Commissioner denied the taxpayer's appeal. Despite the absence of profit in the payments, the Tax Commissioner stated that the taxpayer's payments to the affiliate for the use of equipment owned by the affiliate for a consideration, without the transfer of the title of such equipment, constitutes a taxable lease.

5. Sample Technique. P.D. 12-161 (October 15, 2012). The taxpayer provides automotive repair services. The taxpayer was audited by the Tax Department and assessed for its failure to charge sales tax on disposal fees. The taxpayer appealed and argued the disposal fees assessed in the sample months do not reconcile to actual amounts in the sample. The Tax Commissioner upheld the assessment with respect to this issue. The purpose of the audit sample is to determine an error factor within a representative select period. Once the error factor is determined, it is extrapolated over the entire period. In the audit, the sample months were used to calculate the average percentage of untaxed sales for the audit period. Estimated untaxed disposal fees for the entire three-month sample period equaled the amount found in the detailed test period. Accordingly, the Tax Commissioner found the sample methodology was properly applied and there was no basis for adjustment.

6. Manufacturing Exemption. P.D. 12-173 (November 2, 2012). The taxpayer is a manufacturer of paint and coating products. The taxpayer manufactures various products separately in batches and uses a different production tank for each batch of product produced. The products must be produced separately due to various product formulations and colors. A batch of product is produced in a tank every one to three days, depending on the product. After a batch of product is completed, the tank is power washed using a power wash system that is hard piped into each production tank. Production personnel operate a control panel to select the tank to be cleaned after a product batch is finished. The tank is emptied and a high pressure solvent is applied to the tank agitator and the tank walls. The used cleaning solvent is pumped to solvent recovery for reclamation. The taxpayer stated that the power wash cleaning system is used in a specialized process that is integral to the quality control of the production process because it maintains the color, chemistry, and integrity of each batch of paint and coating product produced. Product batches that are contaminated by a previous product must be scrapped and disposed. The taxpayer sought a ruling that repair parts for the integrated power wash system qualify for the manufacturing exemption. The Tax Commissioner denied the taxpayer's request for a ruling and opined that the power wash system itself, not just the repair parts, was not eligible for the manufacturing exemption.

Virginia Code § 58.1-609.3(2)(iii) provides an exemption for "[m]achinery or tools or repair parts therefor or replacements thereof, fuel, power, energy, or supplies, used directly in processing, manufacturing ... products for sale or resale ...." The term "used directly" is defined in Va. Code § 58.1-602 as "those activities which are an integral part of the production of a product, including all steps of an integrated manufacturing or mining process, but not including ancillary activities such as general maintenance or administration." Title 23 of the Virginia Administrative Code (VAC) 10-210-920 B 2 interprets the term "used directly" as it applies to manufacturing activities and states that:

> The integrated manufacturing process ... includes the production line of a plant, factory, mill, etc., starting with the handling and storage of raw materials at the plant site and continuing through the last step of production where products are finished or completed for sale and conveyed to a warehouse at the same plant site, and also includes production line testing and quality control.

The Tax Commissioner determined that the use of the power wash system is not an immediate part of the taxpayer's production process because power washing of the production tanks does not occur during production. The tanks are power washed only after the production of a product batch has ended. In addition, the tanks are power washed every one to three days, which cannot be considered an immediate part of the taxpayer's production process. Therefore, the power wash system is not eligible for the manufacturing exemption.

7. <u>Reconditioning Used Catheters</u>. P.D. 12-178 (November 9, 2012). The taxpayer is headquartered outside of Virginia and offers a reprocessing service to hospitals and medical clinics. Used medical catheters are mailed to the taxpayer's out-of-state location for reconditioning. The taxpayer cleans, decontaminates, reconditions, tests, packages, labels, and sterilizes the used medical catheters. The taxpayer never takes, title to the medical catheters being serviced. The reconditioned catheters are mailed to the hospitals and medical clinics in Virginia for reuse. The taxpayer charges the hospitals and medical clinics for its services in reconditioning the used medical catheters. The taxpayer requested a ruling on the taxability of the services provided to Virginia customers. The Tax Commissioner ruled that because no tangible personal property was provided, the service of reconditioning the catheters was not subject to sales tax. Oddly, the ruling did not mention or discuss the fact that the service is performed outside of Virginia.

8. <u>True Object Test</u>. P.D. 12-185 (November 15, 2012). The taxpayer is an independent armored car company that provides security related services to its customers geared towards safeguarding valuables for business organizations. The taxpayer's services include providing armed security personnel and specialized transportation vehicles for the purpose of transporting monetary funds and other valuables from a customer's business establishment to a particular point. The taxpayer is contemplating offering cash manager safes (the "safes") to its customers. Customers who use the safes will pay a monthly fee in addition to the taxpayer's normal service charges. The customers will not have the option of renting a safe independent of the taxpayer's core services. The taxpayer provided that the safes will play an integral role in the core services provided by the taxpayer, in that they will enable the taxpayer's customers to secure cash and other valuables on-site until the taxpayer collects the same for transportation via its armored cars. The taxpayer stated that the customers' safes will be electronically monitored by

the taxpayer. The taxpayer further stated that once the valuables are placed in the safes by its customers, the customers no longer have any access or control over the contents. Rather, the taxpayer's personnel will be authorized and able to access the contents of the safes. The taxpayer requested a ruling on whether the safe rental will be subject to sales tax. The Tax Commissioner determined that the safe rental is part of an exempt service and not subject to sales tax. In this instance, the taxpayer is deemed to be providing an exempt service when it provides secure transportation of its customers' valuables. The rental of the safes to these same customers is an extension of the security and transportation services provided by the taxpayer to its customers. The true object of the transaction between the taxpayer's and its customers is the provision of an exempt service, *i.e.*, the secured transportation of valuables.

9. Suture Materials. P.D. 12-186 (November 15, 2012). The taxpayer is located outside Virginia and is engaged in the retail sale of sutures, surgical mesh, surgical staple products, and other similar wound closure and healing materials (collectively, "suture materials"). The taxpayer's suture materials are non-medicated or may be coated or infused with antiseptic or bacterial control products and remain in the body after surgery. The suture materials are labeled "Rx" and can only be purchased by licensed physicians or under a licensed physician's order. The taxpayer sells the suture materials to healthcare practitioners such as physicians, hospitals, nursing homes, medical clinics, and surgical centers. The taxpayer requested a ruling on whether it is required to collect and remit the sales tax on the sale of suture materials to healthcare practitioners in Virginia. The Tax Commissioner determined that the sale of the suture materials may be exemption from sales tax. The taxpayer may sell suture materials exempt of the tax under the prosthetic device exemption when such product is purchased by or on behalf of an individual for use by such individual. To be exempt, a taxpayer's purchase documentation must include patient identification information at the time of purchase in order for the purchase to be deemed made on behalf of an individual. The sale of suture materials in bulk and suture materials not purchased on behalf of an individual for use by such individual are subject to the tax.

10. Veterinarians. P.D. 12-187 (November 15, 2012). The taxpayer is a national distributor of health products, feed and supplies for equine, livestock and companion animals. The taxpayer's customer, a veterinarian, is disputing the sales tax charged on the purchase of agricultural products and specifically cites the agricultural exemption for which it believes it qualifies. Based on Va. Code § 58.1-609.2, it is the taxpayer's understanding that veterinarians are only allowed an exemption for medicines and drugs that are consumed directly in the care, medication, and treatment of agricultural production animals or for resale to a farmer for direct use in producing an agricultural product for market. The taxpayer requested a ruling regarding products sold to a veterinarian and sought confirmation from the Tax Department that it is in compliance with Virginia law regarding the taxation of such products. The Tax Commissioner confirmed the taxpayer’s understanding. The agricultural exemption provides a sales and use tax exemption to a farmer who produces an agricultural product to be sold on the open market. Agriculture generally involves the cultivation of soil, production of crops, and raising of livestock. Veterinarians are not engaged in agricultural production for market. Rather, they are engaged in rendering professional services. Therefore, with the exceptions of those medicines and drugs used for agricultural production animals that are exempt to veterinarians under Va. Code § 58.1-609.2(1), veterinarians do not qualify for the agricultural exemption.

11. Cloud Computing. P.D. 12-191 (November 29, 2012). The taxpayer plans to provide access to a web-based portal that it refers to as cloud computing services. The taxpayer will provide such access to a reseller of the services. The portal would allow the reseller to maintain a database of its pharmaceutical inventory. The reseller would sell access to the web-based portal to pharmacies. The pharmacies would use the portal to keep track of their patients' prescriptions and doctors' visits, as well as to facilitate remote consultations with the patient. When the patient visits they pharmacy, the pharmacy would use the web-based portal to verify the patient's information from the primary physician's database. The pharmacy would order the patient's medicine based on the information provided in the database. The pharmacy would also be able to use the portal to monitor the patient's prescription on a periodic basis and make changes to the order as needed. The taxpayer also plans to use a third party billing service to bill its customers a monthly fee for access to the portal. The taxpayer requested a ruling regarding the taxability of the monthly subscription fee it plans to charge the reseller for access to the web-based portal. The taxpayer also requested guidance as to the taxability of the billing services. The Tax Commissioner determined that sales tax is not applicable to either transaction. As no tangible personal property is being transferred and the computing service is not a taxable service, the subscription fee is not subject to sales tax. Although the billing service may issue paper bills, the true object (Title 23 of the Virginia Administrative Code 10-210-4040) of the taxpayer's purchase is to obtain nontaxable services that produce bills that are unique to each customer.

12. Overseas Contractor. P.D. 12-207 (December 13, 2012). The taxpayer is a registered Virginia dealer that sells materials to a customer who constructs US embassies overseas. The customer's Virginia warehouse is a consolidated receiving point (CRP). This means that materials destined to classified overseas projects must be shipped to the CRP, where the materials are received, temporarily stored and prepared for overseas shipment. Once the materials are ready for shipment, a U.S. State Department agent will inspect the material and the shipping container and seal it. At this point, the container with the prepared materials is sent to a freight forwarder. The taxpayer asked if any exemption from the Virginia sales or use tax applies to materials in international commerce. The Tax Commissioner responded that Va. Code § 58.1-609.3(1) provides an exemption from the retail sales and use tax for personal property purchased by a contractor which (1) is used solely in another state or in a foreign country, (2) the property could be purchased by a contractor for use free from sales tax in another state or foreign country, and (3) the property is pending shipment to such state or country.

13. Defaulting on Leases. P.D. 12-208 (December 13, 2012). The taxpayer entered into leasing contracts with customers. Customers defaulted on the leasing contracts and the balance was charged off or in some instances the property was sold to a third party for a price on which sales taxes were collected leaving a balance due that was charged off to bad debts. In the first instance, a lessee defaulted on a 60 month lease leaving a deficiency balance of $55,000.00, which has been charged off to bad debts. Sales tax was remitted on each monthly lease payment. Subsequently, the taxpayer received a settlement from litigation or a settlement amount from a third party guarantor. In the second instance, the lessee defaulted on its 60 month lease agreement with an option to purchase at the end of the lease for $1.00. Sales tax was remitted on each monthly lease payment. After the taxpayer sold the equipment to an unrelated third party, a net deficiency of $25,000.00 remained unpaid. The taxpayer charged this amount off to bad debts. Subsequently, through litigation, the taxpayer received a settlement for

$8,000.00 as a final judgment, or receives $2,000.00 from another guarantor. The taxpayer requested a ruling on the application of the sales tax to the receipt of funds from the litigation of the leasing contracts or the subsequent receipt of funds from third party guarantors. The Tax Commissioner opined that in both instances, the taxpayer must report the amount received on its first return after such collection and compute the tax on such amount included in its return based on Virginia Code § 58.1-621.

14. Campground Leases. P.D. 12-209 (December 13, 2012). The taxpayer is a privately-owned campground, which operates as a seasonal campground, open from April 1 through October 31 every calendar year. The taxpayer's seasonal campers lease campsites from the taxpayer during the entire seven-month operating period. The lease also entitles the customers to onsite winter storage for the five-month winter off season. The taxpayer stated that a lease agreement is never signed for less than 90 days. The taxpayer requested a ruling on whether the accommodations provided to seasonal campers pursuant to seven-month leases are taxable. The Tax Commissioner stated that the seven month leases are not subject to sales tax. Virginia Code § 58.1-602 defines a "retail sale" to include the sale or charges for any room or rooms, lodgings, or accommodations furnished to transients for less than 90 continuous days. As the leases exceed 90 days, they do not fall under the definition of a “retail sale.”

15. Business Records. P.D. 12-213 (December 18, 2012). The taxpayer operates an automotive repair business. The Tax Department's audit disclosed that the taxpayer has not reported any sales. Accordingly because sales tax returns had not been filed, the assessment was issued based on the best information available. The taxpayer appealed the assessment contending that its business was closed in 2005. The taxpayer stated that the auditor's use of the taxpayer's business license information, rather than returns, as a basis for the assessment is erroneous. The taxpayer asserted that its business is not operational, and the business license was kept active for purposes of keeping the location zoned for business. The taxpayer requested that the assessment be abated. The Tax Commissioner denied the appeal. The auditor had information that showed the Tax Commissioner that the business was operational. The Tax Commissioner determined that the methodology in determining the assessment was valid, but gave the taxpayer an additional 45 days to provide documentation to the auditor sufficient to determine the actual tax liability for the audit period at issue.

16. Meal Plan Services. P.D. 12-214 (December 21, 2012). The taxpayer provides meal plan services to grade school students, university students (primarily at fraternity and sorority housing facilities) and a private primary educational facility in Virginia. The taxpayer entered into a contract with a Virginia customer for the provision of meals plan services. The taxpayer and customer mutually agree on the menu and portion sizes of the meals. The taxpayer is responsible for purchasing all the food, providing a chef to prepare the meals, serving the meals, and keeping the kitchen and dining room service areas clean during and after service of all meals. The taxpayer will also provide certain food items for a fixed fee in accordance with the customer's specifications. The taxpayer prepares a specific number of meals based on the customer's daily count of students desiring to purchase a meal. The taxpayer incorporates a management fee into the per-plate cost billed to the customer, which in turn sells the meals to its students for a fixed price. The taxpayer requested a ruling regarding the application of the sales tax to several scenarios related to meal services contracts. The Tax Commissioner opined that (1) food sold to for-profit school for service to students was subject to

sales tax as the school is the consumer of the food; (2) food sold to for-profit schools for resale was exempt under the resale exemption, (3) food sold to nonprofit school was exempt when the food was purchased for students as part of their meal plan; (4) food sold to a nonprofit school was taxable when the food is intended to be provided at a social event outside of school hours; and (5) food sold to fraternity or sorority houses is subject to the sales tax.

17. Licensed Software. P.D. 12-215 (December 21, 2012). The taxpayer is a medical practice in Virginia. The taxpayer purchased a license to use electronic medical records software from Company A, a healthcare software developer located in another state. No tangible personal property was received by the taxpayer in conjunction with this purchase. In addition, Company A separately charged and collected the Virginia sales tax for employee travel and hotel expenses in connection with on-site training not included in the license agreement. The taxpayer contracted with Company B, a full service software company located in another state, to host the licensed electronic medical records software applications. The taxpayer utilizes the software application hosted by Company B by remote access via the Internet. Again, no tangible personal property was received by the taxpayer in conjunction with this purchase. The taxpayer requested a ruling on whether the licenses and the travel expenses are subject to Virginia sales tax. The Tax Commissioner determined that neither the licenses nor the travel expenses were subject to Virginia sales tax. The Tax Commissioner discussed the taxation of software in the ruling. However, the fact that no tangible personal property was provided to the taxpayer and the services are not among the services taxed by Virginia led to the conclusion that no tax was due. Furthermore as the travel expenses were associated with the provision of an exempt service, no sales tax was due.

18. Lump Sum Charges. P.D. 12-217 (December 21, 2012). The taxpayer is a licensed mechanical contractor that installs and repairs process piping and exhaust systems for various industrial and commercial customers. The taxpayer also removes and installs machinery used in customers' manufacturing and processing operations and provides other similar contract services. The taxpayer was audited and assessed sales tax on lump sum charges billed to customers for the performance of its contract work. Some of the lump sum billings included fabrication labor charges for various contract jobs. The taxpayer appealed and argued that the Tax Department's assessment is incorrect because the audit includes exempt labor charges that were separately stated on customers' invoices. In addition, the taxpayer states that some of the charges in the audit were invoiced for exempt real property construction services. The Tax Commissioner upheld the assessment because he determined, despite the taxpayer’s argument, that the charges included both taxable and exempt charges. In such an instance, the entire charge is taxable. The Tax Commissioner did allow the taxpayer an additional 45 days to present evidence that the charges were in fact for wholly exempt services and did not include a taxable component.

19. Nonprescription Drug Exemption. P.D. 13-1 (January 4, 2013). A taxpayer requested a reconsideration of a previous ruling regarding the application of the retail sales and use tax exemption for nonprescription drugs to various anti-bacterial products sold by the taxpayer's affiliates. In the prior ruling, the Tax Commissioner denied the taxpayer an exemption from the retail sales and use tax on the sale of anti-bacterial products sold by the taxpayer's affiliates that include skin nourishing and softening ingredients and fragrances. The taxpayer argued that the guidance provided in the Nonprescription Drug Exemption Question

and Answer (Q&A) Summary reflects the broad application of the nonprescription drug exemption to anti-bacterial products that was intended by the General Assembly at the time of enactment. Based on the Q&A Summary, the taxpayer believed there is ample support to exempt all consumer over-the-counter antiseptic drugs recognized by the Federal Food and Drug Administration (FDA), as they contain a nonprescription drug and are marketed as such. Accordingly, the taxpayer believed, that the products in question qualify for the nonprescription drug exemption provided in Va. Code § 58.1-609.10(14).

Virginia Code § 58.1-609.10(14) provides an exemption from the retail sales and use tax for "(i) Any nonprescription drugs and proprietary medicines purchased for the cure, mitigation, treatment, or prevention of disease in human beings and (ii) any samples of nonprescription drugs and proprietary medicines distributed free of charge by manufacturer, including packaging materials and constituent elements and ingredients." Subsection b of Va. Code § 58.1-609.10(14) provides that "[t]he terms 'nonprescription drugs' and 'proprietary medicines' shall be defined pursuant to regulations promulgated by the Department of Taxation. The exemption authorized in this subdivision shall not apply to cosmetics."

The Tax Commissioner disagreed with the taxpayer and determined that although an item may be classified as a drug by the FDA, products that contain coloring, perfume, or similar additives are considered to be cosmetic or toiletry products, *e.g.*, lipstick, foundation makeup, soaps, and lotions. Anti-bacterial products may fall within the definition of an "antiseptic hand wash product" for FDA regulatory purposes; however, to exempt such products that also advertise skin nourishing and softening effects, as well as provide a large selection of fragrances, violates the clear intent of the statute, *i.e.*, to exempt nonprescription drugs and proprietary medicines. **Comment: This is a perfect topic for a regulation.**

20. Pollution Control Exemption Policy Change. P.D. 13-2 (January 10, 2013). The taxpayer drills and operates oil and natural gas wells. The Tax Department audited the taxpayer and assessed use tax on various equipment and supplies purchased for use in the operation of the business. The taxpayer appealed and disputed the use tax assessed on pit liners and storage tanks. The taxpayer maintained that the pit liners and storage tanks qualify for the pollution control exemption. The taxpayer provided a listing of pit liners and storage tanks that was submitted after the audit was completed to the Virginia Department of Mines, Minerals and Energy (DMME) for pollution control certification. Virginia Code § 58.1-609.3(9)(ii) provides the following exemption from the sales and use tax:

> Effective retroactive to July 1, 1994, and *ending July 1, 2006*, certified pollution control equipment and facilities as defined in § 58.1-3660 and which, in accordance with such section, have been certified by the Department of Mines, Minerals and Energy for coal, oil and gas production, including gas, natural gas, and coalbed methane gas. (Emphasis added.)

Virginia Code § 58.1-3660(B) defines "[c]ertified pollution control equipment and facilities", in part, as:

> any property, including real or personal property, equipment, facilities, or devices, used primarily for the purpose of abating or preventing pollution

> of the atmosphere or waters of the Commonwealth and which the state certifying authority having jurisdiction with respect to such property has certified to the Department of Taxation as having been constructed, reconstructed, erected, or acquired in conformity with the state program or requirements for abatement or control of water or atmospheric pollution or contamination.

Virginia Code § 58.1-3660(B) then states that DMME is the "[s]tate certifying authority" for coal, oil and gas production. DMME issued a letter to the Tax Department dated February 21, 2012 certifying the pit liners and storage tanks at issue are primarily used for the abatement or control of water or atmospheric pollution or contamination. Based on the information provided to the Tax Department by DMME, the Tax Commissioner exemption in Va. Code § 58.1-609.3(9) (ii) applies to the taxpayer's purchases of pit liners and storage tanks that were certified by DMME. This exemption expired July 1, 2006, and the exemption statute was not amended by the Virginia General Assembly to extend the exemption. On May 9, 2012, the Tax Department issued Public Document (P.D.) 12-73, which states that the exemption for pollution control equipment and facilities certified by DMME applies only to those purchases of qualifying property made prior to the July 1, 2006 expiration of the exemption.

Subsequent to the issuance of P.D. 12-73, the Tax Department reviewed and reconsidered its policy with respect to the pollution control exemption administered by DMME. <u>Effective immediately and retroactive to July 1, 2006, the Tax Department continues to recognize the pollution control exemption administered by the DMME. The Tax Department's determination in P.D. 12-73 relied on the statutory language in Va. Code § 58.1-609.3(9)(ii) which set out the July 1, 2006 expiration date of the exemption. The Tax Department will now follow the statutory language in Va. Code § 58.1-609.3(9)(i), which provides an exemption for "[c]ertified pollution control equipment and facilities as defined in § 58.1-3660, except for any equipment that has not been certified to the Department of Taxation by a state certifying authority pursuant to such section ...."</u>

Although the exemption in Va. Code § 58.1-609.3(9)(ii) has expired, the Tax Commissioner stated that DMME remains a state certifying authority for pollution control equipment and facilities under Va. Code § 58.1-3660. For this reason, the Tax Commissioner interprets Va. Code § 58.1-609.3(9)(i) to apply to the exemption for pollution control equipment and facilities certified by DMME for coal, oil and gas production. The Tax Commissioner rescinded P.D. 12-73 with respect to the pollution control exemption administered by the DMME in accordance with this determination.

Comment: Isn't this "policy change" a different way for the Tax Department to admit that they misinterpreted the exemption in the first place?

21. <u>Gross Sales Price</u>. P.D. 13-3 (January 10, 2013). The taxpayer operates a resort. An audit resulted in the assessment of use tax on certain tangible assets and expensed purchases of tangible personal property. In addition, the use tax was assessed on certain fees, such as shipping and handling fees, setup fees and purchasing fees. In the process of renovating its facilities, the taxpayer engaged a vendor to find specified products at the best possible price. The taxpayer agreed to pay a purchasing fee in which the vendor would charge 10% of the

product price of such specified products. On the vendor invoices, the product prices, shipping fees, and purchasing fees are separately staffed. The taxpayer claimed that the purchasing fires held in the audit are exempt because they constitute labor and are separately stated on the vendor invoices. The taxpayer requested the abatement of the tax assessed on such fees. The Tax Commissioner upheld the assessment. The statute defining “sales price” contains no exemption or exclusion from the retail sales and use tax for such fees. Accordingly, the purchasing fees charged in connection with the retail sale of tangible personal property were determined to be part of the sale and therefore taxable.

22. Rebates. P.D. 13-4 (January 10, 2013). A retailer sells products to customers throughout the month and collects and remits the retail sales and use tax for each transaction. Some of the retailer’s customers purchase a high volume of products monthly. At the end of each month, the retailer reviews their total sales for each customer to determine if a rebate is warranted. For example, if a customer purchases $10,000 in products, a retailer may decide to give a 10% rebate back to the customer. The retailer issues a check to the customer for $1,000. A ruling was requested on whether the sales taxes that were collected should be refunded with regard to the rebate. The Tax Commissioner opined that the sales taxes should not be refunded. He observed that the customers of the retailers at issue are not returning any tangible personal property previously purchased. In the example, the rebate of $1,000 is a gesture of goodwill between the retailers and their high volume customers. The sales tax should not be refunded on the amount of the rebate because there is no tangible personal property that has been returned upon which to base a deduction from gross sales and thus, a refund of the sales tax.

23. Exempt Organizations. P.D. 13-9 (January 31, 2013). The taxpayer sells tangible personal property to exempt organizations and questions the acceptance of an exemption certificate in good faith. The taxpayer specifically requested a ruling on whether the exemption applies only to purchases paid directly from an organization's funds whether by organizational check or by credit card. The taxpayer also asked if it is necessary to retain proof of payment, such as a copy of the organization's check or credit card, to substantiate the exempt sale. The Tax Commissioner opined that the organization must pay directly from its own funds for the products and recommended retaining proof of payment.

24. Manufacturing and Research and Development Exemptions. P.D. 13-11 (January 31, 2013). The taxpayer designs, develops, and manufactures electronic measuring devices that monitor power quality and electrical usage. These handheld devices are primarily used by electric companies to gather customer usage for billing purposes and to monitor the quality of power being transmitted to its customers. An audit by the Tax Department resulted in the assessment of tax, penalty, and interest. The taxpayer appealed the assessment contending it erroneously includes purchases used in exempt manufacturing and industrial production and exempt research and development activities. The Tax Commissioner addressed each contested item recommending either that the item was correctly assessed or an on-site visit to obtain more information.

25. Occasional Sale. P.D. 13-22 (February 20, 2013). The taxpayer is in the business of selling tires, accessories and related automotive services. During the audit period, the taxpayer entered into an asset purchase agreement with three related entities (the “Sellers”). The Sellers owned and operated retail automotive service and repair stores (the “Stores”). The

taxpayer agreed to purchase, and the Sellers agreed to sell, all equipment, inventory, customer lists and other personal property located at or related to the Stores. Acquired assets include all furniture, fixtures, equipment and supplies owned by the Sellers, all inventory, all customer and supplier lists, all business records, correspondence, files, and other related books and records, as well as all intangible property and intangible property rights. The asset purchase agreement includes a non-compete agreement between the taxpayer and the Sellers. The taxpayer appealed the assessment of tax on certain fixed assets related to the asset purchase agreement contesting that the sale at issue is an occasional sale and not subject to the retail sales and use tax. The Tax Commissioner agreed finding that the sale at issue is for the sale of all or substantially all the assets of the Sellers' business. In accordance with the definition of an "occasional sale," the sale at issue was deemed an occasional sale that is not subject to the retail sales and use tax.

26. True Object Test. P.D. 13-23 (February 20, 2013). The taxpayer, who operates an athletic facility, was assessed use tax on its purchase of a marketing consulting package. Based on the initial sales invoice reviewed during the audit, the price of the package includes both consulting services and tangible personal property. The taxpayer appealed and presented a second invoice to support its contention that the price of the marketing package was for services and shipping and handling only. The Tax Commissioner reviewed the evidence and although tangible personal property was included in the purchase price of the package determined it was not critical to the transaction. Also based on the contract's language, the Tax Commissioner determined that package develops a customized marketing strategy that enables the taxpayer to attract and retain new members. Therefore the Tax Commissioner found that the true object of the taxpayer's purchase is to obtain custom marketing services, not tangible personal property. As the taxpayer purchased a nontaxable service from its vendor, it was not subject to the sales and use tax on the charge for such service.

27. Durable Medical Equipment Exemption. P.D. 13-26 (March 5, 2013). The taxpayer specializes in the development of innovative drug-device products that promote the healing of musculoskeletal injuries and diseases, including orthopedic, spine and sports injury applications. The taxpayer requested a ruling on the application of the retail sales tax to two products, Device A and Device B. Device A is a combination device/drug product for use in bone repair and regenerative procedures of foot and ankle fusions. Device A is pending approval by the federal Food and Drug Administration (FDA) as a Class III medical device. Device B is a synthetic mineral-collagen bone graft matrix for bone void filling and fracture repair. The taxpayer indicated that Device B has been cleared by the FDA as a Class II medical device for prescription use only. The taxpayer will sell Device A and Device B to hospitals and surgical centers in the Commonwealth. The taxpayer requested a ruling on whether it is required to collect and remit the sales tax on the sale of these medical devices. The Tax Commissioner opined that provided the FDA approves Device A as a Class III medical device, the taxpayer may sell Device A exempt of the tax when such product is purchased by or on behalf of an individual for use by such individual. However until the FDA approval is received, the taxpayer must charge the retail sales and use tax on the sale of Device A. The taxpayer may sell Device B exempt of the tax when such product is purchased by or on behalf of an individual for use by such individual.

28. Fabrication. P.D. 13-30 (March 12, 2013). The taxpayer operates as a welder. An audit disclosed that the taxpayer was fabricating tangible personal property and

providing repair parts for repair services without charging or collecting the retail sales tax. In some instances, the taxpayer's invoices reflected lump sum charges for fabrication and repair charges and other times separately stated the repair parts on repair invoices. The taxpayer considers itself to be a contractor and paid the tax on all purchases used in welding and repair services. The taxpayer sought a waiver of the assessment stating it was not aware of its responsibility to collect the sales tax on sales of fabrication or repair parts. The Tax Commissioner denied the taxpayer's request. The Tax Commissioner determined that the assessment was correct. The Tax Commissioner noted that the Tax Department published regulations in 1966, 1969, 1979, 1985, and 1997 that were widely distributed and made freely available to the general public. As the regulations provide guidance in the registration of dealers and the application of the tax to retail sales and consumer purchases of tangible personal property, the Tax Department disseminated information on the sales tax which was readily available to the taxpayer.

29. Nonprescription Drugs and Proprietary Medicines Exemption. P.D. 13-32 (March 15, 2013). The Tax Department issued Tax Bulletin 13-5 to provide an overview of the exemption available for nonprescription drugs and proprietary medicines.

30. Real Property Contractor. P.D. 13-34 (March 15, 2013). The taxpayer has a contract with a prime contractor, and the prime contractor has a real property construction contract with a tax-exempt entity. The taxpayer purchases raw materials for the project and has them shipped to its facility in Virginia. The taxpayer stated the raw materials are fabricated into product that is installed in a building. The taxpayer stated that it was paying tax on the purchase of the tangible personal property at issue prior to the issuance of a letter from the Tax Department. The taxpayer continued to pay the same following receipt of the Tax Department's letter. The taxpayer requested guidance regarding the application of the temporary storage exemption in Va. Code § 58.1-609.3(1) to the purchase of the tangible personal property at issue. Based on the information provided, the Tax Commissioner deemed the taxpayer to be a contractor with respect to real property construction. Accordingly, the taxpayer is the user and consumer of the tangible personal property purchased with respect to the real property construction contract at issue and does not make a retail sale of the property to the purchaser and the taxpayer is the user and consumer of the property at issue. Accordingly, the taxpayer is liable for the tax on the purchase of the tangible personal property used in the real property construction.

31. Exempt Sales. P.D. 13-35 (March 18, 2013). The taxpayer is a seller of tires, parts and supplies to the automotive retail industry. An audit discovered that the taxpayer made sales for which no tax was charged, a partial tax was charged, and invalid exemption certificates were accepted to support exempt sales. The taxpayer disagreed with the audit results contending the auditor disallowed exempt sales to dealers that are resellers, as well as sales supported by exemption certificates. The taxpayer stated that it will continue working with the auditor by providing additional documentation validating the exempt sales erroneously included in the Tax Department's audit. The Tax Commissioner upheld the assessment. The Tax Commissioner noted that the taxpayer was given ample time to secure valid exemption certificates to prove that the sales held in the audit were exempt. The auditor requested additional information from the taxpayer at least six times over the span of four years. The Tax Commissioner ultimately determined that the continual review of sporadically submitted

documentation over an extended period of time is not acceptable. The taxpayer was given sufficient opportunity to provide the proper documentation to support its position that the sales assessed in the audit are exempt. **Lesson:** Be prompt and responsive to the auditor.

32. Shipping and Handling. P.D. 13-37 and 13-38 (March 20, 2013). The taxpayer sells apparel via the Internet. The Tax Department audited the taxpayer and assessed additional tax and interest. The taxpayer protested the assessment of shipping and handling charges on its sales to Virginia residents. The taxpayer argued that although its sales transaction spreadsheet indicates charges for combined shipping and handling, it only bills its customers for shipping and presents an invoice to support its protest. The taxpayer submitted one invoice as evidence, but the invoice was not an invoice subject to the audit and it was unclear what sales and use tax was charged. Regardless, the Tax Commissioner allowed the taxpayer one final opportunity to provide documentation supporting its position.

33. Sampling. P.D. 13-39 (March 20, 2013). The taxpayer is a drywall contractor. The taxpayer was assessed consumer use tax in the audit in instances where the Virginia sales tax was not paid to the vendor at the time of the sale. The purchases were for lead lined drywall and represent the two exceptions included on the Purchases Exceptions list in the audit. The taxpayer stated that the lead lined drywall at issue is a specialty item, and that it does not typically use lead lined drywall in its applications. The taxpayer maintained the purchases at issue were one-time purchases from the vendor, and that the purchases were made from the vendor at issue because the product was not available from a local vendor. The taxpayer did not contest the assessment of tax on the charges at issue. However, the taxpayer did contest the extrapolation of the purchases sample over the entire audit period. The taxpayer stated that it conducted an extensive review of all invoices and receipts over the audit period, and found that it had complied with and had paid all Virginia sales tax as required. The Tax Commissioner agreed and adjusted the sample. Based upon the nature of the taxpayer's business, the Tax Commissioner determined that the purchases at issue were isolated in nature, not a normal part of the taxpayer's business, and represented a one-time event that occurred during the audit period.

34. Lease of Tangible Personal Property. P.D. 13-41 (March 21, 2013). The taxpayers operate as hotels that are part of a Real Estate Investment Trust (REIT) structure. Pursuant to the REIT structure, the taxpayers lease from the Lessor the land, building, furniture, fixtures, and equipment associated with the hotels. Under the REIT structure, the Lessor acquires all assets associated with the hotel and leases the same to the taxpayers. The taxpayers contested an assessment of tax on the tangible personal property leased from the Lessor. The taxpayers maintained that the Lessor, not the taxpayers, carries the tangible personal property at issue on its books and records. The taxpayers asserted that the Virginia sales tax was paid by the Lessor at the time the property at issue was purchased. The taxpayers provided proof the tax was paid by the Lessor, and no additional tax should be assessed. The taxpayers requested that the tax assessed in the audit with respect to the tangible personal property at issue be abated. The Tax Commissioner disagreed and upheld the assessment. The lease of the tangible personal property at issue is subject to the Virginia retail sales and use tax. While the Lessor is legally obligated to collect the tax from the taxpayers, the tax is the legal debt of the taxpayers. The taxpayers' sales and use tax compliance is not evaluated based upon the Lessor's compliance.

35. Credit for Payment of Other State's Sales Tax. P.D. 13-42 (March 21, 2013). The taxpayer operates a retail store that sells clothing and housewares. As a result of an audit, the taxpayer was assessed use tax on its asset purchases. The taxpayer protested the application of tax to such purchases and provided documentation to support its position that the assessment of use tax on several assets is erroneous. The taxpayer provides invoiced that indicate another state's sales tax was charged at the time of purchase. The Tax Commissioner reviewed the invoices and allowed a credit per Virginia Code § 58.1-611 for the payment of the other state's sales tax.

36. Industrial Processing Exemption. P.D. 13-44 (March 29, 2013). The taxpayers, an industrial processor as determined in a prior ruling, protested the assessment of purchases used to transmit water from storage to the customer qualify for the industrial processing exemption. The taxpayers believed industrial processing includes quality control testing performed during the transmission process. The taxpayers also stated that purchases of chemicals and additives used in water treatment remain in the assessment. The taxpayers further contended the assessed purchases are required by the Virginia Department of Health and to ensure as the water is transmitted for use in fire protection. The Tax Commissioner disagreed and upheld the assessment. Although water may be tested throughout distribution, testing and quality control are only deemed exempt activities during the manufacturing process in accordance with Title 23 VAC 10-210-920(C)(2), which provides that testing and quality control on the production line are part of exempt production. For the taxpayer, the testing occurred during distribution of the water. Title 23 of the Virginia Administrative Code (VAC) 10-210-920(C)(3) defines distribution as "the transport or conveyance of products after the completion of production and is not part of manufacturing or processing. Distribution includes the storage of a product subsequent to its production (other than storage at the plant site) and the actual transport of the product for sale. All tangible personal property used to convey, transport, handle, store, market or display finished products is taxable." The regulation goes on to state that such property includes "[t]angible personal property used to transport manufactured products to market or customers."

37. Subcontractor. P.D. 13-45 (March 29, 2013). The taxpayer operates as a general contractor. An audit determined that the taxpayer purchased construction materials without payment of the tax to suppliers or accrual and payment of the tax to the Tax Department. The taxpayer, in agreement with the audit results with the exception of four purchases, stated that the subcontractor was responsible for and paid the tax to the Tax Department on the purchases. The taxpayer submitted documentation supporting its position that the tax was paid by the subcontractor. Accordingly, the taxpayer requested an adjustment of the assessment for the purchases at issue, as well as a waiver of the assessed penalties. The Tax Commissioner disagreed. A review of the documentation showed that the purchases were made by the taxpayer for its own use.

38. Medical Gases. P.D. 13-46 (April 1, 2013). The taxpayer is a distributor of industrial, medical and specialty gases. The taxpayer sells the medical and specialty gases to licensed hospitals and physicians. The gases include, but are not limited to, oxygen used for respiratory therapy, nitrous oxide which is an anesthetic, nitrogen used in cryogenic therapy by licensed dermatologists, helium used in the treatment of respiratory ailments and argon used in cryosurgery. In addition, the taxpayer sells medical oxygen to home healthcare providers. The

taxpayer believes the sale of medical and specialty gases qualify for exemption as either controlled medicines under Title 23 of the Virginia Administrative Code (VAC) 10-210-940 or nonprescription drugs pursuant to Virginia Tax Bulletin (VTB) 13-5 (3/15/13). The Tax Commissioner determined that the taxpayer may sell medical gases exempt of the tax to a licensed physician, dentist, optometrist, licensed nurse practitioner, or licensed physician assistant for use in his professional practice. The taxpayer may also sell medical gases exempt of the tax to a licensed hospital, nursing home, clinic or similar corporation. The FDA classifies medical gases (*e.g.*, oxygen, carbon dioxide, helium, nitrogen, nitrous oxide, medical air and combinations of these) as drugs within the meaning of section 201(g)(1) of the Federal Food, Drug, and Cosmetic Act (the Act) (21 U.S.C. 321(g)(1)) and pursuant to section 503(b)(1)(A) of 51 the Act (21 U.S.C. 353(b)(1)(A) and are required to be dispensed by prescription. The Virginia Board of Pharmacy concurs with the federal classification and deems medical gases as Schedule VI controlled substances under the Virginia Drug Control Act found in *Va. Code* Title 54.1 Chapter 34.

39. Pre-written Software. P.D. 13-51 (April 29, 2013). A taxpayer requested a ruling as to whether the retail sales and use tax applied to various transactions involving software. The taxpayer indicated that software was delivered both electronically and by compact disc (CD). The questions concerned specific fact situations regarding the sale and delivery of the software. One important aspect of several of the questions is that the Tax Commissioner stated that the contract was not specific with regard to terms of delivery. In other words, he could not make a determination from the language of the contract whether the software was delivered electronically (and not subject to sales tax) or by a tangible medium and possibly subject to sales tax.

40. Place of Delivery. P.D. 13-52 (April 29, 2013). The taxpayer, located outside of Virginia, manufactures golf, utility, and transportation vehicles. The taxpayer appealed an assessment of the retail sales tax on several utility vehicles that were sold to a Veteran's Administration Hospital (the "VA hospital") located outside of Virginia. The auditor held the sales taxable in Virginia asserting that constructive possession took place in Virginia because the vehicles were initially delivered to a Virginia dealer before they were delivered to the VA hospital. The taxpayer paid the assessment and requested a refund. The Tax Commissioner removed the sales from the sample and ordered the assessment to be adjusted and a refund issued. The Tax Commissioner examined documents provided by the taxpayer and determined that the taxpayer, not the VA hospital, delivered the vehicles to the Virginia dealer and then to the VA hospital. Accordingly, no delivery occurred in Virginia.

41. Distributors. P.D. 13-54 (May 1, 2013). The taxpayer appealed an assessment of additional sales taxes. The taxpayer markets and distributes frozen food products that consist primarily of meats such as beef, pork, chicken and seafood. The taxpayer utilizes a network of individual distributors (the "Distributors") to sell its products utilizing door-to-door sales. The taxpayer is registered as a dealer with the Tax Department and was reporting and remitting retail sales taxes on behalf of the Distributors. The business relationship between the taxpayer and the Distributors is governed by a Distributorship Agreement (the "Agreement") that is signed by both parties. The Tax Department audited and assessed the taxpayer retail sales tax based on a determination that the Distributors' sales were underreported. Upon appeal, the Tax

Commissioner determined that the Distributors were not employees of the taxpayer and thus that the taxpayer was not required to collect sales tax based upon their sales.

42. Guidelines for the Retail Sales and Use Tax Changes Enacted in the 2013 General Assembly Session. P.D. 13-57 (May 1, 2013). The Tax Commissioner issued guidelines for the retail sales and use tax changes enacted in the 2013 General Assembly Session by House Bill 2313 (Chapter 766).

43. Guidelines for the Accelerated Sales Tax Payment. P.D. 13-61 (May 6, 2013). The Tax Commissioner issued guidelines for the accelerated sales tax payment due in June 2013.

44. Sampling. P.D. 13-66 (May 10, 2013). The taxpayer is a contractor providing drilling services for commercial and residential water wells and geothermal systems. In addition, the taxpayer installs pump and filtration systems. The taxpayer was assessed consumer use tax in the audit in instances where the Virginia sales tax was not paid to the vendor at the time of purchase. The purchases included equipment, pipe, materials, tools, and office supplies used in the taxpayer's drilling operation. The taxpayer appealed and claimed that the sample is not representative of the audit period because the majority of the purchase exceptions relate to a new line of business activity that required out-of-state purchases. The Tax Commissioner upheld the assessment after determining that the auditor used the best available information to create the sample.

45. Durable Medical Equipment. P.D. 13-67 (May 10, 2013). The taxpayer is a healthcare provider that operates for-profit hospitals in Virginia. Through a contractual agreement with the supplier, the taxpayer leases specialty beds and mattresses used in the prevention and treatment of various pulmonary and wound conditions. At issue is the tax assessed on specialty beds leased under an Acute Care Expense Limitation ("CAP") program. The CAP program provides the taxpayer with a lease arrangement of specialty beds. The auditor assessed tax on the lease of the specialty beds because the lease of the specialty beds did not meet the criteria of being purchased by or on behalf of an individual which is required to receive the durable medical equipment exemption. The taxpayer appealed and the Tax Commissioner mostly upheld the assessment. Virginia Code § 58.1-609.10(10) requires that the purchase of durable medical equipment must be made for a specific individual to be eligible for the exemption. The Tax Commissioner did not have any information on all but three of the leases to determine that the bed was leased for a specific individual. For the three leases, the assessment was adjusted.

46. Hurricane Preparedness Sales Tax Holiday Guidelines. P.D. 13-71 (May 14, 2013). The Tax Commissioner issued guidelines for the hurricane preparedness sales tax holiday which occurred on May 25, 2013 through May 31, 2013.

47. Government Contractor. P.D. 13-73 (May 21, 2013). The taxpayer is a government contractor that provides various training courses in firearms and security. The taxpayer entered into a contract with an agency of the United States government to provide such training. The contract required the taxpayer to provide instructors, as well as weapons, ammunition, and other equipment to be used in the training courses. The Tax Department's

auditor deemed the contract at issue a contract for services, and all tangible personal property purchased in performance of the contract was held taxable in the audit. The taxpayer appealed contending that certain purchases made pursuant to the contract qualify for exemption from the tax. The Tax Commissioner reviewed the contract and determined that each contract line item was for the provision of services. Therefore, the property purchased by the taxpayer in connection with the contract was subject to sales and use tax.

48. Durable Medical Equipment Exemption. P.D. 13-77 (May 29, 2013). The taxpayer sells dental equipment, supplies, and implants. As a result of the Tax Department's audit, an assessment was issued for untaxed sales not supported by valid certificates of exemption and sales of durable medical equipment lacking documentation to support the exemption in Va. Code § 58.1-609.10(10). The taxpayer appealed and asserted that the contested sales of durable medical equipment to dentists are for specific patients and are exempt under Va. Code § 58.1-609.10(10). To that end, the taxpayer provided additional documentation in support of its claim and requested that the Tax Department adjust the audit accordingly. Based on a review of the documentation submitted to the Tax Department, the audit was adjusted to remove those items in which the taxpayer provided documentation that the medical equipment was purchased on behalf of a specific individual.

49. Durable Medical Equipment Exemption. P.D. 13-78, 13-79, 13-80, and 13-81 (May 29, 2013). The taxpayer is a for-profit hospital in Virginia. The taxpayer pays a flat amount each month based upon its historical leasing levels of acute care beds. The auditor held the specialty beds in the audit because the pricing based on historical usage of the specialty beds did not meet the criteria of being purchased by or on behalf of an individual and issued an assessment. The taxpayer appealed claiming that the lease of the specialty beds is for specific patients and qualifies as exempt durable equipment under Va. Code § 58.1-609.10(10). The Tax Commissioner adjusted the assessment after determining that a prescription work order was issued by a licensed physician when the taxpayer needs a specific type of bed for a patient. The work order included the name of the patient. The bed was provided from either the supplier's inventory at its warehouse or its supply at the taxpayer's hospital location. The taxpayer was invoiced on a monthly basis for the lease of the specialty beds and the number of days the patient(s) used the bed(s).

50. Automotive Dealership Manufacturer's Warranty Package. P.D. 13-85 (June 10, 2013). The taxpayer is an automotive dealership. An audit resulted in the assessment of use tax on untaxed purchases of tangible personal property and sales tax on oil and oil filter changes provided to certain customers at no charge. The taxpayer contested the assessment contending that the tax assessed on oil and oil filter changes that were part of the manufacturer's warranty package that covered normal factory scheduled maintenance for two years or 25,000 miles. The oil and oil filter changes are part of a package included in the sales price of motor vehicles subject to the motor vehicle sales and use tax. For this reason, the taxpayer argued that such oil changes should be exempt from the retail sales and use tax. The Tax Commissioner agreed and revised the assessment. Title 23 VAC 10-210-10, which applies to warranty work on products states:

> When any taxable article is returned to the dealer for adjustment, replacement or exchange and the consumer is given a new article free or at a reduced price under

> a warranty or guarantee, the sales and use tax must be computed on the actual additional amount, if any, paid to the dealer for the new article.

In the instant case, the contested oil and oil filters were returned to the taxpayer for replacement for those vehicles covered by a warranty or guarantee. New oil and oil filters were installed at no charge to the customer under the manufacturer's warranty package.

51. <u>Ready Mix Concrete</u>. P.D. 13-100 (June 11, 2013). The taxpayer produces and sells ready mix concrete. An audit resulted in the assessment of tax on various purchases and sales of tangible personal property. The taxpayer appealed the assessment on untaxed delivery and fuel surcharges made in connection with the sale of its ready mix concrete products. The taxpayer maintained that such charges are statutorily exempt from the tax. The Tax Commissioner denied the appeal as Title 23 of the Virginia Administrative Code (VAC) 10-210-360(B) provides:

> The tax applies to retail sales of concrete produced in concrete mixer trucks. The amount on which the tax must be computed includes the charge for the concrete as well as <u>any other service charges connected with such sale.</u> Examples of taxable service charges include "short load," "holding time" charges, and any other transportation charges, regardless of whether such charges are separately stated.

52. <u>Exemption Certificates</u>. P.D. 13-101 (June 12, 2013). The taxpayer provides technology products and related services and solutions to small and mid-sized businesses. The taxpayer appealed an assessment based on the disallowance of exemption certificates related to sales to two customers that were held taxable in the audit. The Tax Commissioner adjusted the assessment. The exemption certificate for the first customer was disallowed as the auditor determined that the customer was not registered for sales tax. The Tax Commissioner allowed the certificate as the taxpayer could not have known whether or not the customer was registered for sales tax and the taxpayer accepted the certificate in good faith. The Tax Commissioner also accepted the certificate from the second customer as the second customer produced a letter from the Tax Department stating that it was allowed to purchase good for resale exempt of sales tax.

53. <u>New 0.7 Percent Additional Retail Sales And Use Tax</u>. P.D. 13-102 (June 13, 2013). The Tax Commissioner issued Tax Bulletin 13-8 to clarify that the new 0.7 percent additional retail sales and use tax does not apply to sales made in Gloucester and Surry counties.

54. <u>New 0.7 Percent Additional Retail Sales And Use Tax Guidelines</u>. P.D. 13-103 (June 13, 2013). The Tax Commissioner issued revised guidelines for the new 0.7 percent additional retail sales and use tax based upon the removal of Gloucester and Surry Counties.

55. <u>Protection Plans</u>. P.D. 13-106 (June 18, 2013). The taxpayer is a retailer of beauty supply products. The taxpayer sells extended protection plan contracts to their customers who desire the protection of a warranty when purchasing products from the taxpayer. The Tax Department's audit held the protection plans taxable and issued an assessment to the

taxpayer. The taxpayer appealed stating that the protection plans are not warranties or services in connection with the sale of tangible personal property as implied by the auditor. The taxpayer contended that the ultimate benefit of the plan is a gift card, which is a full refund benefit of funds including any sales tax that was charged. The taxpayer also stated that the customer is not entitled to any replacement of the product originally purchased and that the protection plan should not be considered a service but rather an administrative fee that is not related to the sale of tangible personal property. The Tax Commissioner upheld the assessment as Va. Code § 58.1-602 defines "sales price" as "the total amount for which tangible personal property or services are sold, including any services that are a part of the sale . . . without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, losses or any other expenses whatsoever." Furthermore, he noted there is no specific exemption for the protection plans sold by the taxpayer.

56. Occasional Sales Exemption. P.D. 13-107 (June 19, 2013). The taxpayer entered into an Asset Purchase Agreement with the Seller to purchase the assets related to a franchised motor vehicle dealership (the "dealership") owned by the Seller. An audit by the Tax Department resulted in the assessment of tax and interest on the tangible personal property purchased pursuant to the Asset Purchase Agreement. The taxpayer appealed the assessment. Relying on the definition of "occasional sale" in Va. Code § 58.1-602, the taxpayer maintained that the assets at issue were properly purchased exempt of the tax. The taxpayer contended it purchased all or substantially all of the Seller's assets pertaining to the dealership. The Tax Commissioner agreed and applied the exemption.

In this instance, the Seller's ownership of a used motor vehicle operation led to the determination in the audit that the sale of the dealership to the taxpayer did not constitute the sale of substantially all of the Seller's assets, and the assets were held taxable in the audit. Based on the information provided in the taxpayer's appeal, the Seller opened the used motor vehicle operation in anticipation of selling the dealership to the taxpayer. The used motor vehicle operation was housed separately from the dealership. The Tax Commissioner opined that the assets sold by the Seller to the taxpayer were used in the Seller's used motor vehicle operation. Additionally, the Tax Commissioner found no evidence that there was any economic activity between the dealership and used motor vehicle operation. While the taxpayer and the Seller both operate businesses that involve the sale of motor vehicles, it was clear to the Tax Commissioner that the dealership and the used motor vehicle operation are separate and distinct businesses. As such, the sale of the assets associated with the dealership represented the sale of substantially all the assets of the business to the taxpayer.

57. Dredges. P.D. 13-113 (June 26, 2013). The taxpayer sells grain, rock and gravel and engages in mechanical dredging. An audit resulted in the assessment of consumer use tax on various untaxed purchases of tangible personal property used or consumed in its business. The taxpayer appealed the assessment with regard to the tax applied to certain purchases of lumber, plywood and dredging equipment. The Tax Commissioner adjusted the assessment. First, he determined that the lumber and plywood were eligible to be purchased with a resale exemption as they were resold as part of the product. With respect to the dredges, the Tax Commissioner examined Virginia Code § 58.1-609.3(4) provides an exemption from the retail sales and use tax for "dredges, their supporting equipment, attendant vessels, and fuel and supplies for use or consumption aboard such vessels, provided the dredges are used exclusively

or principally in interstate or foreign commerce." The Tax Commissioner determined that the taxpayer's dredges were used to dredge waterways in interstate or foreign commerce. Therefore, he removed the dredging equipment purchases from the assessment.

58. IUDs as Medical Devices. P.D. 13-116 (June 27, 2013). The taxpayer is a manufacturer of an intrauterine copper contraceptive device (IUD). The device releases copper ions into the body that cause contraceptive effects. The taxpayer requested a ruling on whether the device is classified as medical devices for sales tax purposes. The taxpayer stated that the device is approved by the federal Food and Drug Administration (the "FDA") as a prescription drug and believes that the device qualifies for the sales and use tax exemption in Va. Code § 58.1-609.10(9). The Tax Commissioner determined that the device qualifies for the exemption. Based on the FDA guidelines reviewed by the Tax Department, the device is classified by the FDA as a prescription drug. The Virginia Board of Pharmacy concurs with the federal classification and deems the device a Schedule VI controlled substance under the Virginia Drug Control Act found in Va. Code Title 54.1, Chapter 34. Pursuant to Va. Code § 58.1-609.10(9), the Tax Commissioner determined that the taxpayer may sell the device exempt of the tax to a licensed physician, licensed nurse practitioner, or licensed physician assistant for use in his or her professional practice.

59. Exemption Certificates. P.D. 13-117 (June 27, 2013). The taxpayer is a wholesaler of building supply products. The Tax Department's audit disclosed that the taxpayer made exempt sales that were not supported by valid exemption certificates. The taxpayer was given an opportunity to secure valid certificates from its customers. Based on the certificates acquired and presented and their verification by the auditor, the audit and assessment were revised. The taxpayer submitted additional documentation with its appeal stating that one customer has provided a valid resale exemption certificate and another customer has presented a valid manufacturer's exemption certificate. The Tax Commissioner determined that the first certificate was not complete and denied it. On the manufacturer's exemption, he sent it to the auditor for review. **Question:** Why not just review it and rule? Why is the taxpayer made to wait longer?

60. Installation Charges. P.D. 13-119 (July 1, 2013). The taxpayer is a computer sales and service company. An audit resulted in the assessment of sales tax on trip charges made in connection with taxable repairs of equipment and on setup and configuration charges made in connection with taxable sales of equipment. The taxpayer appealed and argued that the setup and configuration charges were exempt installation labor charges. According to the taxpayer, a typical installation includes unpacking the product, attaching peripherals, plugging in the power cord, adding client ordered off-the-shelf software, transferring files from the old computer to the new computer, adjusting network connections to accept the hardware, and checking for compatibility. The Tax Commissioner agreed and treated the contested charges as exempt installation charges. He reasoned that while installation of a computer in a customer's business involves unpacking the computer, the physical placement of the computer, the attachment of peripherals and plugging in the power cord, installation activities of a computer would also include setting up the computer for use after its physical placement. Furthermore while some configuration activities may be synonymous with the act of installation, it must be emphasized that not all configuration activities are synonymous with installation. In the taxpayer's case, adjusting the network connections on a computer for it to accept certain

hardware is a configuration activity that is also an installation activity. Such activity is intended to prepare the computer for use after its physical installation and is thus part of the installation of the computer. The same rationale applies to checking the computer for compatibility.

61. Estimation of Tax Liability. P.D. 13-120 (July 1, 2013). The taxpayer provides leak detection and related services to public and private gas utility companies. The taxpayer also manufactures and sells safety, survey, maintenance and leak detection equipment. Consumer use tax was assessed on equipment withdrawn from the taxpayer's out-of-state inventory for use by its technicians to perform services in Virginia. In accordance with Va. Code § 58.1-634, the audit period was extended to 66 months because a liability was found in the original 3-year audit period. The taxpayer's records for much of the extended audit period were unavailable. The assessment for this period was estimated based on the audit results for the periods in which records were available. The taxpayer appealed and argued that the assessment of tax is overstated. The taxpayer proposed a different methodology for estimating the liability. The Tax Commissioner rejected the methodology as inconsistent with other records of the taxpayer.

62. Lack of Documentation. P.D. 13-126 (July 3, 2013). The taxpayer is a specialty retailer that sells products from vending machines and kiosks. During the Tax Department's audit, the auditor examined the taxpayer's Chart of Accounts and noted a line item for the cost of vending machines and kiosk rentals. The taxpayer did not provide supporting documentation regarding these transactions. Therefore, the auditor assessed the taxpayer use tax on the payments it made to the vendors of the vending machines and kiosks. The taxpayer appealed and contended its payments to the vendors of the vending machines are for exempt services in accordance with Title 23 of the Virginia Administrative Code (VAC) 10-210-4040. The taxpayer also contended that the sales tax is included in its kiosk payments. The Tax Commissioner upheld the assessment as the taxpayer did not provide any documentation to support its contentions.

63. Sample Adjustment. P.D. 13-127 (July 3, 2013). The taxpayer operates as a commercial textile services company providing rental and laundry services for linens and uniforms. The taxpayer is also a distributor of hygiene products. The Tax Department's audit disclosed that the taxpayer made sales for which the sales tax was not collected, as well as purchases for which tax was not paid to suppliers or accrued and remitted to the Tax Department. The taxpayer stated that one of its customers has provided proof that the use tax on purchases from the taxpayer was accrued and paid to the Tax Department. Based on the customer's documentation, the taxpayer paid that portion of the Tax Department's assessments it believes to be correct. The taxpayer appealed the assessment challenging the sample. The Tax Commissioner denied the appeal. He determined that find the audit sample as computed by the auditor to be a valid representation of the taxpayer's period of audit. While the Virginia tax on some of the transactions may have been paid by the customer, there are likely similar transactions outside the sample period on which the Virginia tax has not been paid.

64. Converted Assessment. P.D. 13-128 (July 3, 2013). The taxpayer is shareholder and president of the Restaurant. The taxpayer appealed converted assessments contending that he is not liable on the basis that all of the corporate officer liability criteria set out in *Va. Code* § 58.1-1813, and the related tests set out in *Angelson v. Commonwealth*, 25 Va.

Cir. 319 (1991), cannot be satisfied. According to the taxpayer, he did not serve in an operational or day-to-day role of the Restaurant and only served as an investor for the Restaurant. The taxpayer also maintained to have no managerial role in the accounting or bookkeeping of the Restaurant and no role in hiring employees or the payment of taxes. Rather, the taxpayer maintained that such responsibilities were the duties of the general manager who was employed during the period in which these contested liabilities occurred and whose employment with the Restaurant ended in January 2012. In the latter part of 2010, the taxpayer discovered that the Restaurant's state taxes were delinquent and subsequently learned from the general manager that the Restaurant was in dire financial distress. At that time, the taxpayer took a more active role in the business by paying the current taxes out of his personal funds and hiring a new general manager. The Tax Commissioner disagreed and upheld the assessments.

Virginia Code § 58.1-1813 which provides for converted assessments, states the following:

> A. Any corporate . . . officer who willfully fails to pay, collect or truthfully account for and pay over any tax administered by the Department of Taxation, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected or accounted for and paid over, to be assessed and collected in the same manner as such taxes are assessed and collected.
> B. The term "corporate . . . officer" as used in this section means an officer or employee of a corporation . . . who as such officer, employee, member or manager is under a duty to perform on behalf of the corporation . . . the act in respect of which the violation occurs and who (1) had knowledge of the failure or attempt as set forth herein and (2) had authority to prevent such failure or attempt.

In Angelson v. Commonwealth, 25 Va. Cir.319 (1991) the City of Richmond Circuit Court stated:

> First, the person must willfully fail to pay, collect, or truthfully account for and pay over a state tax, or willfully attempt in any manner to evade or defeat such tax or its payment. Second, the person must be an officer or employee of the corporation and have a duty to perform the act in respect to which the violation occurs. Third, the person must have (actual) knowledge of the failure or attempt as set out in the statute. And fourth, the person must have the authority to prevent such failure or attempt.

In this ruling, the Tax Commissioner relied upon the taxpayer's actions in trying to satisfy older tax liabilities to find the elements of knowledge, authority and willfulness required to impose a personal liability. The Tax Commissioner stated:

> While the taxpayer may not have actually known about the tax liabilities in question when they became delinquent, the facts establish that the taxpayer became aware of such liabilities while the Restaurant was still operating and initially acted to satisfy the tax liabilities. By not carrying through with the

payment plan, the taxpayer acted willfully to avoid paying such liabilities. As president of the corporation that owns the Restaurant, and with actual knowledge of the tax liabilities, the taxpayer had the authority to prevent a failure to pay the tax liabilities owed the Commonwealth.

Comment: It is difficult to say whether the ultimate result in this specific case is correct. However, the position that actions to satisfy older tax liabilities are sufficient to show authority to prevent the failure to pay a tax debt is dangerous. Ignoring whether that policy is consistent with the statute, the Commissioner's decision sets a horrible precedent. The precedent is that if an officer who legitimately has no knowledge of a delinquent state tax tries to satisfy the debt and fails, he could be held personally liable for the debt. This new policy encourages officers to bury their heads in the sand rather than try to make the state whole.

65. Satellite Programming Provider. P.D. 13-130 (July 5, 2013). The taxpayer operates as a retailer of televisions, television receiving equipment, antennas and satellite equipment. The taxpayer stated that it purchased such equipment exempt of the tax for resale. The taxpayer entered into a contract with the satellite programming provider to provide services throughout its coverage area for the satellite programming provider's customers. During the audit period, the taxpayer stated that it purchased the equipment from the vendor, exempt of the tax for resale. The taxpayer further stated that the equipment was sold to the satellite programming provider in accordance with the contract. The taxpayer stated that the equipment was sold to the satellite programming provider exempt of the tax pursuant to resale exemption certificates. The auditor assessed sales tax against the taxpayer based on its exempt purchases and sales. The taxpayer appealed the assessment. The Tax Commissioner abated the assessment in full upon his finding that the taxpayer accepted resale exemption certificates in good faith. However because the satellite programming provider is deemed the taxable user and consumer of the equipment leased to its customers to provide the programming services, the Tax Commissioner required the taxpayer to charge and collect the tax from the satellite programming provider on sales of equipment.

66. Exemption Certificates. P.D. 13-131 (July 8, 2013). The taxpayer is in the business of selling and servicing commercial food service equipment. The audit disclosed that the taxpayer made exempt sales that were not supported by valid certificates of exemption. The taxpayer also made purchases for which tax had not been paid to vendors or accrued and remitted to the Tax Department. The taxpayer appealed and submitted additional documentation related to certain sales. The Tax Commissioner adjusted the assessment. He accepted the additional documentation provided by the taxpayer and removed certain items with little discussion. He also accepted the resale exemption certificates provided by the taxpayer. He discussed three in particular though. One had an FEIN instead of a Virginia registration number. He accepted this certificate based on prior policy. Another had an incomplete registration number. It was only accepted after the Tax Department was able to confirm the exemption was valid. A final certificate was rejected as it was not complete. The purchaser failed to indicate its use of the purchased product.

67. Exemption Certificates. P.D. 13-132 (July 8, 2013). The taxpayer is a retailer making sales of medicine and medical supplies. The audit disclosed that the taxpayer made exempt sales and accepted exemption certificates that were deemed to be invalid. The

taxpayer secured valid replacement certificates and the audit was adjusted. The taxpayer has also submitted corrected exemption certificates for one customer in its protest and sought a further revision of the assessment. The Tax Commissioner agreed and accepted the certificate which indicated the purchaser's FEIN rather than its Virginia account number.

68. Real Property v. Tangible Personal Property. P.D. 13-134 (July 15, 2013). The taxpayer is an out-of-state refrigeration contractor. An audit resulted in the assessment of use tax on purchases of tangible personal property that the auditor deemed used or consumed in connection with real property construction subcontracts conducted in Virginia. The taxpayer contests the assessment and maintains that the purchases remain tangible personal property upon installation. The Tax Commissioner agreed and abated the contested portion of the assessment. The issue in this ruling is whether the equipment remains tangible personal property or becomes a part of the real estate. The Virginia Supreme Court in Transcontinental Gas Pipe Line Corporation v. Prince William County, 210 Va. 550 (1970), ruled that:

> Three general tests are applied in order to determine whether an item of personal property placed upon realty becomes itself realty. They are: (1) annexation of the property to the realty, (2) adaptation to the use or purpose to which that part of the realty with which the property is connected is appropriated, and (3) the intention of the parties. The intention of the party making the annexation is the chief test.

Based on information provided to the Tax Commissioner, he determined that the intent is not to make permanent installations of the contested items. Subject to terms of a lease, the land must be returned to the condition existing when first use was granted. Furthermore, the contested equipment is not usable in any other capacity and is expected to last only as long as the lease. When the lease expires, the contested equipment will need to be removed and discarded. Because of these circumstances, the contested items are not intended for permanent usage but remain tangible personal property upon installation.

69. Media Service Provider. P.D. 13-136, 13-137, 13-138, and 13-139 (July 18, 2013). The taxpayer is a provider of cable television, high-speed Internet, and Voice over Internet Protocol (VoIP) digital phone services to residential and commercial subscribers. The audit resulted in the assessment of consumer use tax on various untaxed assets and expensed purchases as well as on items in which the consumer use tax was underreported. The taxpayer appealed and disputed the inclusion of several items held in the audit and maintained that such contested items are not taxable. In a lengthy ruling, the Tax Commissioner agreed and removed certain items. This is likely a very important ruling to this industry. However its application beyond the industry is limited.

70. Converted Assessment. P.D. 13-143 (July 22, 2013). The taxpayer was the sole officer of and held a 100% interest in the LLC. The Tax Department audited the LLC and issued assessments for unreported sales and use taxes on October 18, 2012, and unreported litter taxes on October 17, 2012. Pursuant to Va. Code § 58.1-1813, the Tax Department converted the LLC's outstanding sales and use tax and litter tax liabilities to the taxpayer on December 7, 2012. The taxpayer stated that he was the CEO of a separate business in a different city and was not actively involved in the LLC's business. The taxpayer's brother initially managed the LLC's business operations from 2004 until 2006. Subsequently, other persons

managed the business. The LLC was not financially successful. The business ceased operations and the LLC's assets were sold in April 2011. The taxpayer has provided documentation that includes a settlement statement that lists the LLC's final receipts, including the sale proceeds, and the final disbursements of the LLC. The taxpayer maintains that, pursuant to *Va. Code* § 58.1-1813 and Angelson v. Commonwealth of Virginia, 25 Va. Cir. 319 (City of Richmond, 1991), he is not personally liable for the business assessments made against the LLC. The Tax Commissioner agreed and abated the assessments. Based on the facts and documentation presented, the taxpayer was not knowledgeable of the sales and use tax and litter tax liabilities assessed in the Tax Department's audit because the LLC ceased doing business 18 months prior to the audit. In addition, there was never a time when the LLC's creditors were paid in preference to the audit assessments issued by the Tax Department because the LLC was no longer in business. For these reasons, the taxpayer does not satisfy all of the conditions required to be considered a corporate officer pursuant to Va. Code § 58.1-1813.

71. Estimate of Tax Liability. P.D. 13-145 (July 26, 2013). The taxpayer operates an independent grocery store. The audit disclosed that the taxpayer did not have any financial records for the years 2009, 2010 and 2011. The taxpayer stated that these records were destroyed in 2012. Because the taxpayer did not have any records, the auditors applied an alternative methodology to evaluate the taxpayer's sales tax compliance. The taxpayer disagreed with the methodology used by the auditors to develop the assessment. The taxpayer, however, did not offer any reasoning or explanation related to its disagreement but asks for an adjustment to the assessment. Also, the taxpayer asserts that payment of such an amount would cause a financial hardship to the taxpayer's business. Due to the lack of records, the Tax Commissioner upheld the assessment. The Tax Commissioner also advised the taxpayer to request an offer in compromise based on doubtful collectability.

72. Manufacturing Exemption. P.D. 13-152 (August 2, 2013). The taxpayer is a wholesale distributer of computer cables and related parts. An audit resulted in the assessment of consumer use tax on tangible personal property used in the taxpayer's business. The taxpayer buys manufacturing machinery that it depreciates for federal income tax purposes and pays personal property taxes on such equipment. This machinery is not used by the taxpayer in an exempt production process. Rather, the taxpayer's sister corporation uses such equipment to produce specialized items for sale only to the taxpayer who resells them. The taxpayer hired several employees that are dedicated to operating the machinery used to manufacture the specialized items on behalf of the sister corporation. The sister corporation has no employees or payroll and owns no capital equipment but pays a management fee to the taxpayer for the use of such production employees. The taxpayer contended that the contested equipment qualifies for the industrial manufacturing exemption set out in Va. Code § 58.1-609.3(2) on the basis that the taxpayer is the alter ego of its sister corporation. The taxpayer maintained that the sister corporation is a manufacturer eligible for the industrial manufacturing exemption. The taxpayer also maintained that it purchased the contested machinery for exempt use in the production process of its sister corporation. The Tax Commissioner upheld the assessment and rejected every application of the alter ego argument. Every argument was denied based upon the Tax Commissioner’s view that the taxpayer was not conducting any manufacturing or processing activities. Those activities were performed by the sister corporation.

73. Reduced Food Tax Rate. P.D. 13-154 (August 6, 2013). The taxpayer is a retail food franchise that sells specialty meats. In addition, the taxpayer sells cold deli trays and party platters for business and social events. The prepackaged cold deli trays and party platters are ordered from the taxpayer's "catering" menu. The cold deli trays and party platters are packaged in containers affixed with lids or tops. Customers may pick up the orders or have the taxpayer deliver the prepackaged food. During the audit, the taxpayer prepared, packaged and sold cold deli trays and party platters and charged the 2.5% reduced sales tax rate. The auditor treated the sale of the prepackaged cold deli trays and party platters as the sale of catered food subject to the 5% retail sales tax. The auditor held the taxpayer liable for the difference between the reduced sales tax rate and the general sales tax rate. The taxpayer disagrees with the assessment and cites Virginia Tax Bulletins (VTB) 05-7 (5/31/05) and 99-11 (10/1/99) to support its position. The Tax Commissioner agreed with the taxpayer and abated the assessment. Apparently the Tax Bulletins were directly on point as this ruling had next to no discussion. **Query:** How did the auditor miss this?

74. Pollution Control Exemption. P.D. 13-157 (August 8, 2013). The taxpayer is a natural gas production contractor that manages the drilling and operation of natural gas wells. The Tax Department audited the taxpayer and assessed use tax on various equipment and supplies used in the operation of the business. The taxpayer filed an administrative appeal of the audit assessment under Va. Code § 58.1-1821. A determination letter was issued on May 9, 2012 to the taxpayer as Public Document (P.D.) 12-73. In the Tax Department's determination, the taxpayer was granted partial relief for use tax and interest assessed on pit liners, tanks and silt fence that were certified by the Department of Mines, Minerals and Energy (DMME) as pollution control equipment and purchased prior to July 1, 2006. This determination was based on Va. Code § 58.1-609.3(9)(ii), which provides the following exemption from the sales and use tax:

> Effective retroactive to July 1, 1994, and *ending July 1, 2006*, certified pollution control equipment and facilities as defined in § 58.1-3660 and which, in accordance with such section, have been certified by the Department of Mines, Minerals and Energy for coal, oil and gas production, including gas, natural gas, and coalbed methane gas. (Emphasis added.)

In accordance with the same statute, the assessment was upheld for purchases of the same items made on or after July 1, 2006 because the statutory language in Va. Code § 58.1-609.3(9)(ii), states that the exemption expired on July 1, 2006. Although pit liners, tanks and silt fence were certified as pollution control equipment by the DMME, the Tax Department ruled that these items did not qualify for the exemption if purchased on or after the exemption's expiration date of July 1, 2006. The taxpayer requested that the Tax Department reconsider its position on this issue. The Tax Commissioner abated the remaining items in the assessment. Subsequent to the issuance of P.D. 12-73 to the taxpayer, the Tax Department reconsidered its policy with respect to the pollution control exemption administered by the DMME. As a result, P.D. 13-2 (1/10/13) was issued to another taxpayer that had appealed an assessment with the same issue. P.D. 13-2 rescinds the Tax Department's determination in P.D. 12-73 with respect to the expiration of the pollution control exemption administered by the DMME. P.D. 13-2 states that the Tax Department will continue to recognize the pollution control exemption administered by the DMME, effective retroactive to July 1, 2006.

75. Out of State Dealers. P.D. 13-166 (August 23, 2013). The Tax Commissioner issued Tax Bulletin 13-11 concerning sales tax collection requirements for certain out-of-state dealers. Beginning September 1, 2013, out-of-state dealers, who belong to a commonly controlled group in which a person or entity maintains a distribution center, warehouse, fulfillment center, office, or similar location in Virginia that facilitates the delivery of tangible personal property sold by the out-of-state dealer, are required to register and collect Virginia Retail Sales and Use Tax for sales made into Virginia.

76. Sales Price Component. P.D. 13-167 (August 27, 2013). The taxpayer is an out-of-state manufacturer of heating, ventilating and air conditioning systems for sale to contractors who install them as capital improvements to real property. The taxpayer sells its systems via independent dealers. An audit resulted in the assessment of use tax on local marketing group ("LMG") fees charged by the taxpayer to its independent dealers. The LMG fees are for advertising and dealer training costs incurred by the taxpayer and charged to its dealers at the rate of 2% of the sales price of the product sold. While the taxpayer charged and collected Virginia use tax on the sales price of the products, no sales or use tax was charged on the LMG fees. The taxpayer appealed contending that the LMG fees are non-taxable because they are for services entirely separate and apart from the sales of its products. According to the taxpayer, it enters into advertising service agreements with its dealers who have agreed to participate in an LMG pool. The taxpayer maintained that such service agreements are separate and apart from any sales of tangible personal property. Contributions to the LMG pool are measured as a percentage of each dealer's total sales, up to a maximum LMG contribution of $10,000 annually. Once the maximum annual contribution is met, no further LMG fees are charged for the year. The taxpayer further maintained that the LMG fee has no connection to the sale of tangible personal property because such fee is not related to any service provided in connection with the sale of tangible personal property and does not contribute to the procurement of the product. The Tax Commissioner disagreed and upheld the assessment. This determination was based on his finding that the LMG fees were inextricably linked to the sale of tangible personal property. Among the reasons that he cited are:

- The fees are required fees because dealer participation in the LMG pool is mandatory;
- The fees are computed based on a fixed percentage of the sales price of tangible personal property and thus become linked directly to the sales of products;
- A 1.00% discount available to dealers for making timely payments applies to the sales price of the product fees as well as to the LMG fees;
- The fees are collected by the taxpayer to pay for costs associated with dealer training and educational costs regarding the taxpayer's products. Such educational and training costs directly impact the sale of the taxpayer's products at the dealer level and facilitate the training of salesmen and technicians who sell and repair the taxpayer's products; and,
- The fees are similar to a fee for overhead and/or profit added to the sales price of goods.

D. Opinions of the Attorney General

1. Additional Taxes in Northern Virginia and Hampton Roads. Va. Op. Atty. Gen. No. 13-014 (March 22, 2013). Delegate Bob Marshall inquired whether the General Assembly constitutionally may impose an additional 0.7 percent sales tax for certain localities in Notthern Virginia and Hampton Roads as well as impose additional recordation and transient occupancy taxes for certain localities in Northern Virginia. He specifically asked whether House Bill 2313's imposition of different tax rates on similar transactions in different areas of the Commonwealth violates Article X, § 1 of the Virginia Constitution. He also inquired whether the taxes imposed are prohibited special laws and/or are subject to the two-thirds voting requirement of Article VII,§§ 1 and 2. The Attorney General opined that opinion that, although the imposition of different taxes on transactions in different localities does not violate Article X, § 1, HB 2313's imposition of taxes in the specific localities constitutes a local law related to taxation prohibited by Article IV, § 14(5) of the Virginia Constitution. He also opined that, because the taxes were imposed directly by the General Assembly, the taxes cannot be saved by the provisions of Article VII, § 2, even if they had obtained the affirmative vote of two-thirds of the members elected to each house. **(Subsequent to this opinion, HB 2313 was amended to correct the concerns expressed in this opinion.)**

2. Additional Sales Tax in Surry County. Va. Op. Atty. Gen. No. 13-055 (June 14, 2013). The County Attorney for Surry County inquired whether Surry County is subject, on July 1, 2013, to the regional transportation taxes and fees included in the 2013 Transportation Funding Bill, Chapter 766 of the Virginia Acts of Assembly, 2013 Reconvened Session ("the Act"). The Attorney General opined that Surry County would not be subject to the regional transportation taxes and fees included in the Act based on its planning district.

IV. PROPERTY (AD VALOREM) TAXES

A. 2013 Legislation

1. Constitutional Amendment: Exempting Residences of Surviving Spouses. House Joint Resolution 551 (Chapter 727) proposes an amendment to the Constitution of Virginia to provide a real property tax exemption for the primary residence of surviving spouses of members of the military who are killed in action. Such tax exemption may not be claimed by a surviving spouse who has remarried. This proposed amendment would be ratified subsequent to passage of an identical resolution in the 2014 session of the General Assembly and adoption in the general election following the 2014 Virginia General Assembly.

2. Payment Agreements for Delinquent Taxes. House Bill 1401 (Chapter 334) extends the maximum permitted period for installment payment agreements between local treasurers and property owners owing delinquent taxes, penalties, and interest from 24 months to 36 months. This legislation also requires that notice be given to the taxpayer that the taxpayer may request that the treasurer allow the taxpayer to enter into a payment agreement to permit the payment of the delinquent taxes, penalties and interest. Additionally, this legislation authorizes the circuit court in which an action for a judicial sale is pending, on its own motion or on the motion of any party, to refer the parties to a dispute resolution proceeding. This legislation is effective on July 1, 2013.

3. City of Bedford Reversion to the Town of Bedford. House Bill 1756 (Chapter 342) and Senate Bill 1041 (Chapter 384) clarify the transition of real and personal property taxation of property currently located in the City of Bedford that will become the Town of Bedford within the County of Bedford on July 1, 2013 due to the City's reversion to town status. The County is required to assess town and county real property taxes on such property for a short tax year, beginning July 1, 2013 and ending December 31, 2013, with a January 1, 2013 tax day, but based on the City's July 1, 2012 assessment of the property, at the rates imposed in the County and Town reduced by one-half to account for the short tax year. Additionally, the legislation authorizes owners of real property in the Town to apply to both the County and the Town for the special use value assessment on qualifying property for the short tax year by submitting their application by August 1, 2013. This legislation was effective on March 14, 2013.

4. Apportionment of Expenses for Affordable Rental Housing. House Bill 1553 (Chapter 249) authorizes owners of real property operating in whole or in part as affordable rental housing with expenses and expenditures common to two or more units to compel the assessor to make a pro rata apportionment of the expenses and expenditures to each unit based on each unit's assessed value as a percentage of the total assessed value of all such units, for purposes of determining the fair market value of such property. In order for the owners to obtain this authority:(i) the two or more units of real property must be controlled by a single restrictive use agreement regulating income and rent restrictions; and (ii) the expenses and expenditures cannot practicably be attributed to a particular unit. The provisions of this legislation apply regardless of whether the units are in one tax parcel or multiple tax parcels. This legislation is effective on July 1, 2013.

5. Discretion to Impose Roll-Back Taxes. House Bill 1697 (Chapter 269) gives localities the discretion to elect, by ordinance, whether to impose roll-back taxes and whether to allow a change in zoning to affect a property's eligibility for a land use taxation program when the property's zoning classification changes to a more intensive use at the request of the owner or his agent. This legislation is effective on July 1, 2013.

6. Boards of Equalization. House Bill 1598 (Chapter 197) makes a number of changes to various provisions governing local Boards of Equalization. This legislation: (1) sets stricter requirements for legal and financial professionals serving on certain Boards of Equalization; (2) allows applications for complaints to the Board to be made electronically, and set forth requirements for mailing and submitting paper applications; (3) specifies the evidence that a board may and may not consider in hearing complaints; (4) allows a taxpayer to appoint a representative who may apply to the Board on the taxpayer's behalf to adjust the assessment; and (5) prohibits the Board from increasing assessments on commercial, multifamily, residential or industrial property without the assessor's recommendation and compliance with certain procedures. The provisions of this legislation related to: (i) electronic filing, (ii) the evidence that a board may and may not consider, and (iii) the appointment of a representative is effective for assessment appeals made for tax years beginning on or after January 1, 2014. The remaining provisions are effective on July 1, 2013.

7. Fort Monroe Authority: Payments in Lieu of Real Property Taxes. House Bill 2038 (Chapter 221) modifies the method of determining the amount of fees in lieu of real

property taxes owed by the Fort Monroe Authority. This legislation ensures that properties at Fort Monroe that would be taxed by the City of Hampton if privately held, will be charged a fee in lieu of taxes. Properties at Fort Monroe that would not be taxed by the City if privately held will be exempt from the fee. This legislation also permits the Fort Monroe Authority to appeal the assessed value of its property used in calculating the fee. This legislation is effective on July 1, 2013.

8. Land Use Valuation. Senate Bill 799 (Chapter 677) authorizes Goochland County to exclude from its land use assessment program any property located in a service district created after July 1, 2013 that (1) is in a planned development, industrial or commercial zoning district established prior to January 1, 1981 or (2) has been rezoned to allow a more intensive nonagricultural use at the request of the owner. This legislation is effective on July 1, 2013.

9. Loudoun County Board of Equalization. Senate Bill 1356 (Chapter 548) authorizes the Loudoun County Board of Supervisors to appoint the members of its board of equalization rather than the appointment of such members by the circuit court. This legislation is effective on July 1, 2013.

B. Recent Court Decisions

1. Vienna Metro LLC v. Bd. of Supervisors, 2013 Va. Cir. LEXIS 30 (County of Fairfax Circuit Court, April 23, 2013). Vienna Metro LLC challenged the property tax assessments based on what it claimed was a manifest error--a significant disparity between the actual fair market value of the property and the assessed value. The court relied upon West Creek Associates v. County of Goochland, 276 Va. 393, 414, 665 S.E.2d 834 (2008) for determining when manifest error exists. According to Vienna Metro, manifest error exists if the taxpayer establishes a significant disparity between the actual fair market value of the property and the assessed value. The principle from West Creek relied upon by the court was that if "a taxpayer attempts to prove manifest error solely by showing a significant disparity between fair market value and assessed value without showing that the taxing authority employed an improper methodology in arriving at the property's assessed value, the taxpayer cannot prevail 'so long as the assessment comes within the range of a reasonable difference of opinion . . . when considered in light of the presumption in its favor.'" West Creek, 276 Va. at 414.

When it considered the experts' appraisals, the court had difficulty with the standards and differing degrees of emphasis exercised by Vienna Metro's expert, David Lennhoff. Conversely, the court found Fairfax County's expert, Peter Korpacz, to offer a very credible opinion. The court took issue with Mr. Lennhoff's mix of objective and subjective standards, valuation of proffers, selection of a discount rate, and utilization of three different timeframes to resolve legal issues and develop the property. As for Mr. Korpacz, the court found his testimony and report credible and not speculative. Furthermore, his use of comparable sales, his more reasonable estimate of time to conclusion of the legal issues, and his adjustments did not contain speculation or conjecture as interpreted by the court. Ultimately, the court found that the disparity between the board's assessment and the testimony of the board's expert regarding fair market value did not establish that the board's assessment was not within the range of a reasonable difference of opinion as to the property's value.

2. IPROC Norfolk, L.L.C. v. City of Norfolk, 2013 Va. Cir. LEXIS 19 (Norfolk Circuit Court, April 24, 2013). The owners of the Norfolk Waterside Marriott Hotel and Convention Center lost their challenge to the City of Norfolk's real estate tax assessments for tax years 2009 through 2011, on their theory that the city, in determining fair market value of the properties, failed to take into account the economic downturn that started in late 2007 and caused a steep drop in hotel occupancy rates and revenue streams. The city contended that the owner's "methodology [was] flawed because it relied on calculations based upon uncertain and speculative future expenses." The city also contended that the capitalization rate utilized by the owner's expert to calculate fair market value was significantly higher than that used by the city's appraiser and included factors the city asserts were superfluous. The trial court noted that appraisers typically rely on three methods of assessment to determine the fair market value of a property: (1) the cost approach, (2) the sales approach, and (3) the income approach. Furthermore, the appraisers for both the city and the owners agreed that the income based approach was the most appropriate method for determining the fair market value of the hotel and convention center.

The owner's expert criticized the city for relying on income and expense data from two years prior, that he asserted did not reflect the property's true fair market value. The circuit court held, however, that the city used concrete financial data from the previous two years and employed an accepted methodology to arrive at a fair market value for the hotel and convention center. In fact, the court noted that three highly respected valuation experts testified to the value of the property by weighing a series of financial indicators and that none of the experts appeared to have made mistakes in their appraisals or calculations. By basing its assessments on the earnings of the hotel and convention center over the past two years, the trial court found the city developed a fair market value for the property based upon concrete data calculated by the owners for the prior two years. The trial court stated the appraisers simply used different formulas and emphasized particular factors more than others. "Absent clear error," the court said, "more than a difference in expert opinions or formulas is required to overcome the presumption of correctness that clothes the taxing authority's assessment." The circuit court held the City of Norfolk did not err when it calculated the fair market value of the hotel and convention center for the 2009 through 2011 assessments at issue in the case. The final order of the trial court's decision was entered on May 3, 2013.

C. Recent Virginia Tax Commissioner Rulings

No recent rulings.

D. Opinions of the Attorney General

1. Veterans' Exemption and Real Estate Cooperatives. Va. Op. Atty. Gen. No. 11-056 (December 21, 2012). The Virginia Beach real estate assessor asked whether the exemption from real estate taxation provided by Article X, Section 6-A, of the Virginia Constitution as implemented by § 58.1-3219.5 applies to certain interests under the Virginia Real Estate Cooperative Act ("Act"). He specifically inquired whether the cooperative interest of a veteran in a real estate cooperative is exempt from taxation provided the veteran otherwise satisfies all of the requirements set forth in the Article X, Section 6-A exemption and in

§ 58.1-3219.5 implementing the exemption. The Attorney General opined that the exemption from taxation under Article X, § 6-A and § 55-3219.5 does not apply in favor of a veteran who is a proprietary lessee in a real estate cooperative, regardless of whether the veteran otherwise satisfies all of the other requirements imposed by law to claim the exemption.

2. Property Qualifying for Land Use. Va. Op. Atty. Gen. No. 12-051 (March 8, 2013). The Middlesex County Commissioner of the Revenue asked whether a parcel of real property consisting of 8.6 acres of woodland and 3.2 acres of marsh/swamp land, in addition to one acre used for a home site, qualifies for Middlesex County's Land Use Program, which implements the use taxation and assessment authorized by§ 58.1-3230. The Attorney General opined that, should a commissioner of the revenue make the factual determination that a parcel of land meets the criteria set forth in § 58.1-3230, but fails to meet the acreage requirements of § 58.1-3233(2), such parcel may not qualify for use taxation and assessment.

3. Short Term Rental Property. Va. Op. Atty. Gen. No. 12-105 (July 12, 2013). The Culpeper County Commissioner of the Revenue requested guidance regarding the taxation of short-term rental property in a locality that does not have a local ordinance establishing either a merchant's capital tax or a tax on short-term rental property. The Attorney General opined that short-term rental property is to be classified as a distinct category of merchants' capital and may be taxed by a locality as merchants' capital or as short-term rental property, but may not be classified or taxed as personal tangible property. He also stated that a locality lawfully may decline to impose a tax on merchant's capital, including short-term rental property. Finally, the absence of a local ordinance imposing a tax on merchant's capital or short-term rental property represents a choice by the locality's governing body not to impose a tax on such property.

4. Exemption for Planned Parenthood of Southeastern Virginia. Va. Op. Atty. Gen. No. 13-041. (August 2, 2013). The Virginia Beach Commissioner of the Revenue inquired whether Planned Parenthood of Southeastern Virginia, Inc. ("PPSV") is exempt from local real and personal property taxes by classification as a hospital conducted not for profit. The Attorney General opined that PPSV is exempt from local real and personal property taxes as a consequence of licensure as a category of hospital if the commissioner of the revenue determines that PPSV is operated not for profit, but to promote the charitable purposes of the organization, and that the property belongs to and is actually and exclusively occupied and used by PPSV.

V. PROCEDURAL

A. 2013 Legislation

1. Local Tax Administration: Treasurers May Transmit Bills from Database. House Bill 1982 (Chapter 299) authorizes local treasurers, with the taxpayer’s consent, to transmit local tax bills by allowing the taxpayer to view his bill online from a database on the treasurer’s website. This legislation is effective on July 1, 2013.

2. Confidentiality of Tax Information. House Bill 2092 (Chapter 230) authorizes the Tax Commissioner to provide the Department of Agriculture and Consumer

Services with the name and address of taxpayers who are licensed by the Commonwealth and identify themselves as subject to Board of Agriculture and Consumer Services regulations to operate food establishments. This legislation is effective on July 1, 2013.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Protective Claim. P.D. 12-179 (November 9, 2012). In October 2008, the taxpayer filed a protective claim for refund pursuant to the Virginia Supreme Court's decision in Virginia Cellular, LLC v. Virginia Department of Taxation, 276 Va. 486, 666 S.E.2d. 374 (2008). Subsequent to the Virginia Supreme Court’s opinion, the General Assembly passed legislation that attempts to effectively overrule the opinion. This legislation is effective for taxable years beginning on and after January 1, 2004. On May 4, 2009, the Tax Department rejected the taxpayer's refund claim with regard to the Virginia Cellular case because of the actions taken by the General Assembly. On April 27, 2009, the taxpayer filed an addendum to its protective claim requesting a refund for overpayment of telecommunications minimum tax based on computational errors made on the original returns. The Tax Department denied the refunds because the submission in April 2009 did not include an amended return. In addition, the Tax Department concluded that the filings for the 2004 and 2005 taxable years were submitted beyond the statute of limitations. The Tax Department reasoned that because the issues included in the April 2009 claim were not addressed in the Virginia Cellular decision, they could not be treated as an addendum to the October 2008 protective claim. The taxpayer appealed the denial of the refund contending that nothing in the statute prevents a taxpayer from amending or adding to an outstanding protective claim pending before the Tax Department. In addition, the taxpayer asserted that the protective claim statute does not require the filing of a complete return, and its submission would qualify as a return under federal income tax rules.

The Tax Commissioner agreed with the taxpayer and requested that the appropriate returns are filed. Under Title 23 of the Virginia Administrative Code (VAC) 10-20-190 B, when the Tax Department determines to hold a protective claim without decision because it involves issues that depend upon resolution of a pending court case, the issues included in such protective claim "will be strictly limited to those issues which actually depend upon resolution of a pending case." The regulation goes on to say that all other issues included in such a protective claim will be decided on the merits. Based on the regulation, a protective claim that includes multiple issues may be filed and the Tax Department may decide to address some of the issues based on the merits, while holding others without decision pending the resolution of a court case. In this case, the taxpayer filed a protective claim, which the Tax Department held without decision pending the final resolution of the Virginia Cellular case. Before the final resolution, the taxpayer introduced another issue that was not dependent on the court case. Under Virginia's statute and regulation, the Tax Department is obligated to address this issue on its merits. The taxpayer's protective claim regarding its computational errors was timely filed.

According to Title 23 VAC 10-20-190(A), no specific form for a protective claim is required. However, the protective claim must include information that sufficiently identifies the taxpayer, type of tax, taxable period, remedy sought, date of assessment, and the date of payment. An appropriately executed statement setting forth each alleged error, grounds upon which taxpayer relies, and all facts relevant to taxpayer's contention must also be included. If applicable, the taxpayer must also show that the determination of the issues depend upon the outcome of another case pending in court. The Tax Commissioner reviewed the information the taxpayer submitted in April 2009 and concluded that the information included all of the information required under Title 23 VAC 1020-190(A). The fact that amended income tax returns were not filed did not cancel the validity of the April 2009 protective claim.

2. Protective Claim. P.D. 12-180 (November 9, 2012). In October 2008, the taxpayer filed a protective claim for refund pursuant to the Virginia Supreme Court's decision in Virginia Cellular, LLC v. Virginia Department of Taxation, 276 Va. 486, 666 S.E.2d 374 (2008). Subsequent to the Virginia Supreme Court's opinion, the General Assembly passed legislation that attempts to effectively overrule the opinion. This legislation is effective for taxable years beginning on and after January 1, 2004. On May 4, 2009, the Tax Department rejected the taxpayer's refund claim with regard to the Virginia Cellular case because of the actions taken by the General Assembly. On May 11, 2009, the taxpayer filed an addendum to its protective claim requesting a refund for overpayment of telecommunications minimum tax based on computational errors made on the original returns. The Tax Department denied the refunds because the submission in May 2009 did not include an amended return. In addition, the Tax Department concluded that the filings for the 2004 and 2005 taxable years were submitted beyond the statute of limitations. The Tax Department reasoned that because the issues included in the May 2009 claim were not addressed in the Virginia Cellular decision, they could not be treated as an addendum to the October 2008 protective claim. The taxpayer appealed the denial of the refund, contending that nothing in the statute prevents a taxpayer from amending or adding to an outstanding protective claim pending before the Tax Department. In addition, the taxpayer asserts that the protective claim statute does not require the filing of a complete return, and its submission would qualify as a return under federal income tax rules.

The Tax Commissioner denied the taxpayer's claim. The new issues were introduced after the initial protective claim was closed. Therefore, the Tax Commissioner treated it as a separate appeal. The Tax Commissioner determined that the claims for both the 2004 and 2005 taxable years were out of statute. For the 2004 taxable year, the taxpayer filed its return on the extended due date, October 17, 2005. Under the statute, the statute limitations for filing a protective claim would have expired on October 17, 2008. The protective claim for the 2004 taxable year was not filed until May 2009.

For the 2005 taxable year, the Tax Department had no record of receiving a timely filed return. As a result, the Tax Department issued an assessment in November 2006. The taxpayer eventually provided a copy of a telecommunications company minimum tax form (Form 500 T) in February 2008 and a corporate income tax return (Form 500) in October 2008. In reviewing the protective claim for 2005, the Tax Department determined that Form 500T did not constitute a return because the taxpayer failed to include it with a properly executed Form 500. Because no return had been filed, the Tax Department concluded that the protective claim had not been filed within the statute of limitations. Virginia Code § 58.1-202(7) grants the Tax Commissioner the authority to prescribe "the forms of books, schedules and blanks to be used in the assessment and collection of state taxes." Under Title 23 of the Virginia Administrative Code (VAC) 10120-320

C, every corporation required to file a return for a taxable year must complete a return as prescribed by the Tax Department and provide a complete copy of the corporation's federal income tax return, including schedules and other information provided to the Internal Revenue Service. Despite what might be considered to be a return for federal income tax purposes, the Tax Department has been given express authority to prescribe the method for filing corporate income tax returns. Tax Department instructions for telecommunications corporations require taxpayers to file a Form 500 and attach Form 500T. Because the taxpayer failed to timely file Form 500, the taxpayer failed to properly file its 2005 Virginia income tax return. Because no return was properly filed, the self assessment would be deemed to have occurred when the tax was paid. In this case, the taxpayer had paid enough estimated payments to cover its liability. As such, the date of payment would be the original due date of the tax return or April 17, 2006. See Va. Code § 58.1-453(B). Accordingly, the statute of limitations for the taxpayer to file a protective claim for refund expired on April 17, 2009. The taxpayer did not file the protective claim for refund until May 11, 2009.

3. Deadline for Appealing an Assessment. P.D. 13-7 (January 23, 2013). The taxpayer, an information technology services business that performs contract work for the federal government, was audited and assessed use tax on various purchases that were made in connection with the performance of government contract work. The taxpayer filed an administrative appeal of an assessment dated April 17, 2008. The Tax Department responded to the taxpayer's appeal in a determination letter issued on December 15, 2010. The determination allowed the taxpayer to provide documentation to support some of the claims made in its appeal. The assessment was deemed correct with respect to other issues raised in the appeal. The taxpayer provided some documentation to the Tax Department which was reviewed by the Tax Department's audit staff. This review resulted in the revision of the audit and the assessment. The taxpayer subsequently paid the revised assessment in full on February 16, 2012. The taxpayer filed a request for reconsideration on April 11, 2012. The taxpayer maintained that the tax was paid in error on a number of exempt transactions and requested a refund of the tax amounts erroneously paid based on several issues set out in this appeal. The Tax Commissioner cited title 23 VAC 10-20-165(F)(1) which states that a request for reconsideration must be received by the Tax Department within 45 days after a final determination is issued by the Tax Commissioner. On this basis, the Tax Commissioner refused to consider the request. However, the Tax Commissioner noted that Va. Code § 58.1-1823(A)(iv) allows a person that has paid an assessment for a tax administered by the Tax Department to file an amended return within two years from the date of payment of the assessment. Based on the provisions of Va. Code § 58.1-1823(A)(iv), the taxpayer can still timely file amended returns claiming refunds of the sales and use taxes it contends were paid in error. In addition, if the Tax Department denies the refund, the taxpayer would have renewed appeal rights as the denial of a refund is considered an assessment under Va. Code § 58.1-1823(A).

D. Opinions of the Attorney General

No recent opinions.

VI. BUSINESS LICENSE TAXES

A. 2013 Legislation

No 2013 legislation.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Foster Care Services. P.D. 12-167 (October 23, 2012). A foster care provider has a contract with the government for providing foster care services to mentally and emotionally disabled individuals. The provider is exempt from federal income tax under Internal Revenue Code (IRC) § 131. The provider subcontracts foster care services and compensates an individual (the "taxpayer") who performs the services at a definite place of business in the County. The County requested an opinion as to whether the taxpayer is subject to the BPOL tax. Based on the information provided to the Tax Commissioner, it was unclear to him whether the taxpayer is engaged in a licensable business. He directed the County to determine whether the taxpayer's foster care activities meet the definition of a business in Va. Code § 58.1-3700.1.

2. Freight Forwarder. P.D. 12-172 (November 2, 2012). The taxpayer, an interstate trucking company headquartered in State A, maintains a definite place of business in the County. The office in the County primarily arranges for the transportation of goods with unrelated transportation providers when the taxpayer is unable to provide transportation services with its own equipment. It also solicits potential customers and new tonnage from existing customers within an assigned territory. The taxpayer filed BPOL tax returns for the 2008 through 2011 tax years with the County and deducted those gross receipts passed through to third party independent transportation providers. Under audit, the County disallowed the deductions and issued assessments. The taxpayer filed an appeal requesting a refund of all BPOL taxes paid, maintaining it is exempt from the BPOL tax. In its final local determination, the County held that the taxpayer is not operating as a motor carrier in the County, but is providing a business service as a freight forwarder. Accordingly, the County denied the taxpayer's request for refund. The taxpayer appealed the County's final determination to the Tax Commissioner contending it is a motor carrier and, therefore, exempt from BPOL taxation. The Tax Commissioner agreed and ordered the refund. Under 49 U.S.C. § 13102(8), a “freight forwarder” is an entity that provides transportation of property for compensation and conducts a number of other activities in the normal course of business. The taxpayer argued that it did not meet all the elements of a freight forwarder in 49 U.S.C. § 13102(8). Instead, the taxpayer asserted that it is a motor carrier formerly certified by the Interstate Commerce Commission and provided documentation to show that it is currently registered with the Surface Transportation Board of the United States Department of Transportation, Federal Highway Administration.

3. Mobile Telephone Services. P.D. 12-182 and 12-183 (November 13, 2012). The taxpayer is organized as a limited partnership and is engaged in the business of reselling mobile telephone services to end users. The taxpayer purchases the mobile telephone services from third parties that are licensed by the Federal Communications Commission (FCC) to provide such services. The taxpayer is not licensed by the FCC and does not hold a certificate of convenience and public necessity issued by the State Corporation Commission (SCC). Partner

A, a partnership licensed by the FCC, owns a 25% general partnership interest and a 74% limited partnership interest in the taxpayer. Partner B, which owns a 1% limited partnership interest in the taxpayer, is also a federally licensed provider. Both Partners A and B are licensed to operate in Virginia and in other states. The taxpayer, Partner A, and Partner B all trade under the same trade name. The City classified the taxpayer as a telephone company and assessed additional BPOL tax. The taxpayer filed an appeal with the City seeking an abatement of the assessments. The City issued a final determination upholding the assessments. The taxpayer appealed the City's final determination contending the Tax Department previously determined that the taxpayer was not a telephone company. The Tax Commissioner agreed. In prior rulings, it was determined that the taxpayer was not a telephone company. Based on the evidence presented with this appeal, the Tax Commissioner determined that taxpayer was merely selling mobile telephone services provided by its related entities. The taxpayer did not provide mobile telephone services during the tax years at issue and was not a telephone company as set forth in Va. Code § 58.1-2600.

4. <u>Separate Line of Business</u>. P.D. 12-220 (December 21, 2012). The taxpayer operated a farm winery in the County during the tax year at issue. It held a farm winery license. As a farm winery, the taxpayer sold wine manufactured on its premises from grapes grown on its farm. It also rented its facilities for weddings and other events. Under audit, the County determined that the taxpayer was properly licensed for its farm winery. However, it concluded that the rental of its facilities for events constituted a separate business subject to the BPOL tax. As such, the County requested that the taxpayer segregate its gross receipts derived from the rental of its facilities when not promoting its wines. The taxpayer appealed the audit conclusion to the County. In its final determination, the County determined that the rental of the taxpayer's facilities was a separate business subject to the BPOL tax. The taxpayer filed an appeal with the Tax Commissioner contending the rental of its facilities is a usual and customary activity of a farm winery and not a separate licensable business. The Tax Commissioner determined that the taxpayer appears to be operating multiple businesses. However he remanded the appeal back to the County with the instruction to reconsider the taxpayer's appeal. The Tax Commissioner also directed the taxpayer to provide the County with sufficient documentation to show if it engaged in multiple businesses, and the breakdown between its sales of wine and fees for the facility rentals.

5. <u>Classification</u>. P.D. 13-25 (March 5, 2013). The taxpayer operated at a definite place of business in the County since 2003. The taxpayer classified itself as an equipment broker, both on its original business license application, and on all of its County BPOL tax returns through the 2011 tax year. As such, it paid BPOL tax at the rate for service providers. On its 2012 BPOL return, the taxpayer reclassified itself as a supplier. In accordance with this reclassification, the County determined that the taxpayer was subject to tax at the retail rate and issued a refund for the 2012 tax year. The taxpayer filed an appeal requesting a refund of BPOL taxes paid, maintaining that it should have been classified as a retailer for all prior years because the County accepted the retailer classification for the 2012 tax year. In its final local determination, the County held that the taxpayer was a service provider for the 2009 through 2011 tax years based on how it classified itself on its BPOL returns. Accordingly, the County denied the taxpayer's request for a refund. The taxpayer appealed the County's final determination to the Tax Commissioner contending it should have been liable for the BPOL tax as a retailer. Other than its declaration on its BPOL returns, the taxpayer provided no

explanation or documentation to the Tax Commissioner concerning its licensable business operations. Because the determination of a taxpayer's classification is a factual determination, this case was remanded back to the County with the instruction to reconsider the taxpayer's appeal with regard to the 2009 through 2011 tax years upon the submission of additional documentation.

6. Classification. P.D. 13-31 (March 12, 2013). The taxpayer commenced operations in December 2009 at a definite place of business in the City. It reported no gross receipts on its initial license application. For the 2010 and 2011 tax years, the taxpayer reported a portion of gross receipts under the City's classification for qualified research and development. The remaining gross receipts were classified as manufacturing. In May 2011, the taxpayer filed a request to be reclassified as a manufacturer on the basis that most of its income was derived from manufacturing. In its final local determination, the City found that the taxpayer was conducting multiple licensable activities including manufacturing, qualified research and development, and business services. The taxpayer appealed the City's final determination to the Tax Commissioner contending it should be reclassified as a manufacturer because a majority of its activities constitute manufacturing. Based on contract information for the 2010 tax year provided by the taxpayer, the Tax Commissioner determined that the descriptions of these contracts clearly show the taxpayer was engaged in research and development activities. In addition, the City inspected the taxpayer's facilities, contracts and invoices in sufficient detail to determine the extent of the taxpayer's manufacturing activities. Accordingly, the Tax Commissioner found no reason to overturn or adjust the City's final determination.

7. Contractors. P.D. 13-76 (May 23, 2013). The taxpayer is a limited liability company that purchased a residential dwelling in 2012. It hired a contractor to rehabilitate the dwelling. The taxpayer does not have an office, but an owner who is the taxpayer's registered agent resides in the County. The County audited the taxpayer, determined it was engaged in a licensable business activity within its jurisdiction, and issued a BPOL tax assessment for the 2012 tax year. The taxpayer appealed the County's assessment. In its final determination, the County determined that the taxpayer was subject to the BPOL tax as a contractor because it was engaged in the business of purchasing, renovating and selling homes. The taxpayer filed an appeal with the Tax Commissioner contending it was not engaged in a licensable business, did not have a definite place of business in the County, and should not be classified as a contractor. The Tax Commissioner disagreed and upheld the assessment.

In its appeal, the taxpayer contended that it was not engaged in a continuing course of business because it purchased, got a permit for, and renovated only one residence in the County. In making his determination, the Tax Commissioner relied on one line of dicta from a 1979 Virginia Supreme Court case involving the question of whether a business that owned rental properties in a locality was engaged in business and non-precedential public documents. He determined that the taxpayer exercised time, attention, and labor in getting a building permit and engaging a contractor to renovate the dwelling in order to make it more marketable for sale. The Tax Commissioner added that the taxpayer was likely looking for other investment opportunities as well. Therefore, the Tax Commissioner determined that the LLC was engaged in business and had a definite place of business in the County as one of its owners resided in the County. As for how to classify the LLC, the Tax Commissioner classified it as a contractor. Citing Public Documents 04-83 and 97-423, the Tax Commissioner held that a business making improvements to its own real estate with the intention of offering the real estate for sale, may be properly classified and subject to the tax as a contractor.

Comment: Here, the LLC was classified as a contractor for hiring a contractor. The LLC does not perform any contracting services as it is merely an entity to hold and sell the property. It is one thing if a classification is created to tax entities that hold and sell investment properties. To classify it as a contractor is ludicrous. If the LLC purchased turn-key property, what would it be classified as then?

8. Insufficient Information. P.D. 13-82 (May 29, 2013). The taxpayer operated a convenience store and gas station in the City. In conjunction with an audit of the taxpayer, the City requested financial records to ascertain the correct tax liabilities for all of the tax years at issue. When the records were not provided, the City issued assessments based on the available information for 2008 through 2010 tax years for BPOL tax and BTPP tax. The taxpayer appealed the assessments and provided the City copies of its federal income tax returns and income statements. In its final determination, the City upheld the assessments on the basis that the taxpayer failed to provide sufficient records to substantiate items reported on the income tax returns. The taxpayer filed an appeal with the Tax Commissioner contending the City's assessments are overstated. The Tax Commissioner upheld the assessments. Through the course of this appeal, the Tax Commissioner requested the same documentation that the City requested. The taxpayer only partially complied and argued that the information provided was sufficient. The Tax Commissioner found the information provided to be insufficient.

9. Separate Line of Business. P.D. 13-112 (June 24, 2013). The taxpayer is a commercial printer located in the City. During the 2011 tax year, the taxpayer offered certain mailing services, including direct mail marketing campaign development and design, mailing list development and hygiene, and the preparation of printed products for mailing. In nearly every case, customers who used these mailing services did so in connection with a printed product the taxpayer produced for them. Initially, the City classified the taxpayer as a retailer and assessed BPOL tax. The taxpayer filed an appeal with the City contending it was exempt from BPOL tax as a manufacturer. In its final determination, the City concluded that the taxpayer was a manufacturer, but the City segregated the taxpayer's mailing functions as a separate line of business and assessed BPOL tax against it under a commercial service classification. The taxpayer filed an appeal to the Tax Commissioner contending that it is a manufacturer, not a commercial service provider, and its print equipment and mail equipment operate together as part of the same process. The Tax Commissioner agreed and determined that the taxpayer's mailing functions did not constitute a separately licensable business, but were ancillary to the principal business as a printer. Citing 23 VAC 10-500-110(B), the Tax Commissioner stated that an activity for which no separate charge is made will be presumed to be ancillary to the activity for which a charge is made, but separately stating charges for different activities will not create a presumption that each such activity is a separate business. He also stated, “To the extent that additional services are offered to make the sale of a good or service more attractive to the consumer, the offering of such supplemental services are usually ancillary to the principal business.” The information provided by the taxpayer indicated nearly every customer who used the taxpayer's mailing functions did so in connection with a printed product the taxpayer produced for the customer. By combining the services, the taxpayer effectually made its printing service more attractive and convenient for customers.

10. Jurisdiction. P.D. 13-147 (July 31, 2013). The County audited the taxpayer. After reviewing her federal income tax returns, the County determined that the taxpayer was engaged in a licensable business activity and had business tangible property within its jurisdiction. The County issued assessments for the BPOL license fee and issued BTPP tax assessments for the tax years at issue. It also denied the taxpayer's request for personal property tax relief for her automobile. The taxpayer appealed the County's assessments. In its correspondence, the County determined that the taxpayer was subject to the BPOL tax on the basis that she was operating a licensable business. The taxpayer filed an appeal with the Tax Commissioner contending that she was not engaged in a licensable business and therefore owed no BPOL or BTPP tax. The Tax Commissioner determined that he had no jurisdiction on any of the issues. For BPOL and BTPP, the County failed to include appeal instructions in the determination which was precluded it from being a final determination which is necessary for the Tax Commissioner to have jurisdiction.

11. Intercompany Receipts Deduction. P.D. 13-163 (August 15, 2013). The taxpayer, an S corporation wholly owned by four shareholders (collectively, the "Shareholders"), has a definite place of business in the County. The taxpayer provides management and administrative services to seven Virginia operating entities in Virginia. The Shareholders owned partnership interests in the Virginia operating entities. The Shareholders also collectively wholly own ASC, an S corporation that also had a definite place of business in the County. It provides management and administrative services to nine operating entities located in State A. The Shareholders also owned partnership interests in State A operating entries. Under audit, the County made an adjustment to include intercompany receipts from all of the entities. The taxpayer appealed the assessments to the County. In its final local determination, the County held that the intercompany payments from the Virginia and State A entities were not exempt because the taxpayer, ASC, the Virginia entities and the State A entities were not an affiliated group. The taxpayer appealed the County's final determination to the Tax Commissioner contending that both the Virginia entities and the State A entities are affiliated with the taxpayer under the brother-sister test. The Tax Commissioner adjusted the determination after applying the brother-sister test from 23 VAC 10-500-50. Under this test, two or more entities are deemed to be affiliated if five or fewer owners that are individuals, estates, or trusts (the "ownership group") hold stock or other ownership interests that meet both the total membership and common ownership prongs of the test. Entities will meet both prongs of the test if:

1. the ownership group owns at least 80% of the total voting power of all classes of ownership interests or the total value of all ownership interests (total membership), and
2. the ownership group holds more than 50% of the total voting power of all classes of ownership interests or the total value of all ownership interests to the extent that the ownership interests are identical for each entity (common ownership).

12. Out of State Receipts Deduction. P.D. 13-170 (September 13, 2013). The taxpayer, a provider of computer-based services with multiple locations in the City and throughout the world, apportioned its gross receipts based on payroll. The taxpayer calculated its gross receipts by subtracting from its total worldwide gross receipts those gross receipts generated from each state in which it filed an income tax return and multiplied the net total by

the percentage of its Virginia payroll to total payroll. The City audited the taxpayer and disallowed the subtraction for the gross receipts attributed to states in which the taxpayer filed income tax returns, and assessed additional BPOL tax. The taxpayer appealed the City's assessment, asserting the audit computations did not follow the policies and procedures set forth in Public Document (P.D.) 11-13 (1/21/2011). In response, the City issued a final determination and a revised audit report concluding that the revised findings were supported by P.D. 11-13. The taxpayer filed an appeal with the Tax Department. In its appeal, the taxpayer newly claimed it was able to situs gross receipts to the definite place of business where the work was performed. In addition, the taxpayer contended it would be eligible for an out-of-state deduction for gross receipts attributable to contracts for which the customer was located outside of Virginia and the taxpayer filed an income-like tax return. The Tax Commissioner remanded the appeal back to the City as he determined that the taxpayer showed that it is possible to situs its gross receipts using the under the general rule. The Tax Commissioner directed the City to evaluate the taxpayer's method of situsing gross receipts to a definite place of business and grant an out-of-state deduction in accordance with this determination. Furthermore, if the City accepts the taxpayer's direct labor method for situsing gross receipts, the Tax Commissioner directed the taxpayer to work with the City to determine how it would be practical to situs gross receipts in the same manner for subsequent tax years.

13. Classification. P.D. 13-173 (September 19, 2013). The taxpayer, headquartered in State A, is a business finance company that has a definite place of business in the County. The taxpayer offers a variety of financing options to businesses, such as purchasing future receipts and receivables, making loans, and providing access to credit. The County assessed the taxpayer for BPOL tax for the 2009 through 2012 tax years. The taxpayer appealed the assessments to the County. In its final determination, the County stated that the taxpayer agreed with it that the BPOL assessments should be based on the Virginia income tax return and upheld the assessments. The taxpayer filed an appeal to the Tax Commissioner contending that the County's assessment method applied only to service companies and should not apply to the taxpayer because it bought and sold tangible personal property and had no gross receipts subject to BPOL tax in Virginia. First, the Tax Commissioner determined that the taxpayer should be classified as a financial services provider. Virginia Code § 58.1-3700.1 defines "financial services" as "the buying, selling, handling, managing, investing, and providing of advice regarding money, credit, securities, or other investments." In addition, Title 23 VAC 10-500-390 provides a list of specific activities that are considered financial services, including, but not limited to, financing accounts receivable, installment financing, inventory financing, providing loans or mortgages, and working capital financing. However, the taxpayer did not provide any information regarding the situs of its receipts despite arguing that it did not purchase any credit or debit card receipts from businesses in Virginia. In addition, it has provided no information concerning its other lines of business. Therefore, the Tax Commissioner remanded the case back to the County with the instruction to reconsider the taxpayer's appeal with regard to the 2009 through 2012 tax years. The taxpayer was instructed to provide the County with sufficient documentation to describe its operations, both in Virginia and elsewhere, and determine its gross receipts subject to BPOL tax.

D. Opinions of the Attorney General

1. Exemption for Railroads and Other Carriers. Va. Op. Atty. Gen. No. 11-110 (July 19, 2013). The Spotsylvania County Commissioner of the Revenue inquired whether a corporation claiming to be a subsidiary of a Class I railroad that operates a transloading facility qualifies for the local business license tax exemption provided by§ 58.1-3703(C)(l). In addition, she asked whether the corporation is eligible for the real and tangible personal property tax rate provided by§ 58.1-2607. The Attorney General opined that the exemption afforded under § 58.1-3703(C)(l) does not apply to the subsidiary of a Class I railroad that operates a trans loading facility unless it was certified by the Interstate Commerce Commission (ICC) during that agency's existence or is registered with the Surface Transportation Board (STB) for insurance purposes. He also opined that the application of § 58.1-2607 depends on who owns the real and tangible property being taxed.

VII. TANGIBLE PERSONAL PROPERTY AND MACHINERY AND TOOLS TAXES

A. 2013 Legislation

1. Tangible Personal Property Tax; Separate Classification for Computer Equipment in Data Centers. House Bill 1699 (Chapter 271) and Senate Bill 1133 (Chapter 393) create a separate classification of property for computer equipment and peripherals used in a data center for local tangible personal property tax purposes. Localities would be authorized to tax these items at a rate not to exceed the rate applied to the general class of tangible personal property. This legislation would also mandate that if computers and peripheral equipment used in a data center could fall under any of the other computer-related classifications, the computer equipment and peripherals would be taxed at the lowest rate among those specified classifications. This legislation is effective on July 1, 2013.

2. Tangible Personal Property Tax: Advertising Signs. House Bill 1860 (Chapter 287) and Senate Bill 1236 (Chapter 652) create a separate classification for valuation purposes under the local tangible personal property tax for outdoor advertising signs adjacent to rights-of-way of highways. This legislation also prohibits a locality from levying the real property tax on outdoor advertising signs and from considering such signs or any income generated by such signs, in assessing the value of real property or any leasehold or easement interest in such real property. This legislation was effective on March 13, 2012 for tax years beginning on or after January 1, 2013.

3. Personal Property Tax: Motor Vehicles Leased by a Locality or Constitutional Officer. House Bill 1522 (Chapter 39) allows motor vehicles leased by a county, city, town or constitutional officer to be separately classified for purposes of the Tangible Personal Property Tax, provided that the locality or constitutional officer is obligated by the lease to pay the vehicle’s tangible personal property tax. Localities are permitted to tax these vehicles at a rate not to exceed the rate applicable to the general class of tangible personal property. This legislation also mandates that motor vehicles that fall under multiple classifications be taxed at the lowest rate assigned to such classifications. This legislation is effective on July 1, 2013.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Business Tangible Personal Property Tax: Improperly Included Property. P.D. 12-160 (October 12, 2012). The taxpayer is a kitchen supply retailer that operated in the City. Pursuant to an audit, the City adjusted the taxpayer's fixed assets listed on its BTPP tax returns for the 2007 through 2009 tax years. The taxpayer filed an appeal with the City contending that the fixed asset schedules on its returns were overstated, and the City included assets that had been replaced, were obsolete, or were no longer on the premises. In its final determination, the City reviewed the taxpayer's amended schedule of fixed assets, but affirmed its conclusion that the assets were properly included as tangible personal property subject to the BTPP tax because the property was either present at the taxpayer's store or the taxpayer failed to provide sufficient documentation of the property's disposal. The taxpayer appealed the final local determination to the Tax Commissioner asserting that the assets as adjusted by the City contained property not subject to the BTPP tax. The Tax Commissioner upheld the final determination as the taxpayer did not show that the City's assessment is incorrect. However, the case was remanded back to the City in order to consider any other documentation the taxpayer may be able to provide with regard to the assets it owned during the tax years at issue.

2. Business Tangible Personal Property Tax: Cable Box Converters. P.D. 12-162 and 12-163 (October 16, 2012) and P.D. 12-198 and 12-199 (December 6, 2012). The taxpayer is affiliated with a cable television provider. In order to receive the cable service, customers must have a converter, also known as a set top box. The converters are owned by the taxpayer and are issued to cable customers by the cable television provider. The taxpayer classified the converters as tangible personal property on the 2008 through 2010 BTPP returns filed with the County. In June 2011, it filed a request for the refund of BTPP paid on the converters for the tax years at issue contending the boxes were intangible property exempt from the BTPP tax. In its final determination, the County determined that the converters were machinery subject to tax. The taxpayer filed an appeal with the Tax Commissioner contending the converters are intangible property not subject to the local taxation. The Tax Commissioner agreed and determined that the converters should be classified as intangible personal property. In Chapter 692, 1984 Acts of Assembly, Va. Code § 58-405 was amended to provide a separate subsection for cable television businesses as follows:

> Personal property, tangible in fact, used in cable television businesses, except machines and tools, motor vehicles and delivery equipment of such businesses, trunk and feeder cables, studio equipment, antennae and office furniture and equipment of such businesses.

A reference to tuners and converters was removed from the list of property subject to local taxation. The County argued that the term "machines" in the statute includes the tuners and converters and, therefore, they are subject to local taxation. Citing a tax bulletin and a fiscal impact statement, the Tax Commissioner determined that the intent of the 1984 legislation was to classify converters as intangible property.

3. Machinery and Tools Tax: Amended Returns. P.D. 12-166 (October 23, 2012). On December 29, 2011, a representative of the taxpayer (the "Representative") filed amended M&T tax returns for the 2008 through 2011 tax years on behalf of the taxpayer. The County issued refunds for the 2009 through 2011 tax years, but denied the refund for 2008. The County determined that the Representative was not authorized to represent the taxpayer at the time the amended return was filed and did not obtain such authorization until after the statute of limitations had expired. The taxpayer filed an appeal with the County. In its final determination, the County acknowledged that the amended returns were timely filed; however, the 2008 refund was denied because the Representative's authorization was not received prior to the expiration of the statute of limitations. The taxpayer appealed the County's final determination contending the Representative has submitted all tax returns from tax years 2006 to present and provided evidence of the Representative's authorization for those years. The Tax Commissioner agreed and ordered that the County issue the 2008 refund. For the 2008 tax year, the taxpayer contracted with another entity to prepare its M&T tax returns. In January 2009, the entity transferred the contract and its servicing agent to the Representative. The taxpayer provided evidence of the agreement permitting the assignment of the 2008 through the 2012 tax years from the former service provider to the Representative.

4. Machinery and Tools Tax: Idle Machinery. P.D. 12-177 (November 5, 2012). The taxpayer operated a manufacturing plant in the County. By letter dated March 23, 2010, the taxpayer notified the County that the manufacturing plant ceased production as of December 31, 2009. The taxpayer, however, kept some of the machinery in production through January 7, 2010, in order to complete an order for a customer. The taxpayer filed an M&T tax return with the County for the 2011 tax year that excluded all equipment that was not in operation as of December 31, 2009. The County audited the taxpayer for the 2011 tax year and issued an assessment on the basis that all of the taxpayer's machinery and tools were subject to the M&T tax. The taxpayer filed an appeal with the County arguing that all of its equipment was idled for the 2011 tax year except for the machinery operating in January 2010. The County issued a final determination concluding that all of the taxpayer's equipment was subject to the M&T tax for the 2011 tax year because it failed to give proper notice and failed to prove that its machinery ceased operation as of December 31, 2009. The taxpayer appealed the County's final determination to the Tax Commissioner contending the equipment at issue was continuously not in use for more than a year and it had given proper notice to the County. The Tax Commissioner remanded this case back to the County in order to reconsider its determination. The taxpayer produced an affidavit and newspaper articles that show that the operations ceased as of December 31, 2009. While the County has the final authority to determine what constitutes satisfactory documentation, it was the Tax Commissioner's opinion that the taxpayer demonstrated that the equipment in question became idle prior to December 31, 2009, remained idle on January 1, 2011 and was not returned to use during the 2011 tax year.

5. Machinery and Tools Tax: Packaging and Shipping Equipment. P.D. 12-181 (November 13, 2012). The taxpayer, a manufacturer located in the County, filed amended machinery and tools tax returns for the 2007 through 2010 tax years requesting removal of certain equipment included on the original returns as machinery and tools. The County agreed to some of the taxpayer's amendments and refunded the associated tax but declined to allow the removal of all of the equipment requested by the taxpayer. The taxpayer filed an appeal with the County. In its final determination, the County made additional adjustments to the machinery and

tools tax assessments for the 2007 through 2010 tax years. The taxpayer appealed the County's final determination, contending certain equipment was incorrectly classified by the County as machinery and tools. It asserted that certain equipment was not machinery and tools because it was used in packaging and shipping.

The taxpayer is a manufacturer of plastic bottles. The bottles go through a molding machine where they are formed. After exiting the molding machine, the bottles are transported via a conveyor to area where they are palletized in groups and eventually wrapped, strapped and ready for shipping. The taxpayer asserted that the equipment used to palletize the bottles, wrap them and prepare for shipping is not used directly in its manufacturing process because the bottles were completely transformed at the point the bottle exits the molding machine. The taxpayer contended the palletizers are not used in connection with the operation of equipment used directly in its manufacturing process, but rather are used in packaging and shipping. As such, the palletizers are not subject to the machinery and tools tax. In its final determination, the County concluded that because the taxpayer's customer required the bottles to be packed in pallets, the conveyors arid palletizers are connected to the finished goods process and, therefore, subject to the machinery and tools tax. No evidence was presented to demonstrate that the palletizing function is performed for product quality (consumer demands). Absent of such proof, machinery used for packaging the product for shipping purposes is not directly used in the manufacturing process. Accordingly, the Tax Commissioner considered the palletizing and wrapping functions a part of the shipping process and exempt from the machinery and tools tax.

6. Machinery and Tools Tax: Fair Market Valuation. P.D. 12-212 (December 13, 2012). The taxpayer manufactures a building product in a manufacturing facility located in the City. In 2007, it expanded its facility and began to operate new machinery. At the time the new machinery went into operation, the housing and construction markets went into a recession, resulting in a sharp decline in demand for the taxpayer's building product. As such, there was a substantial underutilization of the taxpayer's machinery. For purposes of the machinery and tools tax, the City assesses the value of machinery and tools based on the depreciated cost of the property. In July 2011, the taxpayer requested that the City reduce the assessed value of the machinery and tools using a method that took into account the economic obsolescence of the subject equipment. The taxpayer's proposed valuation methodology was made pursuant to an economic obsolescence analysis prepared by the taxpayer's representative. In its final local determination, the City denied the taxpayer's request for the revaluation because it determined that the statutory methodology of valuation was proper. The taxpayer appealed the City's final local determination asserting that the City's method of valuation does not reflect the actual fair market value of the machinery and tools. The taxpayer did not submit an independent appraisal with its appeal.

Article X, §§ 1 and 2 of the Constitution of Virginia provide that all property, unless specifically exempted within the provisions of the Constitution, shall be taxed at a uniform rate among classes, and that "all assessments of real estate and tangible personal property shall be at their fair market value to be ascertained as prescribed by general law." In attempting to achieve property valuations that reasonably approximate fair market value, the General Assembly statutorily prescribed different methodologies for use in the valuation of different classifications of property. The method of valuation to ascertain the fair market value of machinery and tools used in a manufacturing business is set forth in Va. Code § 58.1-3507(B).

> Machinery and tools segregated for local taxation . . . shall be valued by means of depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest. In valuing machinery and tools, the commissioner of the revenue shall, upon written request of the taxpayer, consider any bona fide, independent appraisal presented by the taxpayer

Because the taxpayer did not submit an appraisal, the Tax Commissioner did not have sufficient evidence to show that the City's valuation method is invalid. The Tax Commissioner remanded this matter to the City with the instructions that it consider any bona fide independent appraisal that the taxpayer may be able to provide to demonstrate the fair market value of its machinery and tools.

7. <u>Machinery and Tools Tax: Fair Market Valuation</u>. P.D. 13-20 (February 15, 2013). The taxpayer operates a manufacturing facility in the County. The County values machinery and tools as a percentage of original total capitalized cost. The taxpayer and the County have jointly requested that the Tax Department define "original total capitalized cost" and provide an analysis of the relationship between "original total capitalized cost" and fair market value. Va. Code § 58.1-3507(B) requires that machinery and tools segregated for local taxation should be valued by means of depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest. However, Article X, §§ 1 and 2 of the Constitution of Virginia provide that all property, unless specifically exempted within the provisions of the Constitution, shall be taxed at a uniform rate among classes, and that "all assessments of real estate and tangible personal property shall be at their fair market value to be ascertained as prescribed by general law." The Tax Commissioner determined that the original total capitalized cost would be the purchase price of the owner that first purchased the machinery and tools, regardless of subsequent sales and purchases. The consideration does not stop there. Virginia Code § 58.1-3507(B) also requires a local taxing authority to consider any bona fide, independent appraisal presented by the taxpayer when valuing machinery and tools when requested in writing by a taxpayer. The taxpayer commissioned an independent appraisal valuing its machinery and tools at the time of their purchase. It contended that the appraisal supports the use of book value for valuing its machinery and tools. The Tax Commissioner stated, "Because an appraisal is an approximation of fair market value, the original total capitalized cost of an asset must be revised to reflect the appraised fair market value." **Note:** This is an important ruling discussing how the valuation of the machinery and tools tax base must also comply with the Constitution of Virginia. In other words, an good, independent appraisal is quite necessary and important.

8. <u>Machinery and Tools Tax: Idle Equipment and Recycling Exemption</u>. P.D. 13-21 (February 20, 2013). At the beginning of the tax year, Business A had machinery and tools that qualified as idle under the notification test at facilities located in the County. In April, Business A sold the idled equipment to, and leased the facilities to Business B. In July, Business B returned the idle machinery and tools to service. The equipment purchased by Business B is certified recycling equipment. The County's ordinance partially exempts certified recycling equipment from local taxation. The County requested an opinion as to whether the idled equipment becomes subject to the M&T tax. If so, is Business A or Business B subject to M&T tax on the machinery and tools returned to use? The County also asked whether Business B can

claim a certified recycling exemption from local tax. The Tax Commissioner determined that the equipment is subject to the M&T tax in the tax year in which it was put into use. When idle machinery and tools are returned to use, Va. Code § 58.1-3507(E) provides "such machinery and tools shall be subject to tax ... in the same manner as if such machinery and tools had been in use on the tax day of the year in which such return to use occurs." The Tax Commissioner also opined that the County's recycling exemption which allows 50% of the tax be subtracted from tax due on real property on which the certified recycling equipment, facilities, or devices is attached could not be claimed as Business B did not owe real property tax on the real property to which the equipment was attached.

9. Business Tangible Personal Property Tax; Real vs. Tangible Personal Property. P.D. 13-47 (April 4, 2013). The taxpayer has property at four data center sites within the County that are leased from unrelated third parties. The taxpayer filed amended returns for the 2010 and 2011 tax years removing certain assets from these returns on the basis that they were either real property or application software. The County accepted some of the taxpayer's adjustments, but stated it was unable to determine whether some assets were either real property or software because the taxpayer had not provided requested documentation. As such, it issued a final local determination granting the taxpayer an opportunity to file amended returns that reflected the County's adjustments. The taxpayer appealed the County's final determination to the Tax Commissioner, asserting that certain generators, transfer switches, and power whips are real property. It also contends that certain other assets it removed from the amended returns are application software that is exempt from the BTPP tax. The Tax Commissioner upheld the County's final determination. The taxpayer argued that generators, transfer switches and power whips are part of the real property it leases. An examination of the lease for the data center facilities, however, indicates the back-up generators, modular digital center equipment, electrical transformers, and electrical switchgear are the taxpayer's tangible personal property subject to removal from the datacenter by the taxpayer at the end of the lease term. Based on the tests of annexation, adaptation, and intention, equipment that is removable at the end of a lease term is generally considered to be tangible personal property, not realty. With regard to the application software, the taxpayer did not provide sufficient evidence to show that the application switches were not tangible or even software.

10. Business Tangible Personal Property Tax: Reconsideration of P.D. 12-160. P.D. 13-53 (April 29, 2013). The taxpayer requested a reconsideration of Public Document 12-160 (10/12/2012), in which the Tax Department upheld assessments of Business Tangible Personal Property Tax. In the prior ruling, the Tax Department determined that the taxpayer had failed to provide sufficient documentation to the City to show that its fixed asset schedules were overstated and that certain assets that had been replaced, were obsolete, or were no longer on the premises. Accordingly, the taxpayer was given 30 days to provide additional documentation to the City. After not receiving any indication that such documentation was provided, the Tax Commissioner upheld the previous ruling.

11. Business Tangible Personal Property Tax: Pollution Control Exemption. P.D. 13-62 (May 9, 2013). A taxpayer, who has a definite place of business in the County, applied to the Department of Environmental Quality (DEQ) to have certain business tangible personal property certified as pollution control equipment. According to the County, the taxpayer would file refund claims for property tax paid based on the certification. The County

requested guidance from the Tax Commissioner concerning the effective date of such certification. The Tax Commissioner responded that for tax years prior to January 1, 2011, pollution control equipment was only exempt to the extent permitted by local ordinance. Such ordinances would govern how a locality would respond to a refund request by a taxpayer for tax years both before and after the effective date of the General Assembly's amendment to Va. Code § 58.1-3660. If a locality did not have an ordinance exempting or partially exempting pollution control equipment property from local taxation, no exemption would be granted and no refund of property tax would be required for tax years prior to January 1, 2011. For tax years beginning on or after January 1, 2011, the Tax Department defers to the certifying agency as to the effective date of any pollution control equipment and facility certification.

12. <u>Machinery and Tools Tax: Packaging Equipment</u>. P.D. 13-63 (May 10, 2013). The taxpayer, a manufacturer located in the County, filed amended machinery and tools tax returns for the 2008 through 2011 tax years. The taxpayer requested removal of certain equipment included on the original returns as machinery and tools. The County agreed to some of the taxpayer's amendments and refunded the associated tax but declined to remove the entire list of equipment as requested by the taxpayer. The taxpayer filed an appeal with the County, contending certain equipment was used for packaging and shipping, not manufacturing. In its final determination, the County held that the packaging of the goods for shipment was a part of the manufacturing process. The taxpayer appealed the County's final determination contending the manufacturing process ends once its products are packaged for resale and any additional packaging is not a part of the manufacturing process. The Tax Commissioner determined that once the taxpayer’s products are placed into the packaging to be consumed at retail, all industry, governmental, and consumer standards have been met. As such, the taxpayer's manufacturing process included dispensing the products into containers. All subsequent packaging would be considered a logistical process and exempt from taxation as M&T.

13. <u>Machinery and Tools Tax: Idle Machinery</u>. P.D. 13-96 (June 11, 2013). The County requested a reconsideration of P.D. 12-177. The County asserted the taxpayer should be subject to M&T tax on all of its machinery and tools for 2011 because it failed to properly notify the County that its assets were idle and the plant continued to operate in 2010. The County contended that the taxpayer has failed to show that any of its machinery and tools was idle by December 2009 because it was still in operation in January 2010. The County pointed to conflicting statements and information provided by the taxpayer. The taxpayer claimed all of its assets were idle when it filed its 2011 M&T tax return. In the February 2012 amended filing, the County claimed the taxpayer only sought adjustments for assets that were either transferred or disposed. According to the County, subsequent claims for refund were based on varying statements by the taxpayer that only a limited amount of machinery was operating in January 2010. The Tax Commissioner disagreed. The taxpayer demonstrated to the Tax Commissioner’s satisfaction that it intended to shut down its operations by December 31, 2009. Both the taxpayer and the County agreed that manufacturing operations did, in fact, cease in early January 2010. Given the short time the taxpayer remained open in 2010, the Tax Commissioner found it doubtful that the taxpayer operated at full capacity in 2010. Accordingly, some if not most of the machinery and tools at the plant would have been idle for more than a year by January 1, 2011.

14. Machinery and Tools Tax: Disposed Machinery. P.D. 13-129 (July 3, 2013). The taxpayer, a manufacturing business, operated several facilities in the City. The City issued an assessment for the 2011 tax year and also issued bills for delinquent assessments for previous tax years. In February 2012, the taxpayer filed amended M&T Tax returns for the 2008 through 2011 tax years reporting a reduced assessment for obsolete and discarded equipment. The City disallowed the amendments for the 2008 through 2010 tax years but allowed adjustments for disposals and idle equipment on the 2011 return. The taxpayer appealed the City's assessments for the 2008 through 2010 tax years. In its final determination, the City determined that the amended return for the 2008 tax year was filed outside the statute of limitations. In addition, the City found that the taxpayer had failed to provide adequate documentation to show that the machinery and tools at issue were idle or disposed of prior to 2011. The taxpayer appealed the City's final determination to the Tax Commissioner contending that the documentation provided should be considered sufficient to justify its amended return. First, the Tax Commissioner determined that the 2008 amended return was filed outside the three year statute of limitations by relying on Va. Code § 58.1-3980 (which has no application to the filing of an amended return). Next, the Tax Commissioner remanded this case back to the City to reconsider whether some of the machinery could have been considered to be idle for the 2009 or 2010 tax years. While the City has the final authority to determine what constitutes satisfactory documentation, the facts presented to the Tax Commissioner indicated that the taxpayer may have sufficient documentation to demonstrate that certain machinery was idle prior to December 31, 2007 and remained idle until such point that they were sold or otherwise disposed.

D. Opinions of the Attorney General

No recent opinions.

VIII. MISCELLANEOUS TAXES

A. 2012 Legislation

1. Coal Severance Tax. House Bill 2100 (Chapter 305) and Senate Bill 918 (Chapter 618) reduce the rates of the local coal severance tax on coal and the local coal road improvement tax severed from the earth by small mines from one percent to 0.75 percent of the gross receipts from the sale or use of such coal. “Small mine” is defined as a mine that sells less than 10,000 tons of coal per month. Gross receipts for the purpose of the local coal severance taxes is defined by this legislation as the purchase price received by a producer for the sale of coal to an unaffiliated purchaser in an arm’s length transaction. The cost of transporting the coal to the unaffiliated purchaser is excluded from gross receipts. Costs incurred transporting coal to another county for processing and the costs of processing it in the other county is allowed to be deducted from gross receipts. No other deductions are authorized. This legislation also clarifies that any person who only receives royalty payments will not be considered to have an economic interest in the coal and would not be subject to the taxes. The foregoing provisions are effective for coal sold or utilized on or after July 1, 2013.

This legislation also provides that no provision shall change or affect, invalidate, or interfere with any agreement regarding coal severance license taxes entered into between a taxpayer and Commissioner of Revenue. Localities imposing a coal severance license tax as of January 1, 2013, are required to amend its ordinance effective July 1, 2013, to be consistent with this legislation. This legislation was effective on March 13, 2013, except for the provisions changing the imposition of the local coal severance license taxes described above.

2. Cigarette Tax: Bond and Letter of Credit Requirements. House Bill 2219 (Chapter 311) and Senate Bill 1092 (Chapter 389) authorize the Tax Commissioner to reduce the face amount of the required bond or irrevocable letter of credit filed by a stamping agent in order to obtain Virginia cigarette revenue stamps without concurrent payment. Such amount will be a face amount determined by the Tax Commissioner to be satisfactory to cover possible losses resulting from the failure to remit taxes due, but not to exceed two times the anticipated average monthly amount of stamp purchases by the stamping agent as determined by the Tax Commissioner. This legislation is effective on July 1, 2013.

3. Transient Occupancy Tax. House Bill 1670 (Chapter 200) and Senate Bill 980 (Chapter 378) add Dickenson County, House Bill 1797 (Chapter 19) adds Greensville County, and Senate 720 (Chapter 319) adds Grayson County to the list of localities that are currently authorized to impose the transient occupancy tax at a maximum rate of five percent. Revenues from the portion of tax in excess of two percent would be required to be used solely for tourism or marketing of tourism. This legislation is effective on July 1, 2013.

4. Gas Severance Tax Appeals. House Bill 1771 (Chapter 208) and Senate Bill 1111 (Chapter 391) allow taxpayers to appeal additional assessments of local severance taxes for license years 2011 through 2013, which are made on or after January 1, 2014, for coal or gas severed from the earth prior to July 1, 2013. This legislation authorizes the administrative or judicial appeals to be filed with the commissioner of the revenue or the circuit court within one year from the last day of the license year for which such assessment is made, or within one year from the date of the assessment or increase in the assessment, whichever is later. This legislation is effective on July 1, 2013.

5. Motor Vehicle Rental Tax Exclusions. House Bill 1993 (Chapter 84) excludes the following from the gross proceeds upon which the Motor Vehicle Rental Taxes and Fee are applied: (1) cash discounts taken on a contract; (2) finance charges, carrying charges, service charges, and interest from credit given on a contract; (3) charges for motor fuels; (4) charges for optional accidental death insurance; (5) Motor Vehicle Sales and Use Tax; (6) violations, citations, or fines and related penalties and fees; (7) delivery charges, pickup charges, recovery charges, or drop charges; (8) pass-through charges; (9) transportation charges; (10) third-party service charges; and (11) refueling surcharges. The legislation requires the Department of Taxation to publish guidelines implementing the provisions. This legislation is effective for rental periods beginning on or after July 1, 2013.

6. Peanut Tax: Extension. House Bill 1320 (Chapter 6) and Senate Bill 698 (Chapter 40) extend the expiration date of the current $0.30 per 100 pounds rate of the Peanut Excise Tax from July 1, 2013 to July 1, 2016. Beginning July 1, 2016, the tax will revert to the rate of $0.15 per 100 pounds. The Peanut Excise Tax is imposed on peanuts grown in and sold in the Commonwealth for processing. This legislation is effective on July 1, 2013.

7. Insurance Premiums Tax Technical Corrections. House Bill 2155 (Chapter 29) and Senate Bill 1216 (Chapter 163) make several technical changes related to the administration of the Insurance Premiums License Tax by the Tax Department. Specifically, this legislation continues the SCC's current practices by waiving penalty and interest for quarterly estimated payments made by surplus lines brokers and by clarifying that the Tax Department would not pay interest on the refund of overpayments of the Insurance Premiums License Tax. This legislation changes the interest rate applied to underpayments by insurance companies so that it is consistent with the standard interest rate applied to other taxes administered by the Tax Department. This legislation also creates a uniform payment and billing deadlines by increasing the time period within which a taxpayer would be required to pay additional amounts owed from 14 days to 30 days from the date of the notice. This legislation clarifies the authority for disclosing information to the other state agencies, including the disclosure of information to the SCC for purposes of administering the Insurance Premiums License Tax. This legislation is effective for taxable years commencing on or after January 1, 2013.

8. Cigarette Tax and Other Tobacco Products Tax: Electronic Filings and Purchases. Senate Bill 1021 (Chapter 381) authorizes the Attorney General and the Tax Department to allow the reports required to be submitted by stamping agents to be filed electronically. This legislation also authorizes the Tax Department to allow the reports required to be submitted by manufacturers producing cigarettes and tobacco products to be filed electronically. Additionally, this legislation authorizes the Tax Department to allow for the electronic purchase and payment of Virginia cigarette tax revenue stamps. This legislation is effective on July 1, 2013.

9. Recordation Tax: Exemption for Transfers on Death. Senate Bill 1093 (Chapter 390) provides a recordation tax exemption for the recordation of any transfer on death deed or any revocation of transfer on death deed made pursuant to the Uniform Real Property Transfer on Death Act when no consideration has passed between the parties. This legislation is effective on July 1, 2013.

10. Insurance Premiums Tax: Reduced Rate. Senate Bill 780 (Chapter 136) repeals the reduced Insurance Premiums License Tax rate currently imposed on the direct gross subscriber fee income derived from certain contracts issued by corporations that operate a health services plan, dental services plan, or optometric services plan. In its place, a new rate of 2.25 percent is imposed on the direct subscriber fee income derived from all contracts issued by such corporations. Also, this legislation repeals the open enrollment requirement for corporations that offer a health services plan and convert into domestic insurers or stock insurers. Because the open enrollment requirement will no longer be imposed, the Insurance Premiums License Tax rate structure that applies to premium income generated by such insurers following a conversion is also repealed. This legislation is effective on January 1, 2014. The Insurance Premiums License Tax rates under this legislation is effective for taxable year 2014 and thereafter.

B. Recent Court Decisions

1. Small v. Fannie Mae. 2013 Va. LEXIS 102 (September 12, 2013). The Supreme Court of Virginia answered a question from the federal district court as to whether a clerk of court possessed statutory standing to initiate a lawsuit, in his official capacity, to enforce

the real estate transfer tax on the recording of instruments imposed by Va. Code Ann. §§ 58.1-801 and 58.1-812. The Court held that he did not, because the legislature designated the real estate transfer taxes as state taxes to be enforced by the Tax Department, and no statute authorized the clerk of court to collect unpaid real estate transfer taxes by filing an enforcement action. Jeffrey S. Small, in his official capacity as clerk of the Circuit Court of the City of Fredericksburg, filed a putative class action in the United States District Court for the Eastern District of Virginia (the federal district court) against the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). Purporting to represent the class of all clerks of court in the Commonwealth, Small alleged that Fannie Mae and Freddie Mac had failed to pay the taxes imposed by Code §§ 58.1-801 and -802.

Small contended that his authority to file the enforcement action arises from his affirmative duty, as clerk of court, to collect the real estate transfer taxes under Virginia Code §§ 58.1-802(B) and -812(B). Small argued that because clerks of court cannot force the Tax Department to bring enforcement actions, they cannot protect their interests without the ability to file enforcement actions. Small also maintained that there is nothing inconsistent with allowing both clerks of court and the Tax Department to enforce these tax statutes because the General Assembly created a "multi-track system of tax collection." The Court disagreed and found that the General Assembly granted exclusive authority to the Tax Department to collect recordation taxes.

C. Recent Virginia Tax Commissioner Rulings

1. Bank Franchise Tax: Alternate Method of Apportionment. P.D. 12-157 (October 4, 2012). The taxpayer is a nationally chartered bank headquartered in another state that maintains a mortgage loan office in Virginia. The taxpayer filed its 2008 and 2009 bank franchise tax returns reporting no capital apportioned to Virginia. In Public Document (P.D.) 11-182 (11/3/2011), the Tax Department ruled that the taxpayer was subject to the bank franchise tax, but would be required to use an alternative method (a single property factor) to apportion its capital subject to tax. The taxpayer disagreed with the method established by the Tax Department and filed its 2012 bank franchise tax return using a method that alters the single property method. It requested the Tax Department permit the taxpayer to rely on the statutory method of apportionment for banks or, in the alternative, to use an alternative method that includes loans in the single property factor. The Tax Department denied the request and required the taxpayer to utilize the single property factor. The Tax Department *relied* on corporate income tax regulations which set out a procedure for requesting an alternate method of apportionment. The regulation (Title 23 VAC 10-120-280) requires the request be made in a certain manner and show that the alternative method that has already been granted is unconstitutional or inapplicable as it would apply to the taxpayer.

Comment: What?!?!? The Tax Department used a regulation promulgated for a different tax to deny a request for alternate method. Furthermore, the Tax Commissioner appears to have decided this should become the standard in this very ruling. The taxpayer had no notice of this standard based on the language in this ruling. Are they supposed to guess what standard will apply? A method of apportionment for this tax must be provided to multi-state banks per the Commerce Clause of the U.S. Constitution and federal banking laws. Why not promulgate a regulation instead of making up rules as they go along?

2. Pass-Through Entity Withholding Tax. P.D. 12-201 and P.D. 12-202 (December 6, 2012). The taxpayer was a Virginia limited partnership that was owned by several Virginia residents and one domiciliary resident of State A. The taxpayer generated income from its ownership interest in savings accounts, certificates of deposit, stocks, bonds and royalty income. The taxpayer filed its nonresident withholding tax return and remitted withholding tax on behalf of a nonresident member after the due date. The Tax Department issued an assessment for penalty and interest to the taxpayer for failing to timely withhold income tax for income attributed to the nonresident member. The taxpayer paid the assessment and filed an appeal contending it did not have taxable income subject to the withholding requirement. The Tax Commissioner agreed and abated the assessment and ordered a refund. Virginia pass-through entities that are established solely to invest in intangible personal property, such as stocks and bonds, and that have no employees, and no real or tangible property are not considered to be carrying on a trade or business. Thus, income from the intangible property held by an investment pass-through entity is not income from Virginia sources. Pass-through entities that are established solely to invest in intangible personal property and that have no employees and no real or tangible property are not required to withhold Virginia income tax.

3. Virginia Insurance Premiums License Tax Guidelines. P.D. 12-203 (December 7, 2012). The Tax Commissioner issued guidelines regarding the Virginia Insurance Premiums License Tax.

4. Communications Sales and Use Tax: Wireless Telecommunications Services. P.D. 13-13, 13-14, 13-15, and 13-16 (February 5, 2013). The taxpayer is located outside of Virginia and provides wireless telecommunications services to customers located inside and outside Virginia. The taxpayer sells applications to its customers. The applications are for use on mobile devices and are made available to the customers via electronic download. The applications include items such as ring tones, games, wallpaper, GPS navigation tools and access to sport and weather information. The applications are offered at a variety of price points including: free of charge, monthly recurring (i.e., subscription based), or one-time unlimited charge. Pursuant to Public Document (P.D.) 08-64 (5/19/08), the taxpayer was assessed tax on the subscription based charges in the audit. The taxpayer contested the assessment and contends that the ruling in P.D. 08-64 is an erroneous interpretation of the statute because it creates a distinction between digital products that are downloaded electronically and charged to the customer on a monthly recurring basis and those digital products downloaded and charged a one-time fee. The taxpayer maintained that the applications sold on a subscription basis are exempt digital products and/or exempt information services, in accordance with Va. Code §§ 58.1-647 and 58.1-648(C). The Tax Commissioner agreed.

Virginia Code § 58.1-648(A) imposes the 5 percent communications sales and use tax on the customers of communications services providers. Virginia Code § 58.1-648(C) provides, in pertinent part, that the communications services on which the communications tax is levied shall not include "digital products delivered electronically, such as software, downloaded music, ring tones and reading materials." Virginia Code § 58.1-647 defines communications services, in pertinent part, as:

> The electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals, including cable services, to a point or between or among points, by or through any electronic, radio, satellite, cable, optical, microwave, or other medium or method now in existence or hereafter devised, regardless of the protocol used for the transmission or conveyance.

Based upon the information provided to the Tax Commissioner, he determined that the applications at issue are digital products that are downloaded electronically to the taxpayer's customers' mobile devices. In accordance with Va. Code §§ 58.1-647 and 58.1-648, the communications sales tax does not apply to the sale of the applications provided by the taxpayer to its customers.

The taxpayer also appealed the imposition of certain penalties. The penalties were discovered by the taxpayer's Parent while the taxpayer was being audited by the department with respect to its communications sales tax compliance. The Tax Department's auditor had not detected the errors during the performance of the audit. Immediately upon discovering the errors, the taxpayer voluntarily approached the Tax Department's auditor to disclose the outstanding liability. The taxpayer also willingly signed statute waivers to ensure the liability was included in the audit period at issue. Prior to the closing of the audit, the taxpayer issued a payment to the Tax Department that represents the unreported liability that was voluntarily disclosed. The taxpayer requested a full waiver of the compliance and amnesty penalties assessed on the unreported liability. The taxpayer maintained that its error in remitting the tax was not the result of gross negligence. The Tax Commissioner upheld the penalties citing statutes requiring the imposition of the penalties. **Lesson:** Being a good, truthful taxpayer may cost you more than just tax and interest.

5. Communications Sales and Use Tax: Internet-Based Services. P.D. 13-17 (February 5, 2013). The taxpayer provides an Internet-based service to its customers, which allows its customers to search for, select and view television and movie content (the "content") through the taxpayer's website. The taxpayer was assessed with communications sales and use tax it failed to charge its customers. The taxpayer appealed and contended that the service it provides is not subject to the communications sales and use tax (the "communications tax") because it does not constitute a communications service. The taxpayer further maintained that it provides "digital product, delivered electronically" to its customers that are expressly excluded from the communications tax by statute. The taxpayer also maintained that the ruling rendered in Public Document (P.D.) 08-64 (5/19/08) provides no basis to assess tax on the sale of the content to its customers. Using the same basis discussed in P.D. 13-13 *et seq.*, the Tax Commissioner abated the assessment.

6. Fiduciary Income Tax: Committee of Trustees. P.D. 13-18 (February 5, 2013). The Trust is an irrevocable, *inter vivos* trust created in Florida and governed by Florida law. The grantor was a Florida resident at the time the Trust was created. The grantor has never resided in Virginia and the Trust does not own property in Virginia. The Trust is being administered in Florida by a committee of two co-trustees. One co-trustee ("Co-Trustee 1") is a corporate trustee located in Florida. The other co-trustee ("Co-Trustee 2") is an individual and a Virginia resident. Co-Trustee 2 is also the beneficiary of the Trust. The Trust requires Co-Trustee 2 to serve with an independent co-trustee at all times. Co-Trustee 2 may replace any

independent trustee without restriction, but must replace that independent trustee with another independent trustee. The Trust provides that the co-trustees must make decisions by majority. As the beneficiary of the Trust, Co-Trustee 2 may receive distributions of principal or income which the co-trustees determine are necessary for the health, education, support and maintenance needs of Co-Trustee 2 during his lifetime. Co-Trustee 1 may distribute income or principal to Co-Trustee 2 for any purpose that Co-Trustee 1 determines is in Co-Trustee 2's best interest. A ruling was requested addressing whether the Trust has nexus with Virginia and whether the Trust is required to file a Virginia fiduciary income tax return. The Tax Commissioner the trust did not have nexus. In the present case, Co-Trustee 2 is a resident of Virginia, but he cannot make decisions regarding the Trust individually. Instead, any power or discretion that he has over the Trust may be exercised only if Co-Trustee 1 agrees. Therefore, the Trust is not being administered in Virginia and is not a resident trust for Virginia income tax purposes. The Trust is not required to file a Virginia fiduciary income tax return.

7. Recordation Tax: Federal Land Credit Association. P.D. 13-58 (May 1, 2013). In 2012, a deed of trust was submitted on behalf of a federal land credit association ("FLCA") in the County securing a loan made by FLCA. On submission of the deed of trust, the Virginia Recordation Tax was not paid because of a claim that a federal statute exempted the deed from the tax. The deed of trust was rejected from recordation by the County Circuit Court Clerk's Office because it did not cite a Virginia code section exempting the deed from the Recordation Tax. FLCA then paid the Recordation Tax under protest. FLCA appealed and contended that it has demonstrated that the deed of trust is exempt from the Virginia Recordation Tax under federal law. The Tax Commissioner agreed and determined that 12 U.S.C. § 2098 exempted federal land credit associations from federal, state or local taxation.

8. Communications Sales and Use Tax: Sale of Video via the Internet. P.D. 13-59 (May 2, 2013). The taxpayer requested a ruling on the application of the communications sales and use tax to the sale of video content delivered to the taxpayer's customers via the Internet. The Tax Commissioner determined that the sales were not subject to the tax. The video content at issue is a digital product downloaded electronically to the taxpayer's customers. In accordance with Va. Code §§ 58.1-647 and 58.1-648, the communications sales tax does not apply to the sale of the taxpayer's video content to its customers. The type of license granted to the customers (with or without permanent use) does not affect the application of the tax to the sale of the video content by the taxpayer to its customers. The other types of digital content (books and music) delivered by the taxpayer to its customers over the Internet are excluded from the communications sales and use tax in accordance with Va. Code § 58.1-648(C).

9. Withholding Tax: Insufficient Information. P.D. 13-83 (May 29, 2013). The taxpayer operates a shuttle service. Shuttle operators are paid by the trip. The taxpayer did not register to remit Virginia employer withholding tax and did not maintain any employee records for the period at issue. Under review, the auditor concluded that the operators were employees of the taxpayer, estimated the amount of the taxpayer's payroll, and issued assessments for failing to withhold income tax. The taxpayer appealed the assessments contending its shuttle operators are independent contractors and not employees. The Tax Commissioner upheld the assessment as the taxpayer failed to provide any evidence to support its claims.

10. Communications Sales and Use Tax: Inclusion of BPOL tax. P.D. 13-104 (June 15, 2013). The taxpayer is a provider of telecommunications services. The taxpayer contested the inclusion of the BPOL tax in the taxable base or sales price upon which the assessment was computed in the audit. Relying on Va. Code § 58.1-648, the taxpayer maintained that the BPOL tax is specifically exempted from inclusion in the sales price. The Tax Commissioner disagreed and upheld the assessment. Virginia Code § 58.1-648(B) excludes taxes "on the purchase, sale, use or consumption of any communications service . . ." and taxes "required to be added to the price of service if the fee or assessment is separately stated." The BPOL tax is imposed on businesses and professionals for the privilege of doing business in a locality. The BPOL tax is not a tax levied by a government entity on the purchase, sale, use or consumption of communications services, nor is it a fee or assessment levied by a government entity that is required to be added to the price of the service.

11. Guidelines for the Motor Vehicle Rental Taxes and Fee. P.D. 13-109 (July 1, 2013). The Tax Commissioner amended the guidelines for the motor vehicle rental taxes and fee which were first published on June 25, 2012 as Public Document 12-101.

12. Updated Virginia Insurance Premiums License Tax Guidelines. P.D. 13-122 (July 1, 2013). The Tax Commissioner issued updated guidelines for the Virginia Insurance Premiums License Tax. The original guidelines were published as P.D. 12-203.

13. Tobacco Products Tax: Promotional Tobacco Products and Cash Discounts. P.D. 13-144 (July 22, 2013). The taxpayer is engaged in the business of selling tobacco products through seven retail locations within the Commonwealth. The taxpayer was assessed the tobacco products tax on promotional tobacco products and cash discounts. The taxpayer contested the audit assessment stating the manufacturer's sales price used to calculate the tobacco products tax does not include promotional items. In addition, the taxpayer contended that the cash discounts disallowed in the audit are exempt of the tobacco products tax because they refer to payment terms only and are not related to discounts on tobacco products. The taxpayer states that it relied on the guidelines for the tobacco products tax issued by the Tax Department to properly calculate its tax liability. The Tax Commissioner adjusted the assessment. The Tax Commissioner found that there was no sale of promotional tobacco products for a consideration. Accordingly, the promotional tobacco products were not subject to the tobacco products tax. Based on Va. Code § 58.1-1021.01, the manufacturer's sales price does not include any cash discount allowed and taken. Therefore, the Tax Commissioner determined that the taxpayer correctly calculated the tobacco products tax based on the manufacturer's sales price taking into consideration the cash discount taken for early payment.

14. Withholding Tax. P.D. 13-145 (July 30, 2013). The Tax Commissioner issued Tax Bulletin 13-10 regarding Virginia household employer annual withholding. Legislation enacted during the 2012 General Assembly session created the opportunity for employers of household employees to file payroll and tax reports and pay the unemployment tax required by Va. Code § 60.2-511 on an annual basis with the Virginia Employment Commission, effective for wages paid on or after January 1, 2013.

15. Telecommunications Company Minimum Tax: Retroactive Application. P.D. 13-158 (August 8, 2013). In September 2008, the Virginia Supreme Court's decision in

Virginia Cellular v. Virginia Department of Taxation, 276 Va. 486, 666 S.E.2d 374 (2008) overturned the Tax Department's regulation, which imposed the telecommunications company minimum tax, codified at Va. Code § 58.1-400.1, on non-corporate telecommunications companies. In 2009, legislation (2009 Acts of Assembly Chapter 37) was enacted to impose the telecommunications minimum tax on pass-through entities. The provisions of the bill were made effective September 1, 2004. The taxpayer, a single member LLC providing telephone services in Virginia, filed a 2008 Virginia corporate income tax return reporting a net operating loss and paid telecommunications minimum tax on its gross receipts as certified by the State Corporation Commission (SCC). In October 2012, the taxpayer timely filed a claim for a refund of telecommunications minimum tax asserting that the Virginia Cellular decision prohibits the Tax Department from imposing the telecommunications tax on pass-through entities. The taxpayer also argued that the retroactive provision of the legislation is a violation of its right to due process. In addition, the taxpayer contended the legislation violates the United States Supreme Court's standard of meaningful backward looking relief. The Tax Commissioner denied the refund claim. Citing Colonial Pipeline v. Commonwealth of Virginia 206 Va. 517, 145 S.E.2d 227(1965), Welch v.Henry, 305 U.S. 134, 59 S.Ct. 12(1938) and United States v. Carlton, 512 U.S. 26, 114 S.Ct. 2018 (1994), the Tax Commissioner stated that the retroactive enactment of a statute will overcome a Due Process challenge if it supports a legitimate legislative purpose and is founded by a rational basis. The Tax Commissioner also rejected the taxpayer's argument that Harper v. Virginia Dept. of Taxation, 509 U.S. 86, 113 S.Ct. 2510 (1993) and Davis v. Michigan Dept. of Treasury, 489 U.S. 803, 109 S.Ct. 1500 (1989), requires relief from the illegally imposed tax. The Tax Commissioner countered that "In *Davis*, the United States Supreme Court struck down Michigan's tax scheme because it favored retired state and local government employees over retired federal employees. Virginia showed no such favoritism in imposing the telecommunications minimum tax. It was imposed on both corporations and pass-through entities."

16. Withholding Tax: Responsible Officer and Fraud Penalty. P.D. 13-159 and 13-160 (August 13, 2013). Under audit, the taxpayer, a corporation, was assessed tax, penalties, and interest for failure to withhold taxes from employee wages during the taxable periods at issue. The taxpayer appealed the assessments. It claims the Tax Department did not consider evidence that should have resulted in a lower withholding rate being applied. The taxpayer further argued that a former officer of the taxpayer should be held liable for all assessed amounts, not the taxpayer. Finally, the taxpayer protested penalties assessed as a result of the audit. The Tax Commissioner denied the taxpayer's appeal. The taxpayer provided no information to show that a lower tax rate should have applied. The Tax Commissioner also stated that Va. Code § 58.1-1813 does not prohibit the collection of taxes from a taxpayer as it allows the Tax Department to assess the responsible officer in addition to the taxpayer. The penalties, fraud and amnesty, were upheld. The fraud penalty was upheld because the taxpayer's former officer testified in a criminal case that he knowingly and willfully evaded the assessment of certain federal withholding taxes which the Tax Commissioner stated also applied to Virginia withholding payments. Lastly, the Tax Commissioner stated that the 20% amnesty penalty was properly applied.

D. Opinions of the Attorney General

1. Recordation Tax: Exemption for Federal Credit Unions. Va. Op. Atty. Gen. No. 13-010 (March 29, 2013). The Clerk of the Winchester Circuit Court asked whether Federal Credit Unions are exempted from paying the recordation tax imposed on grantors by § 58.1-802 of the Code of Virginia pursuant to the exemption provided by 12 U.S.C. § 1768. The Attorney General determined that Federal Credit Unions are exempted from paying the recordation tax. United States Code § 1768 provides that

> The Federal credit unions organized [under 12 U.S.C. Chapter 14], their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such Federal credit unions shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed.

As the recordation tax is not imposed on property, but on the privilege of recording, the Attorney General determined that United States Code § 1768 exempts Federal Credit Unions from the recordation tax.

2. Motor Vehicle Sales Tax: Vehicles Purchased Before July 1, 2013. Va. Op. Atty. Gen. No. 13-043 (May 22, 2013). Two members of the House of Delegates, the Commissioner for the Department of Motor Vehicles, and the Executive Director of the Motor Vehicle Dealer Board jointly asked which tax rate, 3% or 4%, should be imposed when a motor vehicle is purchased prior to July 1, 2013 but titled by the Virginia Department of Motor Vehicles ("DMV") subsequent to that date. The Attorney General opined that that the proper tax rate to impose on a vehicle sale transaction in Virginia is the tax rate in effect at the time of the sale, when ownership or possession of the vehicle is transferred, whichever of these events of sale occurs first. After the tax is imposed on the sales transaction, the tax is then owed and is paid and collected when the vehicle is titled by the DMV.

3. Recordation Tax: Subordinate Mortgage. Va. Op. Atty. Gen. No. 12-110 (June 28, 2013). The Warren County Circuit Court Clerk asked whether a subordinate mortgage giving a security interest to the Secretary of Housing and Urban Development, Department of Housing and Urban Development (HUD) is subject to state and local recordation taxes. The Attorney General opined that a subordinate mortgage giving a security interest to HUD is subject to state and local recordation taxes. This conclusion was determined as the subordinate mortgage is a new agreement and does not relate to the primary mortgage.

4. Transient Occupancy Tax: Definition of "Tourism". Va. Op. Atty. Gen. No. 11-139 (June 14, 2013). The Wythe County Attorney inquired whether the term "tourism" has been defined for purposes of § 58.1-3819 and sought clarification as to the meaning of a "local tourism industry organization" referenced in the same provision. He also inquired regarding the degree to which the local tourism industry must be consulted in spending transient occupancy taxes in excess of two percent. The Attorney General opined that while "tourism" has not been defined for purposes of § 58.1-3819, it is generally considered to be a domestic and international travel market that is important to the economy of the Commonwealth. It is also a requirement in § 58.1-3819 for those specified localities' is that any transient occupancy tax

imposed in excess of two percent must be spent to attract travelers to the locality, increase occupancy at lodging properties, and to generate tourism. A determination on spending requires input from the local tourism industry and localities have reasonable discretion in determining what are "local tourism industry organizations," but the inclusion of representatives of lodging properties is required.