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RECENT TAX DEVELOPMENTS IN VIRGINIA: 2013 – 2014

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I. CORPORATE INCOME TAX¹

A. Legislation

1. Conformity Date. Except for the EITC, Virginia's income tax conformity remains pegged to January 2, 2013. (No federal legislation requiring shift to January 1, 2014).
2. Add-backs. Both budget bills originally had provisions that would have approved the Department of Taxation's strained interpretations of Virginia's add-back statutes relating to royalty payments and certain interest payments. These provisions were struck. The "Caboose Budget Bill," however, contains these provisions and passed. There is confusion about the effect of this retroactive legislation because the Bill expires June 30, 2019.
3. DISCs. For 2014 and after, DISCs are exempted from Virginia income tax by HB 480 (Va. Code §58.1-401(9)).

B. Rulings of the State Tax Commissioner

1. Add-Back. PD 14-6 (January 16, 2014). Consistent with its controversial interpretation of the Add-Back statutes, Commissioner holds that only an apportioned deduction for royalties paid to an intangible holding company is allowed even though the royalties were subject to tax in another jurisdiction. Interest expense is also added back based on the fact that IHC held intangibles which were licensed to affiliates. Commissioner

¹ The summaries in this outline are intended to alert the reader to certain developments in Virginia law. Not all developments are reviewed. Readers should refer to the actual legislation, ruling, etc. for a complete and correct understanding of the development.

notes authority to make an “equitable adjustment” under §58.1-446 even if Department’s Add-Back policies are incorrect. **Comment.** Note that Virginia’s definition of “interest expense” does not permit the Add-Back of interest paid to an affiliate unless it is related to royalties or other intangible property.

2. Add-Back/Franchisees. PD 13-239 (December 19, 2013). Restaurant chain claimed an exception to the Add-Back requirement based on the circuit court of the City of Richmond’s decision in *Wendy’s International v. Virginia Department of Taxation* (April 25, 2012). Commissioner denies the refund claim asserting that the agreements with franchisees did not parallel the agreements with related parties and that the taxpayer had not proved that the transactions were comparable. Commissioner also holds that an “equitable adjustment” under §58.1-446 may be appropriate. **Comment.** Without more facts, it is difficult to determine if this ruling reflects the Department’s intention not to follow the *Wendy’s* decision even though the Supreme Court of Virginia declined to review that case on appeal.
3. Add-Backs. PD 13-238 (December 19, 2013). In line with the Department’s controversial interpretation of Virginia’s Add-Back statute, only an apportioned deduction was allowed for royalties paid by affiliated entities to an intangible holding company. Commissioner declines to rule on the taxpayer’s claim that it should qualify for the “business exception” for the Add-Back statute, but allows the taxpayer additional time to follow the statutory procedure for presenting such an argument. That procedure requires the taxpayer to file returns making the required Add-Back, pay the tax and then file an amended return.
4. Add-Backs. PD 13-193 (October 22, 2013). Commissioner reiterates the Department’s position that the safe harbor when royalties are “subject to tax” in another state is not a safe harbor, but an apportioned deduction. Only “to the extent” that the royalties are taxed in another state can they be deducted on a Virginia return and not added back.
5. Addback/Proof. PD 14-62 (May 6, 2014). Taxpayer failed to provide proof to support its position on several issues. Accordingly, assessment against the taxpayer on those issues was upheld. With respect to the taxpayer’s position that seven affiliates did not have nexus in Virginia, the Commissioner agrees that there was no nexus because the affiliates did not have positive Virginia apportionment factors. As to royalty addbacks, the Commissioner applies his position that essentially makes the “addback” an apportioned deduction. Commissioner holds that this policy is constitutional.
6. Add-Backs\Business Purpose. PD 13-195 (October 23, 2013). Taxpayer proved that bankruptcy remote entities were created to enable it to obtain financing using accounts receivables of affiliates as collateral served a

valid business purpose. Taxpayer had followed the statutory procedure of filing returns, with the add-back, and then requesting and proving its valid business purpose.

7. Add-Backs\Business Purpose. PD 13-211 (November 12, 2013). When auditor computed the add-back of factoring expense, he did not allow the taxpayer to net out bad debts and cash discounts. On appeal, the Commissioner requires the taxpayer to follow the statutory procedure when claiming a “valid business purpose” as a defense to the add-back. Taxpayer must file its return making their add-back, pay the tax and then prove its case.
8. Add-Backs\Interest. PD 13-213 (November 18, 2013). When changes in a tax return (type of return filed) affect NOLs, the Department can adjust NOLs outside the three-year audit period. This is not making an assessment beyond the statute of limitations; it is simply making a correct assessment for the years that are still in statute. Auditor’s disallowance of certain interest deductions, which were added back, was reversed. The interest did not relate to any intangibles held by the taxpayer.
9. IHC/Management Fees. PD 14-60 (April 30, 2014). Management fees are generally allowed as a deduction based on the cost of such fees, without a profit element. With respect to royalties and other payments, the taxpayer failed to provide proof to the auditor but submitted such evidence on appeal. The case was returned to the auditor.
10. Addback Netting/Expenses. PD 14-71 (May 27, 2014). Commissioner follows his established policy in requiring addback of royalties paid to affiliates based on an “apportioned deduction” approach. Denies the taxpayer the ability to claim a “business purpose” exception because taxpayer did not follow the statutory procedure in requesting that exception. Finally, taxpayer requested that any addback of royalties must net out expenses related to those royalties. Commissioner denies that.
11. Royalty Add-Back\NJ. PD 13-226 (December 17, 2013). After reiterating the Department’s position with respect to royalty add-backs being essentially an apportioned deduction, the Commissioner considers how to determine the deduction for royalties added back in a New Jersey income tax return. He concludes that the exclusion amount is determined by multiplying the taxpayer’s royalty deduction by a ratio equal to the IHCs royalties reported on the New Jersey return divided by the IHCs total royalty income.
12. Nexus PL 86-272. PD 13-172 (September 19, 2013). Taxpayer had one employee in Virginia who, while working at her home, developed test methods relating to the company’s consulting services. Although the company had no customers in Virginia, its employee’s activities, because

they occurred after sales had been made, were deemed to exceed the protection of PL 86-272.

13. Nexus\Virginia Employee. PD 13-203 (November 1, 2013). Corporation had one employee residing in Virginia who performed legal services from her home. Commissioner holds that corporation must withhold income taxes from this employee's wages. Commissioner also holds that the presence of an employee working in Virginia provides nexus requiring the corporation to file a Virginia income tax return unless the corporation can show that the legal services provided were *de minimis* in nature.
14. Nexus/PL 86-272. PD 14-145 (August 26, 2014). Activities of sales personnel who merely solicit sales are protected by PL 86-272 even though those sales people may be resident in Virginia. The use of an independent contractor to conduct clinical trials is likewise protected by 86-272 – if the relationship between the parties is truly independent. Whether periodic visits by employees in Virginia to recruit participants for clinical trials and engage in activities related to education and lobbying is *de minimis* will depend upon the frequency of the visits and the activities.
15. Telecommuting. PD 14-158 (August 28, 2014). Resident of Virginia traveled throughout the United States “scouting” for athletes and reporting his findings to his employer's office outside Virginia. Commissioner holds that in these circumstances, the employee's compensation will be deemed paid or accrued in Virginia if (i) the base of operations is in Virginia or, if there is no base of operations, the place from which the service is directed or controlled is in Virginia; or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the employee's service is performed, but the employee's residence is in Virginia. Assuming some part of the employee's services are performed in Virginia, his residence may be considered a ‘base of operations’ in this state. More facts are required to determine whether his residence is a base of operations.
16. Consolidated Election. PD 13-341 (December 31, 2013). Parent acquired a Virginia consolidated group, but parent was not subject to Virginia income tax so was not part of that affiliated group. When parent later acquired another subsidiary taxable in Virginia, the consolidated election of the previous Virginia consolidated group continued in effect and the newly acquired subsidiary was required to be included in that group.
17. Trust Fund Taxes\Bankruptcy. PD 13-181 (October 18, 2013). Taxpayer admits that he was a corporate officer with knowledge of the corporation's tax obligations and ability to make sure they were paid. Nevertheless, sales taxes collected from customers and withholding taxes collected from employees were not paid, and the corporation filed for bankruptcy. Commissioner holds that the declaration of bankruptcy was a voluntary act

designed to prevent the payment of trust fund taxes from being remitted to the Commonwealth. The corporate officer is personally liable.

18. Statute of Limitations. PD 13-186 (October 18, 2013). Nonprofit entity failed to pay tax with its return reporting unrelated business taxable income. Department collected that tax by setting off against a refund from a Virginia college. Although the taxpayer's statute of limitations on filing an amended return, measured from the date of the return, had expired, it was still within the two year period from the date the tax was paid/collected. Accordingly, its amended return was accepted and the erroneous amount of tax refunded.
19. Foreign Source Income. PD 14-8 (January 24, 2014). Taxpayer established from its contracts that services provided overseas were necessary in order for software and other technology it sold to be usable. Accordingly, the "technical fees," being related to property, were deductible.
20. Flow-Through Income/Tax Exempt Trust. PD 13-169 (September 6, 2013). A tax-exempt qualified pension trust received income from a limited partnership doing business in Virginia. Commissioner acknowledges that the less than 10% holding of the qualified trust means that it is not required to include its proportionate share of the partnership's factors in its apportionment factors. The Commissioner further rules, however, that these rules do not apply to a trust. Accordingly, this tax-exempt trust will have income from Virginia sources.
21. SSF Wage Data. PD 13-194 (October 23, 2013). In calculating "average weekly wage data" for purposes of a manufacturer's election to file using single sales factor, it is permissible to include (or presumably exclude) the wages of executives if they actually work in Virginia or the company's headquarters is located in Virginia. The VEC's published wage data is inconsistent in this respect because it is based on voluntary responses by employers, some of which include and some exclude executive's wages.
22. MeadWestvaco. PD 14-148 (August 27, 2014). S corporation held stock investments in other companies with which it did not have a unitary relationship. Gain was recognized when some of that stock was distributed to the S corp's shareholders. The Department rejects the taxpayer's argument that the decision in *MeadWestvaco Corp. v. Illinois* prohibits the taxation of this gain absent a unitary relationship. Department holds that the taxpayer's primary function was to manage investments and other going concerns, and disposing of those investments was a normal function of this business and produces apportionable income.

II. TAX CREDITS

A. Legislation

1. Motion Picture Production Credit. Virginia Code §58.1-439.12:03 is amended to increase the motion picture production income tax credit. Percentage of qualifying expenses is increased from 15% to 20% and 25% in economically distressed areas.
2. Ports Credit. Virginia Code §58.1-439.12:06, :09 and :10 are amended to increase the aggregate value of ports tax credits to \$1.25 million, decrease barge and rail credits to \$500,000 and allow a taxpayer that meets the criteria for both to claim both. Other adjustments to the qualifications for these credits are also made.
3. R&D Credits. Virginia Code §58.1-439.12:08 is amended to increase qualified research and development expenses to \$234,000; 15% for R&D credits and 20% for qualified R&D expenses conducted in conjunction with a Virginia institution of higher education.

B. Policy Announcements

1. Land Preservation Credits. PD 13-8 (January 25, 2013). This Tax Bulletin depicts the increases in the \$100 million cap in land preservation income tax credits attributable to inflation. The cap amount in 2013 is \$113,909,000.

C. Rulings of the State Tax Commissioner

1. R&D Tax Credit. PD 13-189 (October 18, 2013). The Department's published policies, including Guidelines authorized by the General Assembly, require that Form RDC documenting the taxpayer's credit must be submitted on or before April 1 following the taxable year in question. This tax credit operates under a budgetary cap. The deadline is necessary for the Department to apply that cap to all applicants. Accordingly, failure to meet the April 1 deadline (subject to the usual extensions for holidays, etc.) means that the taxpayer's credit will not be allowed.
2. LPC Valuation. PD 14-7 (January 21, 2014). Taxpayer's appraiser determined a value for a land preservation credit easement at \$4.4 million. The Department's appraiser valued it at \$500,000. The Commissioner determined that the taxpayer's appraiser did not take into account factors such as flood plain, wetlands, and local zoning ordinance, all of which restricted the ability to develop the parcels in question. Assessments against the persons who purchased these tax credits were upheld.
3. LPC/Valuation. PD 14-61 (April 30, 2014). In this battle of the appraisers, the taxpayer's appraiser found a value of \$9.6 million for a

conservation easement, which it increased to \$12.8 million subsequently. The Department's appraisal valued the easement at \$1.6 million. A key point of dispute appeared to be the availability of water and sewer to the property to enable it to be developed into the number of parcels projected. The Department concludes that the taxpayer's appraiser was wrong in his projections about the availability of water and sewer and did not choose comparables that accurately reflected the value of the property.

4. LPC Valuation/Buyers. PD's 14-76, 14-77 and 14-78 (May 30, 2014). Taxpayers filed protective claims for refund pending the outcome of the administrative appeal filed by the donor of the land preservation credit (LPC) on which their credits were based. The Department rejected the donor's appeal and, accordingly, rejected the protective claims of that donor's transferees.
5. LPC Valuation/Buyers. PD 14-25 (July 28, 2014). Taxpayers filed administrative appeals paralleling the administrative appeal of the entities from which they acquired their LPCs. When the administrative appeal of the LPC donor was rejected, the parallel appeals of its transferees were rejected. The Commissioner notes, however, that litigation has been filed contesting the Department's valuation; therefore, the transferees may be able to file a protective claim under §58.1-1824 after payment of the contested tax.
6. LPC/Procedural Rights. PD 14-93 (June 19, 2014). The taxpayer who purchased LPCs was not denied any rights guaranteed by the Virginia Taxpayer Bill of Rights. The valuation audit was conducted of the transferor who had all its appeal rights. The assessments made of its transferee all included the name and number of a staff person who could have been contacted with questions and concerns. There was no violation of the statute of limitations by the Department's assessment of the transferee. The statute runs from the date of the taxpayer's return, not from the date of the LPC filings.
7. LPC\Federal Audit. PD 13-225 (December 17, 2013). Federal audit treated capital contributions to the taxpayer's partnership of Virginia land preservation tax credits as sales. Taxpayer advised the Department of the audit and the results, but asserted that no changes would result to Virginia taxable income because of Virginia's policies contrary to federal policy. The Commissioner, after an involved opinion, agrees that the federal audit will not result in any change to the taxpayer's Virginia taxable income. Nevertheless, the Commissioner requires the taxpayer to file an amended return reporting the changes just to make certain of this conclusion.
8. LPC/Transfer Fee. PD 14-24 (February 27, 2014). Taxpayer purchased tax credits from a third party, but the transfer fee was not paid. The credits cannot be claimed until the transfer fee is paid. Any contrary

advice from the Department was not in writing and therefore not able to be relied upon.

9. LPC Credit/Buyer Responsibility. PD 14-32 (March 7, 2014). Buyer of a land preservation credit is responsible for any additional tax the Department may assess, plus interest, if the valuation used by the initial donor of the easement is later adjusted. Any agreement between the donor of the easement and the credit buyer as a matter of private contract to which the Department is not a party. Accordingly, buyer of the credit must look to the donor of the easement for any remedy.
10. Coal Credit/Double Deduction. PD 14-86 (June 6, 2014). Taxpayer claimed the benefit of Coalfield Employment Enhancement Tax Credits and then included the same credits in federal taxable income and subtracted them from federal taxable income in computing its Virginia taxable income. The auditor disallowed the subtraction asserting that the taxpayer would not be entitled to both a subtraction and a credit. Commissioner holds that the way the credits and subtractions were accounted for did not result in a double benefit.
11. Motion Picture Tax Credits. PD 13-188 (October 18, 2013). This ruling sets forth a detailed analysis of what payments are considered compensation and “qualified expenses” for purposes of calculating the motion picture tax credits. The ruling addresses: (i) box and equipment rentals; (ii) unemployment insurance; (iii) FICA taxes; (iv) workers compensation insurance; (v) pension contributions; (vi) health insurance premiums; (vii) paid holidays and vacation; (viii) meal per diems; (ix) lodging per diems; and (x) payroll handling fees.

III. PASS THROUGH ENTITIES

A. Rulings of State Tax Commissioner

1. LLC Member Liability. PD 14-28 (March 4, 2014); PD 14-35 (March 18, 2014). LLC was found to have underreported its sales and not to have properly withheld income tax from employees’ wages. The Department then made assessments against the members for additional income tax attributable to those sales. The members requested the Department to convert the assessment to another member who allegedly was responsible for these errors. Although the Commissioner holds that the computations of additional income tax were erroneous, he confirms that the responsibility for the additional income tax flows through to the members of the LLC.
2. Nexus/LLC. PD 14-48 (April 2, 2014). Out-of-state LLC providing engineering services to Virginia customers had no nexus with Virginia. It had no property or payroll in Virginia. Although site visits were made to

Virginia, the majority of the costs related to those services was incurred out of state. Accordingly, the company had no nexus with Virginia.

3. Pass-Through Withholding. PD 14-39 (March 19, 2014). Although the facts are unclear, out-of-state partner was apparently assessed with tax because partnership reported the pass through withholding on Form W-2 instead of Form 502 and Form 502W. Commissioner notes reporting error but gives credit for the withholding anyway.

IV. INDIVIDUAL INCOME TAX

A. Policy Announcements

1. Earned Income Tax Credit. PD 14-18 (February 12, 2014). These Guidelines provide taxpayers with directions on how to treat Virginia's conformity to the federal Earned Income Tax Credit with their 2013 Virginia income tax returns.
2. Same Sex Marriage. PD 13-209 (November 8, 2013). These Guidelines describe how Virginia will deconform from the federal income tax treatment of same-sex marriage. **Comment.** The Guidelines indicate that the Department has received legal advice that the Virginia Constitution requires this deconformity. Virginia adopts federal adjusted gross income as the starting point for determining its taxable income. There is no Virginia statute providing specific deconformity with respect to this calculation and same sex marriage. How does the Constitution of Virginia require or allow the Department to do this? In Virginia, taxes can be collected only as specifically provided by law.

B. Rulings of the State Tax Commissioner

1. Virginia Residents. The following rulings all deal with who is a domiciliary or resident of Virginia: PD 13-178 (October 10, 2013); PD 13-180 (October 16, 2013); PD 14-5 (January 16, 2014); PD 14-13 (January 30, 2014); PD 14-25 (February 27, 2014); PD 14-26 (February 27, 2014); PD 14-45 (March 28, 2014); PD 14-46 (April 2, 2014); PD 14-99 (July 2, 2014); PD 14-137 (August 11, 2014); PD 14-138 (August 12, 2014); PD 14-141 (August 13, 2014); PD 14-159 (August 28, 2014).
2. Domicile/Burden of Proof. PD 14-108 (July 26, 2014). Simply providing the Department with an income tax return filed in another state did not prove the person was a domiciliary of that state. Because that person did not provide the additional proof requested, the assessment as a Virginia resident was upheld subject to receipt of additional proof.
3. Domicile/Burden of Proof. PD 14-136 (August 8, 2014). The taxpayer requested reconsideration of an earlier ruling, PD 13-110, in which he was determined to be a Virginia resident from 2005 through 2010. Because

the taxpayer did not provide the Department with the requested information, such as tax returns filed with other states and documents establishing his relationship with certain business interests, the assessments were upheld.

4. Domicile/Federal Employee. PD 14-104 (July 3, 2014). Taxpayer, a federal employee in DC, claimed to be domiciled in another state even though he resided in Virginia, had a Virginia driver's license and numerous other indicia of Virginia residence. Although federal employees do not necessarily become DC residents while employed there, there was no evidence this person maintained his domicile in another state and every indication that he intended to make Virginia his domicile.
5. Domicile/Retirement Income. PD 14-88 (June 10, 2014). The taxpayer, an actual resident of another state but a domiciliary resident of Virginia, was subject to tax by Virginia on his retirement income. There was no credit for the other state's tax because it did not tax retirement income.
6. Part Year Resident. PD 14-67 (May 20, 2014). Based on its reciprocity agreement with Maryland, Virginia auditor denied any credit for Maryland tax which, under that agreement, was not owed. Commissioner rules that the taxpayer was a part year resident for the year in question. Accordingly, he was taxable by Virginia only during the part of the year he was a resident of Virginia.
7. Reciprocal Income Tax Agreements. The taxpayers are Virginia residents. The husband received an honorarium from a Pennsylvania university for teaching a summer course in a foreign country. The taxpayers filed a nonresident Pennsylvania income tax return and remitted tax on the honorarium. They claimed an out-of-state tax credit on their Virginia return, which was denied on audit. The Commissioner determined that the honorarium was not "compensation," subject to the Reciprocal Income Tax Agreement between Virginia and Pennsylvania. However, the Commissioner questioned whether Pennsylvania had the right to tax income for services not performed in Pennsylvania. More documentation was requested.
8. Part Year Resident/Credit for Taxes Paid. PD 14-156 (August 28, 2014). The taxpayer moved to and established domicile in Virginia on July 1, but continued to be employed in New York for the remainder of the calendar year. She claimed a tax credit for income tax paid to New York, which was denied. A part-year resident cannot claim a credit for income tax paid to another state for any part of the year during which the taxpayer was a domiciliary or actual resident of that other state. Thus, in order to claim the credit, the taxpayer must establish she was not a resident of New York from July-December.

9. Part-Year Resident/Executive Compensation. PD 13-95 (June 11, 2013). Couple moved to Virginia and established their domicile here on March 7, 2010. Husband had previously earned a nonqualified pension distribution while working in Texas. Although earned in Texas, it was not paid until April, 2010, after establishing Virginia residence. Taxpayer argued that distribution had been constructively received while in Texas and was not taxable by Virginia. Commissioner disagrees and holds the income to be taxable by Virginia.

Observation. Commissioner has been asked to reconsider this ruling.

Comment. The better argument for the taxpayer is that income earned from services rendered in another state, while resident in that state, is not taxable by Virginia. Virginia Code §58.1-325 requires that the calculation of a part-year resident's income be based on a fraction that reflects "income, gain, loss and deductions from Virginia sources" to total sources. The term "income from Virginia sources" is defined by Virginia Code §58.1-302 to include "a business, trade, profession or occupation **carried on in Virginia.**" The regulation, 23 VAC 10-110-40 is inconsistent, declaring in one part that the calculation looks to "received" and, in the examples relating to earned income, to "wages earned in Virginia during the period of residence." Note that if the Department continues to tax "incoming residents" based on receipt, its rulings will be inconsistent with its taxation of "outgoing residents" who are taxed based on when and where the income is earned. *E.g.*, PD 99-79 (April 20, 1999); PD 05-32 (March 15, 2005).

10. Part Year Resident. PD 14-79 (May 30, 2014). In a part year return, the Commissioner rules that receipt of a nonqualified retirement plan payment was taxable by Virginia because received during the part of the year during which the taxpayer was a resident of Virginia. This was so even though the income was earned in another state. **Comment.** Note that the Department's regulation is not consistent in this position, treating earned income differently than investment income. Interest, dividends and other such income are taxed based on time and place of receipt. In the regulation's examples, however, income is taxed where earned.
11. Domicile/Military Spouse. PD 14-124 (July 25, 2014). Virginia cannot tax a service member's spouse if the domicile is the same for both service member and spouse and service member moves to Virginia under orders. In this case, spouse lived with service member's parents outside Virginia for three months and moved to Virginia to be with her spouse. Her efforts to establish indicia of domicile outside Virginia did not occur while she in fact lived with her service member spouse's parents. Accordingly, she did not prove domicile outside of Virginia and is subject to Virginia income tax.

12. Domicile/Service Member. PD 14-85 (June 4, 2014). In order for a service member's spouse be exempt from Virginia income tax, the service member and spouse must both have the same state of domicile. After reviewing the facts, the Commissioner holds that spouse was not subject to Virginia income tax.
13. Domicile/Service Member Spouse. PD 14-80 (May 30, 2014). Facts showed the service member's spouse had taken a number of steps, including obtaining a Virginia driver's license and filing returns showing a Virginia residence, to become a domiciliary of Virginia.
14. Service Member Civil Relief Act. PD 13-184 (October 18, 2013). PD 13-215 (December 5, 2013).
15. Military Pay. PD 13-222 (December 13, 2013). Virginia law allows three possible subtractions for military compensation: (1) combat pay; (2) extended active duty pay; and (3) active or inactive service in the National Guard. An item of income can only be deducted once, and it can only be deducted if it was included in FAGI.
16. Basic Military Pay. PD 14-75 (May 29, 2014). The Virginia deduction for military pay applies only to "basic pay." Although the Commissioner notes that certain benefits such as subsistence allowance and basic housing allowance are not part of "basic pay" the Commissioner holds that the service member correctly calculated the deduction in this case. Although the facts of this ruling are unclear, the implication is that items such as housing allowance and subsistence shown on the W-2 are subject to Virginia income taxation and are not deductible as "basic pay."
17. Gambling Winnings. PD 14-73 (May 28, 2014). Individual who had winnings from playing the slots in West Virginia was subject to both West Virginia income tax and Virginia income tax. The reciprocity agreement between the two states applies only to "compensation." The out of state tax credit does not apply either because the income is not earned or business income.
18. Federal Obligations. PD 13-5 (January 10, 2013). Taxpayer complained that in calculating his age deduction for Virginia income tax purposes, the Commonwealth included income he received when cashing a US Savings Bond. Commissioner rules that this income was reduced from Virginia taxable income. He acknowledges that it was taken into account in determining the age deduction. The ruling does not address the constitutional issue, but simply relies on the fact that the General Assembly did not choose to omit from the income qualifications for the age deduction income attributable to federal obligations.
19. Death Benefit. PD 14-107 (July 16, 2014), PD 14-112 (July 17, 2014). Payments made pursuant to a retirement plan cannot be deducted from

Virginia taxable income. According to the Department's interpretation, the death benefits subtraction was never intended to be permitted for payments from a retirement plan.

20. Annuity Death Benefit. PD 13-210 (November 12, 2013). Virginia Code §58.1-322C(32) allows a subtraction for "death benefit payments from an annuity contract that are received by a beneficiary of such contract and are subject to federal income taxation." The Department interprets this to have three requirements: (1) the source of the payment must be an annuity contract between the customer and an insurance company; (2) the annuity payment must be awarded to the beneficiary in a lump-sum; (3) the payment must be subject to taxation at the federal level. The taxpayer's periodic payments did not qualify. **Comment.** This ruling misstates the law, claiming that the Department's construction of a tax statute is entitled to "great weight." Virginia Code §58.1-205 expressly provides that only a regulation issued by the Department is entitled to "great weight." Its rulings are entitled to nothing more than judicial notice. *See, also, Chesapeake Hosp. Auth. v. Commonwealth*, 262 Va. 551 (2001).
21. Annuity\Tax Return Instructions. PD 13-228 (December 18, 2013). Taxpayer could not rely on the tax form instructions as being a complete and exhaustive interpretation of the statute. Commissioner has the power to issue rules and regulations, and the tests concerning the taxation of lump sum annuity death benefits are clearly set out in the Commissioner's prior rulings.
22. Annuity\Tax Form Instructions. PD 13-229 (December 18, 2013), PD 13-231 (December 18, 2013); PD 13-230 (December 18, 2013). Instructions in the tax return are not specific advice given to a taxpayer about a specific issue. They are general advice. A taxpayer is not entitled to rely on those instructions when they are contrary to the interpretation of the statute by the Commissioner in rulings.
23. Disability Subtraction. PD 14-65 (May 15, 2014). Payments under a federal retirement annuity were not taxable because the taxpayer demonstrated that the income he earned in the "service industry" was only 25% of his pre-retirement pay rate. Therefore, he was not engaged in substantial gainful activity under IRC §72(a)(1).
24. Conformity/Standard Deduction. PD 14-11 (January 27, 2014). In audit, the taxpayer's itemized deductions as reported on the federal return were reduced for lack of substantiation. Auditor apparently not only reduced the deductions, but did so below the amount of the standard deduction; and the Commissioner's ruling suggests that this was not inappropriate. Nevertheless, following federal audit procedures, the Commissioner granted the taxpayer a standard deduction.

25. Substantiating Deductions/Procedure. PD 14-155 (August 28, 2014). An auditor disallowed several federal deductions on the taxpayer's Virginia return. The Commissioner agreed with adjustments to the deduction for state and local taxes, and the denial of a deduction for taxes the taxpayer could not provide proof of payment. The Commissioner also adjusted the miscellaneous deduction taken for job expenses to be consistent with the federal rules concerning transportation expenses incurred in traveling between jobs.
26. Nonresident Alien/Standard Deduction. PD 13-187 (October 18, 2013). The Department's longstanding policy has been that because a nonresident alien individual cannot claim the standard deduction on his federal return, he must itemize his deductions on his Virginia return as well. In the case of students and business interns from India, however, federal treaty allows these individuals to claim the standard deduction. Accordingly, Virginia will conform to that as well.
27. IRS Info Sharing. PD 13-10 (January 31, 2013). Taxpayer's complaints that the Department illegally obtained his information from the IRS was to no avail. The Department was entitled to rely on that information and make an assessment which the taxpayer has not refuted in any respect.
28. Assessments from IRS Info. PD 14-157 (August 28, 2014). The Department obtained tax information from the IRS and issued assessments for years 2009-2011. The taxpayer then submitted a 2009 return but did not provide the Commissioner with information supporting the reported income. The Commissioner declined to amend its assessments without supporting information.
29. Statute of Limitations. PD 14-123 (July 25, 2014), PD 14-119 (July 24, 2014). When a taxpayer fails to file a return within the extended due date, the time for filing an amended return is three years from May 1 of that year, not three years from the extended due date filing which was never made.
30. Amended Return Due Date. PD 14-149 (August 27, 2014). The taxpayers requested an extension to file their 2009 return, and filed that return in September 2009. In September 2013, they later filed an amended 2009 return claiming a refund. The Commissioner determined that the three year statute of the limitations period began on the extended due date of the original return, not the regular (May 1) due date. Thus, their amended 2009 return was timely filed.
31. State of Limitations/IRS Audit. PD 14-120 (July 24, 2014). Department made an assessment based on information provided by the IRS relating to a federal audit. The taxpayer's amended Virginia return, filed upon request, did not agree with the IRS results. The taxpayer asserted that he was still working with the IRS. The Department says it will not look

behind the results of the IRS audit, results that have already been finalized. (Presumably, if the IRS does make further adjustments based on an amended return, those results will be accepted by Virginia unless the taxpayer's statute of limitations has expired.)

32. Statute of Limitations/Electronic Filing. PD 14-118 (July 24, 2014). Taxpayers did not have a record that their Virginia return was received by the Department (*e.g.*, no confirmation number). As a result of not having filed a return, the Department has an unlimited period of time within which to access the omitted tax. Although regulations state that records shall be preserved for three years from the required date of the return, the Department ignores that and holds that it is the taxpayer's obligation "to preserve suitable records to determine this proper Virginia income tax liability," presumably whenever that is assessed.
33. Statute of Limitations. PD 14-113 (July 18, 2014). Taxpayer's administrative appeal was filed more than 90 days after the date of the assessment. It was untimely.
34. Incomplete Appeal. PD 14-110 (July 16, 2014). Taxpayer did not file a complete appeal because his correspondence did not set forth the alleged error, relevant facts or grounds on which he relied. The appeal, therefore, was not timely filed.
35. Wrong Address. PD 14-100 (July 2, 2014). Based on information from the IRS that tax documents had been sent to the taxpayer in Virginia, the Department requested additional information, to which no response was received, and then issued an assessment also sent to that address. The taxpayer did not receive it for several years. The Commissioner holds that the assessment is valid because it was sent to the taxpayer's last known address and that her administrative appeal was not timely filed. The Commissioner, however, appears to recognize the gross unfairness of this situation and solicits a return and additional information which can presumably correct the mistake. **Comment.** It is good that the Department found a fair result in this ruling. It likely would not be comfortable for the Attorney General to argue that an address the taxpayer never had was nevertheless the taxpayer's last address known to the Department. It does not appear from the facts in this ruling that the taxpayer ever filed a return or other notice with the Department claiming a Virginia address.
36. Sue the Accountant. PD 14-101 (July 2, 2014). Taxpayers asserted that their untimely refund claim resulted from an error by their accountant. The Department's answer: refund claim was untimely; any remedy is with the accountant.
37. Burden of Proof. PD 14-63 (May 12, 2014). Taxpayer asserted in 2012 that she would pay a 2003 assessment with respect to her 2000 taxable

year “when the Department provides proof that the assessment is correct.” Wrong. The burden of proof is on the taxpayer.

38. Written Advice. PD 13-227 (December 18, 2013). Taxpayer challenged taxation of payments under an annuity contract. Commissioner holds that information in tax form instructions is general in nature, and a taxpayer must still refer to the statutes, regulations and rulings for a full explanation. Taxpayer also asserted that in a previous audit the Department had not taxed the same payments. Commissioner concludes that the facts (perhaps as misunderstood) of the previous audit were different from the ones in the current audit. Accordingly, there was no specific written advice on identical facts on which the taxpayer could reasonably rely.
39. Software Error. PD 14-27 (February 28, 2014). Even though the Department may have approved the particular software program, it does not guarantee the computational accuracy of that software. In this case, the software erroneously allowed a deduction for certain annuity death benefits.
40. No India Credit. PD 13-232 (December 18, 2013). Virginia allows a credit only for taxes paid to another state. Accordingly, no credit was allowed for capital gain taxes paid with respect to the sale of real estate in India.
41. Work Opportunity Credit. PD 14-109 (July 16, 2014). Virginia allows a deduction to an employer with respect to wages that are disallowed for federal tax purposes because claimed as a federal credit. In this case, an employee attempted to claim a deduction for his own wages shown on his own W-2 and that was not allowed.
42. NY Commuter Tax. PD 13-185 (October 18, 2013). Virginia does not allow a credit for the New York Metropolitan Commuter Transportation Mobility Tax. The tax is more like a payroll tax than an income tax and it is earmarked for a particular purpose (transportation services). Virginia allows a credit only for a tax that is substantially similar to the Virginia income tax.
43. Fraud Charges Dismissed. PD 13-207 (November 7, 2013); PD 13-206 (November 7, 2013). Based on evidence that taxpayer’s husband and a business partner were engaged in a mortgage fraud scheme, the Department assessed additional tax and fraud penalties. Because the criminal charges for filing fraudulent returns were dismissed by the court, these penalties were abated. Taxpayer, however, did not carry burden of proof with respect to certain deposits to her checking account and that portion of the assessment was affirmed.

44. Tax Protester. PD 14-33 (March 7, 2014). Taxpayer objected to the Department's using information from the IRS to make an assessment of Virginia income tax, claiming she was exempt. Commissioner rules that a Virginia resident has no exemption and that the Department is entitled to use whatever information may be available in order to make an assessment.
45. NOL. PD 14-34 (March 10, 2014). An NOL can be claimed on the Virginia return only to the extent it is reflected in the federal return, and an NOL cannot be applied to produce negative taxable income in any year. The difference between the amount of NOL claimed on the federal return and the amount usable on the Virginia return is reported as a fixed date conformity adjustment.
46. NOL. PD 14-47 (April 2, 2014). Nonresident taxpayer tried to offset Virginia source income from an LLC with NOLs previously suffered by that LLC. These NOLs, however, were suffered in earlier years and were not reflected on income tax returns of the LLC in the year in question. Accordingly, they are not available in the taxpayer's return for that year.
47. Tax Protester. PD 14-84 (June 4, 2014). Based on information from the IRS, the Department assessed additional tax which the taxpayer challenged saying that "they had no intention to gift or pledge any tax to the Department and they have no fiduciary contracts with the Department." The argument was a loser.
48. No Withholding. PD 13-233 (December 18, 2013). Employer failed to withhold proper amount of Virginia income tax. This did not relieve the employee of its obligation to report and pay.

V. FIDUCIARY INCOME TAX

A. Rulings of the State Tax Commissioner

1. Resident Trust. PD 14-49 (April 2, 2014). Generation-skipping trusts were established outside Virginia by grantors who never resided in Virginia. The day to day operations of the trust were managed by a corporate trustee out of state. Commissioner rules that the trust will not be subject to Virginia income taxation if a Virginia resident becomes a co-trustee and, as a member of a committee, is responsible for discretionary distributions from the trust.

VI. RETAIL SALES & USE TAXES

A. Legislation

1. Satellite Television. Virginia Code §58.1-602 (definition “retail sale”) is amended to recognize as a sale for resale separately stated monthly charges for set top box used to receive satellite tv programming.
2. Accelerated Sales Tax Payments. The threshold for having to make accelerated sales tax payments in June is now \$48.5 million of taxable sales.

B. Policy Announcements

1. Energy Star and WaterSense. PD 13-175 (September 30, 2013). These Guidelines relate to the sales tax holidays for Energy Star and WaterSense products. These Guidelines will be treated by the Department in the same fashion as regulations.
2. Guidelines: Accelerated Sales Tax Payment. PD 14-58 (April 28, 2014). These Guidelines are the equivalent of regulations and provide guidance with respect to the accelerated sales tax payment required by certain retail merchants.

C. Rulings of the State Tax Commissioner

Taxable Transactions & Measure

1. Sales Price/Kitchen Equipment Contractor. PD 13-177 (October 10, 2013). Taxpayer sold and installed countertops, sinks, bowls and china vanities. Prior to the change in law occurring on and after July 1, 2010, the taxpayer was considered a contractor with respect to its sales and services. It thus was required to collect sales tax on the cost price of the items sold. As a result of the change in law, Va. Code § 58.1-610.D. was amended to provide that a person selling countertops, kitchen equipment or other like or comparable items is deemed to be a retailer taxable on the sales price. The Department determined that the taxpayer’s sinks, bowls and vanities were “kitchen equipment” described in Va. Code § 58.1-610.D. and further held that the term “kitchen equipment” would apply to those items even if installed in areas outside of the kitchen.
2. Contractor/Window Treatments. PD 14-43 (March 21, 2014). Tennessee real estate contractor installed blinds, shades, drapes and valances. Commissioner holds that this contractor is not taxable as a retailer because it does not maintain an inventory of window treatments for general sale. To the extent it is required to pay tax as a using and consuming contractor in Tennessee, it will be given credit for those payments in any Virginia audit.

3. Contractor/ATMs. PD 14-59 (April 30, 2014). On and after July 1, 2011, businesses engaged in the furnishing and installation of ATMs are treated as retailers of that equipment. They are not treated as contractors. When the company merely installs, for example, signage which it does not sell, it is providing exempt services. Similarly, when the company repairs the structure of an ATM, separately stated services for such repairs are nontaxable. Finally, when these companies transport ATMs to the job site, that is a nontaxable charge, provided that the company does not sell the ATM.
4. Real Estate Contractor/Modular Buildings. PD 14-89 (June 10, 2014). Contract provided for the design, fabrication, installation of modular buildings for a federal agency. Commissioner holds that the contract is for real estate construction, and the contractor is subject to sales tax on all materials purchased under the contract. The government exemption does not apply.
5. Contractor/Retailer. PD 14-91 (June 12, 2014). Although presented in the context of a government contractor and subcontractor, this ruling request ultimately concerns what property is used or consumed by a real estate contractor in the performance of its contract. The Commissioner holds that the FFE sold under this contract are actually resold to customers and do not become permanently affixed to the real property. Accordingly, the FFE can be purchased exempt pursuant to a resale exemption certificate. **Observation.** Simply because someone is a real estate contractor does not mean that everything he touches is consumed in rendering the real estate construction services. This ruling and the ruling it cites may facilitate situations, for example, when a real estate contractor is separately tasked with purchasing furniture and equipment for a building is constructs.
6. Contractor/Moveable Partitions. PD 14-83 (May 30, 2014). Commissioner holds that floor to ceiling moveable wall systems were part of the real estate construction. Rails along which they ran were screwed into the ceiling. The seller advertised them as being intended for the “long term.” In the absence of any indication of the intent of the building owner and tenant, the Commissioner infers that the partitions were intended for permanent use. **Comment.** The taxpayer apparently based its case on IRC Investment Tax Credit Regulations. A better case would have focused on the terms of the lease agreement between the landlord and tenant, *e.g.*, whether the tenant was allowed to remove these partitions at the expiration of the lease.
7. Kitchen Cabinet Contractor. PD 13-204 (November 1, 2013). The Taxpayer installs cabinets and shelving at its customer’s locations. The Department determined the Taxpayer was a contractor, liable for tax on its purchases of tangible personal property furnished in connection with its installation, regardless of whether the installation charge is included in the total project price or separately stated. The taxpayer was not a retailer

because it did not maintain an inventory of materials. Cabinets and shelving units that are ordered for a particular customer are not inventory. Further, the trim pieces and parts used to modify the shelves were not inventory because those parts could not, on their own, be fabricated into a finished product.

8. Government Contract/True Object. PD 13-202 (November 1, 2013). Taxpayer contracted with the US Navy and, pursuant to that contract, purchased or leased office equipment for the Navy's use. The Department determined that the true object of the specific work order was to furnish office space to the Navy and that the sewage removal and janitorial services were provided in connection with the leasing of tangible personal property. The true object of a different task order, which required the taxpayer to provide office equipment, an administrative assistant, janitorial and sewage services, was also determined to be the lease or rental of tangible personal property.
9. Government Contract/Indeterminate Contract. PD 14-15 (February 3, 2014). Taxpayer requested redetermination of an earlier ruling in which the Department held it liable for tax on purchases of tangible personal property used in the provision of services under its contract with a federal government agency. The Department upheld its prior determination that the contract was not an indeterminate delivery contract under 23 VAC 10-210-693, as effective prior to October 6, 2008, and so the application of the tax could not be based on the true object of task and delivery orders.
10. Government Contractor. PD 14-66 (May 20, 2014). The true object test is applied to the "lowest level mixed order" under a government contract, not at the overall contract or task order itself. When a task order provides for the acquisition of property, together with services that facilitate the acquisition of the property, the true object is the property. The items of property can be purchased under a resale exemption certificate.
11. Automobile Diagnostic Testing. PD 13-223 (December 13, 2013). The taxpayer was an automobile dealership that also operated a repair shop. The Department determined that charges for a separately stated diagnostic test were not a separately stated exempt charge for repair services under Va. Code § 58.1-609.5. The Department's policy is to apply the exemption only to labor performed in the actual repair activity. Since the diagnostic testing was performed prior to the actual repair, it does not qualify. If the diagnostic testing was made in connection with the consequential sale of a repair or replacement part, such as a battery, alternator or water pump, then the "true object" of the transaction was for the consequential sale of tangible personal property and the entire charge would be taxable. If a customer simply desires to have a problem diagnosed but not repaired, the "true object" of the transaction would be for an exempt service.

12. Electronic Document Services. PD 14-14 (January 30, 2014). Taxpayer provides printing, direct mail, electronic document and online bill pay services. At issue was its electronic document services, which allow its customers to view electronic versions of documents, such as billing and bank statements. The services are optional, can be provided independently of the Taxpayer's printing services, and appear as a separately stated charge on the invoice. The Department held that the true object of the electronic document services is to provide customers access to the transfer of information electronically and, as such, were exempt. The optional programming services, which are offered to customers requiring software to make their data compatible for transmission to the Taxpayer, were also exempt. These services are billed on an hourly basis and are separately stated on the invoice. Whether the programs were the modification of prewritten programs or custom computer programs, they would be exempt if separately stated.
13. Armored Car Services. PD 13-196 (October 24, 2013). Taxpayer provides armored car services to its customers, which may include the use of a safe by the customer. The safe is drop shipped directly to the customer by the manufacturer but title remains with the taxpayer throughout the service contract period. It is the taxpayer's intention to recover the safe when the contract ends. The Department determined that the true object of the sale is for the provision of an exempt service, the secured transportation of currency. Thus, the customer does not owe sales tax on the contract charges. However, as the taxpayer is the deemed user and consumer of the safe, the taxpayer is liable for the tax on the purchase of the safes.
14. Aerial Photography. PD 14-51 (April 14, 2014). Taxpayer used aerostat balloon technology to provide aerial photography services. Commissioner holds that viewshed studies are essentially aerial photographs which are taxable under the Department's traditional policy. Thermal imaging studies and aerostat surveillance counts, under the true object test, qualify as exempt service transaction. The provision of multiple or additional copies of photographs reports, maps, etc. are taxable sales.
15. Party Packages. PD 14-1 (January 3, 2014). Taxpayer operates a children's entertainment and amusement center and sells birthday party packages to the public. The packages include entry into the entertainment space, a private room, party coordinator and food and beverages. Because the packages include the sale of food, the entire charge for the package was subject to the sales tax. The Department rescinded its prior ruling to the taxpayer, 11-24 (February 24, 2011), because that ruling applied the true object test to the transaction, finding that the charges were not taxable because the true object of the transaction was the provision of services. The Department held that the true object test was inapplicable when a taxpayer charges a single price for food and services. **Note** that PD 11-24 contains references to other public documents that apply the true object

test in similar situations. This seems to be an area where the Department has taken inconsistent positions.

16. Party Packages. PD 14-41 (March 20, 2014). Theme amusement center provided a variety of amusement opportunities and also sold “party packages” which would include access to various amusements and food. Notwithstanding conflicting previous opinions, the Commissioner holds that the provision of food causes the entire charge for the “party experience” to be taxable, though the tax in this particular situation was abated because of the confused precedents.
17. Golf Resort Memberships. PD 13-205 (November 7, 2013). A resort that offered lodging, dining, golf and other recreational activities to its customers proposed to sell 3-year memberships entitling the holder to lodging, unlimited golf, golf cart rental and certain other benefits. The Department determined that the lump sum charges were subject to sales tax, as they included charges for room accommodations and the rental of tangible personal property.
18. Plantation Rental Services. PD 13-212 (November 14, 2013). Taxpayer owns a historic plantation that is rented out for weddings, graduations and other events. It also rents rooms to overnight guests. Because the taxpayer was in the business of renting rooms and accommodations to transients on a regular basis (Va. Code § 58.1-602), the Department determined that charges for the use of the plantation building and grounds are subject to tax, regardless of whether tangible personal property (tables, chairs, linens) are provided to the customer. In addition, charges for food, beverages or the use of the taxpayer’s kitchen were also taxable. The answer might have been different had the taxpayer not rented rooms and accommodations to transients on a regular basis.
19. Mandatory Gratuities. PD 14-150 (August 27, 2014). Taxpayer, a hotel and restaurant management company, was assessed tax on the mandatory 20% gratuity charges for banquet events. Most of the charges were distributed to its employees, but 3% was treated as a “house gratuity” and was retained by the Taxpayer. The auditor determined the 20% charge was taxable because [1] the house gratuity was taxable because it was not distributed as tips to employees and the remaining 17% was not separately stated and [2] the Taxpayer was not a “restaurant.” The Department disagreed with the auditor on both accounts: the statute does not require mandatory gratuities to be distributed as tips in order to be excluded from “sales price.” In addition, “restaurant” should be interpreted broadly to include any place where food is served.
20. Cloud-Based Services. PD 13-182 (October 18, 2013). Taxpayer is located outside of Virginia and operates hardware and software necessary to provide cloud-based and hosted phone and other telecommunications services to customers in Virginia. The taxpayer does not own any

personal property in Virginia and customers in Virginia do not download or otherwise possess the software hosted by the taxpayer. The Department determined that fees paid by Virginia customers are for the sale of professional services and exempt from the sales tax. It also determined that the taxpayer provides taxable communications services but the facts were insufficient to determine whether the taxpayer had sufficient nexus requiring it to register and pay Virginia communications sales tax.

21. Computer Software. PD 14-42 (March 20, 2014). This ruling summarizes the various exemptions available for computer software, including the direct use exemption when software is used in manufacturing (but not administrative or other “indirect” activities).
 - Electronic transfers of software are nontaxable service transactions provided the correct documentation exists.
 - Modifications to prewritten software program are nontaxable when labor or services are separately charged.
 - A “custom program,” being one that is specifically designed and developed for only one customer, is not taxable.
 - Modifications to an existing custom program are not taxable if the charges for the modifications are separately stated.
22. Data Center Purchases. PD 13-183 (October 18, 2013). Taxpayer sold switchgear equipment to a Virginia contractor, who installed it at a data center. The equipment provides power to the data center. The contractor provided an exemption certificate to the taxpayer, claiming the exemption for, inter alia, computer equipment and enabling hardware purchased for use in a certain data center centers. The Department determined that the switchgear equipment is “enabling hardware” that qualifies for exemption for the percentage of time it is used in an exempt manner (i.e., powering computer equipment used in the processing, storage, retrieval, or communication of data).
23. Motor Vehicle Fuels. PD 13-240 (December 27, 2013). An out-of-state dealer sold motor vehicle fuel to a volunteer fire department in Virginia. The Department holds that the VFD is an income exempt entity under IRC §501c(3) but it is not an entity of the Commonwealth. Accordingly, for sales prior to July 1, 2010, sales to the VFD are taxable. On and after that date, the taxes imposed at the wholesale level and there is not exemption available. The tax, however, is imposed on the wholesaler’s purchase price, not the sales price.
24. Internet Service Provider. PD 13-179 (October 11, 2013). Taxpayer operated an Internet backbone and provided wholesale dial-up and high-speed Internet access to other Internet service providers (ISP).

Department determined that the taxpayer's purchases of personal property were not exempt from the sales tax because the taxpayer was not a retail ISP. The taxpayer did not sell internet services to end-user subscribers, as required by Va. Code §§ 58.1-609.6(2) and 58.1-602. Also, federal law regarding "internet access" does not control the Virginia sales tax exemption for "internet services." The Department notes that it will not follow Cisco Systems, No. 219609, Va. Cir. Ct., Fairfax Cty (August 17, 2005) (exemption in Va. Code § 58.1-609.6(2) does not differentiate between retail ISPs and wholesale ISPs) outside of Fairfax County.

25. Small Propane Sales for Domestic Consumption. PD 14-3 (January 13, 2014). Taxpayer sold propane for residential use but did not obtain an exemption certificate from individuals. 23 VAC 10-210-630.B. exempts the sale of propane for domestic consumption from the sales tax. An exemption certificate is not required for sales of "small quantities" of propane. The Department determined that a 20 or 34 pound tank of propane qualifies "small quantities." Accordingly, sales of those tanks are exempt from the sales tax and no exemption certificate is required.
26. LP Gas. PD 14-52 (April 15, 2014). With respect to the exemption for "small quantities" of kerosene, firewood or other fuels, Commissioner holds that a "small portable propane gas cylinder (e.g., 20 or 34 pound tank or smaller) will qualify as a "small quantity." The small quantity exemption is applied to each sale. Each sale must be supported by a sales receipt or daily sales record indicating the number of gallons or other measure of the type of fuel sold and the number of purchasers.
27. Block Rentals of Hotel Rooms. PD 14-9 (January 27, 2014). Taxpayer failed to file a complete administrative appeal within the 90 day period. The Department decided to address the taxpayer's issue regarding the exemption for contracts of block rentals of hotel rooms for 90 continuous days or more. The Department's policy is to apply the exemption to the lease number of rooms rented on a given day during a continuous 90 day period and found no error with the auditor's methodology.
28. Short Stay Apartments. PD 14-152 (August 28, 2014) Taxpayer leases furnished apartments to individuals, generally for periods longer than one month. The Department advised that the Taxpayer is a dealer and should collect and remit sales tax on the charges made for accommodations for less than 90 continuous days. If the lease term is renewable on a month-to-month basis, the Taxpayer must charge sales tax up to the 90th day; if the lease is extended beyond the 90th continuous day, then the sales tax is refunded to the customer. Also, the Taxpayer must pay sales or use tax on all of its purchases made to furnish an apartment for lease.
29. Hotel Room Cancellation Charges. PD 14-140 (August 12, 2014). The Taxpayer-hotel agreed to provide its customer with a block of rooms and related meals. The contract provided that in the event of cancellation the

customer would be charged the entire amount for the rooms and meals as liquidated damages, not as a penalty, plus applicable taxes. The customer cancelled and refused to pay the applicable taxes. The Department determined that the cancellation charge was for unused rooms and meals, and not an unrelated cancellation fee. Because the charges were payment for rooms and meals, sales tax was due on the entire sum.

30. Lease Cancellation Charges. PD 14-127 (August 7, 2014). The Taxpayer leased tangible personal property from an out-of-state vendor for a four year lease term. Because it was dissatisfied with the service, the Taxpayer returned the property after one year into the lease term. Pursuant to the terms of the lease, all lease payments, including sales tax, are required to be paid even if the Taxpayer returns the equipment prior to the end of the lease term. The Department held that the vendor properly collected sales tax on the remaining lease payments, even though the Taxpayer no longer had possession over the property and the property no longer was located in Virginia.
31. Interstate Sale. PD 14-81 (May 30, 2014). Taxpayer sells to buyers with centralized purchasing facilities in Virginia. The goods it sells are shipped directly from out of state locations to buyers' facilities out of state. There is no taxable event in Virginia because no title or possession passes in Virginia. The interstate exemption also applies. **Comment.** The reason this ruling was requested may be that the Department's auditors often take the position that any invoice with a "bill to" address in Virginia is a Virginia sale.
32. Vending Machine Operators. PD 14-144 (August 26, 2014). The Department advised that the Taxpayer, a vending machine operator that placed machines in nonprofit and for-profit businesses and schools, had two available methods for remitting sales tax under Va. Code § 58.1-614. Ideally, the Taxpayer should apply the total sales tax rate to the wholesale cost of goods sold. If that method is overly burdensome, the Taxpayer can determine the tax based on a percentage of gross receipts which takes into account the inclusion of the sales tax.
33. Maintenance Contracts. PDs 14-128 and PD 14-129 (August 7, 2014). The Taxpayer is a telephone services provider that has a written agreement with a supplier under which the supplier agrees to furnish repair and replacement services for various telecommunications parts. The agreement sets forth the price of each repair service. The Taxpayer is not obligated to purchase any parts or services and the supplier is permitted to request price changes. The Department determined this was not a maintenance contract (one-half of which would be taxable) because the fee for labor and/or parts was not agreed upon when the contract was signed. Charges were made only if the Taxpayer requested services, and the prices could be changed by the supplier. Because this was not a maintenance contract, sales tax would be computed on each separate transaction.

Exemptions: Industrial

34. Solar Manufacturing. PD 14-37 (March 19, 2014). Because taxpayer was not a public utility, it was entitled to the “direct use in manufacturing” exemption accorded to manufacturers for its activities in generating solar power. Strictly construing the exemption, the Commissioner holds that solar panels, inverters, wires and cables and step-up transformers are exempt. He holds, however, that racking and mounting equipment, conduit and meters are “merely facilitative” and are not exempt. The ruling states that “conduit that serves as a protective cover for wire or cable is not used immediately in a production process.” Similarly, racking equipment that held solar panels into precise alignment to catch the sunlight was not deemed to be directly used. **Query:** Are these holdings consistent with the Department’s more recent rulings that structural steel that serves no purpose other than to hold manufacturing equipment into alignment is directly used?
35. Solar Power. PD 14-57 (April 25, 2014). Is electricity produced by photovoltaic generation systems subject to sales and use tax? Because delivered through a wire, electricity produced under a power purchase agreement will not be subject to Virginia sales and use tax. To the extent a customer uses a master lease agreement, the true object of the transaction is the lease of equipment and not the sale of electricity. That lease (assuming it is tangible personal property) would be subject to sales and use tax.
36. Manufacturing/Packaging. PD 14-103 (July 3, 2014). As a service to a manufacturer, taxpayer receives tobacco which it preserves, packages and ships to the manufacturer’s processing locations outside the US. Commissioner rules that packaging exemption is not applicable for two reasons. First, the company is not itself a manufacturer even though it is providing services as part of a vertical manufacturing process. Second, the packaging activity does not occur “on the production line.”
37. Manufacturing/Quality Control. PD 14-114 (July 18, 2014). In manufacturing ink, it was necessary to clean production equipment between each run to prevent colors in one run from contaminating the next run. Commissioner holds that this is a general maintenance and cleaning process even though it was necessary to insure the integrity of the products manufactured. The chemicals were used before and after actual production. **Comment.** The Commissioner’s distinction of rulings dealing with food and the integrity of that process seems strained. If specialized cleaning is necessary between production runs for one type of production, what is the basis for denying it’s exemption for a different type of production?
38. Manufacturing. PD 14-106 (July 16, 2014). Taxpayer accepted an ST-11 (manufacturer’s exemption) one month after the transaction in question.

Because the certificate was not contemporaneous with the transaction, taxpayer is not entitled to the absolute protection provided by such certificates. Upon showing that the purchaser was engaged in preparing coal mine sites, an exempt activity, the Commissioner allowed the exemption but admonished that ST-11A should be used in the future.

Commissioner holds that a “turntable” apparently used in packaging equipment for sale is not exempt because it does not “act upon the product as to become an immediate part of the actual production process.” **Query.** Why does equipment that is necessary to packaging not come within the “production” definition as “continuing through the last step of production where the product is finished or completed for sale and conveyed to a warehouse at the production site”?

39. Processing/Recycling. PD 14-153 (August 28, 2014). Taxpayer is engaged in a waste collection and recycling business. The waste bins it provides to its customers, its trucks and recycling equipment did not qualify for the manufacturing and processing exemption. “Processing” requires that the product undergo a treatment rendering it more marketable and useful. Because the same grade of paper or metal that went into the recycling process was the same grade of paper or metal that that Taxpayer eventually sold, the Taxpayer does not “process” the material. Also, the Taxpayer’s business was not classified under the Manufacturing NAICs sectors (Sectors 31-33), which the Department typically requires in order for the Taxpayer to claim the manufacturing exemption.
40. Leased Railcars. PD 14-38 (March 19, 2014). The sales tax exemption for railroad rolling stock “when sold or leased by the manufacturer” does not apply when the rolling stock is sold to a financial institution which then leases the rolling stock to the customer. **Observation.** The original transaction was a lease directly from the manufacturer, and that was exempt. The problem arose when the manufacturer later transferred the railcars to a financial institution. From the customer’s perspective, it was leasing the identical railcars for the identical purpose but having to pay sales tax.

Exemptions: General

41. DME/Hospitals. PD 13-234 (December 18, 2013). Taxpayer sells durable medical equipment to hospitals and clinics. The sales tax exemption for durable medical equipment applies only when the item is purchased by or on behalf of an individual for use by that individual. If the items are purchased in bulk by a hospital and then dispensed to individual patients, the purchases are not exempt from the sales tax. The hospital purchase document must include patient identification information at the time of purchase in order to qualify for the exemption. Sales of durable medical

equipment to a nonprofit hospital are exempt from the sales tax provided the hospital gives the taxpayer a copy of its exemption certificate.

42. Nonprescription Drugs. PD 14-98 (July 2, 2014). The factual complexity of applying some of Virginia's sales and use tax exemptions never ceases to amaze. Not exempt from tax based on the nonprescription drug exemption are (i) lip balms, (ii) saline solutions, (iii) Metamucil and Benefiber, (iv) bikini zone cream and (v) diet aids. Whether mouthwash is exempt will depend on whether it includes an antiseptic. (Cool Mint Listerine qualifies). The nonqualifying items above do not cure, mitigate or treat disease. Benefiber also strikes out in its claim for "food for home consumption." Similarly, O'Doul's Non-Alcoholic Brew does not qualify because it is not completely non-alcoholic (one-half percent alcohol by volume).

Prefilled propane tanks do qualify for the "sale of small quantities of propane." The exemption will not apply, however, if the retailer sells or leases the tank, with propane, without separately stating the propane charge.

43. Farming Supplies Exemption. PD 13-190 (October 21, 2013). Taxpayer's business is to spread solid waste materials (bio-solids) on farmlands. It contended that its purchases of equipment and supplies should be exempt from sales tax under Va. Code § 58.1-609.2.1 because they are used in the fertilization of farmlands as a necessary part of agricultural production. The Department disagreed, noting that the exemption is only for purchases by farmers who engage in the business of producing goods for the market. The exemption is to prevent double taxation that would otherwise occur if the farmer paid tax on the purchases of equipment and supplies that were used to produce or become component parts of products which themselves are subsequently taxed.
44. Greenhouses. PD 14-151 (August 28, 2014). Taxpayer received an exemption certificate from its customer, a greenhouse, with respect to the customer's rental of water treatment units and the purchase of salt from the Taxpayer. The Department advised that those purchases qualified for the agricultural products exemption in Va. Code § 58.1-609.2.1 because (1) the customer is in the business of raising or growing products for sale or resale on the open market, and (2) the water treatment units and salt play an integral part in rendering the customer's plants more marketable and are essential to the customer's business.
45. Employer-Provided Meals. PD 13-235 (December 19, 2013). Taxpayer, a country club, allows its employees working during buffet and banquet events to consume leftover food. The taxpayer did not charge the employee for the food, but made an internal \$2/meal/employee adjustment on its books to the cost of food sold and employee meals. The Department

determined that the \$2 adjustment was not subject to the use tax because the food was provided free of charge to the employees.

46. Wholesale ISPs. PD 14-92 (June 16, 2014). The Commissioner reaffirms the Department's position that the statutory exemption for internet service providers applies only to ISPs which provide their service directly to consumers. Wholesalers who resell these internet services are not consumers. The Commissioner specifically *non-acquiesces* with the Circuit Court of Fairfax County's holding in *Cisco Systems v. Thorson*. Treating a Virginia Circuit Court opinion like a federal circuit opinion, the Commissioner allows a refund for customers in Fairfax County only.
47. Wholesale ISPs in Fairfax. PD 14-132 (August 7, 2014). Department reiterates its position that it will not apply the holding in *Cisco Systems* to equipment outside of Fairfax County. In *Cisco*, the court ruled that the exemption for broadcasting and related equipment in Va. Code § 58.1-609.6.2 applies to equipment purchased by internet service providers that provide internet and related services directly to end-user subscribers, whether retail or wholesale.
48. School Supplies. PD 14-1-2 (July 2, 2014). Reusable fabric sandwich bags do not qualify for the sales tax exemption applicable to "school supplies." Although they serve the same function as a lunch box, they are not one of the specifically enumerated items under the Department's Guidelines.
49. Propane/Agriculture/Curing Barns. PD 14-122 (July 25, 2014). Propane sold to farmers for use in heating housing provided to migrant workers is not used in "agricultural production" and is not exempt. Curing barns placed on concrete pads are moveable and therefore would be considered tangible personal property and not real estate.

Audits & Procedure

50. Nexus. PD 14-139 (August 12, 2014). Companies X, Y and Z sell similar products, but have different company names and are separately managed. Z has nexus with Virginia because it owns a retail store in Virginia. X is under common control with Z. X and Y propose to enter into a consignment agreement whereby Y will purchase products from X for resale through the internet. All inventory is maintained by X outside of Virginia, and X will keep title until the moment before the sale is made. At the point of sale, title passes to Y and then to the Virginia customer. The goods will be delivered to the Virginia purchaser by common carrier. Y will collect the sales price and remit to X the purchase price. First, the Department ruled that X does not have nexus with Virginia because it does not make sales to Virginia consumers (if it did sell to Virginia consumers, it would have affiliate nexus only if Z were to facilitate the delivery of the product sold by X). Second, Y should present a resale exemption

certificate issued by the state in which it is registered as a dealer to X. Third, neither X nor Y is required to collect sales tax on the sales to Virginia purchasers. X is not required to do so because the sales are between the Virginia purchaser and Y. Y is not required to collect tax because it has no nexus with Virginia. Finally, assuming X has affiliate nexus with Virginia, X would have to file an out-of-state dealer's use tax return reporting its sales made to Y, and subtracting out those sales as exempt sales for resale.

51. Extrapolation. PD 13-199 (October 31, 2013). Taxpayer objects to the Department's 2012 determination letter, which removed an assessment related to floor repair services but not charges for services to install an HVAC system. The taxpayer contended that the Department improperly extrapolated transactions across the audit period. The Department did not agree, finding that the floor repair services charge was not part of the projection that was extrapolated across the audit and so did not require the removal of any other assessment. Taxpayer is barred from raising other matters not related to the audit period by the 90-day statute of limitations.
52. Sample. PD 14-54 (April 23, 2014). Customer made a purchase on an account separate from his farm account, and retailer mistakenly thought it was exempt. Because this separate, taxable account was opened for only forty-four days, the particular transactions in it were not extrapolated to the entire audit sample. As to various other issues in the audit, taxpayer failed to prove the applicability of any exemption.
53. Sampling. PD 14-154 (August 28, 2014). Taxpayer contested sampling technique, arguing that the sales sample picked up isolated sales that were not a normal part of its operations. It also questioned the sampling period, which pulled in 2013 credit card statements to analyze 2012 tax liability. Because the Taxpayer did not produce invoices or documentation showing that the sales used in the audit were isolated in nature, the assessment was not revised. There was no error in using the Taxpayer's 2013 credit card statements because the Taxpayer did not provide the auditor with its 2012 credit card statements.
54. Burden of Proof. PD 13-197 (October 29, 2013). The taxpayer contended that untaxed purchases were made for subcontract work and that the subcontractor was responsible for the sales tax. The taxpayer did not provide sufficient evidence that the subcontractor was responsible for and did, in fact, pay the tax. Department did not waive penalties because the taxpayer's use tax compliance ratio did not meet or exceed the 85% threshold to avoid penalty.
55. Burden of Proof. PD 14-23 (February 26, 2014). Taxpayer has burden to prove that the assessment made by the Department is wrong. Taxpayer provided no evidence to show that the sample procedure used in the audit was incorrect.

56. Burden of Proof. PD 14-82 (May 30, 2014). Taxpayer failed to provide any proof supporting its various contentions for why the audit report was wrong. Because it is the taxpayer's burden of proof, taxpayer loses. Taxpayer's mistake was retaining sales records for only a few months.
57. Burden of Proof. PD 14-95 (June 24, 2014). Taxpayer was unable to locate specific invoices related to vendor purchases held taxable in the audit. It offered other invoices in an effort to try to show that vendor charged tax. Taxpayer, however, was unable to show that these invoices were "representative" or that the vendor accurately charged tax.
58. Burden of Proof. PD 13-237 (December 19, 2013). The Department made adjustments to certain contested purchases based on the documentation the taxpayer provided. If the taxpayer provided insufficient information to determine the tax status of a transaction, the assessment was upheld.
59. Burden of Proof. PD 14-4 (January 16, 2014). Taxpayer contested assessments on what it believed to be exempt professional services, but was unable to substantiate those claims in audit. The Statements of Work the taxpayer provided were inadequate to support its claim that services were performed. Based on a strict reading, the SOWs could have been for the sale of property, rather than advertising services.
60. Burden of Proof. PD 14-143 (August 26, 2014). Taxpayer filed an appeal requesting a refund of sales tax is believes it erroneously paid to two vendors. It provided sufficient documentation with respect to one vendor, but not to the other vendor.
61. Ignorance of the Law. PD 14-19 (February 25, 2014). Gas station owner failed to collect tax on sales of telephone cards which he did not know were taxable. He claimed that the Department should have warned him before assessing. Commissioner rules that there is an abundance of information about Virginia's sales tax laws and collection responsibilities which has been made public. If the taxpayer can prove his claims of financial disaster caused by the assessment, the Commissioner will consider an offer in compromise and possible payment plan.
62. Audit Records. PD 14-116 (July 22, 2014). Grocery store operator was unable to produce sale records so auditor established liability based on two days of observation. On appeal, grocery store owner miraculously locates "electronic benefits transfer" records to establish another number. Commissioner holds that he will adjust the audit based on cash register tapes, daily sales logs, bank statements and other such documentation but not the EBTs.
63. Officer/Liability/Bankruptcy. PD 13-201 (November 1, 2013). The Department converted the company's assessment for untaxed sales of meals to a penalty assessment under Va. Code § 58.1-1813 when the

company failed to pay. The company's CEO objected to the penalty assessment claiming he did not have actual knowledge of the failure to pay tax and was not under any duty to collect the tax. The company filed for Chapter 7 bankruptcy and, as part of the settlement agreement, agreed to pay an amount to the Department in full satisfaction of the penalty assessment. The Department accepted that amount as full satisfaction of both company and officer liability.

64. Officer Liability/Collection Procedures. PD 13-200 (November 1, 2013). Taxpayer made numerous complaints regarding the Department's actions to collect outstanding liabilities, none of which were successful. First, the Department may record a personal lien against the taxpayer as well as a lien against the taxpayer's business. Second, the Department may record a lien against the taxpayer's business while the taxpayer is in personal bankruptcy. Third, the Department may record a lien for debts that are not subject to the taxpayer's administrative appeal. Finally, the taxpayer may be held as the responsible officer under the *Angelson* (25 Va. Cir. 319 (City of Richmond, 1991) factors even if the taxpayer's now-deceased business partner was responsible for running the operations of the business during the time period of the delinquent taxes.
65. Penalties and Interest. PD 14-50 (April 4, 2014). Taxpayer carried its burden of proving that tax had been paid on certain invoices from a particular vendor. Based on evidence that the particular vendor had consistently collected sales tax on invoices that could be found, Commissioner abated tax on invoices from same vendor that could not be located. Penalties and interest would not be waived unless the taxpayer's compliance ratio, with the audit adjustments, met the 60% standard in the regulation.
66. Penalties/Unremitted Tax. PD 13-198 (October 31, 2103). At the taxpayer's request, the Department removed several purchases from audit after determining that they were made to exempt organizations. The removal of those purchases from audit caused the taxpayer's compliance ratio for sales tax to be 99.9%, above the 85% threshold to waive penalties. Because this was the taxpayer's fifth audit, the Department waived the penalties associated with the sales tax, but noted that it would not waive penalties on the unremitted sales tax or the use tax. Good faith actions to collect, pay and accrue the tax do not constitute "exceptional mitigating circumstances" as required under 23 VAC 10-210-2032.B.8.
67. Payments "Just to be Safe". PD 14-105 (July 16, 2014). This ruling reviews a number of issues related to manufacturers for which there are many precedents. Also at issue was the fact that the taxpayer made lump sum payments on its returns as a hedge against unforeseen audit liabilities. The taxpayer's position that this fund should be applied to uncontested issues, with a refund for the excess, was rejected. The auditor applied the excess only to the contested issues. Moreover, the auditor computed

penalties without taking the excess payments into account. The Commissioner rules that the excess payments must be taken into account in calculating the penalty but applies the excess only to the contested issues, not the uncontested issues.

68. Credit for Tax Paid. PD 14-56 (April 25, 2014). When taxpayer can establish that its customer has reported and paid use tax on a transaction, the Department will allow a one-time credit for that tax payment but will not remove the sale from the sample computation.
69. Late Appeal. PD 14-36 (March 19, 2014). Taxpayer's appeal was rejected because it was filed on February 5, 2014, ninety-two days after the "date of the assessment." The ninety day filing period is strictly enforced. **Query:** Virginia Code §58.1-1820(2) states, in part: "Assessments made by the Department of Taxation shall be deemed to be made when a written notice of assessment is delivered to the taxpayer by an employee of the Department of Taxation, or mailed to the taxpayer at his last known address. ..." If the taxpayer has a date-stamped copy of the Department's letter transmitting the assessment showing (as is frequently the case) that the date of receipt was long after the "date of assessment," plus reasonable mailing time, might the taxpayer yet resurrect an appeal?

VII. COMMUNICATIONS SALES AND USE TAX

A. Rulings of the State Tax Commissioner

1. Video Points Cards. PD 13-236 (December 19, 2013). Taxpayer sold points cards and memberships which allowed the buyer to rent high-definition movies and play games on-line. Consistent with its treatment of telephone cards and similar credit devices, the Commissioner holds that these cards serve as mediums to secure access to on-line amenities and are not taxable tangible personal property and are not themselves communication services.
2. Communications Tax/Activation Fees. PD 14-64 (May 14, 2014). Activation fees were held not subject to the tax. Such fees were charged when the telephone was sold, either by the telephone company or a retailer. When the phone was returned, the fees were refunded. No fee was charged when the taxpayer activated service with respect to his own phone and not one purchased from the company.

Taxpayer's request to expand its appeal to include a new issue was rejected. This was not a question of providing new arguments or evidence with respect to the originally appealed issue, it was a new issue and, because it had not been raised within ninety days of the assessment, it was barred by the statute of limitations.

3. Internet Reactivation Fees. PDs 14-130, 14-131 (August 7, 2014). Consistent with the Department’s published Guidelines and Rules, the Commissioner holds that reactivation fees are part of “taxable communication services.” Taxation of such fees is not prohibited by the Internet Tax Freedom Act.

VIII. BUSINESS LICENSE TAX

A. Cases

1. *Ford Motor Credit Company v. Chesterfield County*, 281 Va. 321 (2011). The Supreme Court of Virginia reversed the holding of the Circuit Court that allowed Chesterfield County to tax 100% of the interest earned on loans “originated” in the regional office located in that County. The loans were documented at dealerships, forwarded to the regional office for review in a three-day process, and then sent to offices in Tennessee and Maryland where all continuing relationships with customers, including billing and collection, were handled during the multiyear lives of the loans. The activities of the Chesterfield office were subject to the supervision and direction of the Michigan headquarters which also produced all of the funds that were loaned to customers. Under these facts, the Supreme Court held that it could not reasonably be said that all the income generating activities of this business occurred in Chesterfield County. The Supreme Court further held that because of the nature of Ford Credit’s business, it was appropriate to use payroll apportionment to determine the revenues taxable by Chesterfield County. The Supreme Court rejected the County’s argument that because an internal accounting report, based on contract accounting, showed exactly the revenues attributable to loans originated in the County, that apportionment and other situs rules were inappropriate. As the Supreme Court noted, the statutes require situs rules based on where services are rendered, and a contract driven accounting system does not do that. Finally, the Supreme Court held that Ford Credit is also entitled to deduct from its taxable base receipts attributable to business in other states, under Virginia Code § 58.1-3732B(2).

Ford Motor Credit Co. v. Chesterfield, CL 07-418 (Opinion dated August 9, 2013). On remand, two years after the Supreme Court’s opinion, the Circuit Court for Chesterfield County granted Ford Credit summary judgment on its proposed apportionment method. The trial court rejected the County’s argument that the income base to be apportionment should be total Virginia receipts with a payroll factor reflecting only Richmond payroll and Virginia payroll. Rather, the trial court held that the receipts to be apportioned are the total loans originated by the Chesterfield Office multiplied by a payroll factor consisting of Richmond branch payroll as a numerator and the payroll of all offices that contributed to generating those receipts (including Richmond) as a denominator. The court uses

total payroll, both direct and indirect, noting that all parties agreed that the percentage difference between the two would not be significant.

With respect to the “interstate deduction” provided by Virginia Code §58.1-3732B(2), the trial court followed a three part test. First, did any employees at the Richmond office participate in interstate transactions? Second, can the interstate participation be tied to specific receipts? Third, if specific tying is not possible, then the same payroll factor must be applied. The trial court held that the Richmond employees participated in interstate transactions when they sent the loans to offices in other states. The trial court then appeared to agree with the taxpayer’s expert that there could be no specific tracing of the receipts. Before agreeing to utilize payroll apportionment, however, the trial court required a further hearing to determine whether the Richmond branch receipts were actually reported on any out-of-state tax returns.

Comment: With respect to the “interstate deduction,” why cannot the interstate participation be tied to specific receipts? The indisputable facts of this case are that all of the loans originated in Richmond were transferred to offices in other states (principally Maryland). All of the payments were billed and received from those out-of-state offices. By focusing on the loans and not the employees, the interstate activity (the loans clearly were transferred from one state office to another state) can be easily established and the income in question can be specifically traced.

2. *Arlington County v. Nielsen Company, (US) LLC*, Cir. Ct. Arl. Case No. CL12-2872 (December 19, 2013). Circuit Court sides with Arlington Commissioner of Revenue in rejecting State Tax Commissioner’s policy for determining “out of state” deduction when payroll apportionment is used. Appeal to be argued week of October 27, 2014.

B. Rulings of the State Tax Commissioner

Exclusions, Exemptions and Reductions

1. Interstate Deduction. PD 14-29, 14-30 and 14-31 (March 5, 2014). Commissioner rejects locality’s argument that there is no statutory authority for using payroll apportionment to determine the deduction for out-of-state business provided by Virginia Code §58.1-3732. Commissioner reaffirms previous decisions and the use of a three-part test in calculating the deduction.

1. Determine if employees from the definite place of business earn or participate in earning receipts attributable to customers in other states where the taxpayer filed an income tax return;

2. Determine the receipts eligible for deduction (multiply gross receipts by payroll percentages in states where income tax return is filed); and

3. Multiply gross receipts eligible for deduction in paragraph 2 above by the Virginia payroll factor.

2. Commerce Clause Challenge. PD 13-191 (Oct. 22, 2013). Taxpayer mounted a Commerce Clause challenge to the locality's BPOL assessment. The taxpayer operated duty free stores in the County at which it sold merchandise to customers leaving the US. The taxpayer argued that the assessment was improper as to gross receipts generated from customers traveling outside the US. The taxpayer argued that its stores were "bonded warehouses" and exempt from state and local property taxes because they were pre-empted by federal law. The Department analyzed the local tax under the four prong test from *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Finding that the local tax passed each of the prongs, the Department held that imposition of the BPOL tax did not violate the Commerce Clause.
3. Affiliated Group. PD 14-20 (February 25, 2014). In order to be affiliated, the "ownership group" must own at least 80% of the total voting power of the entity. To be included in this "ownership group" one must be an individual, estate or trust. Because the taxpayer was a corporation, it cannot be included in this ownership group.
4. Affiliates of Nonprofits. PD 13-176 (Oct. 3, 2013). Taxpayer, a non-stock corporation formed by several nonprofit hospitals to provide laundry services, appealed the locality's final determination assessing BPOL and BTPP tax. The taxpayer claimed it was not subject to BPOL tax because it did not generate income and all of its members were nonprofit organizations. Further, all personal property was used to conduct the nonprofit organizations' missions. The Department held that the taxpayer was not a nonprofit entity, it was a separate legal entity from its nonprofit members, and it was engaged in a different line of business. The Department also found that the taxpayer earned and retained a profit, engaged in cost-sharing activity, and charged its members a fee for the services performed. The Department ruled that the taxpayer was engaged in business activities similar to those of a for-profit businesses and did so to earn a livelihood. Therefore, those activities were subject to tax.
5. Office/Situs of Gross Receipts. PD 13-219 (December 12, 2013). Taxpayer, a traveling expert consultant, appealed the locality's final determination assessing him with BPOL tax on gross receipts from his business as a consultant. Taxpayer claims all business took place outside the locality; therefore, the tax was improper. The taxpayer had several residences in Virginia as well as one in another state. He travelled frequently, testifying and acting as an expert witness or consultant.

Finding that taxpayer did not have any continuous course of dealing in any one locality to constitute a definite place of business, the Department ruled that each of his residences functioned as a definite place of business and the situs for the gross receipts generated from his work. The locality, however, could only tax the gross receipts generated from the residence inside the locality. Moreover, the Taxpayer should receive an out-of-state deduction for any gross receipts arising from business conducted in other jurisdictions and for which he was liable for tax.

6. Situs of Services. PD 14-121 (July 24, 2014). Provider of internet services had administrative headquarters in county and also rented space for servers in data centers and had various employees working out of their homes, all outside the County. In an effort to obtain payroll apportionment, taxpayer argued that the data centers and employees' homes were definite places of business. Commissioner notes that data centers were not held out as places where the taxpayer conducted business. The facts relating to the employees' homes and how they were used, however, were unclear. Commissioner notes that if the taxpayer can prove that it had multiple offices, then its receipts must be situated based on the services performed at each definite place of business. Only if services are not performed at a definite place of business are they to be situated to the place from which they are directed or controlled. **Observation.** Normally a corporate headquarters should not be considered a definite place of business because it is not a place from which business is conducted with members of the general public. What are the facts related to this headquarters' activities?
7. Cost Plus Contract. PD 14-146 (August 26, 2014). In what amounted to a "cost plus" arrangement, taxpayer was paid a fee plus incentive for operating a warehouse. It also paid all expenses related to the warehouse and these were reimbursed dollar for dollar. The Commissioner holds that absent proof of an agency relationship, the expense reimbursements were part of its gross receipts. The Commissioner also rejected that the payment of expenses was essentially a loan to the client. There was no note evidencing the debt.

Classification

8. Classification. PD 13-221 (Dec. 13, 2013). Taxpayer requested an advisory opinion regarding whether it would be classified as a contractor for BPOL purposes. Taxpayer claimed that it purchased and sold investment property. Taxpayer hired independent contractors to renovate and repair the property but the taxpayer did not perform the work itself or obtain any of the necessary permits. The Department determined that if the independent contractors performed the work for the taxpayer, the taxpayer would be classified as a contractor. The Department stated that this was a factual matter for the locality to determine.

9. Wholesale Merchant. PD 14-21 (February 25, 2014). Company mistakenly classified itself as a retail merchant but sought a refund claiming it was a wholesale merchant. Its business was purchasing and reselling replacement parts for equipment used by mining companies. The Commissioner holds that mining is an industrial enterprise and that sales to an industrial user for incorporation in its production equipment qualifies as wholesale sales. Locality's position that company was a retailer because it did not sell to others for resale is rejected.
10. Software Sales. PD 14-117 (July 23, 2014). Taxpayer was engaged in the business of selling prewritten and custom software, as well as fee-based training. The software was sold to customers on memory sticks. Commissioner holds that the primary business activity of this taxpayer was software development which is taxable as a business service. Commissioner, however, rejects the locality's argument that the taxpayer's failure to be registered to collect the sales and use tax establishes conclusively that it is not in the business of selling tangible personal property. Commissioner also acknowledges that it is possible the taxpayer could be engaged in multiple businesses.
11. Common Carriers. PD 14-94 (June 24, 2014). Commissioner holds that common carrier no longer qualifies for the public service corporation "exemption" because the regulatory scheme under which they were formerly governed no longer exists. **Comment.** The Commissioner's argument that the *exclusions* under Virginia Code §58.1-3703 are "exemptions" is wrong. The statute makes very clear that these are limitations on localities' powers of taxation. As such, the Supreme Court of Virginia in both *Ford Motor Credit* and *English Construction* held that the provisions are strictly construed against the locality.

Procedure

12. Lack of Information/Failure to Carry Burden. PD 13-173 (September 19, 2013). The taxpayer claimed that the locality used the wrong assessment method and that taxpayer was not subject to Virginia's BPOL tax because it had no gross receipts subject to the tax in Virginia. The Department held that the taxpayer failed to provide any documentation to support its claim. Observing that the taxpayer failed to carry its burden of proving that the locality's BPOL tax assessment was incorrect, the Department remanded the case to the locality with instruction to the taxpayer to provide the locality with the requisite information in 30 days of the ruling.
13. Procedural Irregularities. PD 14-72 (May 28, 2014). Locality's purported "final determination" did not comply with the Department's guidelines because it did not advise the taxpayer of its administrative appeal rights. Taxpayer's attempt to appeal based on County's delay and failure to issue a proper final determination rejected because it did not comply with the statutory rules for giving the County notice of taxpayer's intent to appeal

for lack of action on its local administrative appeal. **Comment.** Although most Virginia localities appear to follow the appeal procedures, sometimes even using them to play procedural games, it is good that the Department is beginning to hold non-complying localities' feet to the fire. In this environment, however, it is important that taxpayers' representatives understand the rules, dot their "i's" and cross their "t's".

14. Procedural Games. PD 14-96 (June 26, 2014). County rejected taxpayer's arguments that it was a business service, not a professional service, but its letter failed to comply with the Department's guidelines because it did not advise the taxpayer of its appeal rights. County then objected to the taxpayer's appeal as not being timely filed. County also attempted to deny the taxpayer's appeal by issuing its decision under §58.1-3980 from which no appeals are allowed. The State Tax Commissioner rejects the County's arguments and returns the appeals to the locality for further determination and appropriate handling. **Comment.** Once again, credit to the Department for rejecting procedural games and doing what is necessary to make this appeal procedure work. As the ruling recognizes, the administrative procedure should be liberally construed to provide taxpayers with a remedy.

IX. PROPERTY TAXES

A. Legislation

1. Solar Facilities. Virginia Code §58.1-3660 amended to exempt from real and personal property tax business-owned or operated solar energy equipment or facilities that collect, generate, transfer or store thermal or electric energy.
2. Property Tax Exemption. Virginia Code §58.1-3506 allows localities the option of exempting new businesses during the first two years in the locality if gross revenues do not exceed \$100,000.

B. Attorney General's Opinions

1. Conservation Easements. PD-12-099 (September 20, 2013). The attorney general opined that a conservation easement covered by the provisions of § 10.1-1011 must meet the minimum acreage requirements in §58.1-3233 at the time the easement is dedicated unless the easement predated the locality's land use program. Once, however, the land qualifies for the land use assessment and taxation under § 10.1-1011(C), subsequent changes in acreage or use do not affect the continued eligibility of the land as long as those changes are permitted under the conservation easement and the localities continue the land use program.. Moreover, no back taxes or roll-back taxes may be assessed when the conservation easement land no longer qualifies for the land use assessment under § 10.1-1011(C).

2. “Original Cost” and Property Tax. PD 14-018 (June 26, 2014). The attorney general opined that “original cost” for purposes of the tangible personal property tax in 58.1-3503(A)(17) and “original total capitalized cost” for purposes of the tax on machinery and tools in 58.1-3507(B) mean the original cost paid by the original purchaser of the property from the manufacturer or dealer. Thus, a taxpayer purchasing property at a bankruptcy sale could not use the bankruptcy price as the “original cost” or “original total capitalized cost” of the property. The attorney general also opined that this construction did not violate the requirements of uniformity and fair market value in the Virginia Constitution because the resulting tax would not be based upon more than fair market value of the property.
3. Refunds of Real Property Taxes. PD 13-081 (May 16, 2014). The Suffolk City Assessor lacked statutory authority to refund more than three years’ of erroneously levied real property assessments even though the assessments double counted the value of one building, and another building continued to be assessed after it was destroyed in a hurricane. The administrative correction procedures in Va. Code 58.1-3980 and 58.1-3981 only authorize a 3-year refund period.

C. Rulings of State Tax Commissioner

1. Direct Use Manufacturing. PD 14-12 (Jan. 27, 2014). Taxpayer, a manufacturer, appealed the locality’s determination that certain equipment was used in the manufacturing process. The taxpayer contended that its coal silo and fire safety equipment were not subject to M&T tax because they were not used in the manufacturing process. Determining that the coal silo was used only to store coal and was not connected to any machinery used in the manufacturing process, the Department agreed with the taxpayer. The Department stated that any equipment integrated into equipment directly used in the manufacturing process was subject to the tax. The fire safety equipment was built into the kiln system and monitored the oxygen and temperature levels in the coal silo. The kiln system could not be operated safely without the fire safety equipment. It, therefore, was used on the manufacturing process and subject to M&T tax. **Comment:** But could the kiln operate and manufacture without this sprinkler?
2. M&T/Paper Slicers. PD 14-22 (February 26, 2014). Finished paper is stored in the form of large rolls that are later resized and cut to a customer’s specifications. Although the matter is returned to the locality for further fact finding, the Commissioner indicates that the manufacturing process was concluded when paper was stored in large rolls. Thus, machinery used for packaging for shipment is non-taxable capital. Slicers do not transform the paper into a product that is substantially different in character and therefore probably are not taxable M&T.

3. Signage. PD 14-90 (June 12, 2014). Is the signage for a dental practice tangible personal property or realty? Because the lease agreement required the dentist/tenant to remove its signage at the conclusion of the lease, the Commissioner holds that it is not part of the real estate and is therefore taxable as tangible personal property.
4. Gas Pumps/Real Estate. PD 14-53 (April 22, 2014). City refused to classify fuel pumps at a gas station as part of the real estate, ignoring the Department's ruling in PD 00-65 because it was a sales and use tax ruling. The Commissioner holds that these gas pumps are fixtures to real estate. The manner of affixation to the real estate is not determinative as long as it is actual or constructive. These pumps were clearly essential to the purpose for which the property was used. The attachment was to the land even though it was not to a building. The intention of the owner was to make this long term, the previous pumps which these replaced having been in place for over twenty years and the fuel pumps being essential to the purpose of the property.
5. M&T/Valuation and Valuation Date. PD 14-55 (April 24, 2014). Equipment cannot be taxed as machinery and tools "used in a manufacturing business" until actually used in that business. Accordingly, even though equipment was purchased before the tax date, it was not taxable on that date because it was not put into use until a subsequent date.

What is "original cost"? It is the cost paid by the original purchaser of an asset purchased new. Thus, when an asset is purchased used, it still carries the original cost of the first purchaser. Nevertheless, a locality may be required to adjust this original purchase price to reflect the actual fair market value when the property is sold to a new owner in a subsequent year.

6. Economic Obsolescence. PD 14-147 (August 26, 2014). Taxpayer challenged county's assessment based on a percentage of original total capitalized cost. Taxpayer's independent appraisal used an "inutility" approach which produced significant economic obsolescence. In critiquing that appraisal, the County concluded that it had little support or analysis for its reliance on significant economic obsolescence. It did not explain the external factors that caused that obsolescence, marketplace factors, etc. The Commissioner holds that the taxpayer has not carried its burden of proof. The County considered its appraisal and "raised valid issues."
Comment. Once again, it is clear that the Commissioner will not intercede in a valuation dispute between taxpayer's appraisers and a locality. The Commissioner will require that the locality consider the taxpayer's appraisal, but if the County Attorney can come up with any basis for challenging that appraisal, the Commissioner almost invariably will affirm the local assessment based on the uniform application of the statutory methodology.

7. Cable TV. PD 14-68 (May 21, 2014). Recognizing that there is a “split in the circuits” on this issue, the Department holds that the “legislative history”, consisting of the Department’s Tax Bulletins and Fiscal Impact Statements, indicates that tuners and converters are properly classified as intangible property and are not subject to local taxation. With respect to “headend” equipment, optical electronics and modems, however, the Commissioner holds that these meet the definition of “machines” and are taxable locally. With respect to capitalized costs incurred to prepare utility poles for the installation of aerial cables, the Commissioner holds that the taxpayer did not carry its burden of proof that these costs are not properly taxable. **Comment.** Is the burden of proof here against the County of the taxpayer? The definition of what constitutes intangible personal property has been held by the Supreme Court of Virginia the strictly construed against local taxation. *See Tultex v. City of Martinsville*. Moreover, is a utility pole even “tangible personal property”?
8. Cable TV/Converter Boxes. PD 14-69 (May 21, 2014). Consistent with the holding in PD 14-68, the Commissioner holds that converter boxes are intangible personal property not subject to local taxation.
9. Cable TV/Converter Boxes. PD 14-70 (May 21, 2014). Consistent with PD 14-69, Commissioner holds that converter boxes of a cable television provider are intangible personal property not subject to local taxation.
10. Technical Games. PD 14-111 (July 16, 2014). Department remanded an appeal to the County to determine facts concerning the vertically integrated nature of this poultry processor. Taxpayer provided information within the time specified by the Department. Locality found the information insufficient and demanded more, but did not consider the later provided information because it was not within the 45 days originally specified. The Commissioner holds that the taxpayer made good faith efforts to comply with the Department’s original determination and with the locality’s request. The appeal was returned to the County to consider the information the taxpayer provided. **Comment.** Kudos to the Department. These administrative appeal processes are not intended to be technical traps for the unwary or places for local tax officials to play technical games.
11. M&T/Audit Request. PD 14-142 (August 13, 2014). Taxpayer mistakenly reported its M&T at book value, not original capitalized cost. When it requested a refund, the County responded with a request for additional information including federal and state income tax returns and associated schedules. The County declined the refund because the taxpayer did not respond to the request for information. On appeal, the State Tax Commissioner confirms that the County’s actions were proper but remands the audit to give the taxpayer one more chance to cooperate. **Comment.** It is indeed risky for taxpayers not to provide any information

the locality reasonably requests, and it is also risky to try to guess what is “reasonable.” The taxpayer was lucky that it got a remand.

X. MISCELLANEOUS TAX

A. Policy Announcements

1. Guidelines for Tobacco Products Tax. PD 14-126 (July 30, 2014). These Guidelines are what the Department considers to be the equivalent of regulations. They supplement or supersede the Guidelines issued by the Department on December 17, 2010. New provisions relate to the penalties for the possession, transportation or sale of untaxed tobacco products.

B. Rulings of the State Tax Commissioner

1. Recordation Tax/Leasehold. PD 14-44 (March 24, 2014). Property was conveyed subject to a leasehold interest which is an encumbrance on the property. The grantor’s tax should be calculated based on the value of the property excluding the value of the leasehold interest. Even though the leasehold and the fee were conveyed to the same person, the deed expressly stated that the two would not be merged.
2. Insurance Cos./Late Filing Penalty. TD 14-3, PD 14-74 (May 29, 2014). The Tax Department will follow the SCC’s administrative policy of capping the late filing penalty on surplus lines brokers at \$250 for the first offense and \$500 for the second offense.
3. Statute of Limitations. PD 14-134 (August 7, 2014). An administrative appeal, without paying the tax, under Virginia Code §58.1-1821 is available only if filed within ninety days of the date of the assessment. Thereafter, the taxpayer’s remedy is to pay the tax and file an amended return.
4. Statute of Limitations/New Issues. PD 14-135 (August 8, 2014). A timely appeal must be filed within ninety days of the assessment. If the taxpayer thereafter seeks to raise new issues in the appeal, and does not do that within the ninety days, they are barred by the statute of limitations.

XI. TRENDS

Addback Litigation. The Virginia Department of Taxation’s interpretation of the addback legislation enacted in 2004 has been controversial, to say the least. Cases are now queuing up for litigation. The Department has already lost the first case dealing with the safe harbor for entities that have more than one-third of their revenues from unrelated parties and deal with related parties on the same basis. As reported above, the trial court agreed with Wendy’s International that the statute is plain and unambiguous. Two royalty addback cases are set for trial at the end of this year. As with the related party safe harbor, the taxpayer’s position is that the “subject to tax in

another state” safe harbor is unambiguous and not subject to the distorted interpretation made by the Department of Taxation.

In the midst of this, the legislature has passed (snuck into a “caboose” budget bill) 10 year retroactive legislation approving the Department’s position.

Regulations. The Department of Taxation is apparently moving forward with its new policy of avoiding the issuance of regulations whenever possible. Because the procedure for adopting regulations was asserted to be too cumbersome, the Department will rely on a variety of published documents to set forth its new policies. These will include comprehensive “guideline” on a subject, “Policy Statements” as well as continued reliance on published rulings and appeals. Taxpayers will no longer be able to look just to regulations to determine the Department of Taxation’s policy on any issue, and published regulations may no longer be valid in the Department’s eyes. When asked the degree to which taxpayers can rely on such policy statements not published as a regulation, the Department has informally replied that for purposes of taxpayer reliance, the Department will provide the same protection as it does for taxpayers who rely on regulations. It is a curious anomaly when an informal Guideline or ruling purports to revoke a regulation.

Interest. Local commissioners of the revenue have continued to press for legislation restricting interest payable on tax refunds. During the past two Sessions of the General Assembly, these proposals have been couched in terms of denying interest when the error is due to the fault of the taxpayer. This wolf in sheep’s clothing argument would effectively deny interest whenever a taxpayer files an amended return, the fault being corrected necessarily originating in a return filed by the taxpayer. So far various trade associations representing the business community in Virginia have beat back these efforts, but this important issue merits careful attention in coming years.

Business License Tax. Various Virginia localities continue to complain about the structure of the gross receipts business license tax, a significant local revenue resource. This tax was substantially rewritten in 1997 to rein in localities’ efforts to make it effectively a gross income tax. Since that time local administration of this tax has been subject to supervision by the Virginia Department of Taxation in an effort to bring about state-wide rules. Rulings by the Virginia Department of Taxation concerning the use of payroll apportionment to determine the tax base for multi-state taxpayers and the deduction for “interstate commerce” have led to a number of lawsuits being filed. Discussions with local tax authorities suggest that the business community will see legislative attempts as well to cut back on state supervision and what has been for fifteen years a very effective administrative appeal procedure.

Interstate Apportionment. The *Nielsen* case reported above is now on appeal to the Supreme Court of Virginia. Fairfax County and several local government trade associations have filed *amicus* briefs in an effort to change State policy with respect to interstate apportionment and deductions.

Norfolk/Manufacturing. The City of Norfolk is taking very aggressive audit positions aimed at taxing manufacturers. Distribution centers are deemed taxable if any sales activity arguably occurs there. Manufacturing plants are treated as taxable if, as is typical under federal regulations, title to materials passes before manufacturing is concluded.

Procedural Games. Local tax authorities are increasingly trying to create procedural traps for businesses that seek to appeal local tax assessments to the State. Although the State Tax Commissioner appears not to support these procedural games, it is vital for businesses to dot their procedural “i’s” in their appeals.

Machinery & Tools Valuation. Manufacturing and mining companies should expect to see litigation soon about how localities value machinery and tools. Although the Constitution of Virginia requires property to be taxed at fair market value, Virginia Code §. 58.1-3507(B) provides the basis for the machinery and tools tax as “depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest.” As reported above, the Attorney General opined that, “the term ‘original cost’ means the amount paid by the original purchaser of the equipment. Op. Va. Atty. Gen. No. 08-109 (February 25, 2009). This opinion was reaffirmed by the Attorney General in Opinion of the Attorney General of Virginia No. 14-018 (June 26, 2014). The problem arises when there is a current arm’s length sale of the property for a price substantially below the locality’s depreciated “original cost,” as defined by the Attorney General. Assessing based on what some purchaser paid decades before and ignoring a current sale price flies in the face of the constitutional mandate of assessments at fair market value.

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