Recent Developments in Virginia Taxation

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RECENT DEVELOPMENTS IN VIRGINIA TAXATION

A Discussion of Tax Legislation, Recent Court Decisions, Tax Department Rulings, and Opinions of the Attorney General from January 1, 2015 Through September 25, 2015

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RECENT DEVELOPMENTS IN VIRGINIA TAXATION


I. CORPORATE INCOME TAX

A. 2015 Legislation

1. Conformity to the Internal Revenue Code. House Bill 1727 (Chapter 61) and Senate Bill 1044 (Chapter 1) amend § 58.1-302 to advance Virginia’s date of conformity to the Internal Revenue Code from January 2, 2013 to December 31, 2014. This conforms the Virginia tax code to the provisions of the Tax Increase Prevention Act of 2014. This legislation was effective on February 16, 2015.

2. Alternate Method of Apportionment for Corporations with Enterprise Data Centers. House Bill 2162 (Chapter 237) and Senate Bill 1142 (Chapter 92) amend § 58.1-408 to allow taxpayers with an enterprise data center operation to apportion Virginia taxable income using single factor apportionment based on sales if such taxpayer enters into a memorandum of understanding with the Virginia Economic Development Partnership Authority to make a new capital investment of at least $150 million in an enterprise data center in Virginia. Taxpayers that qualify would use a quadruple-weighted sales factor for taxable years beginning after July 1, 2016 but before July 1, 2017. For taxable years beginning after July 1, 2017, these taxpayers would use the single sales factor method to apportion Virginia taxable income.

3. Out-of-State Businesses and Employees Providing Disaster Relief Assistance in Virginia. House Bill 1386 (Chapter 595) amends § 12.1-12 and adds § 44-146.28:2 to the Code of Virginia to provide that disaster-related or emergency-related work performed by an out-of-state business within Virginia is not considered in determining whether the business is required to file, remit, or pay any state or local tax or fee, or whether such business or its out-of-state employees are required to be licensed or registered in any manner by Virginia or local governments. The legislation also provides that disaster-related or emergency-related work performed by an out-of-state employee within Virginia would not be considered to have established such person’s residency or a presence in Virginia that would require that person or that person’s employer to file and pay income taxes or be subject to withholding, or file and pay any other state or local tax or fee during the disaster response period. This legislation does not apply to any transaction taxes and fees, including but not limited to, motor fuels taxes, sales and use taxes, transient occupancy taxes, and car rental taxes and fees based on purchases, leases, or consumption in Virginia. Also, the legislation allows the State Corporation Commission (“SCC”) to require any business to disclose whether it is an out-of-state business, and provide certain information to the SCC and to allow the SCC to require any business to provide such information regarding any affiliate that is an out-of-state business to the SCC. This legislation was effective on March 26, 2015.

4. Major Business Facilities Jobs Tax Credit. House Bill 1844 (Chapter 451) amends § 58.1-439 to extend the provision that requires a qualified major business facility to
claim the credit allowed per qualified full-time employee over two taxable years instead of over three taxable years. This legislation was effective on July 1, 2015.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings


2. Apportionment for Financial Corporations. P.D. 15-5 (January 8, 2015). The taxpayer is a registered national securities exchange, which provides both products and services in its normal course of business. The taxpayer requested a ruling as to whether it may use the single factor for financial corporations to apportion its income for Virginia corporate tax purposes. For corporate income tax purposes, a financial corporation must apportion its nonallocable income based upon the ratio of the cost performance in Virginia to the cost of performance everywhere. Virginia Code § 58.1-418 defines a financial corporation to include any corporation not exempted from the imposition of tax under the provisions of § 58.1-401, which derives more than seventy percent of its gross income from the classes of income enumerated in subdivisions 1 through 4 below, without reference to the state wherein such income is earned, including but not limited to small loan companies, sales finance companies, brokerage companies and investment companies:
   1. Fees, commissions, other compensation for financial services rendered;
   2. Gross profits from trading in stocks, bonds, or other securities;
   3. Interest; and
   4. Dividends received to the extent included in Virginia taxable income.

The Tax Commissioner determined that the taxpayer would be considered a financial corporation as it derives more than 70% of its gross income from fees, commissions, and other compensation for financial services as identified above.


4. Intangible Holding Company. P.D. 15-143 (June 30, 2015). Corporation A operated restaurants throughout the United States including Virginia. Corporation B owned and maintained intangible property that included trademarks, trade names, product recipes, and other product intangibles. Corporation B charged Corporation A royalties under a licensing agreement from 2000 through 2008. Beginning in 2005, Corporation A added back intangible expenses in as required by Virginia law. Corporation A requested a ruling that intercompany royalty expenses would not be required to be added back to federal taxable income for 2000 through 2004 taxable years. In addition, Corporation B sought a ruling that it would not be subject to income tax for the taxable years at issue. The Tax Commissioner stated that the statute
of limitations prevents any adjustment to Corporation A’s returns assuming that they were filed. Naturally, the Tax Commissioner did not issue a ruling on Corporation B and only cited the authority under Va. Code § 58.1-446.

5. **Nexus.** P.D. 15-144 (June 30, 2015). The taxpayer, a Subchapter S corporation commercially domiciled in State A, is a procurement company doing business via telephone and internet. Based on its customers’ needs, the taxpayer procures goods and services from vendors, which deliver the goods or services directly to the customer. The vendor is paid by the taxpayer. The taxpayer in turn invoices the customer for the cost of the products or services plus a transaction fee. The taxpayer maintains no property or employees in Virginia, but does have one commercial customer located in Virginia. All sales and solicitation activities by the taxpayer occur at its facility in State A. The taxpayer requested a ruling as to whether these transactions with its Virginia customer create nexus in Virginia. The Tax Commissioner stated that the answer would depend on the taxpayer’s relationship with the vendor. If the vendor is independent of the taxpayer, there would be no nexus. However if the vendor is not independent, the vendor’s activities could create nexus.

6. **Payroll Factor.** P.D. 15-166 (August 18, 2015). The taxpayer, a corporation headquartered in Virginia, provided security services to certain agencies of the United States government. The Tax Department audited the taxpayer for the 2010 and 2011 taxable years and made a number of adjustments. One of the adjustments was to increase the numerator of the taxpayer's Virginia payroll factor based on the amount of employee wages the taxpayer reported to the Virginia Employment Commission (VEC). The taxpayer appealed the adjustment, contending that the compensation for the services of its employees who worked exclusively overseas should have been excluded from the payroll factor numerator. The taxpayer asserted that the numerator should equal the amount of employee wages subject to Virginia income tax withholding. The Tax Commissioner upheld the assessment as total wages reported to the VEC are presumed to be compensation paid to employees in Virginia. Withholding is not always a good indicator as an employer may be required to withhold Virginia income tax from employee wages even if it does not have a positive payroll factor or compensation may be included in the numerator of the payroll factor even if it is not subject to income tax withholding. However, the taxpayer was afforded the opportunity to submit clear, cogent evidence to show which of its employees included on the VEC reports performed services solely outside Virginia.

II. **INDIVIDUAL INCOME TAX**

A. **2015 Legislation**

1. **Land Preservation Tax Credit.** House Bill 1828 (Chapter 235) and Senate Bill 1019 (Chapter 680) amend § 58.1-512 to do the following:
   - Limit the fiscal impact of the Land Preservation Tax Credit by reducing the annual credit cap from $100 million to $75 million;
   - Limiting the amount of credit that may be claimed by each taxpayer annually to $20,000 for Taxable Years 2015 and 2016, and to $50,000 for Taxable Year 2017 and thereafter;
For any qualifying (non-bargain sale) fee simple donation of land (ed. note: Is Virginia still sore about losing the Forest Lodge case???) conveyed to Virginia on or after January 1, 2015, the amount of credit claimed by each taxpayer would be limited to $100,000.

- Prohibit the Department of Taxation from issuing any tax credit for a donation from any allocation or pool of tax credits attributable to a calendar year prior to the year in which the complete tax credit application for the donation was filed;
- Clarify that credits must be issued in the order that each complete application is filed; and,
- Prohibit credits from being issued for any land or interest in land conveyed on or after July 1, 2015, unless a complete application for tax credit with regard to the conveyance has been filed by December 31 of the year following the calendar year of the conveyance.

This legislation was effective on July 1, 2015.

2. **Subtraction for Income Attributable to Discharge of Student Loan.** House Bill 1716 (Chapter 60) and Senate Bill 933 (Chapter 82) amend § 58.1-322 to allow an individual income tax subtraction for income attributable to the discharge of a student loan solely by reason of the student’s death. This legislation is effective for taxable years beginning on or after January 1, 2015.

3. **Subtraction for Gain Derived from the Sale of Land for Open-Space Use Eliminated.** Senate Bill 1012 (Chapter 248) amends §§ 58.1-322 and 58.1-402 to eliminate the individual and corporation income tax subtraction for gain derived from the sale or exchange of real property or an easement for open-space use, effective for taxable years beginning on or after January 1, 2015.

4. **Refund Checks.** House Bill 1286 (Chapter 229) and Senate Bill 701 (Chapter 76) amend § 58.1-1833 to require the Tax Commissioner and the State Comptroller to implement procedures allowing an individual requesting an income tax refund to elect to have his refund paid by check mailed to his address. This legislation is effective for taxable years beginning on or after January 1, 2015.

5. **Technology Business Investment Subtraction Extension.** House Bill (Chapter 336) and Senate Bill 904 (Chapter 335) amend §§ 58.1-322 and 58.1-402 extend the sunset date for making investments in certain high technology businesses that qualify for the individual and corporation income tax subtraction for income taxed as long-term capital gain for federal income tax purposes from June 30, 2015 to June 30, 2020.

6. **Recyclable Materials Processing Equipment Tax Credit.** House Bill 1554 (Chapter 49) and Senate Bill 1205 (Chapter 94) amend § 58.1-439.7 to make the following changes to the recyclable materials processing equipment tax credit:

- Increase the amount of the credits that each taxpayer may claim to an amount equal to 20 percent of the purchase price for machinery and equipment that qualifies for the credit;
- Impose a credit cap of $2 million per fiscal year;
• Allow taxpayers to claim the credit for machinery and equipment used predominantly for qualified purposes, rather than exclusively for such purposes;
• Prohibit denying the credit to a taxpayer based solely on another person’s use of tangible personal property produced by the taxpayer using machinery and equipment that would otherwise qualify for the credit, provided that the tangible personal property was sold by the taxpayer to an unaffiliated person in an arm’s-length sale;
• Require that machinery and equipment be used to manufacture, process, compound, or produce items of tangible personal property from recyclable materials to qualify for the credit; and,
• Extend the sunset date for the credit from taxable years beginning before January 1, 2015 to taxable years beginning before January 1, 2020.

This legislation is effective for taxable years beginning on and after January 1, 2015.

7. **Neighborhood Assistance Act Tax Credit: Eligibility of Physician and Health Care Professional Specialists.** House Bill 1459 (Chapter 153) amends § 58.1-439.22 to allow a physician specialist who donates specialty medical services to patients referred from certain approved neighborhood organizations to be eligible to receive an allocation of Neighborhood Assistance Act Tax Credits from such organizations regardless of where the specialty medical services are delivered. For purposes of determining the amount of credits allowed to such taxpayers, the value of the specialty medical services rendered is limited to the lesser of the reasonable cost for similar services from other providers or $125 per hour. This legislation is effective for fiscal years beginning on or after July 1, 2015.

8. **Neighborhood Assistance Tax Credit: Percentage for Business Firm or an Individual.** House Bill 1701 (Chapter 56) amends §§ 58.1-439.21 and 58.1-439.24 to allow a business firm or any individual that is eligible for the Neighborhood Assistance Act Tax Credit to agree in writing to a credit amount equal to less than 65 percent of the qualified donation. This legislation is effective for taxable years beginning on and after January 1, 2015.

9. **Green Job Creation Tax Credit Extension.** House Bill 1843 (Chapter 486) and Senate Bill 1037 (Chapter 239) amend § 58.1-439.12:05 to extend the sunset date for the Green Job Creation Tax Credit for three years, from January 1, 2015 to January 1, 2018.

**B. Recent Court Decisions**

No recent court decisions.

**C. Recent Virginia Tax Commissioner Rulings**


2. **Overseas Taxpayer.** P.D. 15-3 (January 8, 2015). The taxpayer lived and worked overseas in 2010. The taxpayer filed his return for the 2009 taxable year on July 1, 2013, claiming a refund due. The Tax Department denied the refund on the basis that the return was filed outside the statute of limitations. The taxpayer filed an appeal, contending that the refund
claim was timely because the return was filed within three years from the extended due date applicable to taxpayers who were overseas on the original due date. The Tax Commissioner agreed and granted the refund.


4. **Deductible Business Expenses.** P.D. 15-21 (February 17, 2015). The taxpayers, a husband and wife, resided in Virginia during the 2013 taxable year. They filed a 2013 Virginia resident income tax return, claiming itemized deductions that included business expenses incurred by the wife. The wife was employed as a salesperson with a weekly regional sales route. She used the business standard mileage rate to determine her automobile expenses based on the weekly mileage of the route, less a partial reimbursement by her employer. The wife also claimed a deduction for 50% of the cost of breakfast, lunches and dinners she purchased for client employees. Under review, the Tax Department disallowed automobile and meal expenses claimed as unreimbursed business expense deductions, resulting in the reduction of the taxpayers' income tax refund. The taxpayers appealed the adjustments, contending that the disallowed deductions were for deductible unreimbursed travel and meal expenses incurred by the wife in the ordinary course of business. Upon a review of the records provided by the taxpayers, the Tax Commissioner ordered the balance of the refund to be issued. **Note:** Another above-the-line audit outcome reversed.

5. **Fixed Date Conformity Updated.** P.D. 15-22 (February 19, 2015). The Tax Commissioner issued Virginia Tax Bulletin 15-1 to notify taxpayers of the enactment of Senate Bill 1044 (Chapter 1) which advanced Virginia’s date of conformity from January 2, 2013 to December 31, 2014.

6. **Conformity Subtraction.** P.D. 15-25 (February 24, 2015). The taxpayers amended their 2009 Virginia individual income tax return and claimed a fixed date conformity subtraction for depreciation expense related to the S Corporation they own. Under review, the Tax Department disallowed the subtraction because there was no evidence of bonus depreciation carried forward from prior years. The taxpayers filed an appeal, contending their intent was to claim depreciation deduction unrelated to bonus depreciation. The Tax Commissioner upheld the disallowance as the depreciation deduction should have been reported in the taxpayer's share of ordinary business income.

7. **Death Benefit Subtraction – Retroactive Application of Amended Law.** P.D. 15-26 and P.D. 15-48 (February 24, 2015 and April 3, 2015). The taxpayer filed a 2010 Virginia income tax return and claimed a subtraction for death benefit payments received during the taxable year. Under audit, the Tax Department disallowed the subtraction and issued assessments for additional tax and interest. The taxpayer appealed the assessment, contending the payments received were from an annuity, resulting from death benefits as indicated on the Federal Form 1099R. The taxpayer argued that the audit was based on statutory amendments,
effective 2012 that should not be applied to prior taxable years. The Tax Commissioner denied
the appeal. He stated, "The taxpayer argues that the subtraction is derived from a death benefit
paid to her as an annuity and was subject to federal income tax. As indicated above, however,
meeting the definition of an annuity is not the only requirement for the subtraction. Under the
Tax Department's interpretation and subsequent clarifying legislation, the death benefit
subtraction was never intended to be permitted for payments from a retirement plan. The intent
of the death benefit subtraction was to equalize treatment of certain death benefit payments
resulting from contracts with life insurance companies for Virginia income tax purposes. The
subtraction applies to death benefit payments subject to federal income tax. In this case, because
the annuity payment was made pursuant to a retirement plan, the taxpayer could not have
qualified for the subtraction, even if she accepted a lump sum in lieu of periodic payments."
Comment: The Tax Department decides when legislation is clarifying and effectively
makes no changes to an interpretation? The legislation makes no mention of this.

8. Payment Applied to Prior Year. P.D. 15-33 (March 3, 2015). During the
initial processing of the taxpayers' 2012 Virginia individual income tax return, an addition for
interest on obligations of another state was not included. Upon review, the addition was
corrected and an adjustment was made to the amount of estimated payments because they did not
match the Tax Department's records. An assessment for underpayment of tax was issued. The
taxpayers appealed the assessment, contending they submitted the payments to their local
commissioner of revenue. The Tax Commissioner reviewed its records and determined that an
estimated payment of the taxpayer was applied to the 2011 taxable year. Therefore, the
assessment was upheld.

P.D. 15-34 (March 4, 2015). In 2001, the taxpayers obtained an interest in Virginia Historic Tax
Credit Fund 2001 SCP LLC (the "Partnership") and received an allocation of the Partnership's
Virginia Historic Rehabilitation Tax Credit (the "Credit"). In 2002, the taxpayers sold their
interest back to the Partnership and reported a capital loss, which they carried forward to their
2003 through 2006 federal income tax returns. Under audit, the Internal Revenue Service (IRS)
disallowed the loss, which increased the taxpayers' federal adjusted gross income (FAGI) for
each of the taxable years at issue. The Tax Department received information from the IRS
indicating that the taxpayers' FAGI had been adjusted. When contacted, the taxpayers asserted
the capital loss deductions were allowable for Virginia income tax purposes based on legislation
passed by the General Assembly in 2012. The auditor, however, concluded the legislation did not
apply retroactively and assessments were issued. The taxpayers filed an appeal, asserting
Virginia law permits them to subtract the loss for Virginia income tax purposes. The Tax
Commissioner denied the taxpayers' appeal. The Tax Commissioner recognized that the General
Assembly enacted House Bill 531 (Chapter 92, Acts of Assembly) and Senate Bill 444 (Chapter
639, Acts of Assembly) in 2012 to amend Va. Code § 58.1-339.2 to provide that gain or income
under federal law from the allocation of Historic Rehabilitation Tax Credits are not be taxable
gain or income for purposes of the Virginia income tax. However, this legislation did not
address denials of partnership losses. Due to this, the Tax Commissioner relied on federal
conformity to uphold the loss denial.

The taxpayers appealed an assessment, which the Tax Commissioner upheld, issued as the
taxpayers claimed more than the $4,000 maximum deduction for contributions to a Virginia College Savings Plan.

11. **Subtractions.** P.D. 15-52 (April 3, 2015). The taxpayers claimed subtractions for wages received related to services performed prior to becoming Virginia residents, capital gains earned in a foreign country, and income included in FAGI due to a conversion of a traditional IRA to a Roth IRA. The taxpayer were assessed for these subtractions and the Tax Commissioner upheld the assessment as none of these subtractions were provided for in the Virginia Code.

12. **Long Term Capital Gain Subtraction.** P.D. 15-53 (April 3, 2015). The taxpayers subtracted their long term capital gains and claimed the instructions stated such a subraction was allowable and a Tax Department representative verbally agreed with their interpretation. The taxpayers were assessed for the subtraction and the Tax Commissioner upheld the assessment. He stated that the instructions provide that a subtraction is allowed for investments in a qualified business and the taxpayers must have received guidance from the Tax Department in writing.

13. **Long-Term Health Care Insurance Premiums Subtraction.** P.D. 15-56 (April 3, 2015). The taxpayer claimed a subtraction on their 2011 income tax return for long-term health care insurance premiums paid in 2009 and 2010. The taxpayer was assessed for this subtraction which was upheld by the Tax Commissioner as the 2009 and 2010 premiums could not be subtracted in 2011.

14. **Calculation for Out of State Tax Credit.** P.D. 15-58 (April 3, 2015). The taxpayers challenged the calculation for income taxes paid to Maryland after they received an assessment to reduce the credit claimed. The Tax Commissioner upheld the assessment and reiterated that only the amount of Virginia income tax imposed on the taxpayer's Maryland net income for each taxable year may be subtracted.

15. **Out of State Tax Credit.** P.D. 15-61 (April 14, 2015). The taxpayer requested a ruling on whether he would be eligible to claim a credit for taxes paid to North Carolina for income received from a sale of real property held for investment. The Tax Commissioner confirmed that the taxpayer may claim such a credit.

16. **Retirement Subtraction.** P.D. 15-64 (April 15, 2015). The taxpayer, a resident of Virginia, received pension income from her former employer in State A. The taxpayer claimed a subtraction on her Virginia income tax returns for the entire amount received. Under audit, the Tax Department disallowed the subtraction and issued assessments for the 2010 through 2012 taxable years. The taxpayer paid the assessments and filed an appeal, contending the distributions should not subject to Virginia income tax. The Tax Commissioner denied the appeal as Virginia may tax all of the income of its residents.

17. ** Converted Assessment.** P.D. 15-66 (April 15, 2015). The taxpayer was employed by the Corporation as an operations manager until he was elected its president in June 2012. At the time of his election, the Tax Department was conducting a withholding tax audit for the taxable periods January 2011 through June 2012, and assessments were issued in
December 2012. The taxpayer resigned as president in February 2013. The assessment for the taxable periods from January 2012 through June 2012 has been satisfied. When the Corporation failed to pay the assessment for the taxable period January 2011 through December 2011, however, the Tax Department timely converted the assessments to the taxpayer as permitted under Va. Code § 58.1-1813. The taxpayer filed an appeal, contending that he should not be held personally liable for the assessment because he was not responsible for filing returns or remitting withholding taxes during the taxable periods at issue. The taxpayer also contended that the Corporation's failure to pay the assessment was not caused by any willfulness on his part. The Tax Commissioner agreed and abated the assessment.

The taxpayer contended that he was not a responsible corporate officer under Va. Code § 58.1-1813 because he was employed as an operations manager during the taxable periods at issue and his duties did not include filing withholding tax returns or remitting withholding taxes. Virginia Code § 58.1-1813, however, does not specify that the corporate officer or employee must have had such responsibility at the time the returns and payments were due. A failure to pay, collect, or truthfully account for and pay over the tax continues until the business corrects such failure. In this case, the taxpayer learned of the Corporation's failure to pay withholding tax after he became president and assumed authority for ensuring the Corporation's compliance with federal and state tax laws. The remaining question is whether the taxpayer's failure to pay over the withholding taxes was willful.

After he became president, the taxpayer directed the Corporation to hire an accounting firm to conduct a comprehensive review of the Corporation's accounting. At that time, the Tax Department was already conducting withholding and sales tax audits. Before the accounting firm was hired, the Tax Department had difficulty obtaining the information it needed to complete the audits. This difficulty, however, was not caused by the taxpayer's refusal to cooperate. Rather, according to the auditor, the accounting firm assisted him in obtaining all of the information he needed to conclude the audits and issue accurate assessments. As such, the taxpayer's direction to hire the firm helped produce a truthful accounting of the Corporation's withholding tax liabilities. In addition, the taxpayer was president when the Corporation and the Tax Department agreed to a payment plan in February 2013 covering the Corporation's remaining withholding and sales tax liabilities. At his direction, the Corporation had begun making payments on the plan.

18. Contributions to Deferred Compensation Plan. P.D. 15-69 (April 15, 2015). The taxpayers, a husband and wife, were Virginia residents during the taxable years at issue. The husband was employed by a nonprofit organization located in State A while residing in State B from 1985 through 2001. During his employment, the husband made contributions to a deferred compensation plan established pursuant to Internal Revenue Code (IRC) § 403(b). In 2002, the husband rolled over his contributions to the deferred compensation plan into an individual retirement account (IRA). After moving to Virginia, the husband took distributions from the IRA. Although the contributions were excluded from federal adjusted gross income (FAGI), they were included in the husband's compensation subject to State B income tax. The taxpayers claimed subtractions on their 2011 through 2013 Virginia income tax returns for the full amount of distributions from the IRA. The taxpayers were audited by the Tax Department and the subtraction for the distributions was disallowed. The taxpayers appealed the assessments, contending that they should be permitted to exclude the entire amount of the distributions from
the computation of Virginia taxable income for each of the taxable years at issue. The Tax
Commissioner upheld the assessment but gave the taxpayer an opportunity to provide additional
information.

In Public Document (P.D.) 10-214 (9/15/2010), the Tax Department established a pro-
rate approach that accurately reflects the nature of a distribution from a retirement plan.
Accordingly, a taxpayer who receives a distribution from a retirement plan as described in Va.
Code § 58.1-322(C)(19) and whose contributions to such plan were subject to income taxation in
another state would determine the portion of the annual distribution(s) eligible for the subtraction
by multiplying the total amount of the annual distribution(s) by a ratio equal to the total balance
of previously taxed contributions divided by the sum of the value of the retirement account at the
end of the taxable year plus the total amount of the annual distribution(s). In this case, the
taxpayers' records only showed the contributions the husband made from September 1997
through December 2002. The documentation show the balance of the IRA account as of the
September 1997 date. However, this balance likely includes income on the investment.

Therefore, the Tax Commissioner determined that the information provided by the taxpayers is
insufficient to show the balance of the husband's previously taxed contributions.

19. Deduction for Unreimbursed Business Expenses. P.D. 15-70 (April 15,
2015). The Tax Department audited the taxpayers for the 2013 taxable year and adjusted
business expense deductions the husband claimed for an Internet connection in his home office
and business use of his personal vehicle. The adjustments reduced the overpayment reported on
the taxpayers' return. The taxpayers claimed a deduction for fees for an internet connection used
in the husband's home office. Based on the billing statements provided by the taxpayers, the Tax
Department adjusted the deduction to correspond to the aggregate amount of payments the
taxpayers made for the Internet connection during the taxable year. The taxpayers also claimed a
deduction for vehicle expenses. The taxpayers chose the standard mileage method in computing
the deduction. The auditor denied the deduction, however, because the husband's employer paid
for fuel. The standard mileage rate, however, is designed to cover all of the expenses of
operating a vehicle, not just fuel costs. See IRS Rev. Proc. 10-51 § 4.02 (12/20/2010). The
taxpayers reduced the deduction by the amount the husband's employer paid for fuel. Employees,
however, are permitted to deduct expenses to the extent they exceed reimbursements provided
that such expenses and reimbursements are properly accounted for on their federal income tax
returns. See Treas. Reg. § 1.162-17(b)(3). The taxpayers filed an appeal, contending that the
deductions properly reflected the husband's unreimbursed employee business expenses. With
respect to the vehicle expenses, the Tax Commissioner agreed with the taxpayers. However, he
disagreed on the internet expenses and upheld the assessment with respect to those expenses as
the taxpayers provided no documentation to support the amount of internet service expenses
reported on their return.

husband and wife, were residents of Delaware from 1977 through 1995. The husband was
employed by an agency of the federal government from 1976 until he retired in 2002. During his
employment, the husband made contributions to the Civil Service Retirement System (CSRS).
The contributions were included in federal adjusted gross income (FAGI). Upon retirement, the
husband began receiving pension payments from CSRS, in the form of an annuity payable in
monthly installments. The taxpayers claimed subtractions on their 2011 and 2012 Virginia
income tax returns for the full amount of the retirement distributions. Under review, the Tax Department disallowed the subtractions and issued assessments. The taxpayers appealed, contending that they should be permitted to subtract the entire amount of the payments because they paid both federal and Delaware income tax on the contributions to CSRS. The Tax Commissioner upheld the assessments. Before taxpayers may subtract any portion of their retirement income under Va. Code § 58.1-322(C)(19), contributions to the retirement plan must satisfy a two-part test: (1) they must have been deductible for federal income tax purposes; and (2) they must still have been subject to income tax in another state. The retirement income subtraction in Va. Code § 58.1-322(C)(19) does not apply as the contributions were previously subject to federal income tax. Thus, the taxpayers were not eligible to claim the subtraction, regardless of whether they paid income tax on the contributions in Delaware.

21. Land Preservation Tax Credit. P.D. 15-79 (April 22, 2015). In February 2008, the taxpayer, a limited liability company (LLC), donated a fee simple interest in a tract of land located in County A. Pursuant to the conveyance, the taxpayer registered the donation with the Tax Department for purposes of the Credit. The taxpayer requested and was awarded Credit based on an appraisal by an unrelated third party appraiser contracted by the taxpayer. The Credit was allocated to the owners, a husband and wife, of the taxpayer. The owners claimed a portion of the total Credit on their Virginia income tax returns filed for the 2008 and 2009 taxable years. The husband died in 2010. The joint income tax return for 2010 and the wife's income tax return for 2011 each reported a loss, so the Credit was not utilized for those years. A subsequent review of the taxpayer's application raised questions about the value of the conveyance for which the Credit was granted. As a result, the Tax Department commissioned an appraisal from an independent third party appraiser. Based on this appraisal, the Credit was revalued. The taxpayer appealed the revaluation of the Credit, contending its appraiser followed accepted professional standards and the donation was properly valued in its appraisal. The taxpayer provided an additional appraisal to support its position. The taxpayer also asserted that the Tax Department did not adjust the Credit issued to the husband and wife within the limitations period. The Tax Commissioner agreed that the adjustments to the 2008 and 2009 taxable year were made after the statute of limitations closed. Despite this, the Tax Department reduced the amount of the Credit carried forward. As far as the appraisals, the taxpayer did not allege any error in the Tax Department's appraisal and only alleged that his appraisals were compliant with USPAP. In a shock to no one, the Tax Commissioner upheld the devaluation of the Credit as he felt that the Tax Department’s appraisal had the best analysis. **Comment:** Unless a taxpayer is going to allege an error in an appraisal obtained by the Tax Department, what is the point in filing an administrative appeal? Of course the Tax Commissioner is going to like the appraisal paid for by the Tax Department. In situations like these, the only way to get a fair, impartial appeal is to go to circuit court.

22. Out of State Tax Credits/Tax Software. P.D. 15-88 (April 28, 2015). The taxpayers, a husband and wife, are residents of Virginia. During the 2013 taxable year, the husband earned wage income in California. The taxpayers filed income tax returns in California and Virginia. On the Virginia return, they claimed a credit for income tax paid to California. The Tax Department denied the credit and issued an assessment. The taxpayers filed an appeal, contending the instructions provided by the tax software do not agree with the Tax Department's adjustment. The Tax Commissioner upheld the assessment as the credit should have been
claimed on the California nonresident return and the Tax Department is not responsible for errors in third party software.

23. **Out of State Tax Credit.** P.D. 15-89 (April 28, 2015). On their Virginia resident income tax return for the 2013 taxable year, the taxpayers claimed a credit for payment of the District of Columbia's Unincorporated Business Franchise Tax (UBFT). Under review, the Tax Department disallowed the credit and issued an assessment. The taxpayers appealed, contending that the credit should have been allowed because the UBFT qualifies as an income tax paid to another state and the credit was necessary to avoid double taxation. The Tax Commissioner upheld the assessment. Virginia Code § 58.1-332.2(A) provides for the credit and defines an "income tax" as a term of art that refers to a specific type of tax levied on all of a resident’s earned and unearned income, and all income of a nonresident from sources within the jurisdiction, which is similar to the income tax that Virginia imposes on resident and nonresident individuals. Virginia Code § 58.1-332.2(B) includes examples of taxes that do not qualify for the credit, even though they may be measured, in part, by income. Taxes do not qualify because (i) they are labeled as a franchise or license tax, and (ii) they do not tax all income of the individual. Examples of taxes that do not qualify for the credit pursuant to Va. Code § 58.1-332.2 include the UBFT, the Texas Margin Tax, and the Ohio Commercial Activity Tax.

24. **Capital Gains.** P.D. 15-94 (May 5, 2015). A nonresident taxpayer had wages and a capital loss carryover from outside of Virginia. It also had a capital gain derived from Virginia source income. Under the statutory rules for determining the Virginia source income of a nonresident, the proportion of income from all sources to Virginia sources would equal 100%. The taxpayer asked whether Virginia source capital gains would be limited to federal capital gains on the nonresident proportion calculation. The Tax Commissioner replied that the Virginia capital gains were not limited as the capital losses were from non-Virginia sources and could not offset the Virginia capital gains.

25. **Penalties.** P.D. 15-96 (May 8, 2015). The taxpayer filed a 2012 Virginia income tax return on October 15, 2013. The taxpayer made no estimated payments, no employer withholding was reported on the return, and the taxpayer failed to remit the tax due when the return was filed. The Tax Department processed the return and issued an assessment. The assessment included an addition to tax for the underpayment of estimated tax, commonly known as the estimated underpayment penalty, an extension penalty and a late payment penalty. The taxpayer appealed the assessment, contending that the penalties applied to the assessment are excessive. The Tax Commissioner upheld the assessment after determining that the penalties were applied properly.

26. **Death Benefit Subtraction.** P.D. 15-97 (May 8, 2015). The taxpayer claimed a subtraction for a death benefit annuity for the 2010 taxable year. The source of the subtraction was a Form 1099R from a federal retirement plan. Under audit, the Tax Department disallowed the subtraction and issued an assessment for additional tax and interest. The taxpayer paid the assessment but filed an appeal, contending she was advised by the Tax Department that she qualified for the subtraction. She further argues the auditor's rationale for issuing the assessment was not included in the tax form instructions until 2011. The taxpayer also protests the Tax Department's authority to make retroactive changes to form instructions. The Tax Commissioner determined that because the taxpayer's distribution is derived from a pension plan,
the taxpayer did not qualify for the death benefit subtraction and the assessment for the 2010 taxable year is correct. As for the instructions and advisement by the Tax Department, the Tax Commissioner noted that the 2010 return instructions stated that the benefit must have been subject to federal taxation and the advice was not given in writing.

27. **Subtraction for Pension Contributions.** P.D. 15-104 (May 12, 2015). The taxpayers, a husband and wife, were Virginia residents during the taxable years at issue. The husband was employed by a Kansas municipality from 1974 through 1999. During his employment, the municipality made contributions on his behalf to the Kansas Public Employees Retirement System (KPERS). When he retired in 1999, he began receiving a pension in the form of annuity payments. On their 2011 through 2013 income tax returns, the taxpayers claimed subtractions for the full amount of the pension payments. Under review, the Tax Department disallowed the subtractions and issued assessments. The taxpayers filed an appeal, contending that they should be permitted to exclude the entire amount of the pension payments from the computation of Virginia taxable income because all of the husband's contributions had been taxable in Kansas. The Tax Commissioner determined that the contributions were not subject to federal taxation but were taxed by Kansas. The taxpayers provided Kansas income tax returns for several years showing the amount of contributions that were subject to income tax there. The taxpayers also provided evidence showing what the husband's contributions were for three previous years. In light of the taxpayers' demonstrated pattern of filing returns in Kansas and paying tax on the contributions, the Tax Department accepted proof of the contribution amounts for the previous years as sufficient evidence that such contributions were also subject to Kansas income tax. The taxpayers, however, were unable to provide sufficient documentation for the remaining years. The Tax Commissioner returned the case to the audit staff to compute the taxpayers' subtractions under Va. Code § 58.1-322(c)(19). Once the amounts of the subtractions are determined, revised assessments will be issued to the taxpayers, which will include accrued interest.

28. **Land Preservation Tax Credit Carryforward.** P.D. 15-108 (May 15, 2015). The Credit was issued to a donor during the 2006 taxable year. The taxpayer purchased a part of this Credit during the 2009 taxable year. The taxpayer and her husband filed joint Virginia income tax returns for the 2009 through 2011 taxable years utilizing the Credit to the extent of their income tax liability. Their claim for the remaining portion of the Credit on their 2012 return was denied by the Tax Department because the carry over of the 2006 Credit expired in 2011. The taxpayer requested that the Tax Department grant an additional year to claim the Credit. The Tax Commissioner denied the request as he did not have the statutory authority to grant the request.

29. **Out of State Tax Credit—Part Year Residents.** P.D. 15-109 (May 29, 2015). The taxpayers, a husband and wife, moved to Virginia in March 2013. They filed a 2013 Virginia part-year income tax return claiming a credit for tax paid to New Hampshire. Under review, the Tax Department denied the credit and issued an assessment for tax due. The taxpayers filed an appeal, contending the credit should have been allowed because they paid tax to New Hampshire on the same income that was subject to tax in Virginia.

The Tax Commissioner denied the appeal. Virginia Code § 58.1-332.2(C) provides that "[t]he credits in §§ 58.1-332 and 58.1-332.1 shall apply only when the tax imposed in the other
state or foreign country is substantially similar to the tax imposed by Article 2 (§ 58.1-320 et seq.), as defined by this section." (Emphasis added.) Thus, a tax, regardless of type, must still be substantially similar to the Virginia individual income tax imposed under Va. Code § 58.1-320 et seq., which applies generally to all of the income of Virginia residents and all of the income of nonresidents sourced to Virginia. The taxpayers claimed the credit against the New Hampshire Business Enterprise Tax (NHBET). The NHBET is imposed on the taxable enterprise value base of every profit or nonprofit corporation, partnership, limited liability company, proprietorship, association or trust, with the exception of those exempt under IRC § 501(c)(3) that do not engage in any unrelated activity, conducting business activities in the state. See N.H. Rev. Stat. Ann. § 77-E:2. The NHBET is assessed on the enterprise value tax base, which is the sum of all compensation paid or accrued, interest paid or accrued, and dividends paid, before special adjustments and apportionment. See N.H. Rev. Stat. Ann. § 77-E:1. Because the NHBET is based on expenditures made by a business enterprise, it is not an income tax substantially similar to Virginia's individual income tax.

30. Land Preservation Tax Credit: Reformation Deed. P.D. 15-120 (June 23, 2015). In December 2007, the taxpayers conveyed and recorded a deed of easement (the "Original Deed") on a parcel of land to the County. Pursuant to the conveyance of the easement, the taxpayers registered their donation with the Tax Department for purposes of the Credit. The initial application for Credit was denied on the basis that the easement did not meet the requirements for a conservation easement and the appraisal was not a qualified appraisal. The Tax Department informed the taxpayer that it would allow the taxpayer to cure the defects in the Original Deed and original appraisal. The taxpayers submitted a second application for the Credit using the same appraisal that was attached to the initial application. This application was denied because it did not include a qualified appraisal. The taxpayers submitted a third application that contained another deed of easement (the "Second Deed") that was filed and recorded in November 2012. They also provided a new appraisal with the application that purportedly valued the easement as of the donation date. Based on the additional changes, the Second Deed was found to be a new easement. Under this finding, the second appraisal failed to value the new easement and the taxpayer's application was denied. The taxpayers appealed the Tax Department's denial of issuing the Credit, contending that the Second Deed and second appraisal met the requirements for the donation of a conservation easement.

The Tax Commissioner agreed with the taxpayers and sent the application back to the tax credit unit for review. In reviewing the deed, the Tax Commissioner noted that the Second Deed contained language that provides that it is merely reforming the Original deed. This language states, "[G]rantor wishes to reaffirm its donation of this gift, to better articulate the conservation purposes protected, and to further restrict the [donated property] so that the perpetual nature of the gift is unquestionable. All of the restrictions of the aforementioned [Original Deed] are hereby reasserted." In a prior ruling, the Tax Department ruled that the Virginia Land Conservation Incentives Act of 1999 permits defective language in a conveying instrument to be corrected in certain circumstances. When the instrument still conveyed an enforceable easement and the parties intended for the document to comply with the IRS requirements, the defective language may be corrected. When an easement is reformed, a conveyance would qualify for the Credit from the date of reformation. The value of the easement, however, would be governed by the value on the date that the enforceable easement was originally conveyed, not the date that the documents were reformed in order to qualify for the Credit.
31. **Subtraction for Military Pay.** P.D. 15-124 (June 24, 2015). The taxpayers, husband and wife, claimed a subtraction from federal adjusted gross income (FAGI) for basic military pay on their 2011 Virginia individual income tax return. Under review, the Tax Department disallowed the subtraction on the basis that, although the husband served on active duty from November 2011 to June 2012, he had not served for more than 90 days in the 2011 taxable year. The taxpayers appealed, contending that Virginia law does not specify that the active duty period must exceed 90 days within the same taxable year. The Tax Commissioner did not issue a ruling and instead requested more information. Military servicemembers may be eligible for a subtraction for military basic pay for personnel on extended active duty for periods in excess of 90 days per Va. Code § 58.1-322(C)(23). The subtraction is allowed even if the period occurs over two taxable years such that the military servicemember served less than 90 days in one or each of the taxable years. While the taxpayer did not serve more than 90 consecutive days in 2011, the Tax Commissioner requested more information to see if days worked in 2012 might satisfy the requirements for the subtraction.

32. **Converted Assessment.** P.D. 15-138 (June 30, 2015). The Tax Department assessed a business (VSC) with sales and use tax and withholding tax for a number of taxable periods between August 2008 and December 2011. VSC filed sales and use and withholding tax returns but failed to remit the payments. When the Tax Department was unable to collect the assessments from VSC, it assessed penalties against the taxpayer pursuant to Va. Code § 58.1-1813 equal to the amount of the sales and use tax and withholding tax, penalties and interest owed by VSC. The taxpayer appealed the conversion of the assessments, contending that she was merely an employee and her father was the only officer. (Dad did it!) The taxpayer contended that she became an employee of VSC in 2008, and she never had been entrusted with the authority to handle VSC's tax matters. She asserted that her father was the only officer of VSC and he always handled VSC's tax matters. However, quarterly employee reports filed with the Virginia Employment Commission (VEC) in December 2008 and January 2009 are signed by the taxpayer as president of VSC. These returns indicated the taxpayer was entrusted with tax matters involving VSC. She also signed checks for sales taxes payable to the Department of Taxation.

Though the taxpayer asserts that she had no knowledge of VSC's tax issues, the Tax Commissioner found it unlikely that the taxpayer had sufficient awareness to file payroll reports with the VEC and sign checks payable to the Department of Taxation yet lack knowledge regarding tax matters. Based on the available evidence, the Tax Commissioner determined that the taxpayer had a duty and authority to perform the act in respect to which the violation occurred on behalf of VSC and was a responsible officer pursuant to Va. Code § 58.1-1813.

33. **Retirement Subtraction.** P.D. 15-139 (June 30, 2015). The taxpayer retired from the State A public school system in 1996. At that time, he rolled over the value of his retirement plan into an individual retirement account (IRA). For the 2010 taxable year, the taxpayer filed a Virginia resident income tax return claiming a subtraction for retirement income. Under audit, the Tax Department disallowed the subtraction on the basis that total amount claimed by the taxpayer exceeds the aggregate contributions made to the plan and issued an assessment. The taxpayer paid the assessment and filed an appeal contending he received pension income from contributions that were previously taxed by State A. Further, the taxpayer
asserted that the Tax Department advised him in writing that his retirement income was not subject to Virginia income tax. Finally, in event that the Tax Department disallows the subtraction, the taxpayer requested that he be permitted to carry the subtraction claimed on the 2009 return forward to the 2010 taxable year. The Tax Commissioner upheld the assessment after the taxpayer was unable to show that the retirement income was taxed in another state. The Tax Commissioner also found that the written advice did not state what the taxpayer claimed. Finally, the carryover of the subtraction was denied as the Virginia Code did not allow for it.

34. Overpayment Credit and Out of State Credit. P.D. 15-147 (July 2, 2015). The taxpayers filed a 2011 Virginia income tax return, claiming a credit to estimated tax from the 2010 taxable year. Because the Tax Department had no record of the taxpayers filing a Virginia individual income tax return for the 2010 taxable year, the estimated credit was denied. In addition, the Tax Department reduced the taxpayers’ out-of-state tax credit because the computation included the New York Metropolitan Commuter Transportation Mobility Tax (the "NY MCTMT") and issued an assessment. In response, the taxpayers filed a 2010 Virginia income tax return. The Tax Department made a similar adjustment to the out-of-state tax credit on the 2010 return and also disallowed a credit to estimated taxes because it had no record of the taxpayers filing a 2009 return. The reduced overpayment was applied toward the 2011 liability and the assessment was reduced. The taxpayers filed an appeal, contending they had timely filed a 2009 individual income tax return and they correctly computed the out-of-state tax credits on the 2010 and 2011 returns. The reduced overpayment was applied toward the 2011 liability and the assessment was reduced. The taxpayers filed an appeal, contending they had timely filed a 2009 individual income tax return and they correctly computed the out-of-state tax credits on the 2010 and 2011 returns. The reduced overpayment was applied toward the 2011 liability and the assessment was reduced. In addition, the Tax Commissioner determined that the NY MCTMT is not an income tax substantially similar to the Virginia individual income tax and denied the credit.

35. Death Benefit Subtraction. P.D. 15-148 (July 2, 2015). The taxpayer filed Virginia income tax returns for the 2011 through 2013 taxable years. He claimed a subtraction for an annuity death benefit payment received from an annuity contract. The payments were received in installments. Under audit, the Tax Department denied the subtraction because the distributions under the contract were not made in a lump sum. As a result, the Tax Department issued an assessment for additional tax and interest for each taxable year at issue. Because the statute providing the subtraction for an annuity death benefit payment was amended in 2012, the taxpayer agrees with the assessment for 2013. The taxpayer, however, appealed the 2011 and 2012 assessments, contending neither the statute nor instructions limit the subtraction to insurance contracts issued as lump sum payments for these taxable years. Further, he asserts he confirmed his interpretation in a telephone conversation with Tax Department staff. The Tax Commissioner upheld the assessment finding that the 2012 legislation was codifying existing policy. Comment: See #7 above. Apparently this 2012 legislation did nothing.

36. Deduction for Virginia College Savings Account Contributions. P.D. 15-168 (August 18, 2015). The taxpayers, a husband and wife, filed a 2011 Virginia income tax return, claiming a deduction for contributions made to three Virginia 529 college savings accounts. The contributions were derived from a rollover of a custodial account created by the Uniform Gift to Minors Act (UGMA) or the Uniform Transfer to Minors Act (UTMA) in New Jersey. Under review, the Tax Department concluded that a UGMA/UTMA account must be
liquidated rather than rolled over in order to claim the deduction and denied the deduction. As a result, the Tax Department issued an assessment for additional tax and interest. The taxpayers appealed the assessment, contending that they made cash contributions to the Virginia college savings accounts and are entitled to the deduction. The Tax Commissioner disagreed and upheld the assessment. Virginia Code § 58.1-322(D)(7) allows owners of Virginia 529 Savings Plans who make contributions to the accounts claim the deduction. Under Va. Code § 23-38.75, a "contributor" is a person who contributes money to a savings plan on behalf of a qualified beneficiary and who is listed as the owner of the savings trust account. A gift to a minor under either the UGMA or the UTMA is irrevocable. See Va. Code § 64.2-1910. Because the contributions made to the Virginia 529 savings accounts were rolled over from the children's UGMA/UTMA accounts, the children rather than the taxpayers were the owners of the assets contributed to the college savings plan. The taxpayers did not own the assets for which the contributions were disbursed. Therefore, the taxpayers would not be considered to be the contributors and would not be eligible to claim the deduction for contributions made to the three Virginia 529 college savings accounts for the 2011 taxable year.

III. RETAIL SALES AND USE TAXES

A. 2015 Legislation

1. Sales Tax Holidays. Senate Bill 1319 (Chapter 382) amends §§ 58.1-609.1, 58.1-611.2, and 58.1-611.3 to combine the existing sales tax holidays for school supplies and clothing, Energy Star and WaterSense products, and hurricane preparedness products into one, three-day annual holiday that begins on the first Friday in August and ends at 11:59 p.m. on the following Sunday. Items exempt under the three current sales tax holidays remain exempt. A July 1, 2017 sunset date is placed on the sales tax holiday for clothing and school supplies. This legislation was effective on July 1, 2015.

2. Definition of “Gross Proceeds”. Senate Bill 1119 (Chapter 252) amends § 58.1-602 to clarify that for purposes of determining the charges that are subject to the Retail Sales and Use Tax in a taxable lease or rental, certain charges are excluded from gross proceeds. Specifically, “gross proceeds” excludes finance charges, carrying charges, service charges, or interest charges from credit extended on the lease or rental under conditional lease, conditional rental, or other conditional contracts providing for the deferred payments of the lease or rental. This legislation was effective on July 1, 2015.

3. Exemption for Gold, Silver, or Platinum Bullion. House Bill 1648 (Chapter 620) and Senate Bill 1336 (Chapter 629) amend § 58.1-609.1 to provide an exemption from the Retail Sales and Use Tax for gold, silver, or platinum bullion when the sales price for the entire transaction exceeds $1,000. The exemption was effective on July 1, 2015 and expires on January 1, 2019.

B. Recent Court Decisions

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

1. Mandatory Gratuity. P.D. 15-8 and P.D. 15-10 (January 12, 2015). The taxpayer operates hotels in Virginia. The hotels prepare and serve meals for meetings, banquets and similar events that are held at the hotels. The taxpayer adds a mandatory 20% service charge to the bills for meetings, banquets and similar events. The taxpayer was not charging retail sales tax on the mandatory service charges. The Tax Department audited each hotel and assessed the taxpayer retail sales tax on the untaxed mandatory service charges billed with the charges for the meeting and banquet services provided by the hotels to customers. The taxpayer contested the assessments of sales tax on the mandatory service charges billed by each hotel.

The mandatory service charges billed by the hotels were held taxable in the audit based on two factors. The statutory definition of sales price was interpreted by the auditor to require the hotels to pay the persons working the banquets and meetings the entire amount of the mandatory service charges billed to customers. The audit assessments on the untaxed mandatory service charges were also based on the inclusion of the term "restaurant" in the statutory language for the exemption. The auditor did not consider the taxpayer's hotels to be restaurants for purposes of the mandatory gratuity exemption. The statutory definition of "sales price" in Va. Code § 58.1-602, which defines "sales price," in part, as:

| the total amount for which tangible personal property or services are sold, |
| including any services that are a part of the sale .... "Sales price" shall not include |
| ... (v) that portion of the amount paid by the purchaser as a mandatory gratuity or |
| service charge added by a restaurant to the price of a meal, but only to the extent |
| that such mandatory gratuity or service charge does not exceed 20% of the price |
| of the meal. |

The Tax Commissioner agreed with the taxpayer and ordered refunds to be issued. He determined that nothing in the definition of “sales price” required the hotels to pay the persons working the banquets and meetings the entire amount of the mandatory service charges billed to customers. He also determined that a “restaurant” is not defined and is defined elsewhere as any place where food is prepared for service to the public on or off the premises, or any place where food is served."

2. Country Club Charges. P.D. 15-9 (January 12, 2015). The taxpayer is a private country club. The Tax Department audited the taxpayer and assessed retail sales tax on various untaxed sales transactions that occurred during the audit period. The Tax Department assessed sales tax on untaxed mandatory service charges and on minimum quarterly charges billed to club members. Sales tax was also assessed on reimbursements paid by club members to the taxpayer for fertilizer purchased on behalf of the club members. The taxpayer contested the assessment of sales tax on these three types of transactions. The Tax Commissioner removed the mandatory service charges and the quarterly charges from the audit. The service charges were not required to be paid to the dining facility staff and no rights to tangible personal property or services were conveyed to club members that were assessed the charge. The Tax Commissioner upheld the tax assessed on the sales of fertilizer. The Tax Commissioner determined that the taxpayer should have purchased the fertilizer as an exempt resale transaction and charged and collected sales tax on the fertilizer sales to club members.
3. **Occasional Sale.** P.D. 15-43 (March 18, 2015). The taxpayer operates as a hospital. During the period at issue, the taxpayer sold its in vitro fertilization lab (the "Lab") to the Buyer. The taxpayer stated that certain items of tangible personal property were sold to the Buyer in conjunction with the sale of the Lab. The taxpayer stated it collected sales tax on the sale of the tangible personal property and it remitted the same to the Tax Department. The taxpayer contends that the sale of the Lab is an occasional sale in accordance with Va. Code §§ 58.1-602 (definition of occasional sale), 58.1-609.102 and Title 23 of the Virginia Administrative Code (VAC) 10-210-1080. The taxpayer requested: (1) a ruling that the sale of the tangible personal property at issue is exempt of the tax pursuant to the occasional sale exemption, and (2) a refund of the sales tax collected and remitted with respect to this sale. The Tax Commissioner agreed that this was an occasional sale and ordered the refund. The reason that the sale of the Lab was an occasional sale is that the Lab’s operations were completely unrelated to the reason (cafeteria and gift shop) that the taxpayer was required to register for sales tax.

4. **Exemption Certificate.** P.D. 15-62 (April 15, 2015). A taxpayer was assessed with sales tax for sales of office furniture to a customer who claimed the purchases were exempt under the manufacturing exemption. The taxpayer appealed and the Tax Commissioner upheld the assessment by stating that the taxpayer should have denied the exemption and could not accept the certificate in good faith.

5. **Purchasing Agent.** P.D. 15-63 (April 15, 2015). According to the taxpayer, it will procure specific items on behalf of the U.S. Army for its use as the end user. These items will be delivered directly to the U.S. Army and not to the taxpayer. Prior to procuring the specific items, the U.S. Army will incorporate the following language into its solicitation with the taxpayer:

The contractor, who has been designated for this effort as a purchasing agent for the government, will coordinate with (insert specific vendor name and specific item to be purchased). The funding for this action will be provided in advance of the procurement, to the contractor by the government. Upon execution of this modification, this specific action has been fully funded by the government, which in effect binds the credit of the government.

Provided the U.S. Army identifies the taxpayer as its purchasing agent for the specific items identified in its solicitation and submits a Virginia ST-12 exemption certificate to the taxpayer, and further provided that such items are purchased within the scope of the government's contract with the taxpayer, the taxpayer asked if it may purchase such items exempt of the Virginia retail sales and use tax. The Tax Commissioner stated that the taxpayer did not present sufficient authority to make such purchases. He stated, “[N]o evidence has been presented that vendor invoices for the items being purchased bear only the government's name, that the government's contract with the taxpayer indicates that the U.S. Army is paying the vendors directly for all of the contract purchases of tangible personal property, and that the taxpayer has no personal liability to the government under the contract for purchasing such tangible personal property using government funds or on behalf of the government.
“Furthermore, despite the government's solicitation declaring that the advance funding binds the credit of the federal government to the purchases, such declaration, by itself, is not sufficient evidence to establish federal immunity for the taxpayer.”

6. **Real v. Tangible Personal Property.** P.D. 15-80 (April 22, 2015). The taxpayer operates as a bowling alley. The taxpayer was assessed the use tax on the purchase of bowling alley equipment, primarily bowling lanes, pinsetters, ball returns and a computerized scoring system. The taxpayer maintained that it is not subject to the retail sales and use tax on its purchase of the equipment at issue. The taxpayer contended that the equipment at issue loses its identity as tangible personal property and becomes real property. The taxpayer leases the space where the bowling alley is housed from a third party. The taxpayer contracted with a separate business (the “Contractor”) for the purchase and installation of the equipment at issue. The taxpayer stated that the bowling lanes were built before the build out of the leased space. The taxpayer stated that before the store front and interior walls were built, the pinsetters were brought in and put in place towards the rear of the space using forklifts. The pinsetters are approximately 6' wide by 8' deep and weigh over 1000 pounds. The taxpayer further provided that the pinsetters are leveled and then bolted into the concrete floors with multiple massive bolts. Once the pinsetters were in place, the taxpayer stated that the floor crib platform system (supports the bowling lanes) was built by hand. This system is stick-built in place, leveled and bolted to the floor throughout the space. The lanes were then installed on top of the platform. The taxpayer states that the remaining bowling equipment, such as ball returns and scoring system for the front section of the lanes, was installed into the platform. The concourse platforms, stairs and railings, walls and storefront windows and doors were the final parts of the construction build out. The taxpayer provided that the terms of its lease do not permit the taxpayer to remove the equipment at issue should the lease be terminated. However, the taxpayer provided that if removal was permitted, the walls, floor framing and concrete would have to be demolished in order to gain access to the equipment. The Tax Commissioner determined that the bowling equipment at issue became part of the real property when it was installed and the taxpayer was not liable for the tax assessed on the purchase of the bowling equipment at issue. Instead, the contractor was deemed to be the taxable user or consumer of the equipment.

To make this determination, the Tax Commissioner relied on Virginia Supreme Court cases, *Danville Holding Corp. v. Clement* and *Transcontinental Gas Pipe Line Corp. v. Prince William County*. *Danville Holding* and *Transcontinental Gas Pipe Line* provide a three part test to determine if tangible personal property loses its identity and becomes real property upon installation. The test is applied when there is no specific agreement between the parties as to the character of the chattel placed upon the freehold. The three general tests are as follows: (1) annexation of the chattel to the realty, actual or constructive; (2) its adaptation to the use or purpose to which that part of the realty to which it is connected is appropriated; and (3) the intention of the owner of the chattel to make it a permanent addition to the freehold. The intention of the party making the annexation is the chief test to be considered in determining whether the chattel has been converted into a fixture. Applying the tests, the property was converted to real property as it was affixed to the real property, adapted to the realty as the operation of a bowling alley, and intended to be permanent.
7. **Exemption Certificates.** P.D. 15-81 (April 22, 2015). The taxpayer is a manufacturer and seller of weld studs and fastening equipment serving the automotive, construction and industrial markets. The Tax Department's audit disclosed that the taxpayer made sales transactions exempt of the tax that were not supported by valid exemption certificates. The taxpayer disagreed with the Tax Department's assessment of the sales tax on such sales. The taxpayer secured exemption certificates to qualify the sales as exempt sales. The taxpayer sought an adjustment of the Tax Department's assessment based on the submitted certificates. Upon reviewing the submitted certificates and subjecting them to greater scrutiny, the Tax Commissioner determined that the submitted certificates were valid and adjusted the assessment.

8. **Research and Development Exemption.** P.D. 15-82 (April 22, 2015). The taxpayer operates a technical center in Virginia that conducts research, development, analysis and testing of film products and ingredients manufactured by a related non-Virginia entity and others. An audit resulted in the assessment of consumer use tax on untaxed purchases of tangible personal property used in the taxpayer's operations. The taxpayer contested the audit findings and contends that some of the contested purchases qualify for the research and development exemption set out in Va. Code § 58.1-609.3(5) and as further interpreted by Title 23 of the Virginia Administrative Code (VAC) 10-210-3071. Specifically, the taxpayer maintained that its production equipment is used directly and exclusively to produce newly designed products or processes and should, therefore, be removed from the Tax Department's audit. Virginia Code § 58.1-609.3(5) provides an exemption from the Virginia retail sales and use tax for "[t]angible personal property purchased for use or consumption directly and exclusively in basic research or research and development in the experimental or laboratory sense." As the taxpayer also performs taxable activities (e.g., testing of defective products from a related entity for quality control purposes, adjusting and modifying the product or process to meet customer specifications or to reduce costs, and the analysis of competitor products) that fall outside the scope of the research and development exemption, the contested equipment was not used exclusively in basic research or research and development and thus ineligible for the exemption.


10. **Durable Medical Equipment Exemption.** P.D. 15-86 (April 28, 2015). The taxpayer is a commercial-stage oncology company dedicated to the development and commercialization of tumor treating fields (TTFs). TTF therapy is for the treatment of cancer patients with solid tumors of the brain. TTF therapy is a low-toxicity treatment that uses low-intensity alternating electric fields to exert physical forces on the electrically charged components of dividing cancer cells, which is intended to disrupt cell division and cause cancer cell death. The TTF therapy involves three main components. These components include: (i) an electronic field generator, connection cables, a portable battery, power supply, rack and a power cord; (ii) external transducer arrays that connect the electronic field generator to the human skull in order to deliver the electronic fields to the tumor; and (iii) ancillary items and accessories consisting of boxes, TTF bags, operations manual and self-exchange kits. The TTF therapy is designed for continuous use throughout the day so that the patient can maintain a normal daily routine while receiving treatment for the disease. The transducer arrays are worn on the head and the electronic field generator is portable and battery powered so that it can be worn on the body.
using the TTF bag provided with the product. The TTF therapy is obtained on the written prescription of a licensed physician, which is submitted to the taxpayer's shipping facility located outside of Virginia. The prescription is filled and the components of the TTF therapy are shipped to the licensed physician or the closest local technical support staff specialist. At this point the patient receives an agreement to review and sign once he or she is trained on how to self-administer the therapy. The on-going care of the patient and the medical assessments are conducted by the attending physician. The patients pay a monthly fee for the TTF therapy that is broken down into a charge for the lease of the electric field generator and other component parts, and a monthly fee to purchase additional transducer arrays. Around the clock technical support is included in the monthly fee. The taxpayer requested a ruling on the application of the Virginia retail sales and use tax to the sale of the TTF therapy. The taxpayer believes the retail sale of the TTF qualifies for the exemption in Va. Code § 58.1-609.10(10) as either a prosthetic device or durable medical equipment, or both. The Tax Commissioner determined that the TTF therapy devices manufactured by the taxpayer qualify for the retail sales and use tax exemption found under Va. Code § 58.1-609.10(10) as durable medical equipment when purchased by, or on behalf of a specific individual. Virginia Code § 58.1-609.10 10 defines the term durable medical equipment as "equipment that (i) can withstand repeated use, (ii) is primarily and customarily used to serve a medical purpose, (iii) generally is not useful to a person in the absence of illness or injury, and (iv) is appropriate for use in the home."

11. Mandatory Gratuity. P.D. 15-92 (April 30, 2015). The taxpayer operates a lodge that provides accommodations, an indoor water park, restaurants, retail shops, and a variety of other amenities for their lodging guests. At issue is the tax assessed to mandatory and house gratuity charges billed in a lump sum to banquet customers. The taxpayer bills a gratuity or service charge in the amount of 18% to banquet customers. The 18% gratuity amounts are divided and 15% is paid to the employees and 3% is a house gratuity. The taxpayer reports the 3% house gratuity charge as taxable sales on its monthly retail sales and use tax return. Because the taxpayer combined the gratuity charges, the auditor held taxable the total 18% gratuity charge and allowed a credit for the 3% gratuity amounts reported to the Tax Department. The taxpayer contests the tax assessed on the 15% gratuity charges and claims that such gratuity charges are below the taxable 20% mandatory gratuity threshold as set out in Va. Code § 58.1-602, definition of sales price. The taxpayer has paid the assessment and requests a refund for the tax assessed on the 15% mandatory gratuity charges. The Tax Commissioner agreed and ordered the refund issued. Based on a prior ruling and the statutory definition of “sales price,” the Tax Commissioner determined that there is no restriction placed on the exemption for mandatory gratuities that requires the full amount billed to purchasers to be distributed to employees or other personnel performing services on behalf of the seller.

12. Government Exemption. P.D. 15-100 (May 11, 2015). The taxpayer is an electrical contractor that was audited by the Tax Department. During the period audited, the City awarded the taxpayer contracts to upgrade the electric lighting at various City facilities to a more energy efficient type. The City provided the taxpayer with a government exemption certificate, Form ST-12, and advised the taxpayer to claim the sales and use tax exemption for state and local governments on purchases made pursuant to the contracts. The taxpayer paid sales taxes on some of its contract purchases from one vendor. The City subsequently requested refunds of the sales taxes paid to the vendor by the taxpayer on these purchases. The taxpayer obtained sales tax refunds from the vendor and credited the refund amounts on the City's final contract billing.
The taxpayer also made some untaxed purchases from the same vendor. The Tax Department assessed consumer use taxes on the taxpayer's untaxed purchase transactions and its use of items purchased pursuant to the contracts. The Tax Commissioner upheld the assessments on the basis that the taxpayer used the property and the government exemption certificate was inapplicable.

13. Anti-aging Milkshakes and Granulated Drink Mixes. P.D. 15-101 and P.D. 15-102 (May 12, 2015). The taxpayer develops and distributes anti-aging personal care products and nutritional supplements. At issue are the taxpayer's sales of the Shakes and granulated drink mixes. The sales tax was assessed in the audit based upon the difference between the amount of tax charged and the general Virginia sales tax rate. The taxpayer contended that it should not be assessed the general Virginia sales tax rate on its Shakes. The taxpayer stated that it has followed the criteria in Virginia Tax Bulletin (VTB) 05-7 (5/31/05) regarding the application of the sales tax on these products. The Tax Commissioner upheld the assessment and noted that VTB 05-7 states that "Food for home consumption by humans, as defined under the Food Stamp Act of 1977...qualifies for the reduced sales tax rate." Dietary supplements are specifically excluded from this definition.

14. Mining Exemption. P.D. 15-106 (May 12, 2015). The taxpayer is an electrical contractor that primarily provides services to customers in the coal mining industry (the "Customers"). The taxpayer was audited by the Tax Department and assessed use tax on untaxed purchases of materials and supplies used to perform contract work for the Customers that issued the direct payment permits. The taxpayer contested the assessment of use tax on chemicals purchased for the maintenance of coal haul roads and at mine sites on the basis that they qualified for the mining exemption. The taxpayer also contested use taxes assessed on purchases of utility poles and accessories installed to transmit electric power to a mine site and on the purchase of fence materials installed around a generator at a mine site on the same basis. The Tax Commissioner upheld the assessment. The exemption requires exempt items to be used directly in a mining activity. The Tax Commissioner determined that none of the items appealed were used in this manner.

15. Parking Charges. P.D. 15-114 (June 29, 2015). The taxpayer operates hotels in Virginia. The taxpayer was assessed tax in the audit on charges for parking to its customers who purchase accommodations at the hotel. The taxpayer contested the assessment and maintained that the charges are separate ancillary charges that are not subject to the retail sales and use tax. The taxpayer stated that the hotel does not include the charges within the room rental (package) rate, and the charges are billed outside of the taxable (room) revenue. The Tax Commissioner upheld the assessment. Title 23 of the Virginia Administrative Code 10-210-730(C) provides that:

Any additional charges made in connection with the rental of a room or other lodging or accommodations are deemed to be a part of the charge for the room and are subject to the tax. For example, additional charges for movies, local telephone calls and similar services are subject to the tax. Toll charges for long-distance telephone calls are not subject to the tax.

Based upon the information provided to the Tax Commissioner, the taxpayer charges its customers for parking both when the customers purchase hotel accommodations and in instances
where hotel accommodations are not purchased. As provided in the regulation, additional charges made in connection with the purchase of hotel accommodations are deemed to be a part of the charge for the room. In this instance, the charges for parking to customers who also purchased accommodations from the taxpayer are deemed to be a part of the charge for the room. Charges for parking only are not subject to the retail sales tax. Accordingly, the parking charges associated with the sale of accommodations are subject to the retail sales tax.

16. **Shipping and Handling.** P.D. 15-115 (June 16, 2015). The taxpayer is a sign manufacturer located outside of Virginia. The taxpayer contested the assessment of tax on combined shipping and handling charges. The taxpayer maintained that the charges labeled "Ship/Handling" on the invoices are for shipping charges only. The taxpayer stated that separate handling charges are listed on the invoices at issue when a handling charge is incurred. The taxpayer provided invoices from the company that shipped the property at issue to the taxpayer's customers. The taxpayer asserted that these invoices indicate the amount charged by the shipping company, and those charges correspond with the shipping charges invoiced to the taxpayer's customers in the transactions at issue. The taxpayer maintained that the documentation provided supports its contention that the charges at issue are for shipping only and are exempt of the tax. The Tax Commissioner reviewed the documentation and agreed that the charges were for shipping only. The Tax Commissioner ordered refunds and for the remaining assessment to be abated.

17. **Manufacturing and Research and Development Exemptions.** P.D. 15-117 (June 16, 2015). The taxpayer is a specialty fiber optics manufacturer and also contracts to perform research and development projects. The Tax Department audited and assessed the taxpayer use tax on various untaxed purchases. The taxpayer maintained that the assessment is erroneous because the audit includes purchases that qualify for the manufacturing exemption or the research and development exemption. The Tax Commissioner upheld almost all of the purchases in which the taxpayer claimed that the manufacturing exemption should apply. The items included Glassware Cleaning Equipment and Supplies, Lab Jacks, Storage Cabinets, Tables, Workbenches and Wire Shelves, Aluminum Wrench and Inspection Mirrors, Timers, Video Borescope, Blue Mats, Custom Platform, and a Dynamic Elbow Socket. On each item, there was no question that each item was important or even vital to the production process. The Tax Commissioner determined however that none of these items were used directly in the manufacturing process. The Tax Commissioner did determine that one item, stainless steel scissors, were used directly in manufacturing as they are used by production employees during the actual production process. For the item in which the taxpayer claimed the research and development exemption applies, the Tax Commissioner requested more information.

18. **Purchase of Services with Software.** P.D. 15-118 (June 16, 2015). The taxpayer was audited and assessed use tax on services provided to the taxpayer in connection with the purchase of a prewritten software program from the Vendor. The Vendor charged the Virginia retail sales tax on the sale of the software to the taxpayer. The services assessed in the audit include training, consulting, and conversion services that were provided in connection with the purchase of the prewritten software program. According to the taxpayer, the software in question was delivered electronically and qualifies for exemption from the retail sales and use tax, as there was no exchange of tangible personal property. Likewise, the taxpayer believes the services provided in connection with the sale of the software are exempt. The taxpayer sought
the removal of these services from the audit findings. The Tax Commissioner disagreed and upheld the assessment. The taxpayer provided an affidavit from one of its employees that states the software in question was electronically conveyed to the taxpayer. In addition, emails that were exchanged between the taxpayer and the Vendor were also furnished to support the claim that the software at issue was delivered electronically.

19. **Refund and Burden of Proof.** P.D. 15-122 (June 24, 2015). The taxpayer is a bakery with two locations in Virginia. As a result of the Tax Department's audits of both locations, the auditor found that the taxpayer failed to file returns for multiple periods. The auditor extended the audit periods to include the non-filed returns. As a result, separate assessments were issued for the tax, penalty, and interest on the unreported sales. The taxpayer claimed that the auditor denied credit in the audits for amended returns filed by the taxpayer correcting a clerical error that resulted in the overpayment of the sales tax. The taxpayer requested that the assessments be adjusted to reflect the credits for overpayment of the sales tax. The Tax Commissioner denied the taxpayer’s request. The request was based on the taxpayer’s claim that it collected sales tax at the reduced tax rate on certain food products and remitted the tax based upon the general sales tax rate. The Tax Commissioner denied the taxpayer’s request because the taxpayer could not provide the reports or documentation from the taxpayer’s point of sale system that showed the rate at which tax was collected.

20. **Documentation.** P.D. 15-128 (June 25, 2015). The taxpayer appealed an assessment in which it claimed that the auditor did not allow sufficient time to provide the necessary records. The Tax Commissioner upheld the assessment as records showed that the taxpayer did not respond to the auditor’s requests and the audit was extended for an additional year.

21. **Agricultural Exemption.** P.D. 15-129 (June 25, 2015). The taxpayer primarily operates as a contractor and developer of housing units. The Tax Department's audit disclosed that the taxpayer made purchases without payment of the sales tax to vendors or the accrual and payment of the use tax to the Tax Department. At issue is the taxpayer's purchase of an ATV for use on the taxpayer's farm. The Tax Department's auditor held the ATV subject to the use tax because it appeared that the taxpayer's use of the ATV was for non-agricultural purposes and thus taxable. The taxpayer, while in agreement with the audit results, disagreed with the application of the tax to the ATV. Accordingly, the taxpayer sought a refund of the tax and interest assessed and paid on the ATV purchase. The Tax Commissioner agreed and granted the refund. The taxpayer claimed the agricultural exemption applied which would require the ATV to be directly used in producing an agricultural product for market. The taxpayer showed that the ATV serves a number of functions such as spraying herbicides to eliminate weed growth in cattle grazing pastures, hauling minerals and additional feed to cattle, herding cattle, and moving feed troughs, cattle feeders and other equipment to various pastures which the Tax Commissioner determined qualified for the exemption.

23. No Documentation and Fraud Penalty. P.D. 15-134 (June 30, 2015). The taxpayer operates an independent grocery store. The taxpayer did not have adequate records to support the gross and exempt sales amounts reported on the sales tax returns that were filed during the audit period. For this reason, the auditor observed the taxpayer's sales activity for two days and then computed the audit liability using the sales data for the two-day observation period. The auditor applied fraud penalty to the underreported sales pursuant to Va. Code § 58.1-635. The taxpayer disagreed with the methodology used by the Tax Department's auditor to develop the assessment. The taxpayer claimed that it has documentation to support gross sales for calculating the sales and use tax for the audit period. In addition, the taxpayer claimed that the auditor erroneously applied a 50 percent penalty and requests that the Tax Department recalculate the penalty at six percent according to the law. The Tax Commissioner reviewed the documentation provided by the taxpayer, determined it to be inadequate, and upheld the two-day methodology. The Tax Commissioner did remove the penalty as this was the taxpayer's first audit.

24. No Documentation and Penalty. P.D. 15-135 (June 30, 2015). The taxpayer operates as a restaurant. The taxpayer was assessed tax in the audit because the sales reported on its sales tax returns were less than the sales shown on the taxpayer's income tax returns for the tax years 2011 and 2012. The taxpayer contested the assessment and maintained that the assessment does not match its records. The taxpayer provided records for review with its appeal. The Tax Commissioner reviewed the records and determined that they were for sales outside the audit period. He upheld the assessment of tax but abated the penalty as this was a first time audit.

25. Home Improvement Products. P.D. 15-136 (June 30, 2015). The taxpayer is a retailer of home improvement products and other items. The taxpayer is also engaged as a licensed Virginia contractor with respect to real estate. An audit resulted in the assessment of sales tax on certain untaxed sales. The audit also resulted in the assessment of consumer use tax on untaxed purchases of tangible personal property. The taxpayer took exception to the sales tax assessed on certain sales and maintains that the tax does not apply. The taxpayer also took exception to the use tax assessed on certain purchases of fixed assets and maintains credit should be given in the audit for valid tax payments made to another state. The Tax Commissioner agreed as the items would be property with respect to real estate once installed by the taxpayer. He removed certain cabinets, countertops and vanity tops, doors and windows, garbage disposals, kitchen faucets and kitchen sinks, roofing and vinyl siding, vinyl flooring, hardwood flooring and tile flooring, water heaters, garage door openers, toilets, wall tile, plumbing fixtures and gas ranges from the audit. On the cabinets, countertops and vanity tops, he recognized that the taxpayer sells stock items without installation and also sells custom items with installation. The tax was assessed on the custom items and he removed them from the audit as the taxpayer does not maintain a stock of these items.

26. Layaway Cancellation Fee. P.D. 15-137 (June 30, 2015). The taxpayer offers a layaway service that requires no initial set up fee. If an order is cancelled, the customer is charged a $10 cancellation fee and refunded the remaining balance paid towards the purchase. Title never transfers to the items unless the customer completes all payments. The taxpayer requested a ruling on whether the $10 cancellation fee is subject to the retail sales tax. The Tax
Commissioner responded that no tax would be due as this is not a taxable sale of tangible personal property or any other taxable item.

27. **Nonprescription Drugs and Durable Medical Equipment.** P.D. 15-146 (July 2, 2015). The taxpayer operates discount retail stores in Virginia and throughout the southeastern United States. As a result of the Tax Department's audit, an assessment was issued on untaxed sales. The taxpayer contested the tax assessed on six products held in the audit. The taxpayer claimed that the contested products qualify as exempt nonprescription drugs or exempt durable medical equipment. The taxpayer cites Virginia Tax Bulletin (VTB) 13-5 (3/15/13) and Title 23 of the Virginia Administrative Code (VAC) 10-210-940 in support of its position. The taxpayer has paid the assessment in full and requests a refund of the tax paid on the contested products.

Virginia Code § 58.1-609.10(14) provides, in pertinent part, that the retail sales and use tax shall not apply to "(i) any nonprescription drugs and proprietary medicine purchased for the cure, mitigation, treatment, or prevention of disease in human beings." VTB 13-5 provides that nonprescription drugs include "any substances or mixture of substances containing medicines or drugs for which no prescription is required and which are generally sold for internal or topical use in the cure, mitigation, treatment, or prevention of disease in human beings." VTB 13-5 defines "proprietary medicines" as "any nonprescription drug sold to the general public under the brand name or trade name of the manufacturer and which does not contain any controlled substance or marijuana." In VTB 13-5, three factors were set out to determine if a product falls within the scope of the exemption: (1) whether the item is a nonprescription drug (i.e., is the product a substance or mixture of substances containing medicines or drugs for which no prescription is required); (2) whether the product is for topical or internal use; and (3) whether the product is for the cure, mitigation, treatment, or prevention of a disease in human beings. Based on the rulings, the Tax Commissioner determined that the taxpayer’s sales of A&D ointment, aloe vera, desensitizing toothpaste, and contact lens solution were properly assessed.

Virginia Code § 58.1-609.10(10) provides, in part, an exemption from the retail sales and use tax for "prosthetic devices, orthopedic appliances, catheters...[and] other durable medical equipment and devices, and related parts and supplies specifically designed for those products ...when such items or parts are purchased by or on behalf of an individual for use by such individual." Durable medical equipment is equipment that (i) can withstand repeated use, (ii) is primarily and customarily used to serve a medical purpose, (iii) generally is not useful to a person in the absence of illness or injury, and (iv) is appropriate for use in the home. Based on this, assessments of sales of heating pads and vaporizers were removed from the audit. However, assessments of disposable chemical pads were upheld. **Query: Why won’t the Tax Department promulgate a regulation on this so taxpayers will know the rules to comply as it is a frequent recurring issue in audits?**

28. **Sales Tax Holiday Guidelines.** P.D. 15-149 (July 10, 2015). The Tax Commissioner issued guidelines for the combined sales tax holiday that begins at 12:01 a.m. on the first Friday in August of every year and ends at 11:59 p.m. on the Sunday immediately following.
29. **Lack of Information and Penalty.** P.D. 15-150 (July 7, 2015). The taxpayer operates two restaurants in Northern Virginia. As a result of the Tax Department's audits, assessments were issued for taxable complementary meals. Because the taxpayer did not provide the necessary documentation to verify taxable and exempt complementary meals, the auditor relied on a prior ruling to estimate the liability for taxable complementary meals based upon a percentage of the total complementary meals. The taxpayer contested the audit methodology for determining taxable complementary meals and claims that it was erroneously assessed the tax on complementary, discounted and employee meals. In addition, the taxpayer requested that penalties be reduced from 30% to 10% on the basis that the taxpayer was dealing with the repercussions of a significant data breach that affected its point of sale systems and credit card information. The Tax Commissioner corrected a math error in the computation of tax due and upheld the assessment of tax as the taxpayer did not have adequate records. The Tax Commissioner did remove the penalty as this was a first time audit.

30. **Records Seized in Criminal Investigation.** P.D. 15-152 (July 16, 2015). The taxpayer operates a pawn shop and provides check cashing services. As a result of the Tax Department's audit, the taxpayer was assessed tax, penalties and interest for underreported sales and the sale of fixtures, furnishings, and equipment. At the time of the audit, there was a criminal investigation of the taxpayer's business operations by other state and federal government agencies. Because the taxpayer's records were seized in conjunction with the criminal investigation, the auditor relied on bank records and testimony by the taxpayer's representative regarding cash sales to estimate the sales tax liability. In addition, the auditor assessed the tax on the sale of fixtures, furnishings, and equipment in connection with the sale of a restaurant. The taxpayer contested the audit assessment and claimed: (i) the audit includes exempt out-of-state Internet sales; (ii) the auditor's assumption that only 10% of cash receipts were deposited is erroneous; and (iii) the tax assessed on the restaurant fixtures, furnishings and equipment cannot be addressed until such time the governmental authorities have returned the taxpayer's records. The taxpayer requested that the Tax Department allow the taxpayer time to respond to the contested assessment once the authorities release the taxpayer's records. The Tax Commissioner upheld the auditor's methodology in making the estimate. However, he allows additional time to review the taxpayer's records as such records had been returned to him. The Tax Commissioner also removed the sale of fixtures, furnishings, and equipment as the taxpayer was not the seller. The Tax Commissioner removed the penalty as this was a first time audit.

31. **Electronic Delivery of Software.** P.D. 15-153 (July 16, 2015). The taxpayer is a value-added reseller of computer products and services. Although the taxpayer has no retail stores, it sells its products via catalogs. Its company headquarters are in Virginia. An audit resulted in the assessment of sales tax on untaxed sales, and the assessment of use tax on untaxed purchases used or consumed in its operations. The taxpayer contested four sales transactions included in the audit and maintains that they are exempt transactions for the sale of prewritten software programs that are delivered electronically. The taxpayer also contended that some of the assessed transactions constitute exempt software maintenance agreements. The Tax Commissioner agreed that the software is delivered electronically based on a combination of the evidence presented and removed the sales from the assessment. The Tax Commissioner did not determine that the maintenance contracts were exempt as the taxpayer's website states that such contracts provide for both parts and labor in the form of phone support and software upgrades and enhancements.
32. **Untaxed Purchases & Information.** P.D. 15-154 (July 20, 2015). The taxpayer operates several manufacturing facilities in Virginia. The Tax Department audited and assessed the taxpayer use tax on untaxed expense purchases and fixed asset purchases made during the audit period. The audit was conducted without complete records and without sufficient information about the taxpayer’s manufacturing operation for the auditor to determine if various transactions qualified for sales and use tax exemption. The taxpayer appealed various transactions in the audit. The taxpayer maintained that the assessment is erroneous because it includes transactions that qualify for the manufacturing exemption. The taxpayer also requested waiver of the compliance penalty assessed in the audit. The Tax Commissioner reviewed the information provided by the taxpayer and removed, upheld, or requested additional information on multiple items without significant discussion. The Tax Commissioner declined to remove the penalty as this was a second time audit and the taxpayer presented no evidence of a mitigating circumstance that caused use tax to not be remitted.

33. **Purchases by Diplomats.** P.D. 15-155 (July 20, 2015). The taxpayer operates retail stores throughout the United States. An audit by the Tax Department disclosed that the taxpayer made sales in which the tax was not charged and purchases in which the tax was not paid to vendors or accrued and remitted to the Tax Department. The taxpayer disagreed with that portion of the audit assessment pertaining to sales to diplomats. The taxpayer stated that the documentation provided with its appeal demonstrates that the purchasers were diplomats and were exempt of the tax. The taxpayer seeks an abatement of the sales tax assessed on sales to diplomats. The Tax Commissioner agreed and abated the tax after determining that the taxpayer proved that purchases were made by diplomats.

34. **Estimation.** P.D. 15-162 (August 18, 2015). The taxpayer operates a grocery store and a café within the grocery store. The Tax Department’s audits disclosed that the taxpayer’s records were incomplete and that the taxpayer accounted for all grocery and café sales through the same register. The taxpayer stated that it did not have register tapes for any of the initial sample months of April through June 2013. The taxpayer did provide end of month sales register reports for March and April 2014. The taxpayer also stated that it provided register tapes for the months of February and March 2013. The taxpayer contended that the Tax Department’s audit assessment is overstated based on the fact that the taxpayer’s operations were closed for a period of time due to flooding of the store and a vehicle crashing into the store. In one instance, freezer equipment was destroyed, and in both instances inventory was lost as were all previous sales records. The taxpayer seeks an adjustment of the Tax Department’s assessments and a waiver of the penalty and interest. The Tax Commissioner upheld the assessments of tax and interest after reviewing the taxpayer’s evidence and arguments. He determined that the proper estimation methodology was used. He did abate the penalty as the auditor estimated the amount of tax collected, but not remitted. For this penalty, an estimation cannot be used.

35. **Statute of Limitations.** P.D. 15-163 (August 18, 2015). A taxpayer requested permission to file amended sales tax returns for periods beyond the three year statute of limitations to collect refunds. The Tax Commissioner denied the request as the statute does not allow it.
36. Purchase of Furniture, Fixtures, and Equipment. P.D. 15-172 (August 25, 2015). The taxpayer entered into a real property contract with a federal government agency (“the Agency”) to design and construct several buildings. An add-on provision to the contract allowed for the acquisition of $3 million in freestanding office furniture, fixtures, and equipment (“FFE”) that would remain permanently unattached to the buildings. On the Agency’s directive, the taxpayer purchased the FFE exempt of the sales and use tax using a resale exemption certificate, Form ST-10, and subsequently resold the equipment to the government tax free. On audit, the Tax Department deemed the taxpayer the taxable final user and consumer of the FFE pursuant to 23 VAC 10-210-693(H), and assessed use tax. The taxpayer appealed asserting that a previously issued ruling with materially similar facts provided the proper interpretation of the law, and should have controlled in this case. The Tax Commissioner agreed and stated that the taxpayer could use the resale exemption to purchase the FFE.

D. Opinions of the Attorney General

1. Public Facility. Op. Attty. Gen. 14-081 (February 5, 2015). The City Attorney for the City of Winchester inquired regarding the application of the term "public facility" as used in Va. Code § 58.1-608.3, which entitles the municipal owner of such a facility to recoup certain sales tax revenues. He specifically asked whether a hotel with any of the following descriptions may qualify as a "public facility" under subsections (iii) or (iv) of § 58.1-608.3(A):

(i) A hotel not originally constructed as part of a qualifying public facility;
(ii) A hotel located across a public street from a qualifying public facility; and
(iii) A hotel located across a public street from a qualifying public facility and connected to that facility via a bridge or walkover.

In all three cases, the Attorney General opined that the hotel qualified as a public facility. His basis was that there is nothing in the statute requiring the hotel to be originally constructed as part of a qualifying public facility and the hotel may be either adjacent or attached to the public facility.

IV. PROPERTY (AD VALOREM) TAXES

A. 2015 Legislation

1. Land Use Valuation. House Bill 1483 (Chapter 485) amends § 58.1-3233 to permit localities to establish minimum acreage requirements that fall below five acres in order for real estate devoted to and used for agricultural purposes to qualify for land use assessment. This legislation was effective on July 1, 2015.

2. Surviving Spouse Exemption. House Bill 1721 (Chapter 577) amends §§ 58.1-3219.9, 58.1-3360.1, and 58.1-3360.2 to do the following:

• Expand the real property tax exemption for the principal place of residence of a surviving spouse of a soldier killed in action by allowing dwellings assessed at more than the average assessed value of all dwellings located within the locality that are zoned as single family residential to qualify for the exemption;

30
• Limit the exemption to that portion of the assessed value of the residence that does not exceed the average assessed value of all dwellings located within the locality that are zoned as single family residential;
• Provide that the exemption applies without any restriction on the surviving spouse moving to a different principal place of residence; and,
• Require that a refund is issued, without interest, of any tax year 2015 real property taxes paid on a qualifying surviving spouse’s real property that would be exempt pursuant to the bill.

This legislation was effective on July 1, 2015.

3. Waiver of Delinquent Taxes Upon Donation. House Bill 2173 (Chapter 498) amends § 58.1-3970.2 to authorize localities to fully release any unpaid taxes, penalties, interest, and other costs on tax-delinquent real property in exchange for the conveyance of the tax-delinquent property to a qualifying tax-exempt organization. This legislation was effective on July 1, 2015.

4. Exemption for Certain Leasehold Interests. House Bill (Chapter 234) and Senate Bill 1031 (Chapter 87) amend § 58.1-3203 to provide a real property tax exemption for a tenant’s leasehold interest on tax-exempt property if the tenant is entitled to or has received rehabilitation tax credits related to the property, and the property otherwise qualifies for exemption. The exemption is also extended to qualifying tenants that use the property exclusively for cultural purposes. Currently, lessees must use the property primarily for charitable, literary, scientific, or educational purposes in order for the exemption to apply. This legislation was effective on July 1, 2015.

5. Assessment Notices. House Bill 1291 (Chapter 151) and Senate Bill 678 (Chapter 157) amend § 58.1-3330 to clarify the information that must be included on the required notice issued by localities when there is a reassessment or a change in the assessed value of real estate. The legislation provides that the required information on the notice regarding assessments in the immediately prior two tax years refers to the immediately prior two tax years’ final assessments. Additionally, the legislation provides that the amount of the total tax levies for the immediately prior two tax years is computed by multiplying the final tax rates for the prior two tax years by the final assessed values of land and improvements for those tax years. This legislation was effective on July 1, 2015.

6. Multijurisdictional Sale of Tax-Delinquent Property. House Bill 1567 (Chapter 50) amend § 58.1-3965 to allow a suit for the judicial sale of tax-delinquent real property located in multiple jurisdictions to be brought in one locality, provided: 1) the taxes are delinquent in each such jurisdiction for not less than the minimum periods established by statute; and 2) the treasurers in each jurisdiction consent. This legislation also provides the information that must be identified in the suit, required publications, and notices, as well as the procedures that must be followed once the property has been sold. This legislation was effective on July 1, 2015.

7. Nonjudicial Sale of Certain Tax-Delinquent Property. House Bill 1711 (Chapter 59) amends § 58.1-3975 to clarify that any official designated by the locality to
administer its zoning ordinance is qualified to make a determination as to whether certain tax-delinquent real property is unsuitable for building due to the size, shape, zoning, or soils of the parcel, and therefore does not meet the criteria for a nonjudicial sale. This legislation was effective on July 1, 2015.

8. **Explanation of Increased Assessment.** Senate Bill 872 (Chapter 244) amends § 58.1-3331 to require a local assessing officer to provide a taxpayer whose property has been assessed for real property taxes, with a written explanation or justification for an increase in the property’s assessed value, if the taxpayer requests such information. This legislation was effective on July 1, 2015.

9. **Liens for Taxes Levied by Community Development Authorities.** Senate Bill 1448 (Chapter 39) amends § 15.2-5158 to provide that any special tax levied by community development authorities and any special assessment by community development authorities:

- Constitute a lien on real estate ranking on parity with real estate taxes;
- May be collected in accordance with the procedures for collecting real estate taxes provided that the enforcement of the lien for any special assessment made subject to installment payments shall be limited to the installment payments due or past due at the time the lien is enforced through sale; and,
- Any sale to enforce payment of any delinquent taxes, assessments, or other levies shall not extinguish installment payments that are not yet due.

This legislation was effective on March 6, 2015.

**B. Recent Court Decisions**

1. **CVAS 2, LLC v. City of Fredericksburg,** 766 S.E.2d 912 (2015). This case involved the forced sale of real property ordered by the Circuit Court of Fredericksburg due to delinquent taxes levied by community development authorities. The Supreme Court of Virginia blocked the sale as it determined that Fredericksburg did not show that it strictly complied with Va. Code Ann. §§ 15.2-5158(A)(5) or 58.1-3965.2 allowing for it to bring suit to collect delinquent special assessments, the city did not establish authority under those statutes to bring suit to sell defendant's real estate as a means to collect the delinquent special assessments. Since Fredericksburg had no basis for relief under those statutes, the Supreme Court of Virginia found that the circuit court lacked authority to order the sale of defendant's real estate. **Subsequent to the issuance of this opinion, the Virginia General Assembly amended the Code of Virginia to essentially make community development authority taxes collectable under the same auspices as real property taxes. See discussion of 2015 Senate Bill 1448 (Chapter 39) above.**

**C. Recent Virginia Tax Commissioner Rulings**

No recent Virginia Tax Commissioner rulings.
V. PROCEDURAL

A. 2015 Legislation

1. Local Taxes: Payments to Third Parties. House Bill 1489 (Chapter 257) amends § 58.1-3018 to extend the maximum length of time and allows for a period of installment payments over eight years during which a taxpayer may reimburse a third party for the local taxes, charges, fees, and other obligations that were assumed by the third party under a third-party tax payment agreement. This legislation was effective on July 1, 2015.

2. Commissioners of the Revenue: Production of Documents Related to Tax Liability by taxpayer. Senate Bill 1177 (Chapter 378) amends § 58.1-3110 to authorize local commissioners of the revenue to compel taxpayers to produce documents for purposes of assessing local taxes. Additionally, local commissioners and their deputies are authorized to administer oaths before questioning taxpayers regarding tax liability. The legislation authorizes any court to compel a taxpayer to comply with a local commissioner’s summons or to produce required documents. Finally, the legislation also authorizes the local commissioner and his deputy to serve writs, warrants, notices, summonses, or other processes that the commissioner may issue. The commissioner is authorized to direct this process to the sheriff for service. This legislation was effective on July 1, 2015.

3. Department of Taxation: Disclosure of Information. Senate Bill 1010 (Chapter 247) amends §§ 58.1-3 and 58.1-3.2 to clarify the Department of Taxation’s authority to disclose confidential taxpayer information in limited situations. The Tax Department is authorized to disclose i) whether a person is registered to collect the Retail Sales and Use Tax and to make available the names and registration numbers of such dealers, ii) tax information relating to sellers and purchasers of cigarettes or other tobacco products to any federal, state, or local agency, and iii) any tax information necessary to facilitate the repayment of gap financing to a developer or economic development authority working with a tourism project entitled to sales tax revenues to repay the debt. The legislation also clarifies that the Tax Department has the authority to disclose information to nongovernmental entities that have entered into contracts with the Tax Department to provide services assisting in the administration of taxes and refunds. This legislation was effective on July 1, 2015.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Collection Period. P.D. 15-15 (February 3, 2015). The Tax Department issued sales and use tax assessments in 2003 and 2004 to a business, and converted the bills to the taxpayer as a responsible officer in 2004. The Tax Department made an attempt to collect the converted bills in 2014. The taxpayer appealed contending that the Tax Department is outside the limitations period allowed to collect assessments. The taxpayer argued that the statutory limitation period for collecting state tax is seven years. As such, because the assessments were issued and converted in 2003 and 2004, the taxpayer asserted that the Tax Department is
prohibited from any collection action in 2014. The Tax Commissioner disagreed and stated, “Although Va. Code § 58.1-1802.1 currently limits the Tax Department's collection actions to seven years from the date of assessment, the statute of limitations has been amended two times due to legislative action. Between July 1, 2010 and July 1, 2012 the statute of limitations was ten years. Prior to July 1, 2010, the statute of limitations was twenty years. As such, because the limitations period was twenty years at the time of the assessment and conversion of the bills at issue, the Tax Department was well within the limitations period for collection.”

2. Reconsideration Period. P.D. 15-85 (April 23, 2015). The Tax Department determined in P.D. 15-7 that the machinery and tools used in the taxpayer's cartoning process were part of the shipping process and, therefore, exempt from the M&T tax. The County sought a redetermination of P.D. 15-7, contending that the cartoning equipment was part of the manufacturing process because it was an integral part of creating different products in accordance with the taxpayer's consumer's demands. Under Va. Code § 58.1-3983.1(D)(4), an appeal to the Tax Department is treated in the same manner as an application made pursuant to Va. Code § 58.1-1821. Title 23 VAC 10-20-165(F) provides that a taxpayer who disagrees with the Tax Department's final determination may request a reconsideration of the determination. A locality may also seek a reconsideration under Title 23 VAC 10-20-165(F). In order for the Tax Commissioner to grant a request for reconsideration, the request must be received by the Tax Department not later than 45 days after the date of the determination letter, and the requesting party must meet one of four specific requirements set forth in that section. On this basis, the Tax Commissioner denied the County's request for reconsideration.

VI. BUSINESS LICENSE TAXES

A. 2015 Legislation

1. Businesses Ceasing Operations. Senate Bill 1040 (Chapter 250) amends § 58.1-3710 to provide that if a taxpayer ceases business and intends to settle outstanding, existing business accounts in the following year, such taxpayer would be authorized to pay the Business, Professional, and Occupational License Tax in that following year based on an estimate of gross receipts for such year instead of on the previous year's gross receipts. This legislation is effective on July 1, 2015.

B. Recent Court Decisions

1. The Nielsen Company LLC v. County Board of Arlington County, 767 S.E.2d 1 (2015). This case involved an appeal from the Circuit Court of Arlington County which rejected Nielsen's claim of a deduction for gross receipts taxed outside of Virginia for purposes of calculating the business, professional, and occupational license (“BPOL”) tax. The Supreme Court of Virginia overruled the Circuit Court and determined that Nielsen validly claimed and calculated the deduction.

The basis of this case is found in a number of rulings issued by the Virginia Tax Commissioner (“Tax Commissioner”). In these rulings, the Tax Commissioner determined that BPOL taxpayers who use payroll apportionment to situs their taxable receipts should use the same apportionment factor to ascertain the proper amount of the deduction permitted by Va.
Code § 58.1-3732. The rationale behind this requirement is that if the taxpayer cannot directly situs its receipts, it also cannot determine which of its receipts should be deducted due to taxation in another state. Specifically, the Tax Commissioner articulated the method to calculate the deduction as follows:

1. Ascertain whether any employees at the Virginia definite place of business participated in interstate transactions by, for example, shipping goods to customers in other states, participating with employees in other offices in transactions, etc. If there has been no participation in interstate transactions, then there is no deduction. If there has been participation, then;

2. Ascertain whether any of this interstate participation can be tied to specific receipts. If so, then those receipts are deducted; however, if payroll apportionment had to be used to assign receipts to the definite place of business, then it is very unlikely that any of those apportioned receipts can be specifically (linked to interstate transactions. If not, or if only some of the participation can be tied to specific receipts, then;

3. The payroll factor used for the Virginia definite place of business would be applied to the gross receipts assigned to definite places of business in states in which the taxpayer filed an income tax return. Note that payroll apportionment would probably be needed to assign receipts to definite places of business in other states.


Arlington filed suit to challenge the usage of payroll apportionment for purposes of the deduction based upon an administrative appeal by the Tax Commissioner in this dispute. One reason for rejecting the Tax Commissioner’s decision was that there allegedly was no “evidence submitted by the taxpayer” justifying the deduction. The circuit court ultimately ruled that usage of payroll apportionment for purposes of the deduction is “arbitrary and capricious” and that “[t]he taxpayer however, is certainly in a position to demonstrate by time sheets, travel expenses, budget, phone logs and other means how Virginia employees may have contributed to revenues generated out-of-state and therefore entitled to the deduction.”

Commentary on the Trial Court’s Opinion

The circuit court’s opinion misses a few key points. The circuit court placed the burden on Nielsen to prove its entitlement to the deduction, but the burden should have been placed on Arlington to prove that Nielsen was not entitled to the deduction it claims. Arlington sought judicial review to set aside the Tax Commissioner’s decision, and the law states that “in any such proceeding for judicial review of a determination of the Tax Commissioner, the burden shall be on the party challenging the determination of the Tax Commissioner, or any part thereof, to show that the ruling of the Tax Commissioner is erroneous with respect to the part challenged.” Virginia Code § 58.1-3703.1(A)(7)(a). Nielsen was not required to present evidence or otherwise prove anything. Arlington bore the burden to prove, if it could, that the
amount of the deduction that the Tax Commissioner approved was excessive. Placing the burden on Nielsen was incorrect.

By requiring Nielsen to calculate its exact deduction ignores Nielsen's reality. If Nielsen were able to calculate its deduction, it would also be able to directly situs its gross receipts and not be required to use payroll apportionment for situsing purposes. Interestingly, Arlington never argued that Nielsen improperly used payroll apportionment to situs its receipts. In fact, Arlington stipulated that using payroll apportionment to situs receipts was proper for Nielsen. So when the circuit court requires Nielsen to calculate its deduction without using an apportionment formula, the circuit court has effectively determined that Nielsen may not claim a deduction that was granted by the General Assembly.

The Supreme Court of Virginia overturned the Circuit Court on the basis that the Tax Commissioner’s ruling was neither contrary to law nor arbitrary and capricious. However, the Supreme Court of Virginia did not say that the Tax Department’s method for calculating the deduction was the method that should be used. After it was acknowledged that the Code of Virginia does not resolve the permissible methodology for calculating the deduction, it was determined that the Tax Department’s requirement of manual accounting, or payroll apportionment in the event that manual accounting is impossible to calculate the deduction, falls within the scope of accounting methodologies permitted by Va. Code § 58.1-3732 which provides for the deduction for out-of-state receipts. Thus, the Tax Department’s methodology is not contrary to law. It was also determined that the methodology was not arbitrary or capricious as it followed the statute’s scheme for determining the situs of gross receipts when it is impossible or not practical to make such a determination for purposes of the tax. Specifically, the Supreme Court of Virginia stated:

The use of an estimate methodology when determining a deduction, but only when it is impossible to determine the exact figures to calculate such a deduction, is neither "contrary to ... established rules of law" nor a mechanism permitting an assessment to be “founded on prejudice or preference rather than on reason or fact” when that very same methodology is used to determine the initial tax to be imposed, but only when it is impractical or impossible to determine the exact figures to calculate such a tax.

On this basis, the case was remanded back to the Circuit Court to issue an order consistent with this opinion. In this case, the Virginia Supreme Court also addressed the issue of the deference or weight that must be given to the Tax Commissioner’s rulings. The Tax Department has a long history of believing that the rulings it issues should be deferred to and given great weight. Courts have disagreed with proving such deference. In this case, the Virginia Supreme Court addresses this contention directly. The Court states, “A court never defers to the Tax Commissioner's interpretation of a statute.” Great weight is only provided when a statute is obscure or its meaning doubtful. If the Tax Department would like its interpretations to receive “great weight,” the Court referenced to an earlier tax decision it issued in 2001 which expressly stated how this could be accomplished. The Court said:

For purposes of giving weight to the positions of administrative agencies, it does not matter whether an agency has been consistent in its rulings. This is because an

The Court also recognized that the Tax Department’s rulings are only accorded judicial notice and nothing more pursuant to Va. Code § 58.1-203. This subject begs the question of why the Tax Department will not promulgate regulations. Simply put, there would not have been an issue for the calculation of Nielsen’s deduction had the Tax Department simply promulgated a regulation instead of publishing a ruling that Virginia courts and Virginia taxpayers cannot rely upon.

FORD MOTOR CREDIT v. CHESTERFIELD update: On June 15, 2015, a Chesterfield County circuit court judge opined that Ford Motor Credit could not claim the deduction because it could not show that actual receipts were not subject to a tax in another state. He also stated that Nielsen did not apply in this case as the Virginia Supreme Court directed to prove that actual receipts had been taxed. This opinion may be found at Ford Motor Credit Company v. Chesterfield County, 2015 Va. Cir. LEXIS 83 (Chesterfield Cty. Cir. Ct., June 15, 2015). Ford is seeking a writ of appeal on this decision from the Virginia Supreme Court.

C. Recent Virginia Tax Commissioner Rulings

1. Licensable Business Activity. P.D. 15-16 (February 3, 2015). The taxpayer, who resided in the County, performed work for a company (the "Company") located in County A for the tax years at issue. The County audited the taxpayer, determined that the taxpayer was engaged in a licensable business activity and had business tangible property within its jurisdiction, and issued assessments for the BPOL license fee and the BTPP tax. The County issued a final determination upholding its BPOL and BTPP tax assessments on the basis that the taxpayer was engaged in a licensable business activity and had business tangible personal property. The taxpayer appealed the County's assessments asserting that she was not engaged in a licensable business and was not subject to BPOL or BTPP tax. The taxpayer contended that she was an employee of the Company, not an independent contractor. The County asserted that the taxpayer was a sole proprietorship engaged in business within the County, subject to business licensure and liable for the BTPP tax on any property used in the business. Relying upon her treatment as an independent contractor for federal payroll tax purposes, the Tax Commissioner agreed with the County and upheld the BPOL and BTPP assessments. **Query: Did she have a definite place of business?**

2. Reconsideration of Treatment of Prewritten Software Sales. P.D. 15-19 (February 11, 2015). The Tax Department determined in P.D. 14-117 that the taxpayer was a business service provider because its principal business consisted of developing measurement software. The taxpayer sought a reconsideration, contending that the sale of the measurement software was either a retail or wholesale sale of tangible personal property. Relying on Black’s Law Dictionary, the Tax Commissioner upheld the prior ruling and determined that the sale of prewritten software at issue is neither a retail nor wholesale sale and that the only classification that would apply would be business services.
3. Situs of Gross Receipts. P.D. 15-20 (February 17, 2015). The taxpayer, a provider of information and technical services, had definite places of business in the City, the County, and in State A. The taxpayer's chief executive officer (CEO) and administrative assistant were the only taxpayer employees that worked in the City office. The taxpayer filed and paid BPOL taxes to the City for the 2010 through 2013 tax years based on the taxpayer's entire gross receipts. In December 2013, the taxpayer requested refunds, asserting that there was no BPOL tax liability because all gross receipts should have been sitused to either the County or State A. In its final determination, the City allowed refunds for the 2011 through 2013 tax years, but denied the refund request for the 2010 tax year because the taxpayer was unable to provide a 2009 State A income tax return. The taxpayer filed an appeal with the Tax Department, contending that all gross receipts should have been sitused to either the County or State A under the general situsing rules. It also asserted that the City did not issue refund interest for the refunds it had issued. The Tax Commissioner upheld the denial of the 2010 refund as the taxpayer is required to provide sufficient documentation. The Tax Commissioner also stated that the City must issue interest on the refunds.

4. Insufficient Information. P.D. 15-30 (February 24, 2015). A taxpayer appealed a BPOL assessment based on numerous issues. However, he failed to provide sufficient information to support his claims. As such, the Tax Commissioner upheld the assessment.

5. Insufficient Information of Both Taxpayer and Locality. P.D. 15-39 (March 4, 2015). On June 6, 2011, the Tax Department received an appeal for assessments of BPOL tax and BTPP tax. The taxpayer contended in its appeal that it was a manufacturer for purposes of the BPOL and BTPP taxes. The City asserted that the taxpayer was a business service provider. On December 13, 2011, the Tax Department met with the taxpayer and the City pursuant to Title 23 of the Virginia Administrative Code (VAC) 10-20-165(E). At the conference, the taxpayer agreed to allow the City's audit staff to revisit its facilities and review documentation. The taxpayer submitted an appeal on September 17, 2014 because the City had not yet issued its final local determination. On October 23, 2014, the City issued a final determination, concluding that the taxpayer was a manufacturer for purposes of both the BPOL and BTPP taxes. A review of both the taxpayer's appeal and the City's final determination letter indicates that while they agree that the taxpayer was engaged in manufacturing, and therefore subject to the Machinery and Tools (M&T) tax, they may disagree on the taxpayer's M&T tax liability and the refund of BPOL tax due. In an unusual twist, the City's Treasurer indicated that its records of the taxpayer's BPOL and BTPP tax payments for the 2007 and 2008 tax years were purged after the June 2011 appeal was filed with the Tax Commissioner. In addition, the taxpayer did not provide adequate records to support its assertions. The Tax Commissioner sent the case back to the City and strongly reminded the City that it has the authority to accept an offer in compromise.

6. Classification of Activity. P.D. 15-68 (April 15, 2015). The taxpayer had a definite place of business in the County where its single federal contract provided a broad array of support services to the United States armed forces and Department of Defense. Services provided included system integration, information technology (IT), systems engineering, IT enterprise solutions, management of large scale IT programs, and simulation and training. The taxpayer filed returns and paid BPOL tax at the rates applicable to business services for the tax
years at issue. The County audited the taxpayer. As part of the audit, it reviewed a particular delivery order for a branch of the military as an example of the services the taxpayer provided. The County determined that the taxpayer was performing engineering services and issued assessments at the rate applicable to professional services. The taxpayer appealed the County's final determination to the Tax Commissioner, contending that it was licensable as a business service because it was primarily engaged in business services and any professional services were ancillary. After a long discussion of the various issues involved with the classification of the taxpayer's activities, the Tax Commissioner remanded the case back to the County to reconsider the request as it was determined that the County did not review all of the evidence in its initial determination including the entire federal contract. In addition, the Tax Commissioner noted that the taxpayer must provide sufficient documentation in order for the local assessing authority to make an informed decision. He directed the taxpayer to provide a breakdown of the gross receipts between business and professional services.

7. **Definite Place of Business and Situs of Gross Receipts.** P.D. 15-74 (April 21, 2015). The taxpayer, a pass-through entity that provided billing services and claims management, had a definite place of business in the City. Substantially all of its services were subcontracted out to independent third party providers. The taxpayer was operated in the City by three managing partners and two employees. The partners received distributions from the taxpayer in lieu of wages. In April 2011, one partner moved to State A. In May 2012, the two other partners moved to State B. The taxpayer maintained a definite place of business in the City with the two employees. Under review, the City determined that the taxpayer had underpaid BPOL tax for the 2012 and 2013 tax years and issued assessments. The taxpayer appealed to the City, contending that the gross receipts should be sitused outside of the City because the services were directed and controlled by the partners located out-of-state. In the alternative, the taxpayer asserted that the gross receipts should have been sitused using payroll apportionment, and the distributions to the partners and the payments to the contractors should be considered wages for payroll purposes. In its final determination, the City concluded that the gross receipts from clients located in Virginia should be sitused to the City. The taxpayer filed an appeal to the Tax Commissioner, contending that its gross receipts should not be sitused by client location because the services were conducted in localities both within and without Virginia. The Tax Commissioner upheld the assessments and remanded the case back to the City. The taxpayer did not present any evidence that it established a definite place of business in either State A or State B. In order to situs receipts to those locations, the taxpayer must have established a definite place of business. The Tax Commissioner also stated that a distribution from a pass-through entity to its owners is not payroll for payroll apportionment purposes. If the taxpayer is able to prove that it established a definite place of business in either State A or State B, the distributions should not be used if payroll apportionment is used to situs the receipts.

8. **Definite Place of Business.** P.D. 15-78 (April 21, 2015). The taxpayer was in the business of purchasing and leasing real property. It purchased a residential property in the County in 2008. In August 2011, the taxpayer leased the residence to an individual. Under audit, the City determined that the personal residence of the taxpayer's owner (the "Owner") located in the City was its only definite place of business during the 2011 through 2013 tax years and sitused all of the taxpayer's gross receipts to this location for BPOL tax purposes. The taxpayer appealed, contending that the gross receipts should have been sitused to the residence in the County because it was the definite place of business from which the taxpayer's business
operations were directed and controlled. The City issued a final determination upholding the assessment. It found that the taxpayer had one definite place of business in the City, and the evidence provided failed to show that the residence in the County had been a definite place of business. The taxpayer filed an appeal with the Tax Department contending that its only definite place of business was located in the County. The Tax Commissioner upheld the assessment. The taxpayer stated that it occupied a portion of the residence in the County while renting out the other part to a tenant while the tenant performed renovation work. The City inspected the County property in July 2014 and found it was uninhabitable and could not be used as an office because it was under renovation. Its inspection occurred after the tax years at issue. As such, it was possible that the County property could have been used both as an office and/or residence during the 2011 through 2013 tax years. The taxpayer listed the County address as the business address on its federal income tax returns and State Corporation Commission filings. However, the County's real estate records showed the Owner's City residence as the taxpayer's mailing address. The lease agreement provided for the property in question pertains only to residential use of the premises and contains no provisions related to business or commercial use. Furthermore, the lease does not provide allowance for the taxpayer's use of the property, or for the tenant to provide any renovation work. In addition, the taxpayer provided no evidence that it filed BPOL or Business Tangible Personal Property tax returns in the County during the tax years at issue.

9. **Situs of Gross Receipts.** P.D. 15-95 (May 7, 2015). The Tax Department determined in P.D. 15-20 that the taxpayer did not provide sufficient documentation to show that its gross receipts should have been sitused to definite places of business located in the County and in State A. The taxpayer requested a reconsideration, contending that the contract for the services generating the gross receipts required that the work be performed at the State A definite place of business. The Tax Commissioner reviewed the contract provided by the taxpayer and remanded the case to the City in order to review any evidence the taxpayer can provide to demonstrate where the services mandated by the contract were actually performed. The Tax Commissioner stated that there is a strong likelihood that the taxpayer may have provided services at the State A facility and that gross receipts should be sitused to the definite place of business in State A.

10. **Classification.** P.D. 15-145 and P.D. 15-159 (June 30, 2015 and August 13, 2015). The taxpayer was a distributor of heating, ventilation and air-conditioning (HVAC) equipment, parts and supplies. Most of the taxpayer's customers were businesses that installed and serviced HVAC systems for their own residential or commercial customers. The taxpayer states that it also made a small amount of sales to industrial or governmental customers but that it did not sell to the general public. The taxpayer classified itself as a retailer on its BPOL returns filed with the County for the 2010 and 2011 tax years. Subsequently, the taxpayer filed amended returns reclassifying itself as a wholesaler and requesting refunds. The County denied the refund requests. In its final determination, the County held that the taxpayer was a retailer because it did not offer discounts based on the volume of products sold and the taxpayer's customers did not use the products in a productive process. The taxpayer appealed the County's determination to the Tax Commissioner, contending that it was a wholesaler because it sold to its customers for resale, its pricing system was more indicative of wholesale trade and the products were used in a productive process. The Tax Commissioner agreed with the taxpayer and determined that it was a wholesaler.
Title 23 VAC 10-500-350(C), however, provides that businesses who sell goods to government, institutional, business or industrial entities for their consumption, use or incorporation in an assembly, manufacturing or processing operation are typically subject to the BPOL tax on wholesalers. The use of "or" in this regulation means that consumption and use are separate from "incorporation in an assembly, manufacturing or processing operation." Typically, if the products are not being incorporated into an assembly, manufacturing or processing operation, they would be used or consumed by such entities for business needs as supplies or equipment. In contrast with retail sales which are typically made to individual consumers to satisfy their own wants or needs, wholesale sales involve sales of goods to be used for such business purposes. See Roland Electrical Co. v. Walling, 326 U.S. 657, 674, 66 S.Ct. 413, 421 (1946). As such, it is likely that any sales made to government and industrial entities were for wholesale purposes. In addition, the standard of Title 23 VAC 10-500-350 C would also apply to HVAC contractors because they are business entities. One of the Tax Department's reasons for holding that the sales to the welding contractors were not at wholesale in a prior ruling was that the contractors should be considered the ultimate consumers of the products. This reasoning is consistent with the treatment of sales to contractors for sales and use tax purposes. See Title 23 VAC 10-210-410. The BPOL tax, however, is a local tax that is separate and distinct from the Commonwealth's retail sales and use tax. Consequently, sales and use tax regulations are not authoritative in BPOL tax cases. For this premise, the Tax Commissioner cited P.D. 09-139 (9/21/2009). In this case, even if the HVAC contractors could be considered to be the consumers of the products, Title 23 VAC 10-500-350(C) indicates that businesses who sell goods to other businesses for their consumption or use are still typically subject to BPOL tax as wholesalers.

11. **Data Transmission Services.** P.D. 15-160 (August 13, 2015). A taxpayer, a telephone company, requested a ruling in which several questions were asked about whether receipts from data transmission services are included in gross receipts, if the exclusion for long distance telephone calls applied to data transmission, and if the same exclusion applied to such transmissions between people in different states. The Tax Commissioner answered the questions by applying old pre-Internet law. (This is not the fault of the Tax Commissioner as technology regularly outpaces language in the law.) He determined that the receipts would be included and that the exemptions do not apply. **Comment:** If there are large dollars at stake, expect to see some sort of legislation.

12. **Deduction from Gross Receipts for Taxes Paid to Other States.** P.D. 15-170 and 15-171 (August 18, 2015). Virginia Code § 58.1-3732(B)(2) provides a deduction from gross receipts otherwise taxable for any receipts "attributable to business conducted in another state or foreign country in which the taxpayer . . . is liable for an income or other tax based upon income." Because revenues are sitused by directly assigning receipts to a taxpayer's definite place of business, the taxpayer would be entitled to claim the deduction for those gross receipts that are attributable to business conducted in another state or foreign country in which it was liable for an income or income like tax based on income. In P.D. 10-228, the Tax Department ruled that when gross receipts are apportioned by using the general payroll apportionment formula, the amount of the out-of-state deduction would be determined by multiplying the total out-of-state gross receipts by the same payroll factor used to determine the situs of gross receipts. The Tax Department further clarified how the out-of-state deduction should be computed when payroll apportionment is used to situs gross receipts in P.D. 12-88 (5/31/2012), P.D. 12-146 (8/31/2012), and P.D 14-29 (3/5/2014). In Nielsen, the Virginia Supreme Court upheld the Tax
Department's methodology computing the out-of-state deduction when payroll apportionment is used to situs gross receipts because it "strikes a balance between the competing interests of the licensing jurisdiction and the taxpayer." The County asked two questions regarding the application of the out-of-state deduction with regard to a taxpayer's BPOL tax liability when payroll apportionment is required. First, "Is it permissible to apply the Virginia payroll percentage to the actual amount of business conducted in another state, when the amount is known, instead of to the amount previously apportioned to the state via payroll apportionment?" The Tax Commissioner said that this would be unlikely to happen if apportionment was used to source receipts. He warned that using the gross receipts shown on the apportionment schedule of the taxpayer's income tax return for the other state is unlikely to be usable for this purpose because it may include goods shipped and services rendered from definite places of business in states other than the state in question. Second, "Is there any deduction for business conducted in states without a definite place of business? Such requests for deductions are not uncommon, as many companies have customers in states where they do not maintain a definite place of business." The Tax Commissioner responded that the taxpayer need only be subject to a tax and not have a definite place of business.

13. Situs. P.D. 15-174 (September 10, 2015). The taxpayer, a provider of information technology services, has a definite place of business in the Town. The majority of its services are performed at customer facilities. Consequently, the vast majority of the taxpayer's employees work at the customer facilities and not at the definite place of business in the Town. The taxpayer has been situsing almost its entire gross receipts outside the Town. The Town requests guidance as to how the taxpayer's gross receipts should be sitused. The Tax Commissioner replied that it would depend on whether the employees established a definite place of business at the customer locations. If the taxpayer's employees are working at customer facilities on a regular and continuous basis, the taxpayer may have established a definite place of business at those facilities. The taxpayer would be required to get a business license for each customer location at which it has established a definite place of business and pay the license tax or fee to the appropriate Virginia locality, if such locality imposes the BPOL tax. If, however, the taxpayer's employees are not found to be working at customer locations on a regular and continuous basis, the gross receipts from these services would be sitused to the definite place of business from which the services are directed or controlled. Because the taxpayer is headquartered in the Town, it is likely that such services would be considered to be directed or controlled at the definite place of business in the Town.

VII. TANGIBLE PERSONAL PROPERTY AND MACHINERY AND TOOLS TAXES

A. 2015 Legislation

1. Machinery and Tools Tax: Renewable Energy Machines. House Bill 1297 (Chapter 230) enacted § 58.1-3508.6 to create a separate class of property for purposes of the Machinery and Tools Tax for machinery and tools owned by a business and used directly in producing or generating renewable energy. This legislation was effective on July 1, 2015.

2. Personal Property Tax Relief for Military. House Bill 1589 (Chapter 266) amends § 58.1-3524 to require that, beginning with tax year 2016, any locality receiving reimbursement from the Commonwealth for providing tangible personal property tax relief for
motor vehicles must ensure that the reimbursement payment pays for all of the tax attributable to the first $20,000 of value on each qualifying vehicle leased by an active duty member of the United States military or his spouse if the vehicle would not be taxed in Virginia if it were owned by such active duty member or spouse.

3. Personal Property Tax Relief; Definition of Qualifying Vehicle. House Bill 1340 (Chapter 152) and Senate Bill 1219 (Chapter 96) amend § 58.1-3523 to expand the pool of vehicles that are “qualifying vehicles,” and eligible for personal property tax relief by including autocycles that are privately owned, leased pursuant to a contract requiring the lessee to pay the tangible personal property tax on such vehicle, or held in a private trust for nonbusiness purposes. Virginia Code § 46.2-100 defines “autocycle” as a three-wheeled motor vehicle that has a steering wheel and seating that does not require the operator to straddle or sit astride and is manufactured to comply with federal safety requirements for motorcycles. This legislation is effective for tax years beginning on or after January 1, 2016.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Business Tangible Personal Property Tax: Set Top Box Cable Converters. P.D. 15-6 (January 8, 2015). The taxpayer is affiliated with a cable television provider. In order to receive the cable service, customers must have a converter, also known as a set top box. The converters are owned by the taxpayer and are issued to cable customers by the cable television provider. The taxpayer did not report the converters as tangible personal property on its 2013 BTPP return filed with the City. After reviewing the return, the City determined that additional tax was due on the omitted converters. The taxpayer filed an appeal with the Tax Commissioner, contending the converters are intangible property not subject to the local taxation. The Tax Commissioner agreed with the taxpayer and determined that the converters are intangible.

Article X, § 4 of the Virginia Constitution provides that all tangible personal property shall be segregated for local taxation in such a manner as the General Assembly provides by law. Virginia Code § 58.1-1101(A)(2)(a) classifies certain property that is tangible in fact as intangible and segregates that property for state taxation only. Intangible property consists of, in part:

Personal property, tangible in fact, used in cable television businesses. Machines and tools, motor vehicles, delivery equipment, trunk and feeder cables, studio equipment, antennae and office furniture and equipment of such businesses shall not be defined as intangible personal property for purposes of this chapter and shall be taxed locally as tangible personal property according to the applicable provisions of law relative to such property.

The Tax Commissioner consulted the changes to the statute back to 1983. He noted that converters were specifically treated as tangible in 1983 but subsequently removed from the
statute in later years. He determined that this removal was to treat the converters as intangible by consulting tax bulletins and fiscal impact statements written by the Tax Department.

2. Machinery and Tools Tax: Packaging Equipment. P.D. 15-7 (January 8, 2015). The taxpayer was a manufacturer of glass beverage bottles that was located in the County. The taxpayer either placed the bottles on pallets or cartons prior to shipment in accordance with the customer's preference. The taxpayer filed amended machinery and tools (M&T) tax returns for the tax years at issue. It requested the removal of certain equipment included on the original returns as machinery and tools. In its initial final determination, the County removed some of the contested equipment from the taxpayer's machinery and tools. However, it determined that equipment used to package the beverage bottles was used in the manufacturing process and subject to the M&T tax. The taxpayer appealed the County's final determination, contending the manufacturing process ends once its products are packaged for resale and any additional packaging was not a part of the manufacturing process.

The Tax Commissioner agreed with the taxpayer and determined that the packaging equipment was not part of the manufacturing process. Generally, the Tax Department considers machinery used for packaging a product for shipping purposes as not directly used in the manufacturing process and, therefore, not subject to the machinery and tools tax. See P.D. 04-39. In P.D. 08-30 (4/2/2008), the Tax Commissioner recognized that many food products are not marketable without additional packaging. Therefore, the Tax Department must consider whether some packaging "is an integral part of the making of a substantially different product." In considering this issue, the Tax Department identified three main factors that contribute to how food is packaged. These include government regulations, industry practices, and market or consumer demands. Thus, to the extent that packaging has to meet performance (industry standards), sanitation (government regulations), or product quality (consumer demands) standards, equipment used for such packaging is considered to be used directly in the manufacturing process. In its revised determination, the County states that only one of the three standards must be met in order for equipment to be used in manufacturing test. It concluded that the taxpayer's efforts to meet customer demands via cartoning satisfied the product quality standard. The taxpayer contends that the cartoning process was only used for shipping and, therefore, not part of the manufacturing process. In P.D. 13-63 (5/10/2013), the Tax Department determined that machinery used to package beverages ultimately sold to consumers in that same packaging would be considered to meet product quality standards and included in the manufacturing process. In this case, however, the cartons would not become part of the final product sold to consumers. In addition, the Tax Department found it doubtful that the cartons are necessary for taxpayer's customers in order to get the bottles into subsequent processing.

3. Business Tangible Personal Property Tax: Exempt Hospital. P.D. 15-17 (February 4, 2015). The taxpayer, a health care system exempt from federal income taxation under Internal Revenue Code (IRC) § 501(c)(3), owns and operates a hospital in the County. The taxpayer does not have a religious affiliation. The County requested a ruling whether the hospital's real and tangible personal property is exempt from local real property and BTPP tax pursuant to Va. Code § 58.1-3606(A)(5). The Tax Commissioner determined that the hospital could qualify for the exemption. Citing Op. Va. Att'y Gen. 13-041, 2013 WL 4039923 (August 2, 2013), he stated that a taxpayer seeking the hospital exemption under Va. Code § 58.1-3606 A 5 must satisfy three requirements: (1) the facility at issue must be a hospital; (2) the property at
issue must belong to and be actually and exclusively occupied and used by the hospital; and (3) the hospital must operate on a not-for-profit basis and exclusively as a charity.

4. Machinery and Tools Tax: Pollution Control Equipment. P.D. 15-18 (February 9, 2015). The taxpayer, a manufacturer located in the City, placed certain pollution control equipment into service prior to January 1, 2013. This equipment was not certified as pollution control equipment by the Department of Environmental Quality (DEQ) until March 2013. The taxpayer filed an amended M&T tax return for the 2013 tax year requesting the removal of the pollution control equipment. The City declined to remove this equipment for the 2013 tax year. The taxpayer filed an appeal with the City. In its response, the City concluded the exemption did not apply because the pollution control equipment was certified after the 2013 tax day. The taxpayer appealed the City's final determination, contending that the pollution control equipment at issue was exempt from the M&T tax because it was in service as of the 2013 tax day. The Tax Commissioner upheld the assessment and agreed with the City that the pollution control equipment must have been certified by the tax day.

5. Machinery and Tools Tax: Inaction by Locality. P.D. 15-23 (February 19, 2015). In P.D. 12-177 (11/05/2012), the Tax Department determined that the taxpayer provided sufficient documentation to demonstrate that the equipment at issue was idle machinery for the 2011 tax year. The case, however, was remanded back to the County in order for it to request documentation and reconsider its decision. The taxpayer submitted additional documentation to the County. Based on this information, the County sought a reconsideration of P.D. 12-177, contending that the taxpayer should be subject to M&T tax on all of its machinery and tools for 2011. In P.D. 13-96 (6/11/2013), the Tax Department determined that some of the machinery may not be idle, but remanded the case back to the County to request specific documentation in order for it to reconsider its determination. The Tax Department further determined that, if the County agreed with the Tax Department that the machinery and tools were idle, then it should adjust the taxpayer's tax liability for the 2011 tax year. The County has not requested any additional information and has not issued a refund of M&T tax as requested by the taxpayer. As such, the taxpayer has requested that the Tax Department overturn the County's determination and direct the County to refund the excess M&T tax paid along with interest. The Tax Commissioner declined to take additional action and advised the taxpayer of its rights to go to circuit court.

6. Business Tangible Personal Property Tax: Insufficient Information. P.D. 15-31 (March 3, 2015). The taxpayer leased medication management systems to hospitals and other healthcare providers. The units at issue were used to distribute and manage medications and were controlled by a personal computer, including a monitor, keyboard and printer. Most of the units had multiple drawers where medications were stored, and some possessed auxiliary shelving. The taxpayer classified the units as computer equipment on its return of BTPP for the 2014 tax year. Under review, however, the County reclassified the units as furniture, fixtures, equipment, or tools and issued an assessment for additional BTPP tax due. The taxpayer filed an appeal with the County. In its final determination, the County upheld its classification. The taxpayer filed an appeal with the Tax Commissioner, contending that the units should have been classified as computer equipment. The Tax Commissioner stated that the units could be computer equipment, but upheld the assessment as the taxpayer did not provide any documentation to support such a finding.
7. Business Tangible Personal Property Tax: Failure to Comply with Requests for More Information. P.D. 15-71 (April 17, 2015). The taxpayer, a large transportation and logistics company, was under contract with a retailer that had a regional distribution center in the City. The contract required the taxpayer to base equipment and personnel within the region including the City for the exclusive use of the retailer at the City facility and another distribution center located in a neighboring state. The taxpayer filed local property tax returns with the City for the 2013 tax year. In early 2014, the City audited the taxpayer and increased the number of tractors (trucks) situated within its jurisdiction and issued an assessment. The taxpayer appealed the assessment to the City. In its final local determination, the City upheld the assessment based on information provided by a manager employed by the taxpayer. The taxpayer filed an appeal with the Tax Department seeking correction of the assessments for the 2013 tax year, citing numerous errors made by the City. With its appeal, the taxpayer provided additional information that had not been previously reviewed by the City. The City requested the new information be returned for its consideration. The Tax Department complied with this request and the appeal was closed. In conjunction with its continuing review, the City requested additional information to reconcile apparent conflicting information provided by the taxpayer. When the taxpayer failed to comply with the request, the City issued a new final determination and upheld the assessment. The taxpayer then filed a new appeal with the Tax Department making a number of arguments. The Tax Commissioner upheld the local assessment as the taxpayer failed to cooperate with the locality with regard to producing records.

8. Machinery and Tools Tax: Responsibilities of Localities. P.D. 15-105 (May 12, 2015). The taxpayer operates a printing facility in the City. In August 2013, the taxpayer filed amended returns for the 2010 through 2012 tax years to remove certain property from the basis of taxable assets. In September 2013, the taxpayer also submitted an application to correct these returns with the City. In addition, the taxpayer submitted its 2013 return in April 2013 and its 2014 return in January 2014. In August 2014, the City issued a letter in response to the taxpayer's application for correction. For each category of property at issue, the City determined that it was either taxable or not, or that more information was needed. In response, the taxpayer submitted additional information. In December 2014, the City issued a letter, which incorporated its prior determination letter by reference. Based on the new information, the City concluded which of the remaining categories at issue were taxable and which were not. The City, however, did not adjust either the amended returns for the 2010 through 2012 tax years or the original returns for the 2013 and 2014 tax years. Rather, the City asked the taxpayer to file amended returns consistent with its determination. The taxpayer appealed to the Tax Department, contending that the categories of property the City considered to be taxable should not be subject to the M&T tax. In its response to the appeal, the City objected, claiming the Tax Department lacks jurisdiction for the 2010 and 2011 tax years.

Under § 1.4 of the Guidelines for Appealing Local Business Taxes, issued as Public Document (P.D.) 04-28 (6/25/2004), an "assessment" is defined as "a determination as to the proper rate of tax, the measure to which the tax rate is applied, and ultimately the amount of tax, including additional or omitted tax, that is due." When a taxpayer files an amended local business tax return, the local taxing authority must make a determination as to the proper amount of the tax. If the locality denies the refund, it has made a determination as to the proper amount
of tax, even if the assessment on that locality's books is not changed. Consequently, the denial of a refund by a local taxing authority would constitute an assessment for purposes of filing an appeal under Va. Code § 58.1-3983.1. In this case, however, the City did not deny the refund or adjust the taxpayer's amended returns resulting in a determination as to the proper amount of tax. Instead, the City has requested new amended returns from the taxpayer for the 2010 through 2012 tax years. The Tax Commissioner sent this case back to the City with instruction to fulfill its obligation under Virginia law to correct the assessments for the 2010 through 2014 tax years based on its determination. Once the assessments are adjusted by the City, the taxpayer, if it is not satisfied with such assessments, may file an appeal with the City under either Va. Code § 58.1-3980 or § 58.1-3983.1 within the time prescribed by law. If the taxpayer files a local appeal under Va. Code § 58.1-3983.1 and is not satisfied with the City's final determination, it may file an appeal with the Tax Department. In lieu of going through the local appeals process again, the City, at its discretion, may issue a final local determination under Va. Code § 58.1-3983.1 in response to the taxpayer's refund request allowing the taxpayer to file directly with the Tax Department if it so desires. **Comment:** The City seems to be playing games to deny the taxpayer's right to an appeal.

VIII. MISCELLANEOUS TAXES

A. **2015 Legislation**

1. **Recordation Tax: Multiple Technical and Substantive Changes.** House Bill 2161 (Chapter 488) and Senate Bill 999 (Chapter 434) amend §§ 58.1-803, 58.1-809, and 58.1-812 to make substantive and technical changes to state recordation taxes and fees. This legislation does the following:
   - Requires that the recordation tax on any deed of trust that modifies or is supplemental to an existing deed of trust be calculated only on that portion of the debt that is in addition to the original debt on which the tax has been paid instead of the existing debt;
   - Extends the current treatment of a single deed of trust conveying property within and without Virginia to separate deeds of trust conveying property in several states to secure the same obligation; and,
   - Relieve Clerks of the Circuit Court from personal liability for uncollected recordation taxes and fees.

   This legislation was effective for transactions occurring on or after July 1, 2015.

2. **Local Gas Road Improvement Tax: Extension of Sunset Provision.** House Bill 1705 (Chapter 271) and Senate Bill 1308 (Chapter 381) amend § 58.1-3713 to extend the sunset date for the local gas road improvement tax for 2 years and provide that the tax may not be imposed on or after January 1, 2018. The local gas road improvement tax is currently set to expire on December 31, 2015.

3. **Motor Vehicle Sales and Use Tax: Expansion of Family Gift Exemption.** House Bill 1279 (Chapter 159) amends § 58.1-2403 to expand the exemption from payment of the motor vehicle sales and use tax for gifts of vehicles to certain family members to include gifts to a parent.
4. **Forest Products Tax: Multiple Changes.** House Bill 1724 (Chapter 170) amends §§ 58.1-1601, 58.1-1602, 58.1-1604, 58.1-1605, 58.1-1612, and 58.1-1617 to do the following:

- Shift the imposition of the tax to the first manufacturer using, consuming, processing, or storing the forest product for sale or shipment out of state.;
  - A manufacturer is defined as any person that for commercial purposes at a fixed place of business i) processes forest products into various sizes and forms, including chips; ii) processes forest products into other products; iii) uses or consumes forest products; or iv) stores forest products for sale or shipment out of state.
- Convert the rate of tax for chips and mulch to a cents per ton rate for loads consisting of pine and loads consisting of other species;
- Impose the Forest Products Tax on loads of chips and mulch consisting of both pine and other species, including products such as biomass chips and fuel chips, at the rate of $0.10 per ton.

This legislation was effective on July 1, 2015.

5. **Withholding Tax: Employer Waivers.** House Bill 2307 (Chapter 156) amends § 58.1-472 to allow any employer otherwise subject to the semi-weekly income tax withholding requirements to request a waiver from such requirements, provided that the employer has no more than five employees subject to Virginia income tax withholding. If the Tax Commissioner grants a waiver, the employer would be allowed to file withholding returns and pay the withholding tax on a monthly basis. This legislation was effective on July 1, 2015.

B. **Recent Court Decisions**

No recent court decisions.

C. **Recent Virginia Tax Commissioner Rulings**

1. **Fiduciary Income Tax: Virginia Beneficiary Sufficient For Nexus.** P.D. 15-12 (January 12, 2015). An individual (the "Decedent") died in 2011. At the time of his death, the Decedent was a resident of Virginia. He had been the beneficiary of a trust established by the will of his father, a resident of State A. The father's will gave the Decedent a power of appointment, exercisable in the Decedent's will, to distribute the assets of the trust to his descendants outright or hold the assets in further trust for their benefit. The Decedent could also choose to distribute the net income of any assets remaining in trust to his spouse. In his will, the Decedent exercised the power of appointment to establish a trust (the "Trust") for the benefit of his spouse and descendants. The Trust is administered by a trustee located in State A. None of the Trust's property is located in Virginia. The Decedent's spouse, however, is currently the primary beneficiary and resides in Virginia. A ruling was requested as to whether the Trust is required to file a Virginia fiduciary income tax return. The Tax Commissioner determined that the trust is required to file a Virginia fiduciary income tax return. As the will created the trust, it was determined that the trust was a resident trust and because the assets of the Trust were not includable in the Decedent's gross estate for federal estate tax purposes or in his probate estate
for probate tax purposes had no bearing on this determination. Also as the beneficiary was a Virginia resident, the trust had sufficient nexus with Virginia.

2. **Recordation/Grantor’s Tax: Bankruptcy.** P.D. 15-13 and P.D. 15-14 (January 12, 2015). The taxpayer was 100% indirectly owned by LP. LP was a controlled subsidiary of Corporation A. Corporation A was a debtor in possession under a Chapter 11 bankruptcy plan (the "Plan") confirmed under 11 U.S.C. § 1129 by a United States bankruptcy court. Pursuant to the Plan, the taxpayer transferred real property by special warranty deed to a grantee and paid the state and local grantor's tax. The taxpayer requests a refund of the grantor's tax it paid, contending it was exempt from the Virginia Recordation Tax under federal bankruptcy law. Under 11 U.S.C. § 1146 (a) (2005), transfers of property pursuant to a plan confirmed under 11 U.S.C. § 1129 may not be taxed under any law imposing a stamp or similar tax, which includes a recordation tax. On this basis, the Tax Commissioner ordered a refund of the grantor’s tax.

3. **Fiduciary Income Tax: Resident Trust.** P.D. 15-46 (March 18, 2015). An irrevocable trust (the "Trust") was created by a grantor (the "Grantor") under State A law in December 2005. The Trust is treated as a grantor's trust for federal income tax purposes. The Grantor's spouse was named sole trustee (Trustee A) of the Trust. The Trust's sole beneficiaries were the Grantor and Trustee A's minor children. At the time of the Trust's creation, both the Grantor and Trustee A were residents of State B. The only property held by the Trust is ownership units of a limited liability company (the "LLC"). The LLC is headquartered in another state, but maintains an office in Virginia. On December 26, 2013, the Grantor, Trustee A and the beneficiaries moved to Virginia. On that date, Trustee A resigned as trustee and an State C resident was named trustee (Trustee B). On December 31, 2013, the Grantor relinquished his power to substitute assets of equivalent value in order to convert the trust from a grantor trust to a complex trust. In February 2014, Trustee B resigned and a Trust Company (Trustee C), which operates in State D, was appointed. Trustee C sought a ruling that the Trust is not a Virginia resident trust and is not required to file a Virginia resident fiduciary income tax return for taxable years beginning on and after December 26, 2013. The Tax Commissioner determined that the Trust would be required to file a Virginia income tax return if it has Virginia source income. The Tax Commissioner was unable to determine which state’s law would apply to the trust as the trust would still be a grantor trust without a court order. If Virginia law applies, the trust would be a resident Virginia trust.

4. **Recordation Tax: Supplemental Deeds of Trust.** P.D. 15-67 (April 15, 2015). In October 2012, the taxpayer recorded a credit line deed of trust in the County paying a recordation tax based on the secured value of the loan. In September 2014, the taxpayer filed a supplement to the original deed of trust that increased the amount secured by the loan from $50.4 million to $65 million. The County based the recordation tax on the difference between the existing balance of the loan, which was $35.4 million, and the $65 million secured by the loan using the rates applicable for new deeds of trust. The taxpayer appealed, contending that the County did not apply the recordation tax in accordance with the graduated rate schedule. The Tax Commissioner agreed and stated that the existing debt must be taken into consideration when determining which rate bracket must first be utilized.
5. **Pass-Through Entity Income Tax Withholding.** P.D. 15-91 (April 28, 2015). A ruling was requested as whether a pass-through entity formed to invest in intangible property would be required to file a Virginia pass-through entity return and withhold Virginia income tax. Two scenarios have been set forth as follows.

1. **PTE1** is located outside of Virginia. It has no employees or real or intangible property. PTE1 invests in a foreign limited liability company (FLLC) that is located in another state and does not do business in Virginia. It also invests in other stocks and notes. PTE1's investment manager does operate in Virginia and files a Virginia income tax return. The Tax Commissioner determined that based on the facts as presented, PTE1 would not have nexus with Virginia or any Virginia source income. As such, it would not be required to file a pass-through entity return.

2. **PTE2** is located outside of Virginia. It has no employees or real or intangible property. PTE2 invests in a Virginia limited liability company (VALLC) that is located in another state and does business in Virginia. It also invests in other stocks and notes. PTE2's investment manager does operate in Virginia and files a Virginia income tax return. The Tax Commissioner determined that the pass-through entity is required to file a return and remit withholding tax on only that income "derived or connected with Virginia sources." As such, only PTE2's Virginia source income would be subject to Virginia withholding tax.

6. **Inheritance Tax.** P.D. 15-93 (April 30, 2015). The Tax Commissioner determined that a taxpayer owed inheritance tax that was deferred from 1963 despite the fact that the tax was repealed in 1980.

7. **Withholding Tax.** P.D. 15-110 (June 2, 2015). The Tax Commissioner issued Virginia Tax Bulletin 15-3 to provide instructions for employers pursuant to 2015 House Bill 2307 which allows certain employers to request a waiver from the Virginia semi-weekly withholding tax filing requirement.

8. **Fiduciary Income Tax: Out of State Tax Credit.** P.D. 15-131 (June 25, 2015). For the 2011 through 2013 taxable years, the taxpayer, a nonresident trust, filed Virginia fiduciary income tax returns and claimed credits for income tax paid to California. Under review, the Tax Department concluded that the tax reported on the California returns was not an income tax, denied the credits, issued assessments for 2011 and 2012 and reduced the refund claimed on the 2013 return. The taxpayer appealed, contending that the tax was the income tax applicable to the portion of an Electing Small Business Trust (ESBT) that consisted of shares of an S corporation. The Tax Commissioner agreed and abated the assessment and ordered the refund to be issued. He determined that the tax on the ESBT was a tax on income.

9. **Forest Products Tax: Tax Bulletin.** P.D. 15-132 (June 25, 2015). The Tax Commissioner issued tax bulletin 15-5 to provide guidance for the changes made to the forest products tax by House Bill 1724 (Chapter 170).

10. **Fiduciary Income Tax: Resident Trust.** P.D. 15-156 (August 12, 2015). The residuary trust under the "Trust" was created under the will of a decedent who died as a domiciliary resident of Pennsylvania. The Trust has three co-trustees, one of whom is a resident of Virginia. The Virginia resident co-trustee is also entitled to a share of the remaining principal
and undistributed income of the Trust upon the death of the current income beneficiary, the
decedent's surviving spouse. The trustees sought a ruling that the Trust does not have nexus with
Virginia for fiduciary income tax purposes and is not required to file a Virginia fiduciary income
tax return. The Tax Commissioner determined that the Trust is not a resident trust and would
only file an income tax return in Virginia if it had Virginia source income. In this case, one
trustee is a resident of Virginia, but he cannot make decisions regarding the Trust individually
either by the terms of the Trust or under Pennsylvania law, which allows co-trustees to act by
majority decision if a unanimous decision cannot be reached. Instead, any power or discretion
he has over the Trust may be exercised only if at least one of the other co-trustee agrees, neither
of whom are Virginia residents. Therefore, if the committee of co-trustees is not operating or
controlled in Virginia, the fact that one trustee is a Virginia resident will not, by itself, cause the
trust to be considered to be administered in Virginia.

EMERGING ISSUES

I. BANK FRANCHISE TAX (Virginia imposes a tax on multi-state banks that does not provide for statutory apportionment)

The Virginia bank franchise tax is imposed in Chapter 12 of Title 58.1 of the Code of
Virginia. The tax is imposed on the net capital of a bank and in lieu of income taxes and other
taxes. “Net Capital” is computed by Va. Code § 58.1-1205 as follows:

The net capital of any bank shall be ascertained by adding together its capital,
surplus, undivided profits, and one half of any reserve for loan losses net of applicable deferred tax to obtain gross capital and deducting therefrom (i) the assessed value of real estate as provided in § 58.1-1206, (ii) the book value of tangible personal property under § 58.1-1206, (iii) the pro rata share of government obligations as set forth in § 58.1-1206, (iv) the capital accounts of any bank subsidiaries under § 58.1-1206, (v) the amount of any reserve for marketable securities valuation which is included in capital, surplus and undivided profits as defined hereinabove to the extent that such reserve reflects the difference between the book value and the market value of such marketable securities on December 31 next preceding the date for filing the bank's return under § 58.1-1207, and (vi) the value of goodwill described under subdivision A 5 of § 58.1-1206.

Nowhere in this definition nor elsewhere in the chapter is a method of apportionment provided for banks that operate in multiple states. However, intra-state apportionment is provided for in Va. Code § 58.1-1211. In this section, banks with branches in more than one Virginia locality are apportion their net capital to the locality by the proportion that the branch’s total deposits bears to the total deposits in the state. In a 1994 ruling (P.D. 94-366, December 8, 1994), the Virginia Tax Commissioner recognized the need for the apportionment of a multi-state bank’s net capital and stated the following:
In the absence of action by the General Assembly to specify the method of apportioning a multi-state bank's net capital, the Department would permit a bank subject to the Virginia bank franchise tax which accepts deposits at branch offices in another state, including the District of Columbia, to apportion net capital based on a deposit oriented methodology similar to that currently specified by the General Assembly for apportionment among Virginia localities.

After the Tax Commissioner issued this 1994 ruling, the General Assembly did not create a method of apportionment for multi-state banks. Despite the fact that the Code of Virginia does not give any authority to the Tax Commissioner to administratively provide for an apportionment method or give even general authority to adjust a taxpayer's net capital, no known challenge was made to this apportionment method.

One questionable aspect of the Tax Commissioner’s interpretation of this tax was how “bank” was defined. The Tax Commissioner determined that to be a “bank,” the entity must accept deposits. This was challenged in the Circuit Court for Norfolk by a trust company in 2011. On the basis that the trust company is chartered as a national banking association which satisfied the definition in Virginia Code § 58.1-1201, the Circuit Court determined that a trust company was exempt from the Virginia corporate income tax and instead subject to the Virginia bank franchise tax. AMG National Trust Bank v. Commonwealth of Virginia, Civil Docket No.: CL10-3031 (City of Norfolk Cir. Ct., April 7, 2011 and July 6, 2011). The Tax Commissioner immediately recognized an issue with this outcome and requested the Circuit Court to determine how the trust company should apportion its net capital for purposes of the Virginia bank franchise tax. The Circuit Court declined to make such a determination.

Despite the Circuit Court’s opinion, the Virginia General Assembly did not create a method of apportionment. The Tax Commissioner has continued to administer this tax with its own administratively created apportionment formula despite having no authority whatsoever to require this.

Recently, the Tax Department has administratively started requiring banks without deposits to use an alternate method of apportionment. Again, there is no statutory authority for this. This alternate method is based on the bank’s real property and tangible personal property. This is puzzling as the computation of “net capital” specifically excludes both the value of real property and tangible personal property from being taxed.

II. MACHINERY AND TOOLS TAX

The Virginia Constitution provides that machinery and tools must be valued at fair market value. Specifically, Article X, Section II of the Virginia Constitution states that, “All assessments of real estate and tangible personal property shall be at their fair market value, to be ascertained as prescribed by law.”

Virginia Code sec. 58.1-3507(B) provides the basis for the M&T tax. This subsection states
Machinery and tools . . . shall be valued by means of depreciated cost or a percentage or percentages of original total capitalized cost excluding capitalized interest. In valuing machinery and tools, the commissioner of the revenue shall, upon the written request of the taxpayer, consider any bona fide, independent appraisal presented by the taxpayer.

The issue with the Code section is the meaning of “original total capitalized cost.” In a 2009 Opinion of the Virginia Attorney General, the meaning of the term “original cost” was defined in the context of property taxes. The Attorney General opined that, “the term ‘original cost’ means the acquisition cost of property from the manufacturer or dealer, i.e., the original cost paid by the original purchaser of such property from the manufacturer or dealer.” Op. Va. Atty. Gen. No. 08-109 (February 25, 2009). The Tax Department, which is authorized by the Code of Virginia to consider appeals and issue rulings concerning many local taxes, has not deviated from the Attorney General opinion and continually cites the opinion in its rulings. See, e.g., Rulings of the Tax Commissioner, Public Document (P.D.) 14-55 (April 24, 2014), P.D. 13-20 (February 15, 2013), and P.D. 12-27 (March 6, 2012).

The Attorney General’s opinion is flawed. To define the term “original cost,” the opinion does not cite any prior Virginia authority or the Virginia Constitutional requirement that all property must be valued at its fair market value. Instead, the opinion solely relies on the 2004 edition of Black’s Law Dictionary for the meaning of the term “original cost.” Additionally, the more reasoned approach would relate to the “original cost” of the taxpayer who actually owns the M&T at issue giving rise to the assessment, such as the taxpayer’s acquisition cost as opposed to a historic cost of a previous owner of the machinery and tools.

In an opinion dated June 26, 2014, the Attorney General revisited the opinion and the meaning of “original cost” when a taxpayer purchases property in a bankruptcy sale. The Attorney General reiterated that “original cost” means “the original cost paid by the original purchaser of the property from the manufacturer or dealer and not the price paid by the current owner.” The Attorney General “affirmed” the prior opinion because “the General Assembly has not amended this language since this Opinion was issued.” However in a footnote, the Attorney General stated:

I am mindful that this construction can lead the fair market value of property for purposes of the machinery and tools tax or the personal property tax to be significantly more than what the current owner/taxpayer paid for the property, as is evidenced by the bankruptcy sale at issue in your request. The fair market value of an asset generally might exceed the purchase price paid for that asset at bankruptcy or similar foreclosure sale. [Citations omitted] This does not, however, necessarily lead to taxation based upon more than fair market value in violation of Article X, § 2 of the Constitution of Virginia. As the Supreme Court of Virginia has stated,

The fair market value of property, as that term is here used means the price which it will bring when it is offered for sale by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it.
The underlined sentence is important. While the Attorney General’s definition of “original cost” is flawed, he does acknowledge that property cannot be taxed based upon a valuation above fair market value. Virginia local governments have not shown any propensity to value machinery and tools at anything less than original cost and then tax such property based on a “percentage” of original cost. If the percentage of original cost used by the local government is high and the machinery and tools have been in use for numerous years, the taxpayer could potentially be eligible for a refund of overpaid machinery and tools tax.