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Recent Developments in Virginia Taxation

Craig D. Bell

RECENT DEVELOPMENTS IN VIRGINIA TAXATION

A Discussion of Tax Legislation, Recent Court Decisions, and Published Rulings of the Tax Commissioner and Opinions of the Attorney General from October 1, 2017 through September 30, 2018

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

*The following McGuireWoods LLP lawyers also contributed to this outline: Emily J.S. Winbigler, J. Christian Tennant, and Joshua A. Labat.

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RECENT DEVELOPMENTS IN VIRGINIA TAXATION

A Discussion of Tax Legislation, Recent Court Decisions, and Published Rulings of the Tax Commissioner and Opinions of the Attorney General from October 1, 2017 through September 30, 2018.

I. CORPORATE INCOME TAX

A. 2018 Legislation

1. Conformity with the Internal Revenue Code. Senate Bill 230 (Chapter 14) and House Bill 154 (Chapter 15) amend § 58.1-301 to advance Virginia's date of conformity to the Internal Revenue Code from December 31, 2016 to February 9, 2018. This conforms Virginia to the Disaster Relief Act, which provides temporary tax relief to individuals and businesses affected by Hurricanes Harvey, Irma, and Maria, the Tax Relief and Airport and Airway Extension Act of 2017, and the provisions of the Bipartisan Budget Act of 2018 that are effective for Taxable Year 2017. This legislation makes an exception for the Tax Cuts and Jobs Act. The legislation specifically deconforms to all provisions from Tax Cuts and Jobs Act effective after the 2017 taxable year. It conforms to three provisions of the Tax Cuts and Jobs Act that are effective for the 2017 taxable year. Those three provisions provide tax relief for specified 2016 disaster areas; provide tax relief for certain individuals performing services in the Sinai Peninsula of Egypt; and repeal the substantiation exception for charitable contributions reported by a donee organization. The one 2017 provision from the Tax Cuts and Jobs Act that is deconformed to reduce the medical expense deduction threshold from 10 percent to 7.5 percent of adjusted gross income. The Tax Department has issued a worksheet to make this adjustment. This legislation was effective on February 22, 2018.

2. Alternate Apportionment for Economic Development. House Bill 222 (Chapter 802) and Senate Bill 883 (Chapter 801) amend §§ 2.2-115, 58.1-405, 58.1-408, 58.1-417 through 58.1-420, 58.1-422, 58.1-422.1, and 58.1-422.2 and add §§ 15.2-958.2:01 and 58.1-405.1 to provide for alternate apportionment for certain eligible businesses who locate and operate in certain qualified localities. The certain eligible businesses who may adjust their apportionment to exclude certain payroll, property, or sale. For those eligible businesses who are motor carriers, financial corporations, construction corporations, railway companies, manufacturing companies, retail companies, and taxpayers with enterprise data center operations that are eligible to use single factor sales apportionment, such factors may also be adjusted. This legislation would be effective on July 1, 2018.

3. Debt Buyers Apportionment. House Bill 798 (Chapter 807) amends §§ 58.1-408 and 58.1-416 to require debt buyers to apportion their Virginia taxable income using a single factor method of apportionment based on sales. This bill provides that, for debt buyers, only money recovered on debt that a debt buyer collected from a person who is a resident of Virginia or an entity that has its commercial domicile in Virginia would be apportioned to Virginia for income tax purposes. This legislation would be effective on taxable years beginning after January 1, 2019.

4. Subtraction for Certain Real Estate Investment Trust Income. House Bill 365 (Chapter 821) amends §§ 58.1-322.02 and 58.1-402 to create a corporate income tax subtraction for certain income attributable to an investment in a Virginia real estate investment trust ("REIT") made on or after January 1, 2019, but before December 31, 2024. To qualify, the REIT would be required to be certified by the Tax Department as a Virginia REIT for the year in which the investment is made. In order to be certified as a Virginia REIT, the REIT trustee would be required to register the trust with the Tax Department prior to December 31, 2024, indicating that it intends to invest:

- At least 90 percent of trust funds in Virginia; and
- At least 40 percent of trust funds in real estate in localities that are distressed or double distressed.

This legislation would be effective on taxable years beginning after January 1, 2019.

5. Agricultural Best Management Practices Credit. House Bill 1382 (Chapter 556) amends § 58.1-439.5 to remove the five year carry over language and add a refundability provision. This legislation would be effective on July 1, 2018.

6. Worker Retraining Tax Credit. House Bill 129 (Chapter 129) amends § 58.1-439.6 to expand the Worker Retraining Tax Credit by allowing a taxpayer primarily engaged in manufacturing to claim a corporate income tax credit equal to 35 percent of its direct costs incurred during the taxable year in conducting orientation, instruction, and training in Virginia relating to the manufacturing activities undertaken by such taxpayer. No taxpayer would be permitted to claim credits in excess of $2,000 per taxable year. This bill will reduce the annual credit cap for the Worker Retraining Tax Credit from $2.5 million to $1 million per taxable year. This legislation will be effective for taxable years beginning on or after January 1, 2018, and before January 1, 2022.

7. Coal Tax Credits. House Bill 665 (Chapter 853) and Senate Bill 378 (Chapter 855) amend § 58.1-439.2 to reinstate the Coalfield Employment Enhancement Tax Credit for taxable years beginning on and after January 1, 2018, but before January 1, 2023 for metallurgical coal and for the production of coalbed methane. This legislation would be effective on July 1, 2018.

8. Green Job Creation Tax Credit Sunset Extension. House Bill 1372 (Chapter 346) and Senate Bill 573 (Chapter 347) amend § 58.1-439.12:05 to extend the sunset date for the Green Job Creation Tax Credit for three years, from January 1, 2018 to January 1, 2021.

B. Recent Court Decisions

1. Kohl's Department Stores, Inc. v. Virginia Department of Taxation, Record No. 160681, Supreme Court of Virginia (March 22, 2018). **REVISED OPINION.** The revised opinion has the same conclusion as the original opinion that the exception to the add-back statute applies only to the extent the royalty payments were actually taxed by another state. However, the Court changed its reasoning. Before, the Court deferred to the Tax Department's

interpretation of the statute. Now the Court has corrected itself by recognizing that § 58.1-205 only permits deference if the interpretation is expressed in a regulation. But the Court opines that the maxim of construing tax laws against the state is trumped by construing the statutes reasonably to effect the legislature's purpose. Relying primarily on the Fiscal Impact Statement released in connection with the enactment of the "add-back statute," which predicted an increase in state revenues from the implementation of the add-back statute, the Court determined that legislative purpose would be thwarted if Kohl's position was accepted. Justices McClanahan and Kelsey, and Chief Justice Lemons, continued to dissent for the reasons set forth below.

ORIGINAL OPINION. 294 Va. 57 (2017).

Kohl's, which operates retail stores in Virginia and elsewhere, paid royalties to its affiliate, "Kohl's Illinois," for the use of intellectual property owned by Kohl's Illinois. Kohl's Illinois also operates retail stores, but none in Virginia. Kohl's deducted the royalties paid to Kohl's Illinois on its federal income tax return as ordinary and necessary business expenses. The issue for the Court was whether Kohl's had to "add back" to its Virginia taxable income some or all of those royalties payments under Va. Code § 58.1-402(B)(8)(a) (the "add-back statute"). The royalty expenses would not be required to be added-back to Kohl's Virginia income if that income "received by the related member is subject to a tax based on or measured by net income or capital imposed by…another state." Va. Code § 58.1-402(B)(8)(a)(1). While the royalty income was included in Kohl's Illinois' income, Kohl's Illinois did not pay state taxes on all of that income because in each state in which Kohl's Illinois filed a return, it was only taxed on an apportionable share of its taxable income. Justice Mims, writing the majority opinion and joined by Justices Powell and McCullough, as well as Senior Justice Russell, opined that the exception to the add-back statute applied only to the royalty income where Kohl's Illinois did, in fact, pay tax in other states. They found that the statutory scheme was ambiguous and of "doubtful import" so it could, notwithstanding Va. Code § 58.1-205 ("judicial notice" given to Department of Taxation published guidance), give "due weight" to the Rulings of the Tax Commissioner and the Fiscal Impact statement prepared by the Tax Commissioner when the General Assembly enacted the add-back statute. The Court held that the exception to the add-back statute applies only to the extent the royalty payments were actually taxed by another state (e.g., on a post-apportionment basis). The tax could, however, be paid by any member of Kohl's affiliated group (for example, in certain combined return states, Kohl's Illinois' income was also included in Kohl's taxable income calculations).

The dissenting opinion, written by Justice McClanahan and joined by Chief Justice Lemons and Justice Kelsey, did not find any ambiguity in the exception to the add-back statute. In its view, the exception to the add-back statute does not contain an apportionment qualifier. The subsequent attempts to amend the add-back statute by the General Assembly would have inserted apportionment language. Those attempts failed or, with respect to two budget bills that appeared to enact retroactive tax legislation, were not at issue in the case. Even if the add-back statute was ambiguous, the dissent would have resolved the ambiguity in favor of the taxpayer (and in favor of finding that the exception to the add-back statute applies on a "pre-apportionment" basis) because general tax statutes are construed most strongly against the Commonwealth and in favor of the taxpayer. Finally, in the dissent's view, the legislative history of the add-back statute was to close loopholes relating to holding companies for which income is not subject to tax in *any* state. By contrast, the income of Kohl's Illinois is subject to tax in many states.

2. Corporate Executive Board v. Virginia Department of Taxation, 96 Va. Cir. 287 (Cir. Ct. Arlington, Sept. 1, 2017). The court denied the request by Corporate Executive Board ("CEB") to use a destination-based sourcing apportionment method in lieu of the statutory prescribed cost of performance method (the "statutory method"). CEB develops information (best practices research, executive education, etc.), which customers purchase for a fixed-fee subscription and can access online. Nearly all of CEB's costs of performance were incurred at its Arlington headquarters but fewer than 6% of its customers had a Virginia billing address. Under the statutory method, CEB reported approximately 90% of its sales in Virginia, while other states with destination-based sourcing rules required CEB to pay income tax on 30-35% of its sales. The court determined that the statutory method was not unconstitutional because there was sufficient connection between its activities generating the income and Virginia and the income attributed to Virginia was rationally related to values connected with Virginia. It also found that CEB's proposed method would produce arbitrary results because a customer may access or use CEB's information in a state different than its billing address. Any double taxation incurred by CEB as a result of the statutory method was attributable to unique sourcing methods used by other states; as such, the statutory method did not produce inequitable or arbitrary results in this case. The Virginia Supreme Court granted CEB's Petition for Appeal. The appellate briefs have been filed with the court and oral argument should occur before the end of 2018. A decision on the appeal is anticipated in 2019.

C. Rulings of the Tax Commissioner

1. Virginia Source Income for Foreign Corporations. P.D. 17-195 (November 16, 2017). The taxpayer, a foreign corporation organized in Canada, with no taxable income, or locations or employees in Virginia requested a ruling as to whether it is subject to Virginia income tax or whether it is required to file a Virginia corporation income tax return. The Tax Department stated that even if the taxpayer did not have corporate income tax liability, it is still must file a Virginia corporate income tax return if it is registered with the SCC to do business in Virginia.

2. Disallowed Payroll Expense Deductions. P.D. 17-192 (November 16, 2017). A group of restaurants sought a ruling on whether they may claim a subtraction from Virginia taxable income for the credit they claim against their federal income tax liability for Social Security taxes paid on employee tips. The Tax Commissioner determined that because the Virginia tax code does not expressly authorize this subtraction, the restaurants were unable to claim the subtraction.

3. Pass-through Entity Withholding Tax. P.D. 18-12 (February 7, 2018). The taxpayer is a limited partnership not organized in Virginia. The taxpayer buys and sells natural gas while it is in pipeline and sells to some buyers located in Virginia; the Virginia buyers often resell the natural gas purchased from the taxpayer. The Tax Commissioner determined that because some of the ultimate purchasers may be located in Virginia, the taxpayer has Virginia Source Income.

4. Fixed Date Conformity Bulletin. P.D. 18-15 (February 26, 2018). The Tax Department issued Tax Bulletin 18-1. During the 2018 General Assembly Session, legislation was enacted to advance Virginia's date of conformity to the Internal Revenue Code from December 31, 2016 to February 9, 2018. This allows Virginia to conform to the Disaster Tax Relief and Airport and Airway Extension Act of 2017, as well as most of the provisions of the Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018 that are effective for taxable year 2017. However, this legislation does not conform to the provision of the Tax Cuts and Jobs Act that temporarily increases the medical expenses deduction for taxable years 2017 and 2018. In addition, this legislation deconforms from most of the provisions of the Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018 that are effective for taxable year 2018 and thereafter.

5. Protective Claim and Filing Requirements. P.D. 18-50 (April 16, 2018). The taxpayer discovered that it failed to claim a subtraction for foreign source income on its 2012 Virginia corporate income tax return, filed a protective claim for refund prior to the expiration of the statute of limitations, and filed its amended return. The Tax Department denied the request for a refund because the amended return was filed after the limitations period had passed. In order to successfully file a protective claim for refund, the taxpayer must include information that sufficiently identifies the taxpayer, the type of tax, taxable period, remedy sought, date of assessment, date of payment, a statement by the taxpayer setting forth the alleged error of the Tax Department, and the ground upon which the taxpayer relies. The Tax Commissioner determined that the taxpayer had satisfied all of the elements necessary for a protective claim. The Tax Commissioner also determined that the taxpayer’s protective claim had been timely filed with the Tax Department, and as a result, the taxpayer’s amended return would be processed and a refund would be issued.

6. Unified Filing Requirements. P.D. 18-71 (May 2, 2018). The taxpayer sought a ruling that grantor trusts, qualified subchapter S trusts (“QSSTs”), and electing small business trusts (“ESBTs”) can be included in a composite nonresident income tax return. The Tax Commissioner concluded that as long as the filing requirements are met for each of the trusts under the applicable Internal Revenue Code sections, then grantor trusts, QSSTs, and ESBTs can be included in a Virginia nonresident composite trust.

7. Telework Expenses and Eligible Employees. P.D. 18-94 (May 21, 2018). The taxpayer, a Virginia S corporation, applied for a Virginia tax credit for employers who incur telework expenses pursuant to a telework agreement. The Tax Department denied the credit on the basis that the individual listed on the taxpayer’s credit application was not an eligible employee, but was 100% owner of the taxpayer. The Tax Commissioner determined that while the individual was 100% owner of the taxpayer, the individual performed services for the taxpayer for compensation and received a W-2. Because the individual did perform services for compensation and received a W-2, the taxpayer was eligible for the tax credit.

8. Allocation and Apportionment. P.D. 18-117 (June 8, 2018). The taxpayer filed amended Virginia corporate income tax returns for the 2012 and 2013 taxable years adjusting its sales factor numerator and claiming refunds. The Tax Department denied the refunds because the taxpayer failed to provide adequate documentation to substantiate its

position. The Tax Department asked for a schedule showing a breakdown of costs associated with generating income by category and state. The taxpayer appealed contending that while it did not have the specific documentation that the Tax Department requested, it had alternative documentation. The Tax Commissioner denied the taxpayer's appeal, stating that because a sales transaction associated with Virginia is a facts and circumstances determination, the taxpayer must retain suitable records of its sales or it will not be able to substantiate its position satisfactorily with the Tax Department.

9. Foreign Source Income and Net Operating Loss. P.D. 18-126 (June 26, 2018). The taxpayer and its affiliates filed consolidated income tax returns for a number of taxable years. The taxpayer argued that the Tax Department made three errors. First, that the Tax Department incorrectly disallowed a subtraction for foreign source income to be carried forward because the taxpayer already had taken net operating losses ("NOLs"). Second, that the Tax Department's NOL schedules did not account for special provisions under Internal Revenue Code ("IRC") section 965. Third, that the Tax Department should permit the taxpayer to claim NOLs carried forward by certain affiliates that were liquidated during the tax years at issue. The Tax Commissioner determined that the taxpayer's subtraction for foreign source income was correctly disallowed because the taxpayer was asking the Tax Department to increase the amount of its net operating loss deductions through a foreign source income subtraction increase. The Tax Commissioner determined that this request would amount to a Virginia NOL, which is not permissible. The Tax Commissioner ruled that the special provisions of IRC section 965 were incorrectly interpreted because losses attributable to the taxpayer's affiliates were not taken into account. As such, the case was returned to the audit staff to revise the taxpayer's NOL schedule. Finally, the Tax Commissioner determined that the taxpayer failed to submit sufficient documentation to substantiate the NOLs the taxpayer was entitled to for the taxable years at issue.

10. Net Operating Loss, Fixed Date Conformity, and Carryforward. P.D. 18-127 (June 26, 2018). The taxpayer reported a net operating loss ("NOL") for the 2011 taxable year. It carried forward the losses for the 2012 and 2013 taxable years. The Tax Department adjusted the 2011 NOL to reflect the balance of the fixed date conformity adjustments. This adjustment resulted in an assessment for the 2013 taxable year. The taxpayer appealed, contending that it properly calculated its net operating loss deduction ("NOLD") carryforward. The Tax Commissioner determined that the taxpayer carried its 2011 federal NOLD forward and offset the loss against its 2012 and 2013 federal taxable income, but the taxpayer failed to adjust its 2012 and 2013 federal taxable income by the fixed date conformity additions and subtractions. As a result, the Tax Department's assessment for the 2013 taxable year was upheld.

II. INDIVIDUAL INCOME TAX

A. 2018 Legislation

1. Subtraction for Certain Real Estate Investment Trust Income. House Bill 365 (Chapter 821) amends §§ 58.1-322.02 and 58.1-402 to create an individual income tax subtraction for certain income attributable to an investment in a Virginia real estate investment trust ("REIT") made on or after January 1, 2019, but before December 31, 2024. To qualify, the

REIT would be required to be certified by the Tax Department as a Virginia REIT for the year in which the investment is made. In order to be certified as a Virginia REIT, the REIT trustee would be required to register the trust with the Tax Department prior to December 31, 2024, indicating that it intends to invest:

- At least 90 percent of trust funds in Virginia; and
- At least 40 percent of trust funds in real estate in localities that are distressed or double distressed.

This legislation would be effective on taxable years beginning after January 1, 2019.

2. Land Preservation Tax Credit. House Bill 1460 (Chapter 560) amends § 58.1-513 to allow an individual taxpayer, upon his or her death, to transfer unused Land Preservation Tax Credits through a will, bequest, or other instrument of transfer to a designated beneficiary. If such taxpayer dies without a will, this bill provides that any unused Land Preservation Tax Credits would be transferred to the next person who is eligible to receive according to Virginia's rules of intestate succession. The ability to transfer Land Preservation Tax Credits upon death is limited to the individual taxpayer who originally earned such credits. This legislation would apply to transfers of unused credits upon the death of a taxpayer occurring on and after July 1, 2018, regardless of when such unused credits were earned.

3. Worker Retraining Tax Credit. House Bill 129 (Chapter 500) amends § 58.1-439.6 to expand the Worker Retraining Tax Credit by allowing a taxpayer primarily engaged in manufacturing to claim an individual income tax credit equal to 35 percent of its direct costs incurred during the taxable year in conducting orientation, instruction, and training in Virginia relating to the manufacturing activities undertaken by such taxpayer. No taxpayer would be permitted to claim credits in excess of $2,000 per taxable year. This bill will reduce the annual credit cap for the Worker Retraining Tax Credit from $2.5 million to $1 million per taxable year. This legislation will be effective for taxable years beginning on or after January 1, 2018, and before January 1, 2022.

4. Notification of Breach. House Bill 183 (Chapter 283) and Senate Bill 271 (Chapter 360) amend § 58.1-341.2 to require that any signing income tax return preparer who prepares Virginia individual income tax returns during a calendar year notify the Tax Department without unreasonable delay after the discovery or notification of unauthorized access and acquisition of unencrypted and unredacted return information maintained by that tax preparer, that compromises the confidentiality of such information and that creates a reasonable belief that an unencrypted and unredacted version of such information was accessed and acquired by an unauthorized person, and causes, or such preparer reasonably believes has caused or will cause, identity theft or other fraud. The signing income tax return preparer is required to provide the Tax Department with the name and taxpayer identification number of any taxpayer that may be affected by a compromise in confidentiality that requires notification to the Tax Department, as well as the name of the signing income tax return preparer, his preparer tax identification number, and such other information as the Tax Department may prescribe. An income tax return preparer is required to complete such notification requirement on behalf of any of its employees who are signing income tax return preparers and who would otherwise be required to notify the Tax Department. This legislation is effective on July 1, 2018.

5. Tax Return Preparers. House Bill 778 (Chapter 150) amends § 58.1-348.2 and adds §§ 58.1-348.3 and 58.1-348.4 to require that any income tax return preparer include his or her preparer tax identification number on any tax return that he or she prepares or assists in preparing. Any income tax return preparer who does not fulfill this requirement would be subject to a civil penalty in an amount equal to $50 per offense, but not to exceed $25,000 per calendar year. This bill also permits the Tax Department to bar or suspend any income tax return preparer for repeated failures of this requirement. This legislation is effective for taxable years beginning on and after January 1, 2019.

B. Recent Court Decisions

1. Woolford v. Virginia Department of Taxation, 294 Va. 377 (2017). This is the first opinion issued by the Supreme Court of Virginia on the Virginia Land Preservation Tax Credit Program. The Court determined that the appraiser hired by the plaintiffs (the "Woolfords") was a qualified appraiser. The Court also determined that the Tax Department could audit the value of the land preservation income tax credits ("Credits") beyond 30 days from the application for Credits that was filed by the Woolfords.

This case involved the issuance and subsequent denial of Credits by the Tax Department. In 2011, the Woolfords placed a conservation easement on real property located in King William County. Based upon an appraisal done by Michael Simerlein, the easement was valued at $13.5 million which, upon application to the Tax Department, generated $4.9 million in Credits which were issued in 2011. The Woolfords sold all of the Credits in 2011 and 2012. In 2013, the Tax Department notified the Woolfords that they would be auditing the value of the conservation easement. The real property upon which the easement was placed was mostly rural, but has significant mineral deposits. The Tax Department ultimately denied the entire amount of the issued Credits for several issues including that Mr. Simerlein was not a qualified appraiser as is required under the statute as he was not qualified to appraise minerals and, as such, the Tax Department denied the entire amount as it determined that the Woolfords had not proven the value of the conservation easement. The Tax Department made no effort to determine an alternate value of the conservation easement.

Virginia Code § 58.1-512(B) incorporates the definition of a "qualified appraiser" from Internal Revenue Code (IRC) § 170(f)(11)(E)(ii) which provides that a "qualified appraiser" is a person who

> (I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,
> (II) regularly performs appraisals for which the individual receives compensation, and
> (III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

Also, IRC § 170(f)(11)(E)(iii) specifies that a person shall not be treated as a qualified appraiser unless "the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal . . . ." Citing Simerlein's lack of mineral-related course work, the Tax Department did not deem him to be a "qualified appraiser." The Supreme Court of Virginia disagreed and determined that Simerlein was a qualified appraiser" based upon his prior experience in performing appraisal work on mineral rights.

An issue raised by the Woolfords was that because the Tax Department did not deem the appraisal false or fraudulent within 30 days of the application being filed that the value of the credits could not be adjusted. This argument is based on Virginia Code § 58.1-512. However, the Supreme Court of Virginia disagreed and stated that the 30 day deadline was only meant for the initial acceptance of the Credits and that the Tax Department could still later audit the value of the Credits.

In a very important conclusion to this opinion, the Supreme Court of Virginia stated

> We finally note the Department's striking position that the Woolfords are entitled to nothing for their donation to the Commonwealth. The tax credits that the General Assembly has authorized must be based on "[t]he fair market value of qualified donations." Code § 58.1-512(B).The object of auditing the claimed credits is to enable the Department to "determine[] the fair market value of the property and the amount of tax credit to be allowed under this section." Code § 58.1-512(B). Even if the Department were to prevail below on its remaining arguments, a point on which we express no opinion, unless the Department concludes in good faith based on the evidence that the value of the easement is zero, it must award the Woolfords tax credits for the fair market value of the donation.

As they did in this case, the Tax Department routinely takes the position that it is incumbent on the taxpayer to prove the value of the donation. Based upon the above excerpt, that position is improper.

C. Rulings of the Tax Commissioner

1. Virginia Residents. The following rulings all deal with who is a domiciliary or resident of Virginia: P.D. 17-191 (November 16, 2017); P.D. 18-25 (March 14, 2018); P.D. 18-27 (March 15, 2018); P.D. 18-33 (March 26, 2018); P.D. 18-34 (March 26, 2018); P.D. 18-45 (April 3, 2018); P.D. 18-48 (April 16, 2018); P.D. 18-49 (April 16, 2018); P.D. 18-54 (April 19, 2018); P.D. 18-56 (April 19, 2018); P.D. 18-57 (April 19, 2018); P.D. 18-58 (April 25, 2018); P.D. 18-61 (April 30, 2018); P.D. 18-77 (May 2, 2018); P.D. 18-78 (May 2, 2018); P.D. 18-84 (May 9, 2018); P.D. 18-89 (May 16, 2018); P.D. 18-90 (May 18, 2018); P.D. 18-92 (May 18, 2018); P.D. 18-118 (June 8, 2018); P.D. 18-110 (June 6, 2018); P.D. 18-129 (June 27, 2018); P.D. 18-132 (June 29, 2018); P.D. 18-135 (July 11, 2018); P.D. 18-145 (July 17, 2018); P.D. 18-153 (August 8, 2018); P.D. 18-156 (August 8, 2018).

2. Domicile: Military. The following rulings all deal with whether a member of the military is required to file an income tax return with Virginia: P.D. 18-37 (March 29, 2018); P.D. 18-40 (March 30, 2018); P.D. 18-55 (April 19, 2018); P.D. 18-101 (May 22, 2018); P.D. 18-108 (June 6, 2018); P.D. 18-119 (June 8, 2018); P.D. 18-142 (July 17, 2018).

3. Statute of Limitations for Refunds Due to Disability. P.D. 17-194 (November 16, 2017). A Virginia taxpayer filed his 2012 individual income tax return in January 2017, reporting an overpayment of income tax and requested that the overpayment be credited as an estimated payment for the following year. The 2012 tax return was filed in 2017 because of the taxpayer's medical condition. The Tax Department denied the credit because the return was filed beyond the refund period allowed by the statute of limitation. Virginia Code § 58.1-341(F) states that if a taxpayer is unable to make a return because of a disability, the taxpayer has the responsibility of having the return filed by a fiduciary or authorized agent. Even though the taxpayer requested a credit instead of a refund, the refund statute of Virginia Code § 58.1-499(D) applies to credits as well. The Tax Commissioner ruled that the taxpayer could not receive a credit for his overpayment because the statute of limitations had already expired.

4. Taxpayer's Reliance on Written Advice from the Tax Department. P.D. 17-204 (December 13, 2017). A taxpayer filed his 2012 Virginia individual income tax return in December 2016, reporting an overpayment and requesting a refund. The Tax Department denied the refund because the refund was filed beyond the refund period allowed by the statute of limitations. The taxpayer appealed, arguing that in October 2013, a representative of the Tax Department told him that he had 5 years to file the return. Virginia Code § 58.1-1835 gives the Tax Commissioner the authority to abate an assessment that is attributable to erroneous advice furnished to a taxpayer in writing by an employee of the Tax Department acting in his official capacity. The Tax Commissioner denied the taxpayer's appeal because there was no record of the conversation between the taxpayer and the Tax Department.

5. Foreign Source Income. P.D. 17-210 (December 18, 2017). The Tax Department determined that a taxpayer was a Virginia resident and issued an assessment. The taxpayer filed an appeal arguing that his income was foreign source and that he paid income tax in the foreign country. The Tax Commissioner upheld the Tax Department's assessment because the information made available to the Tax Department was accurate and the taxpayer had not provided any alternative information.

6. Credit for Taxes Paid to Other States. P.D. 18-4 (January 5, 2018). The taxpayers filed a Virginia nonresident individual income tax return for the 2015 taxable year and claimed a credit for income tax paid to Arizona. The Tax Department adjusted the taxpayers' credits and issued an assessment. The Tax Department erroneously applied the wrong formula to adjust the taxpayers' credit. The Tax Department had to re-compute the taxpayers' credit using the proportion of the entire tax paid to Arizona. As a result, the Tax Commissioner stated that the assessment would be adjusted to correctly reflect the credits.

7. Itemized Deductions on Separate Returns. P.D. 18-11 (February 7, 2018). The taxpayer requested a reconsideration and sought a correction of the individual income tax assessment issued by the Tax Department. The Tax Department reaffirmed its position that where a Virginia resident and nonresident spouse file separate state income tax returns, Virginia Code § 58.1-326 grants the Tax Department authority to modify the allocation of exemptions and deductions claimed. Normally, each spouse must account separately for items of income, deductions, and exemptions, but when this cannot be accomplished such items must be

proportionally allocated between each spouse based upon the income attributable to each. As a result, the Tax Commissioner did not approve the taxpayer's request for consideration.

8. Subtractions for IRA Distributions. P.D. 18-16 (March 7, 2018). The taxpayers claimed a subtraction for distribution from their IRA on their Virginia individual income tax returns. The Tax Department disallowed these claimed subtractions, and the taxpayers appealed, arguing that the subtraction should be allowed because the distributions were income from Treasury funds. The Tax Commissioner agreed with the taxpayers' contention that the subtraction should be allowed. In coming to this conclusion, the Tax Commissioner stated that all obligations or securities of the United States may be subtracted for Virginia income tax purposes in computing Virginia taxable income.

9. Audit and Taxpayer Records. P.D. 18-17 (March 8, 2018). The Tax Department received information from the IRS indicating that the taxpayer may have been required to file Virginia income tax returns for certain taxable years. The Tax Department reached out to the taxpayer, and when adequate response was not received, it issued assessments for each taxable year at issue. The taxpayer appealed, contending that the IRS committed fraud. The Tax Commissioner denied the taxpayer's appeal. The reasoning behind the denial was because the taxpayer provided no evidence that the IRS's information was fraudulent. Further, the Tax Commissioner stated that the taxpayer's claim that the Tax Department's assessments against him were illegal had no basis in fact or Virginia law.

10. Refunds and Protective Claims. P.D. 18-18 (March 8, 2018). The Tax Department issued an assessment to the taxpayer, after the taxpayer failed to file a Virginia individual income tax return for the 2011 taxable year. The assessment was paid in full on February 20, 2015. In August 2017, the taxpayer filed his 2011 return, reporting an overpayment of income tax and requesting a refund. The Tax Department denied the refund because the return was filed beyond the refund period allowed by the statute of limitations. The taxpayer appealed claiming that he timely filed a protective claim for refund. The Tax Commissioner determined that the taxpayer was entitled to have a refund issued because even though he filed his appeal late, Title 23 VAC 10-20-190(A)(1) states that there is no form or application for protective claims. Since the taxpayer properly identified himself, the type of tax, the taxable period, the remedy sought, date of assessment and date of payment, and signed the statement, the taxpayer satisfied his obligation for a protective claim.

11. Subtractions for Foreign Source Income. P.D. 18-19 (March 9, 2018). The taxpayer filed a Virginia nonresident individual income tax return and claimed a subtraction for foreign source income. The Tax Department denied the subtraction and issued an assessment. The taxpayer paid the assessment and appealed, claiming that her foreign source income was not subject to Virginia income tax. The Tax Commissioner denied the taxpayer's appeal because the General Assembly specifically repealed the subtraction for foreign source income.

12. Internal Revenue Code § 338(h)(10) Elections. P.D. 18-20 (March 9, 2018). An S corporation that is incorporated has four nonresident individual shareholders. The taxpayer was contemplating purchasing the stock of this S corporation by utilizing IRC §

338(h)(10) election. The taxpayer requested a ruling as to how the capital gains would be treated by the nonresidents if it does not make the IRC § 338(h)(10) election, *i.e.*, whether the nonresidents would report the capital gain as Virginia source income or as a deduction from Virginia taxable income on their nonresident Virginia returns. The Tax Commissioner stated that because Virginia follows the federal treatment of the IRC § 338(h)(10) election, the sale of the S corporation's assets would be deemed to be income from carrying on a business, trade, profession or occupation within Virginia.

13. Taxes Paid to Other States and Pass-through Entities. P.D. 18-21 (March 12, 2018). The taxpayers, a husband and wife residing in Virginia, filed their income tax return and claimed credit for income tax paid on the on the husband's behalf by a pass-through entity ("PTE") filing a unified Virginia return for its nonresident owners. The Tax Department denied the refund claimed because the husband's income had been included in a unified nonresident return. The Tax Commissioner denied the taxpayers' appeal stating that because the taxpayers were Virginia residents, there was no PTE withholding tax for which the taxpayers could claim credit on their return.

14. Statute of Limitations and Reporting. P.D. 18-29 (March 20, 2018). The taxpayers filed an amended return seeking a refund because they did not report all of their income and withholding. The Tax Department denied the claim on the basis that the statute of limitations for claiming the refund had expired. The taxpayers then received a letter from the IRS indicating that their federal adjusted gross income for the taxable year at issue was adjusted. The taxpayers then requested a refund for the overpayment. The Tax Commissioner allowed the refund request because the taxpayers notified the Tax Department within 30 days of receiving the letter from the IRS.

15. Land Preservation Tax Credits and Statute of Limitations. P.D. 18-31 (March 20, 2018); P.D. 18-35 (March 26, 2018). The taxpayers purchased a land preservation tax credit in 2008, and claimed the credit on their Virginia individual income tax return. In 2012, the taxpayers received notice that the credit was devalued and that the taxpayers would be issued a notice of assessment. The credit was subsequently revalued. The taxpayers appealed, contending that both the original and adjusted assessments by the Tax Department are barred by the statute of limitations because the original assessment was never received. The Tax Commissioner ruled that the assessment would be upheld because the taxpayers received the assessment within three year statute of limitation period.

16. Taxes Paid to Another State. P.D. 18-36 (March 26, 2018). The taxpayer filed a part-year resident income tax return and claimed credit for income taxes paid to another state. The Tax Department denied the credit, and the taxpayer appealed. The Tax Commissioner abated the assessment because the taxpayer's income from his time living in Virginia was sourced to the state in which he claimed the credit.

17. Assessments and Statute of Limitations. P.D. 18-38 (March 29, 2018). In different years, the taxpayer did not file individual income tax returns or failed to pay the tax due for a number of years. In 2017, the taxpayer satisfied his liabilities for certain years through the Virginia Tax Amnesty Program. For the years the taxpayer did not satisfy, he disputes the

collectability of the liabilities, arguing that they are beyond the statute of limitations. The Tax Commissioner denied the appeal because the statute of limitations for collection for the years at issue is 20 years and the Tax Department is within the 20 year statute.

18. Net Operating Losses. P.D. 18-39 (March 29, 2018). The taxpayers filed Virginia nonresident income tax returns for two taxable years and reported a loss from operating rental property in Virginia. In the next taxable year, the taxpayers moved to Virginia and filed a resident return claiming a net operating loss deduction. The Tax Department denied the deduction because the deduction was not reflected in the taxpayers' federal adjusted gross income for the taxable year at issue. The taxpayers appealed. The Tax Commissioner upheld the assessment on the basis that the claimed losses offset the taxpayers' income in the taxable years that they filed nonresident income tax returns.

19. Dependent Exemption Itemized Deductions, Child and Dependent Care. P.D. 18-43 (April 3, 2018). The taxpayer, a Virginia resident, was married to a nonresident member of the armed forces. For the 2007 taxable year, the couple field a joint federal income tax return, and the taxpayer filed a separate Virginia income tax return. On her Virginia return, the taxpayer claimed a deduction for the full amount of the itemized deductions reported on the joint federal return, the full amount of child care expenses, and all of the couple's dependent exemptions. Under audit, the Tax Department adjusted the taxpayer's itemized deductions and exemptions to reflect her percentage of the couple's joint income and issued an assessment for additional tax and interest. The Tax Commissioner upheld the Tax Department's adjustment to the taxpayer's itemized deductions because the taxpayer failed to provide evidence that she was solely responsible for paying for all of the itemized deductions claimed on the couple's federal income tax return. The Tax Commissioner determined that the taxpayer was entitled to claim both dependent exemptions and the full amount of the child and dependent care deduction on her Virginia income tax return.

20. Federal Adjusted Gross Income, Retirement and Distribution. P.D. 18-52 (April 16, 2018). The taxpayer failed to include a distribution from a retirement account in her federal adjusted gross income and did not file an amended Virginia income tax return to report the federal change. The Tax Department issued an assessment and the taxpayer appealed contending that federal income tax was deducted from the distribution. The Tax Commissioner upheld the assessment because Virginia does not provided for a deduction for federal income tax withheld on a distribution from a retirement plan.

21. Reporting Federal Changes. P.D. 18-74 (May 2, 2018). The taxpayers were audited by the IRS, the IRS notified the Tax Department of the changes it made to the taxpayers' federal income tax return, but the taxpayers failed to file an amended return. As a result the Tax Department issued an assessment. The taxpayers filed an appeal, contending that they did not understand why an assessment was issued. The Tax Commissioner upheld the assessment, determining that the Tax Department issued the taxpayers a letter notifying the taxpayers of the change to their federal income tax return, but the taxpayers did not respond to the letter. As a result, the Tax Department correctly adjusted the taxpayers' income tax return.

22. Statute of Limitations and Timeliness of Return. P.D. 18-66 (May 2, 2018). The Tax Department issued an assessment for tax for the 1999 taxable year after it received information from the IRS that the taxpayer had income subject to Virginia income tax. Most of the assessment had been satisfied through collection efforts by the Tax Department. In August 2016, the taxpayer filed a Virginia resident income tax return and reported substantially less federal adjusted gross income than reported by the IRS; the taxpayer also sought a refund. The Tax Department took no action because his return filed in 2016 for the 1999 taxable year was filed beyond the statute of limitations. The taxpayer appealed. The Tax Commissioner upheld the Tax Department's determination. The statute of limitations to claim a refund had to be filed by May 1, 2003.

23. Foreign Source Income and Failure to Provide Information. P.D. 18-68 (May 2, 2018). The taxpayers, a husband and wife, filed joint Virginia resident individual income tax returns for two taxable years. On each return, the taxpayers subtracted a portion of their federal adjusted gross income to compute Virginia taxable income. The Tax Department denied the subtractions and issued assessments. The taxpayers appealed, contending that the husband was a resident of a foreign country. The Tax Commissioner upheld the assessments. In doing so, he stated that the taxpayers failed to respond to a letter from the Tax Department requesting additional information. In addition, the Tax Commissioner stated that from the information available, the husband appeared to keep a Virginia domicile because he obtained a Virginia driver's license during the tax years in dispute.

24. Refund and Statute of Limitations. P.D. 18-69 (May 2, 2018). The taxpayer filed a Virginia Special Nonresident Claim for Individual Income Tax Withheld (Form 763-S) requesting refunds of income tax erroneously withheld by the taxpayer's employer. The Tax Department denied the refunds because the statute of limitations had expired; the taxpayer then appealed. The Tax Commissioner determined that the taxpayer failed to file Form 763-S within the three-year period permitted under Virginia Code §§ 58.1-341 and 58.1-499(D). As a result, the taxpayer's refund request was denied.

25. Subtractions and Foreign Source Income. P.D. 18-72 (May 2, 2018). The taxpayer sought a reconsideration from the Tax Department's disallowance of a subtraction of the taxpayer's claimed foreign source income. Virginia Code § 58.1-402(c)(8) permits a taxpayer to subtract foreign source income from federal taxable income to the extent that it is included in and not otherwise subtracted from federal taxable income. The taxpayer sought to subtract proceeds from an arbitration award granted to a U.S. corporation from a foreign corporation. The Tax Department disallowed this subtraction because the award was granted to a U.S. corporation. The Tax Commissioner ruled that the Tax Department correctly disallowed the taxpayer's subtractions.

26. Credit and Tax Paid to Another State. P.D. 18-73 (May 2, 2018). The taxpayer filed a Virginia resident individual income tax return and claimed a credit for income tax paid to Vermont. The taxpayer received a refund, but the credit for income tax paid to Vermont was reduced by the Tax Department and an assessment was issued. The taxpayer appealed, claiming that he properly computed the credit for income tax paid to Vermont. The Tax Commissioner denied the taxpayer's request for refund because he determined that the Tax

Department had correctly limited the credit to the amount of Virginia income tax imposed on the amount of Vermont income actually subject to tax.

27. Exemption and Convention with Japan. P.D. 18-75 (May 2, 2018). The Tax Department received information from the IRS that the taxpayer may have income subject to Virginia income tax. Upon receiving information from the taxpayer, the Tax Department issued an assessment. The taxpayer appealed, contending that she was not liable for Virginia income tax based on the Convention between Japan and the United States for the Avoidance of Double Taxation. The Tax Commissioner abated the taxpayer's assessment because the taxpayer was a Japanese resident working in Virginia for the Japanese government. Because the taxpayer was rendering services of a governmental nature to Japan, she was exempt from Virginia income tax.

28. Subtractions and Foreign Source Income. P.D. 18-76 (May 2, 2018). The taxpayers, nonresidents of Virginia, were beneficiaries of trusts that owned an S Corporation. The S Corporation had Virginia taxable income. On the taxpayers' Virginia nonresident individual income tax return, the taxpayers claimed a subtraction for foreign source income earned by the S Corporation. The Tax Department disallowed the foreign source income subtraction and reduced the taxpayers' refund. The taxpayers appealed, arguing that they were entitled to claim this subtraction. The Tax Commissioner denied the taxpayers' request for a refund because Virginia Code § 58.1-322 does not provide a foreign source income subtraction.

29. Assessments and Timeliness. P.D. 18-91 (May 18, 2018). The taxpayers were audited by the Tax Department for two taxable years; the audit resulted in assessments of additional Virginia income tax. The taxpayers appealed, not contesting the accuracy of the adjustments, but that the Tax Department failed to timely notify them of the taxpayer's computational errors. The Tax Commissioner denied the taxpayers' appeal because the Tax Department had notified the taxpayers of the assessment of additional tax within the three-year statute of limitations period.

30. Retirement Income and Out of State Pension Appeals. P.D. 18-100 (May 22, 2018). The taxpayer sought reconsideration of P.D. 17-134 (July 19, 2017) in which the Tax Department upheld assessments issued to the taxpayer for improper subtractions of the taxpayer's retirement income. The Tax Commissioner upheld the determination from P.D. 17-134 because the taxpayer failed to satisfy 23 Virginia Administrative Code 10-20-165(F) that sets out when a taxpayer can successfully petition for reconsideration. The taxpayer did not meet the requirements because he only argued that his appeal should be reconsidered because he had difficulty in obtaining proof that he was able to claim the subtraction.

31. Refunds and Statute of Limitations. P.D. 18-103 (May 24, 2018). The taxpayer's successor filed a Virginia individual income tax return on behalf of the deceased taxpayer reporting an overpayment of income tax and requested a refund. The Tax Department denied the refund because the return was filed beyond the three year statute of limitations period. The Tax Commissioner upheld the Tax Department's determination because the taxpayer's successor did file the individual income tax return too late.

32. Statute of Limitations and Refunds. P.D. 18-109 (June 6, 2018). The taxpayers filed for reconsideration from the Tax Department's upheld denial of the taxpayers' refund, which was addressed in P.D. 17-194. The Tax Commissioner denied the reconsideration because the taxpayers did not meet one of the four requirements found in 23 Virginia Administrative Code 10-20-165(F) for a successful reconsideration.

33. Deferred Compensation; Restricted Stock Units. P.D. 18-114 (June 8, 2018). The taxpayer requested a ruling on whether any portion of her restricted stock units (RSUs) are taxable as Virginia income. The facts are as follows: the taxpayer was a resident of Virginia in 2012 and performed services in both Virginia and two other states. The taxpayer received compensation in the form of RSUs. The Tax Commissioner stated that taxpayers receiving income from the vesting of RSUs earned while performing services in Virginia must file a Virginia income tax return. In order to determine Virginia taxable income for purpose of vesting RSUs, the taxpayer must use the ratio of the number of days services were performed in Virginia to the number of days services were performed elsewhere.

34. Statute of Limitations; Assessments. P.D. 18-121 (June 20, 2018). For the 2012 taxable year, the Tax Department received information from the IRS that the taxpayer should have filed a Virginia income tax return. The Tax Department issued an assessment in June 2015. The taxpayer then filed a nonresident income tax return for the 2012 taxable year. The Tax Department then determined that the taxpayer was a Virginia resident for the 2012 taxable year and issued another assessment in 2012. The taxpayer sent the Tax Department additional information, and the Tax Department then determined that the taxpayer was a part-year resident in 2012 and adjusted the assessment once again. The taxpayer appealed, contending that the Tax Department issued the assessments after the statute of limitations had expired. The Tax Commissioner determined that the Tax Department had timely made assessments and that the taxpayer was required to pay the assessments.

35. Statute of Limitations. P.D. 18-122 (June 20, 2018). The Tax Department received information from the IRS that the taxpayer should have filed a Virginia income tax return for the 2007 taxable year. The Tax Department requested additional information from the taxpayer, but did not receive anything. The Tax Department then issued an assessment against the taxpayer and satisfied the assessment through collection. The taxpayer appealed, contending that she did not owe any tax for the 2007 taxable year and that because of the elapse of time she cannot obtain proper documentation. The Tax Commissioner determined that while she cannot appeal the assessment, the taxpayer would be provided additional time to obtain the evidence requested by the Tax Department and could file an amended return to correct the assessment by March 8, 2020.

36. Statute of Limitations, Refunds and Reliance on Tax Preparer. P.D. 18-125 (June 26, 2018). The taxpayers filed 2007 and 2008 Virginia individual income tax returns without claiming a credit for income tax withheld. The Tax Department issued an assessment and collected some of the liability. In July 2017, the taxpayers submitted an offer in compromise ("OIC"), but while the OIC was being considered the Tax Department discovered mistakes made by the taxpayers and issued refunds allowable under the statute of limitations. Some of the payments made by the taxpayers were not refunded, however, because payments were made

beyond the statute of limitations period. The taxpayers appealed asking for a refund of those payments. In furtherance of their argument, the taxpayers placed the blame on their tax preparer for erroneously failing to give credit for income tax withheld. The Tax Commissioner upheld the reduced refund because the payments made were beyond the statute of limitations. The Tax Commissioner also stated that the taxpayers had recourse against their tax return preparer if they alleged an error in their filing.

37. Subtraction, Qualified Technology Business and Eligible Investment. P.D. 18-131 (June 27, 2018). The taxpayers filed a Virginia income tax return claiming a subtraction for a long-term capital gain. The Tax Department denied the subtraction on the basis that the investment that created the long-term capital gain was not a qualified investment. The taxpayers appealed, contending that the investment was qualified. The Tax Commissioner determined that the taxpayers were entitled to the subtraction because the investment was in the form of equity and met the qualifications of Virginia Code § 58.1-322.02(24).

38. Qualified Equity and Subordinate Debt Credit and Filing Deadline. P.D. 18-136 (July 11, 2018). The taxpayer filed an application for the Qualified Equity and Subordinated Debt Tax Credit, but the Tax Department did not accept the application because it was not filed by the April 1, 2018 deadline. The Tax Commissioner upheld the Tax Department's determination because the taxpayer failed to file by the deadline.

39. Residency, Audits and Taxpayer Records. P.D. 18-141 (July 12, 2018). The Tax Department received information from the IRS that the taxpayer should have filed a Virginia income tax return. The Tax Department issued an assessment after the taxpayer did not submit additional information. The taxpayer appealed, contending that the Tax Department did not prove that he was a resident of Virginia. After reviewing the taxpayer's information on file with the Tax Department, the Tax Commissioner determined that the taxpayer had one last opportunity to provide adequate documentation regarding his residence for the taxable year at issue.

40. Assessment and Federal Information. P.D. 18-143 (July 17, 2018). The taxpayers filed Virginia individual income tax returns for taxable years 2011 through 2014. The Tax Department made adjustments to each of these years; this resulted in additional tax due for all four of the taxable years. The taxpayers appealed, contending that the adjustments were incorrect. The Tax Commissioner upheld the assessments because the taxpayers provided no information that the assessments were incorrect.

41. Deductions, Audits, Itemized, Reporting Federal Changes and Substantiation. P.D. 18-144 (July 17, 2018). The taxpayers were audited by the IRS for the 2010 and 2011 taxable years; the IRS then reduced the itemized deductions the taxpayers' claimed on their federal income tax returns. The taxpayers failed to file amended Virginia income tax returns and an assessment was issued for both years. The Tax Department also selected for audit the taxpayers' tax returns for 2014 through 2016. The taxpayers failed to provide the requested information and the Department issued assessments as well. The 2010 assessment had already been addressed in two prior P.Ds. (P.D. 17-78 and P.D. 17-154); the Tax Commissioner ruled that the Tax Department would not issue another determination for the 2010

taxable year. For the 2011 taxable year, the Tax Commissioner determined that the assessment was correct because the taxpayers failed to file an amended return after the IRS audit and redetermination. The Tax Commissioner determined that the taxpayers would have one more opportunity to provide the Tax Department with substantiation information before the assessments for 2014 through 2016 would be considered correct.

42. Amnesty and Payments Related to Returns. P.D. 18-154 (August 8, 2018). The taxpayers filed their 2014 Virginia income tax in August 2017. The return said there was a tax due, but the taxpayers did not remit payment so an assessment was issued in October 2017. The taxpayers paid the tax due and half the interest assessed, claiming amnesty under the 2017 Virginia Tax Amnesty Program. The Tax Department determined that the taxpayers did not qualify for amnesty and declined to abate the penalty and the other half of the interest due. The taxpayers appealed, contending that they met the criteria to be eligible for amnesty. The Tax Commissioner determined that the taxpayers qualified for the amnesty program because they were not under audit for the 2014 taxable year and the assessment was issued during the amnesty period. As a result, the remainder of the assessment was abated.

43. Qualified Technology Business and Eligible Investment. P.D. 18-155 (August 8, 2018). The taxpayers filed a Virginia individual income tax return claiming a subtraction for a long-term capital gain. The Tax Department denied the subtraction on the basis that the capital gain was not attributable to a qualified business. The taxpayers appealed, contending that they met all the statutory requirements to claim the subtraction. The Tax Commissioner determined that the taxpayers' subtraction met the requirements of Virginia Code § 58.1-339.4, and therefore the taxpayers were entitled to the assessment.

44. Credit and Qualified Equity and Subordinated Debt. P.D. 18-157 and P.D. 18-158 (August 8, 2018). The taxpayer filed an application for the Qualified Equity and Subordinated Debt Tax Credit (the "Credit") on April 18, 2018. The Tax Department however, had a deadline in place to claim the credit of April 1, 2018. Because the taxpayer's application was received after the deadline had passed, the Tax Department denied the credit; the taxpayer requested that the Tax Department reconsider its denial. The Tax Commissioner upheld the denial of the tax credit because (1) the deadline was clearly set forth in the official instructions issued by the Tax Department and (2) the Credit is subject to an annual cap, so late applications for the Credit could result in the amount of tax credits exceeding the tax credit cap for the year.

III. RETAIL SALES AND USE TAXES

A. 2018 Legislation

1. Historic Triangle Sales Tax. Senate Bill 942 (Chapter 850) amends §§ 58.1-611.1, 58.1-638, and 58.1-3823 and adds § 58.1-603.2 to impose an additional one percent sales and use tax in the "Historic Triangle," defined as the City of Williamsburg and the Counties of James City and York. Food purchased for human consumption is subject to the new tax. This legislation also repeals the authority of these localities to impose the current $2 transient occupancy tax used to promote tourism in the area. The provisions of this bill are contingent on the City of Williamsburg repealing recent ordinances raising its local transient

occupancy, food and beverage, and admission taxes and would expire if any of the localities within the Historic Triangle reinstate any such taxes prior to January 1, 2026. This legislation would be effective on July 1, 2018.

2. Agricultural Exemption. Senate Bill 332 (Chapter 362) amends § 58.1-609.2 increase the sales tax exemption for sales of agricultural produce and eggs sold at farmers markets or roadside stands from $1,000 to $2,500 per year. This legislation would be effective on July 1, 2018.

B. Recent Court Decisions

1. South Dakota v. Wayfair, 138 S. Ct. 2080 (2018). The U.S. Supreme Court explicitly overruled *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), and *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967). These decisions required, as a matter of constitutional due process, that a vendor have a "physical presence" within a state before the state could require the vendor to collect and remit that state's sales tax. With *Quill* and *National Bellas Hess* overruled, a state can now require both in-state and out-of-state vendors to collect and remit its sales tax for sales made within the state. In short, a vendor's lack of "physical presence" within a state no longer determines its sales tax obligations.

Although the court affirmed the constitutionality of applying South Dakota's statute to the taxpayers in *Wayfair*, it did not determine what level of sales activity amounted to a "substantial nexus" sufficient to subject an out-of-state seller to sales tax obligations under *Complete Auto Transit, Inc.* v. *Brady*, 430 U. S. 274 (1977). Citing "both the economic and virtual contacts" the taxpayers had with South Dakota, the court observed that South Dakota's statute applied only to sellers that conducted 200 or more transactions, or delivered $100,000 or more in goods and/or services, annually. It noted that this volume of business "could not have occurred" by accident, and said the taxpayers were "large, national companies that undoubtedly maintain an extensive virtual presence."

Even as it relegated long-established jurisprudence to the dustbin, the court's sweeping decision was at pains to note that it left for another day legal challenges that may emerge relating to the effect, as well as the administration and enforcement of, out-of-state sales tax obligations. The *Wayfair* majority cited the possibility of further challenges to out-of-state tax regimes as engaging in unfair discrimination, or placing undue burdens, on out-of-state sellers. The court also noted that statutes that impose retroactive liability for sellers may violate the court's apportionment jurisprudence, as both buyers and sellers would be liable for the same tax. Overly complex or cumbersome state tax systems could also effectively discriminate against smaller businesses with few sales in many jurisdictions.

A number of narrow questions emerge from the *Wayfair* decision and can be expected to receive an array of answers from the nation's taxing jurisdictions. Most obviously, how does the substantial nexus test work for taxpayers with less sales revenue, fewer transactions or a smaller virtual presence than those in *Wayfair*? How will states police these limits to determine whether an out-of-state seller must comply? What about state statutes that are retroactive in their terms or in their enforcement, as states seek to collect from out-of-state sellers, as sales tax, the use tax that has long been due from in-state buyers? Practically, how will sellers comply with the maze of collection and remitting obligations, and avoid expensive enforcement actions and ruinous penalties? Expect these issues to generate legislation and litigation for years to come.

Effect on Virginia: Until Virginia law is changed, *Wayfair* should have no effect on Virginia. The primary reason is the definition of a "dealer" as enunciated in Virginia Code section 58.1-612. A "dealer" is essentially required to collect and remit sales tax. The definition of a "dealer" does not include any terms that have ever been applied to an internet retailer. It is likely that this definition would need to be amended. Furthermore, Virginia does not have a minimum threshold that would be applied to small internet retailers as required by *Wayfair*. Also, Virginia is not a member of the Streamlined Sales Tax Project, like South Dakota, nor is it a member of a similar group. These considerations need to be addressed if Virginia intends to impose collection responsibilities on internet retailers.

C. Rulings of the Tax Commissioner

1. Dealer Status. P.D. 17-178 (October 4, 2017). The taxpayer operates a website where customers can purchase food from local restaurants. The taxpayer has no physical operations in Virginia. Customers place online orders through the taxpayer's website. Customer remits payment through taxpayer's website, which includes applicable sales and meals taxes. The taxpayer collects the taxes and remits the proceeds to the Tax Department. There is no mark-up on the customer's invoices for taxpayer's services; rather, taxpayer withholds a portion of the charges from the restaurant for its commission (percentage of charges for food) and credit/debit card fees. The Tax Department determined that the taxpayer was not a "dealer" in Va. Code § 58.1-603 because it did not make sales of tangible personal property as it never took title to or possession of the food.

2. Real Property Contractors. P.D. 17-180 (October 13, 2017). The Tax Department addresses the application of the sales tax to several scenarios involving the purchase and installation of countertops, concluding in each case that the party (contractor or subcontractor) that installs the countertops is responsible for paying sales and use tax on the countertops. The customer would not pay the sales tax, unless it purchased countertops without installation.

3. Manufacturing Exemption/Audit Sampling. P.D. 17-189 (November 16, 2017). The Tax Department overruled auditor in finding that a metal fabrication shop could purchase high temperature masking tape exempt from tax under the manufacturing exemption. Such tape is integral to the powder coating process of metal and is consumed during actual production. The Tax Department denied taxpayer's request to include a payment of sales tax it erroneously made to a vendor as a credit in the audit sample. The sample is used to measure consumer use tax compliance, not sales tax payment. Further, taxpayer's remedy is to obtain a refund of sales tax erroneously paid from the vendor.

4. Durable Medical Equipment. P.D. 17-186 (November 16, 2017). The taxpayer manufactured glass fiber reinforcement composite posts, which it sold to dentists for their use in root canal and crown procedures. The taxpayer could not prove the posts were

deemed sold on behalf of a specific individual, as they can be purchased in six diameters and sold in blister pacts. Thus, sales of the posts to dentists were taxable.

5. Car Mechanic Services. P.D. 17-188 (November 16, 2017). The taxpayer unsuccessfully contested the assessment of sales tax on environmental and certain labor charges billed to its customers. Only separately stated charges for labor or services rendering in installing, applying, remodeling or repairing property sold are exempt. Labor charges for diagnostic services are not exempt if made in the connection of the sale of property. *See* P.D. 16-159 (8/5/16).

6. Agricultural Exemption/Exemption Certificates. P.D. 17-185 (November 16, 2017). The Tax Department determines that mowers and chain saws cannot be purchased from taxpayer by farmers exempt from tax. Only property "necessary" for use in agricultural production is exempt. The purpose of the agricultural exemption is to prevent double-taxation on property purchased by farmers that become component parts of the actual production of agricultural products that are ultimately taxed at the retail level. The Tax Department cautioned taxpayer that it should question a customer's provision of an exemption certificate and, if in doubt as to the application of such exemption, charge the sales tax.

7. Retailer vs. Real Property Contractor. P.D. 17-187 (November 16, 2017). The taxpayer is an engineering and consulting firm that sells and services scientific instrumentation used to measure water flow for waste water and water systems. Most of the instrumentation sold by taxpayer is attached to existing structures. The taxpayer also sells related services, including installation, repair, maintenance and customer training. Service charges are separately stated on invoices. The Tax Department ruled that the taxpayer must determine on a case-by-case basis whether its contracts meet the three-part test set out in *Transcontinental Pipe Line Corporation* to be treated as a real property contract.

8. Substantiation. P.D. 17-201 (December 13, 2017). The taxpayer failed to provide evidence to overturn auditor's determination that cash withdrawals were for expensed purchases that taxpayer failed to pay tax on. The taxpayer's claim that the withdrawals were for personal use was not supported by the evidence.

9. Dental Implants. P.D. 17-200 (December 13, 2017). The taxpayer-dentist argues that its purchase of dental implants are exempt from tax because it only makes such purchases on behalf of a specific patient. Auditor assessed tax on purchases from dental suppliers that were paid by credit card and could not be matched to an appropriate invoice. The taxpayer later provided additional documentation that lists the patient's name handwritten on the invoice as evidence that the items purchased are for specific patients; the Tax Department will review.

10. Real Property Contractors. P.D. 17-180 (October 13, 2017). The scenario is as follows: a big box retailer sells cabinets plus installation to a customer. The big box retailer contracts with a broker/retailer to furnish and install the cabinets, which then subcontracts with an installer to furnish and install the cabinets. The Tax Department concluded that the party responsible for purchasing the cabinets directly from the suppliers for installation is responsible

for paying sales tax or accruing use tax (in this case, either the big box retailer or the broker/retailer). It noted that the other parties are not entitled to the resale exemption because all of them are acting as real property contractors (and resale exemptions are not available to real property contractors). The transaction should thus reflect that charges among them are for real property construction services and not sales of property.

11. Nonprofit Exemption Certification. P.D. 17-221 (December 29, 2017). The Tax Department confirmed that a nonprofit holding a valid exemption certificate could purchase alcoholic beverages from vendors as long as the criteria in Virginia Tax Bulletin 16-3 (5/2/16) with respect to purchases of food, beverages and related catering services were satisfied. The Tax Department also noted that the nonprofit is responsible for confirming that its use of an exemption certificate conforms to VTB 16-3; the vendor need only confirm that the certificate is signed, the charge is billed to and paid for by the nonprofit and that the certificate has not expired.

12. Nexus. P.D. 18-1 (January 3, 2018). The taxpayer proposes to enter into a transaction with its subsidiary and a vendor, pursuant to the subsidiary would take orders for tangible personal property from customers. Once an order is place, the taxpayer would contract with a vendor for the property, which it would immediately transfer to subsidiary. Delivery would be arranged by vendor via common carrier. The taxpayer's only connection to Virginia was the brief ownership of title to the property. Citing the amendment to Va. Code § 58.1-612(C)(9), effective June 1, 2017, the Tax Department ruled that the taxpayer's brief but repeated ownership of tangible personal property for sale located in Virginia is greater than the *de minimis* presence described in *Quill v. North Dakota*. Thus, the taxpayer had nexus with Virginia. But since it did not act as a dealer (because it sold property for resale to its subsidiary) it would not have sales tax collection obligations in the transaction.

13. Responsible Officer. P.D. 18-2 (January 5, 2018). The taxpayer was not a responsible officer and cannot be held personally liable for unpaid assessments dating from an audit that began after taxpayer ceased to be a stockholder, officer and employee of the corporation. He did not have actual knowledge of the audit or the resulting assessments and could not have willfully avoided the payment of the assessments.

14. Nexus and Sourcing Rules. P.D. 18-3 (January 5, 2018). In connection with the amendment to Va. Code § 58.1-612(C)(9), effective June 1, 2017, the Tax Department provided guidance on the sourcing of Virginia sales tax in different scenarios. If an out-of-state dealer's sole connection to Virginia is the storage of inventory, the sales are made electronically at a third-party's website, and the property is shipped by common carrier, then the sale is sourced to the customer's location. This is true even if the out-of-state dealer (which owns some inventory in Virginia) takes orders from its out-of-state location and ships the property from its out-of-state warehouse to a Virginia customer. If the dealer has a home office in Virginia and stores inventory at a 3rd party fulfillment center in Virginia, then sales of such inventory are sourced to the dealer's place of business in Virginia.

15. Sales Tax Paid in Error/Refunds. P.D. 18-10 (February 2, 2018). The taxpayer incorrectly treated itself as a using and consuming contractor. Auditor assessed tax on

the taxpayer's sales, which it should have treated as retail sales. The taxpayer paid assessment and then sought refunds from its vendors for sales tax paid in error. Some of the vendors refused to provide refunds. The Tax Department agreed to refund sales tax provided certain documentation was provided.

16. Refunds. P.D. 18-53 (April 19, 2018). The taxpayer submitted a refund request on November 30, 2016 pursuant to 2013 transitional rules regarding real property contractors. The Tax Department denied all requests for refunds from invoices dated prior to November 1, 2013. Refund requests must be made within 3 years of the date the tax became due; the taxpayer cannot wait until the completion of the contract to file a refund claim for all related invoices.

17. Burden of Proof. P.D. 18-59 (April 25, 2018). The taxpayer was unable to substantiate which of its free meal tickets it issued as a result of poor food quality. As a result, the cost price of all tangible personal property furnished in providing the free meal was subject to tax.

18. Statute of Limitations. P.D. 18-62 (May 2, 2018). The Tax Department denied the taxpayer's refund claim by letter dated March 22, 2016. The taxpayer's subsequent administrative appeal, postmarked July 6, 2016, was beyond the 90 day period within which to file an administrative appeal.

19. Samples; Church Exemption. P.D. 18-63 (May 2, 2018). First, the Tax Department determined that the taxpayer should not have accepted a resale certificate, Form ST-13A, from an association affiliated with churches, as such customer is not a church but rather a ministry support association. As such, sales to it were subject to tax. Second, the Tax Department denied the taxpayer's requests to remove certain transactions from the audit sample. The taxpayer failed to establish that such transactions were isolated in nature and not part of the taxpayer's normal operations.

20. Burden of Proof. P.D. 18-64 (May 2, 2018). The taxpayer failed to prove that a line item in its general ledger, "2009 Capitalize Materials," was intended to be capitalized labor. It provided payroll records and a reverse general ledger entry. The taxpayer failed to provide its amended federal and Virginia tax returns, which were the only proof the Tax Department would accept in order to remove the transaction from audit.

21. Recordkeeping. P.D. 18-65 (May 2, 2018). The taxpayer was registered for the use tax but did not file any returns during the 3 year audit period. The auditor correctly extended the period to 6 years. The taxpayer failed to keep adequate information to determine whether tax was paid on purchase transactions during the audit period so the assessment was upheld.

22. Recordkeeping. P.D. 18-79 (May 4, 2018). The taxpayer proved that certain transactions, which the auditor held were taxable, were for exempt engineering services and labor. Accordingly, those transactions were removed from audit.

23. Freight Charges; Recordkeeping. P.D. 18-81 (May 9, 2018). The Tax Department determined that "freight and handling charges" on the body of the invoices were taxable because of the inclusion of handling charges. The fact that the invoice summary listed only freight charges was insufficient to remove the charges from audit. Furthermore, the taxpayer was unable to substantiate that purchases from a vendor were exempt from sales tax. The Tax Department gave the taxpayer additional time to establish that the vendor was a real property contractor and that no tax was due upon its purchases from the vendor.

24. Reconsideration; Exemption Certificates. P.D. 18-82 (May 9, 2018). The taxpayer requested reconsideration of the Tax Department's determination that certain sales were not exempt. The taxpayer provided additional documentation to support the validity of the resale exemption certificates; however, the Tax Department was not persuaded.

25. Exemption Certificates; Manufacturing Exemption. P.D. 18-86 (May 16, 2018). The Tax Department ruled on a variety of issues, including: (i) taxpayer could not prove certain deliveries were made out-of-state. The "ship to" address field on the invoices and a KY resale exemption certificate were insufficient proof; (ii) the resale exemption certificate from a customer where its stated business was "trucking and excavating" should not have been accepted by the taxpayer because the business is not consistent with resales; (iii) purchase of repair and replacement parts for a water truck were taxable as they were not used directly in the mining activity; (iv) charges for a "service call" were one-half taxable because the Tax Commissioner inferred that the charge likely included labor to repair the flat tire, which the vendor failed to separately state; and (v) the compliance penalty was properly applied because it was the taxpayer's sixth audit and its compliance ratio was 79%.

26. Manufacturing Exemption. P.D. 18-87 (May 16, 2018). The taxpayer, a manufacturer of conveyor systems used in coal mining operations, was assessed sales tax on the sale of hex head bottom rollers and drop hanger units. The Tax Department disagreed with the auditor, finding that such property was repair and replacement parts for exempt machinery and equipment used directly in the mining process. The property was not supports or bolted to the concrete foundations.

27. Converted Assessment. P.D. 18-93 (May 21, 2018). The Tax Department issued assessments to a restaurant for years 2014-2015 because no sales and use tax returns had been filed during that time. Such assessments were converted to the taxpayer. The taxpayer subsequently filed sales and use tax returns on behalf of the restaurant showing no income earned. The assessments were subsequently abated in full.

28. Durable Medical Equipment; Nexus. P.D. 18-99 (May 22, 2018). The taxpayer, an out of state vendor, sells medical devices that are implanted by a physician at the completion of sinus surgery. The device acts like a stent and releases steroids to reduce swelling. The Tax Department ruled that its sale in Virginia is subject to tax because: (i) the device is not a DME is cannot withstand repeated uses and is not appropriate for use in the home; (ii) it is not a prosthetic device because it does not serve a replacement purpose, but merely enhances the post-surgery healing process; and (iii) it is not a medicine or drug because it is classified by the FDA as a medical device. The Tax Department did not rule on whether the taxpayer, which has a

sales representative who occasionally visits Virginia, has sufficient nexus to as to be required to collect sales tax.

29. Grocery Store Shopper Services. P.D. 18-102 (May 24, 2018). The flat fee service charge imposed by a grocery store on customers who use the store's personal shopping services (e.g. Clicklist or other online shopping program) is subject to tax, regardless of whether the charge is itemized. The true object of program is to obtain tangible personal property (groceries). Likewise, a surcharge that is either a percentage of each item purchased or a flat fee per each item purchased is also subject to sales tax, regardless of whether the charge is itemized. A delivery fee that is separately stated is exempt from tax; such fee that is included in the service charge is subject to tax. A service charge (or surcharge) on the sale of food items that qualify for the reduced rate of tax would be subject to the reduced rate of tax; a service charge (or surcharge) on the sale of non-eligible food items and eligible food items would be subject to the full sales tax rate.

30. Government Contracts. P.D. 18-104 (May 31, 2018). A government contractor purchased materials for temporary storage in Virginia. The materials were ultimately used in installing communications equipment on a naval ship docked in a foreign country. The Tax Department applied the true object test to determine that the purchase and sale of the material was a retail sale. As such, the contractor could purchase the material exempt from sales tax by providing a resale certificate to its vendors. *NB.* P.D. 08-156 did not apply because the temporary storage exception that was relied upon in PD 08-156 applies only to real property contracts.

31. Responsible Officer. P.D. 18-105 (June 6, 2018). The Tax Department rejected the taxpayer's contention that he was not the responsible officer of a corporation's delinquent tax assessments. The general powers granted to the taxpayer in the corporation's operating agreement were sufficient to bestow a duty on the taxpayer to file sales tax returns—the taxpayer was unable to prove that such duty had been specifically delegated to someone else. The taxpayer was also deemed to have knowledge of the assessments because he prepared the sales invoices to customers and those invoices charged sales tax. The Tax Department therefore determined that it was likely the taxpayer had knowledge that sales taxes were not being remitted.

32. Audiovisual Systems Services. P.D. 18-106 (June 6, 2018). Programming charges for the creation of code that controls the audiovisual systems may be exempt as a "custom program" provided the taxpayer furnish additional evidence that the charges for programming are customized for each customer. Labor costs associated with developing the design of a customized audiovisual system are not exempt installation charges because they occur prior to the actual installation of the system. Charges relating to drilling holes, installing wiring and repairing the structure are exempt installation charges. However, charges to have an on-site technician available at installation are not exempt installation service charges because management services are not installation services. Charges for a technician to install and tear down rented audiovisual equipment were also taxable because the technician did not operate the equipment.

33. Software. P.D. 18-111 (June 8, 2018). Correspondence from the vendor providing that a certain software and related maintenance agreement were delivered electronically was insufficient to establish that the software was, in fact, delivered electronically. Per P.D. 05-44, only a sales contract, invoice or other sales agreement may establish electronic delivery.

34. Solar Facilities/Manufacturing Exemption & Pollution Control Equipment. P.D. 18-112 (June 8, 2018). The Tax Department ruled that mounting and racking equipment in a solar facility qualifies for the manufacturing exemption, provided the taxpayer is not a public service corporation. Such equipment is used solely to support the solar panels and solar arrays, and the solar panels and arrays cannot function without the racking and mounting supports. Further, the Tax Department ruled that any items certified by Department of Mines, Minerals and Energy ("DMME") as pollution control equipment and facilities would qualify as exempt pollution control equipment. *Note.* DMME can certify a wide array of property as being used primarily to abate or prevent air or water pollution.

35. Sales for Resale. P.D. 18-123 (June 26, 2018). Taxpayer made sales of sod to its affiliate, which either resold the sod to customers or used the sod in connection with lawn care contracts. While the taxpayer failed to maintain a resale certificate on file, the Tax Department removed from audit those sales of sod to its affiliate that were later sold to customers. Sales to the affiliate for use in connection with lawn care contracts were subject to sales tax. The affiliate is treated as a real property contractor.

36. Dialysis Treatment/Stents. P.D. 18-124 (June 26, 2018). Taxpayer uses stents in its dialysis business, which are used to keep the vessels open and to seal tears in the vessels. Because the stents are implants that replace the function of the blood vessel, they are exempt durable medical equipment if purchased on behalf of an individual patient. Because this taxpayer purchases stents in bulk to have on-hand should a patient need them, the exemption does not generally apply. However, there is a specific exemption for "drugs and supplies used in hemodialysis and peritoneal dialysis." Thus, if the stents for use in hemodialysis would be exempt if the taxpayer had a reliable accounting method to determine which purchases would be for exempt purposes.

37. Contractors. P.D. 18-147 (July 25, 2018). A manufacturer of wood shutters is required to remit use tax on purchases of raw materials it makes at its Virginia location, regardless of whether the shutters are installed in Virginia or elsewhere. The taxpayer is required to pay sales or use tax on the purchase or raw materials as it is the end user or consumer of the property that becomes real property after installation.

38. Micro Markets; Food Tax. P.D. 18-148 (July 31, 2018). The Tax Department ruled that food and beverages sold at a micro market (an unstaffed, self-checkout retail food establishment placed in a company's building or break room) are subject to sales tax. The rate of sales tax depends on whether the item is sold for home consumption and the operator must apply the proper tax rate to the items sold and ensure that the kiosks are equipped to adjust the tax rate based on the food and beverage products sold. The operator of a vending machine,

whether or not the operator places in the vending machine at the company location, is responsible for collecting and remitting the sales tax.

39. Broadcasting Exemption. P.D. 18-151 (August 8, 2018). The taxpayer, a retailer of broadcasting equipment, sold such equipment to its customer and charged the retail sales tax. The taxpayer then submitted a request to the Tax Department for a refund of the sales tax charged because the taxpayer viewed its customer as being exempt from sales tax under Virginia Code § 58.1-609.6(2), which exempts the sale of broadcasting equipment from the sales tax if the customer disseminates its signal to the general public. The Tax Commissioner denied the request for refund because the taxpayer's customer did not disseminate its signal to the general public; instead it disseminated to the customer's paying subscribers.

40. Maintenance Contracts and Motor Vehicle Licensed Outside of Virginia. P.D. 18-152 (August 8, 2018). The taxpayer, a vehicle dealer in Virginia, requested a ruling on whether the retail sales tax applies to maintenance contracts on vehicles sold to nonresident buyers. The Tax Commissioner ruled that the retail sales tax applies to vehicle maintenance contracts regardless of where the taxpayer's customers reside because the situs of the sale is in Virginia.

41. 90 Continuous Days Exemption on Hotel Rooms. P.D. 18-159 (August 20, 2018). The taxpayer requested a ruling regarding an airline's claim that it is tax exempt on hotel rooms that were occupied for 90 continuous days. The taxpayer represented that it rents a block of rooms and occupies these rooms daily, even though different airline employees occupy rooms daily and no one room is occupied for 90 continuous days. The Tax Commissioner stated that the airline's calculation was not correct. The airline should be issued a retail sales tax credit or refund for each room, if one of those rooms are occupied for a continuous 90-day period. The determinative factor is the amount of rooms occupied, not whether the same room is occupied by the same employee.

42. Taxable vs. Nontaxable Services and Sale of Tangible Personal Property. P.D. 18-160 (August 22, 2018). The taxpayer, an operator of funeral homes, was assessed retail sales tax on transactions involving a vendor that rented tables, tents, and chairs to the taxpayer for use in the taxpayer's services. The taxpayer sought a correction on the retail sales tax assessment that the Tax Department issued, contending that the vendor provided the taxpayer services in the form of the vendor's attendants, rather than tangible personal property, the tables, tents, and chairs. Using the "true object" test, the Tax Commissioner determined that the Tax Department's assessment was correct because the true object of the transaction was for the use of the tables, tents, and chairs, not the vendor's attendants who came to set up the items.

IV. PROPERTY (AD VALOREM) TAXES

A. 2018 Legislation

1. Single Member Limited Liability Company Exemption. House Bill 894 (Chapter 29) amends § 58.1-3651 to clarify that the property tax exemption by designation or classification for real or personal property, or both, owned by a nonprofit organization, includes

property owned by a single member limited liability company whose sole member is a nonprofit organization. This legislation is effective on July 1, 2018.

2. Solar Energy Exemption. Senate Bill 902 (Chapter 849) amends § 58.1-3660 to make several changes to the property tax exemption for solar equipment and facilities including 1) providing an exemption for 80 percent of the assessed value of projects for which an initial interconnection request form has been filed after January 1, 2015 for projects between 20 and 150 megawatts that are first in service on or after January 1, 2017, and 2) 80 percent of the assessed value of all other projects equaling more than 5 megawatts and less than 150 megawatts for which an initial interconnection request form has been filed on or after January 1, 2019. This legislation would be effective on July 1, 2018.

3. Constitutional Amendment. Senate Joint Resolution 21 authorizes voting on an amendment to the Constitution of Virginia which provides that the General Assembly may authorize a county, city, or town to partially exempt any real estate subject to recurring flooding upon which flooding abatement, mitigation, or resiliency efforts have been undertaken.

4. Board of Equalization Application for Review. House Bill 190 (Chapter 341) amends § 58.1-3378 to clarify the receipt date for local boards of equalization for applications for relief sent electronically. This legislation provides that the date the applicant sends the application electronically would be considered the date of receipt by the governing body if the sender complies with the procedures for such electronic submission. This legislation is effective on July 1, 2018.

5. Land Use Property Changes. House Bill 871 (Chapter 504) amends §§ 58.1-3230, 58.1-3231, and 58.1-3234 to expand the definitions of "real estate devoted to agricultural use" and "real estate devoted to horticultural use" to be used in the special classification of real estate that is eligible for a use value assessment. The bill also expands the definitions to include property devoted to the production of products made from plants, animals, fruits, vegetables and nursery products on such property. This bill also clarifies that a property would not lose such designation solely because of its location in a newly created zoning district that was not requested by the property owner. The bill provides that the minimum time that a parcel must be used for a qualifying purpose would include the time similar property was leased by the owner to a lessee and provide a shorter minimum length of time for real property with no prior qualifying use to qualify. Last, the bill extends the time before which an owner could be required to revalidate the special classification. This legislation would be effective on July 1, 2018.

6. Assessment of Wetlands. House Bill 1442 (Chapter 603) amends § 58.1-3284.3 to clarify that, if the commissioner of the revenue or other assessing official disagrees with the property owner as to the presence of wetlands, then the commissioner of the revenue or other assessing official would be required to recognize (i) the National Wetlands Inventory Map prepared by the U.S. Fish and Wildlife Service, (ii) a wetland delineation map confirmed by a Preliminary Jurisdictional Determination or (iii) an Approved Jurisdictional Determination issued by the U.S. Army Corps of Engineers and provided by the property owner in making the determination. This legislation would be effective on July 1, 2018.

7. Assessment of Community Land Trust Property. House Bill 590 (Chapter 590) adds § 58.1-3295.2 to require duly authorized real estate assessors to consider the following factors when determining the fair market value of structural improvements to such real estate conveyed by a community land trust: (i) restrictions on the price at which improvements may be sold, and (ii) the amount of debt incurred by the owner of the improvements as evidenced by a deed showing no interest being due and no repayment prior to the earlier of satisfaction of any interest-earning promissory note or a subsequent transfer of the property. The bill also requires that, when determining the fair market value of such real property owned by a community land trust in perpetuity, duly authorized real estate assessors utilize the income approach. In so doing, they would be required to consider the property's current use, the contract rent, the income restrictions, and provisions of any arms-length contract, including restrictions on the transfer of title or other title restraints on the alienation of real property. This legislation would be effective on July 1, 2018.

8. Exemption for Leasehold Interests Owned by Land Bank Entities. House Bill 591 (Chapter 437) amends § 58.1-3203 to exempt leasehold interests in property owned by land bank entities from real property taxation. This legislation would be effective on July 1, 2018.

9. Deferral of Taxes Pursuant to an Ordinance. Senate Bill 228 (Chapter 291) amends § 58.1-3216 to provide definitions and rules to clarify when deferred real estate taxes are due on property in a tax deferral program for certain real estate owners who are at least 65 years of age, or permanently and totally disabled. This legislation is effective on July 1, 2018.

B. Recent Court Decisions

1. City of Page v. Flickwir, 2018 Va. Cir. LEXIS 50 (Case No. CL17-613, Circuit Court of Page County, April 6, 2018). The City filed a motion to bypass the necessity of obtaining an appraisal of real property before conducting a tax sale as required by § 58.1-3969. For the property in question, it was 128 years since it was last transferred, the owners could not be located, the property is not shown on the tax map, and the property cannot be specifically located beyond the 1888 deed language. The court determined that it did not have the authority to grant the motion to bypass the appraisal requirement.

2. City of Fairfax v. Wards, Inc., 2018 Va. Cir. LEXIS 52 (Case No. CL-2017-4677, Circuit Court of Fairfax County, April 12, 2018). This is a case between with City of Fairfax (the "City") and the Commissioner of Accounts for the City of Fairfax (the "Commissioner") involving a dispute over a tax sale. Before conducting a tax sale of real property to recover delinquent real estate tax proceeds for the City, the Commissioner determined that all liens against the property must be ascertained. This is necessary so that the proceeds may be distributed to all lienholders to the extent that proceeds are available. The City disagreed arguing that this was an unnecessary step as a tax lien has first priority. Ultimately, the court agreed with the Commissioner that all liens must be ascertained prior to such a sale.

3. Army Navy County Club v. City of Fairfax, 2018 Va. Cir. LEXIS 102 (City of Fairfax June 5, 2018). This case involved the valuation of property comprised of three parcels of land that has functioned as a country club and golf course for decades ("Property"). Pursuant to City zoning regulations, the Property is zoned for by-right residential development. The parties agreed that the Property's highest and best use is for residential development, despite it being used as a country club and golf course. Furthermore, the Property's tax assessment was to be determined using the Property's FMV at its highest and best use.

The court determined that the city's assessment did not conform to generally accepted appraisal practices ("GAAP") because the city's assessor (1) should not have used the cost approach to value the Property as the approach yielded a speculative valuation of the property; (2) should not have considered the improvements on the Property when valuing the Property because the improvements do not contribute to the land's highest and best use; and (3) violated the principle of consistent use - valuing the underlying land for one use and the improvements for another use.

C. Opinions of the Attorney General

1. Exemption for Surviving Spouses. Op. Va. Atty. Gen. 16-060 (June 22, 2017). The Attorney General of Virginia responded to a question from the Commissioner of the Revenue for the City of Newport News that the real property tax exemption for disabled veterans and surviving spouses in § 58.1-3219.5 is retroactive in application to January 1, 2011 based upon language in the enacting legislation. In other words, the exemption requests are not limited to just the prior three years.

The question about the exemption is not the most interesting part of this opinion however. The Commissioner also asked whether there may be an administrative correction of erroneous assessments resulting from a mistake made by the taxpayer. The Attorney General correctly and very succinctly said "an erroneous assessment arising from a mistake of a taxpayer is entitled to administrative correction under § 58.1-3980." Localities are already complaining about paying interest on a refund caused by a taxpayer "mistake." This is the first time that a locality has dipped its toe into the water about not having to pay a refund at all due to a taxpayer mistake. The interest argument is weak because the purpose of paying interest is to compensate on the time that the locality had the use of the money. It is not and was never intended to be a penalty. If a locality decides to set its interest rate at 10%, that is how it has chosen to value the time value of money. What is good for the goose is good for the gander. But not having to pay a refund at all means that taxpayers likely have to file a perfect initial return.

V. PROCEDURAL

A. 2018 Legislation

1. Tax Department Study of Valuation Appeals. House Joint Resolution 98 directs the Tax Department to study and make recommendations by December 1, 2019, on the appeals process for valuation of real and personal property of businesses.

2. Accelerated Refund Program. Senate Bill 531 (Chapter 625) requires the Tax Department to reestablish an accelerated refund program for Virginia taxpayers filing income tax returns in person or via the United States mail with a local commissioner of the revenue. This legislation would be effective for taxable years beginning on and after January 1, 2018.

3. Secrecy of Tax Information: Localities to Disclose to Certain Third Parties. House Bill 495 (Chapter 40) amends § 58.1-3 to provide an exception to Virginia's law prohibiting the disclosure of taxpayer information by authorizing a commissioner of the revenue, treasurer, director of finance, or other similar official who collects or administers taxes for a county, city, or town to disclose tax information to nongovernmental entities with which such locality has contracted to provide services that assist it in the administration of refund processing or other non-audit services related to the administration of taxes. This bill prohibits such disclosure unless the commissioner of the revenue, treasurer, director of finance, or other similar official has obtained written acknowledgement from the nongovernmental entity that Virginia's taxpayer information confidentiality and nondisclosure obligations and penalties apply to such entity and that such entity agrees to abide by such obligations. This legislation is effective on July 1, 2018.

B. Recent Court Decisions

No recent court decisions.

C. Rulings of the Tax Commissioner

No recent rulings by the State Tax Commissioner.

VI. BUSINESS LICENSE TAXES

A. 2018 Legislation

No 2018 legislation.

B. Recent Court Decisions

1. Dulles Duty Free, LLC v. County of Loudoun, 294 Va. 9 (2017), *cert. denied* 2018 U.S. LEXIS 2081, 138 S. Ct. 1440 (2018). Dulles Duty Free, LLC ("Duty Free") is a subsidiary of Duty Free Americas, Inc. which is a duty free retailer that operates in many locations throughout the United States. Duty Free conducted retail operations in five locations within Dulles International Airport in Loudoun County for the years 2009 through 2011 and a sixth location in 2012 and 2013. Duty Free paid to Loudoun County (the "County") BPOL taxes for the years 2009 through 2013 and seeks a refund.

Duty Free sells wine, spirits, tobacco, luxury gifts, fragrances, edibles, cosmetics, skincare items, and other various goods. For the tax years at issue, between 92 and 99 percent of Duty Free's gross sales were exports. For those sales, Duty Free transferred the goods, in sealed packages, to outbound international passengers on the jetway. Duty Free follows specific protocols when handling its merchandise and preparing it for sale. Much of its inventory enters the United States under a bonded warehouse entry. 19 U.S.C. § 1555(a). Bonded warehouses hold goods on which no import duty has yet been paid. Accordingly, the warehouses remain under the joint custody of the customs service and the goods' owner. 19 U.S.C. § 1555(a). Goods held in bonded warehouses may be earmarked for export, and if properly handled and exported, no import duty is ever owed. 19 U.S.C. § 1555(b).

Duty Free takes steps to ensure that its imported goods qualify for this duty-free treatment. Duty Free's parent corporation, Duty Free Americas, Inc., imports merchandise to Miami, Florida or Laredo, Texas. Bonded land carriers move the goods to bonded warehouses that serve as distribution centers in Miami and Laredo, thus legally avoiding the need to pay import duties. When Duty Free needs to re-stock its shelves, bonded carriers move the goods to Duty Free's bonded warehouse at Dulles Airport. Credentialed employees, called cartmen, then bring the goods through security and into the "sterile" international outbound area of Dulles Airport.

Like its warehouses, Duty Free's shops are customs bonded, and so its goods remain under joint custody of the U.S. Customs and Border Protection. Duty Free then stocks its goods and sells them. Duty Free's operations fully comply with federal law, 19 U.S.C. § 1555, and the County did not dispute it. Duty Free's goods avoid all federal taxation—they never pass through customs on entry into the United States. Instead, they are sold as exports, which the Constitution bars the federal government from taxing. U.S. Const. Art. I, § 9, cl. 5 ("No Tax or Duty shall be laid on Articles exported from any State [by Congress]"). Federal law specifically envisions and blesses this arrangement. *See* 19 U.S.C. § 1555(b)(1) ("duty-free sales enterprises may sell and deliver for export from the customs territory duty-free merchandise in accordance with this subsection"); *id.* at § 1555(b)(3)(B) (setting special rules for "duty-free sales enterprise[s]" that are "airport stores"). Based upon these facts, the court agreed that these goods are "in the stream of commerce for export."

In *Richfield Oil Corp. v. State Bd. of Equalization*, 329 U.S. 69 (1946), the Supreme Court held that a California tax violated the Import-Export Clause when imposed on certain sales of oil for export. Richfield Oil sold oil to the government of New Zealand. Richfield delivered the oil by pipeline from its refinery to storage tanks in the Los Angeles harbor, where it pumped the oil into a vessel hired by New Zealand to transport the oil to that country. Meanwhile, California exacted a tax on "the privilege of conducting a retail business" in California. The tax was measured by the "gross receipts" from all of Richfield's sales. Richfield contended that the tax, as applied to its oil exports, violated the Import-Export Clause. The Supreme Court agreed. The Court invalidated the tax because the state levied it directly on goods in export transit. That is, at the time of the sale and delivery of the oil into the tanker, "the export had begun." The Court rejected the idea that California could make the tax constitutional by calling it a "privilege of conducting a retail business" tax and measuring it by gross receipts. The Court said that the "issue turns not on the characterization which the state has given the tax, but on its operation and effect." The Court saw no difference in substance between California's tax and a tax directly on the goods. Therefore, the Court determined that the tax was unconstitutional.

Trial Court Decision

Duty Free argued that the Import-Export Clause of the federal Constitution bars states and localities from exacting "any Imposts or Duties on Imports or Exports" and that the governing rule is that localities cannot directly tax goods in export transit. U.S. Const., Art. I, § 10, cl. 2. Supreme Court precedent, particularly *Richfield*, shows that gross receipts taxes imposed on sales qualify as "directly" taxing the sold goods. *Richfield,* among other cases, also teaches that goods being sold and delivered to those preparing to imminently go abroad means the goods are "in export transit" and cannot be taxed. Therefore, the County's BPOL tax, when collected on Duty Free's export sales, violates the Import-Export Clause.

The County argued that its BPOL tax is not a sales, property or income tax. It is not a tax on a particular transaction. Rather, it is an "indirect" tax for the privilege to engage in a business in Loudoun County. Tax liability is triggered by the decision to operate a business in Loudoun County. It is a means to collect revenue from a business using the roads and variety of protections and services that are afforded by the County. While gross receipts above $200,000 are utilized in determining the tax, this is only a measure of the overall business activity.

Even though it determined that the goods are "in the stream of commerce for export," the Court found that Duty Free was not entitled to the requested refunds. The Court came to this conclusion by relying on two U.S. Supreme Court cases, *Michelin Tire Corp v. Wages,* 423 U.S. 276 (1976) and *Dep 't of Revenue v. Ass'n of Washington Stevedoring Cos.,* 435 U.S. 734, 756 n.21 (1978), not involving goods in the stream of commerce for export. To do this, the Court made three findings. First, the trial court concluded that the U.S. Supreme Court's decision in *Richfield* could be distinguished. Second, the trial court held in any event that *Richfield* is "no longer applicable." And third, the trial court relied on off-point Virginia case law classifying taxes for state law purposes.

The trial court distinguished *Richfield* by focusing on the timing of the imposition of the California sales tax. The circuit court noted that at the point the oil in *Richfield* passed into the control of a foreign purchaser and there was nothing that created the probability the oil would be diverted to domestic use. In other words, there was a certainty of the foreign destination at that point. It was at that point when the sales tax was imposed. In contrast, the trial court found that the BPOL tax in dispute was accrued when Duty Free began conducting business in Loudoun. Therefore, the BPOL tax was not a tax on the goods themselves like the California sales tax in *Richfield*. This is odd since the BPOL tax is measured by gross receipts just like the California sales tax.

The trial court wrestled with whether *Richfield* remains good law. Ultimately, the court decided that *Richfield*'s holding "is no longer applicable." Instead, the court applied *Michelin* and *Washington Stevedoring Cos.* and concluded that "this BPOL tax is not an impost or duty, and does not transgress any of the policy dictates behind the Import Export Clause." However, neither *Michelin* nor *Washington Stevedoring* addressed taxes that fell directly on goods in export transit.

Lastly, the circuit court relied on Virginia Supreme Court opinions that gave no consideration to the U.S. Constitution or the Import-Export clause. The court opined that under Virginia case law, the BPOL tax is deemed an indirect tax. The cases cited by the trial court concern whether Virginia taxes qualified as "property" taxes under the 1902 Virginia Constitution and 1930s-era tax laws and have nothing to do with the federal Import-Export Clause.

<u>Decision by Supreme Court of Virginia</u>

In a unanimous decision, the Supreme Court of Virginia overruled and reversed the decision of the circuit court and determined that *Richfield*, not *Michelin* or *Washington Stevedoring Cos.*, does in fact apply. The Supreme Court of Virginia noted that the United States Supreme Court has not overruled *Richfield*. The County argued that *Richfield* was distinguishable, but the Court found the County's arguments unpersuasive. The County argued that the tax is placed on the privilege to engage in a business activity, and that is not the same as a tax on goods. The Court disagreed and noted that the characterization of a tax for purposes of state law does not control whether the tax violates the Import-Export Clause.

Specifically to *Richfield*, the Supreme Court of Virginia determined that the disputed BPOL tax was a direct tax on the export goods in transit just like the tax in *Richfield* and stated, "We are hard pressed to see a difference of constitutional magnitude between the BPOL tax and the tax at issue in *Richfield Oil*. Indeed, the parallels between the BPOL tax and the tax under review in *Richfield Oil* are striking."

C. Rulings of the Tax Commissioner

1. <u>Internet Tax Freedom Act</u>. P.D. 18-24 (March 14, 2018) and P.D. 18-88 (May 16, 2018). *See also* P.D. 18-95 (May 21, 2018), P.D. 18-96 (May 21, 2018), P.D. 18-97 (May 21, 2018), P.D. 18-98 (May 21, 2018); and P.D. 18-150 (August 3, 2018). P.D. 18-24 addresses a reconsideration request of a determination dated June 9, 2017 in which the Tax Department determined that the City's BPOL tax met the requirements for grandfathering under the Internet Tax Freedom Act. The taxpayer contended that the City did not fulfill its burden of proving it qualified for protection and cited three cases from outside Virginia to show what the City needs to prove. Ultimately, the Tax Department upheld the BPOL assessment. In doing so, the Tax Department cited to the conflicting nature of the fact that the burden is on the taxpayer with an appeal but the burden of proving grandfathering would be on the locality. Stating that those two are incompatible, the Tax Department also cited to the requirement that it must presume that the local determination is correct. Therefore based on this requirement, whether the grandfathering applies must be determined by the locality in the initial appeal.

P.D. 18-88 addresses a reconsideration request of the same determination but instead focuses on the City's assertion that the BPOL is not a transactional tax covered by the Internet Tax Freedom Act, but rather a tax of general application like an income tax. Citing *Dulles Duty Free, LLC vs. County of Loudoun*, 294 Va. 9 (2017), the Tax Department disagreed with the City that the BPOL tax is like an income tax. However, the Tax Department upheld the assessment for the same reasons cited in P.D. 18-24. **Comment:** If the Internet Tax Freedom Act is an issue, it makes more sense to contest the assessment judicially.

2. Jurisdiction. P.D. 18-139 (July 12, 2018). The taxpayer operated at a definite place of business in the County during the taxable years at issue. On its BPOL tax returns, the taxpayer apportioned its gross receipts using payroll apportionment. For the 2012 tax year, the County disallowed the taxpayer's apportionment method and issued an assessment. The taxpayer filed suit in the County's circuit court. Pending the outcome of the litigation, the taxpayer paid the assessment in full and filed a nonsuit. The taxpayer then filed an application for correction pursuant to *Virginia Code* § 58.1-3980(A). Concurrently, the County adjusted the taxpayer's BPOL tax liability to disallow payroll apportionment for the 2013 through 2016 tax years and issued assessments. While the initial assessments were adjusted based on additional information provided by the taxpayer, an appeal was filed with the County pursuant to *Virginia Code* § 58.1-3703.1(A)(3)(b). In its response, the County cited a previous determination issued for the 2012 tax year and considered the assessment closed to appeal. The County also upheld the revised assessments for 2013 through 2016 tax years. The taxpayer appeals the County's letter to the Department for the 2012 through 2016 tax years, contending it should apportion its gross receipts using payroll apportionment.

The Tax Commissioner determined he has no jurisdiction to consider the appeal. As the local appeal of the 2012 tax year was filed pursuant to *Virginia Code* § 58.1-3980(A), there is no authority in the Code of Virginia for an appeal to the Tax Commissioner. For the 2013-2016 tax years, the Tax Commissioner determined that no final determination was issued by the locality which is necessary for an appeal. **Lesson:** Never file an appeal of BPOL tax under *Virginia Code* § 58.1-3980 and ensure that a final determination has been issued prior to appealing to the Tax Commissioner.

3. Jurisdiction. P.D. 18-140 (July 12, 2017). The Tax Commissioner declined to consider an appeal as the letter informing the taxpayer of the upholding of the assessments was not a final determination.

VII. TANGIBLE PERSONAL PROPERTY AND MACHINERY AND TOOLS TAXES

A. 2018 Legislation

1. Separate Class For Data Center Computer Equipment. House Bill 828 (Chapter 28) and Senate Bill 268 (Chapter 292) amend §§ 58.1-3503 and 58.1-3506 to create a separate classification for computer equipment and peripherals used in data centers when valuing such equipment for personal property tax purposes. This legislation also provides that this new classification of property must be valued by means of a percentage or percentages of original cost, or by such other method as may reasonably be expected to determine the actual fair market value. This legislation is effective on July 1, 2018.

2. Definition of Agricultural Products. House Bill 1022 (Chapter 30) and Senate Bill 314 (Chapter 618) amend § 58.1-3505 to clarify the definition of "agricultural products" for local property tax purposes to mean any livestock, aquaculture, poultry, horticultural, floricultural, viticulture, silvicultural, or other farm crops. This legislation is effective on July 1, 2018.

B. Recent Court Decisions

1. Virginia International Gateway, Inc. v. City of Portsmouth, CL15-2813, CL16-1427, 2018 Va. Cir. LEXIS 69 (City of Portsmouth Mar. 22, 2018). The Circuit Court of the City of Portsmouth had to rule on both the taxpayer's challenges of its real estate and personal property tax assessments, and a counterclaim by the City of Portsmouth seeking an increase of the tax assessments. The trial court ruled that neither party presented credible expert testimony on real property value, and rejected the owner's calculation of fair market value for high-tech terminal cranes for which no market currently exists.

Virginia International Gateway, Inc. ("Gateway") owned a large tract of land in the City of Portsmouth, used as a "marine container terminal and [at the time of the case] under long-term lease to the Virginia Port Authority." Gateway challenged its real property assessments for tax year 2016 and its personal property assessments for tax years 2015 and 2016. Gateway engaged Glen Fandl to appraise the real estate and serve as their expert witness; Fandl had his real property license from New York, but he obtained temporary Virginia appraisal licensure on two separate occasions. Contemporaneously with the case, Fandl performed tax consulting work on valuing the real property for a meeting with the Portsmouth Commissioner of the Revenue, and again when he prepared his written appraisal report. Subsequently, when Fandl testified at trial as a real property appraisal expert, his temporary Virginia appraisal license had lapsed.

The trial court noted that Fandl's training and experience as a state and local tax consultant was impressive; however, as a real estate appraiser, his experience was less impressive "and seemingly an adjunct to his primary work of consulting." The court did find Fandl's experience and training sufficient to be qualified as an expert to opine on valuations of real property over the City of Portsmouth's objections. However, Portsmouth also objected to Fandl as an appraiser on the grounds that "he violated Virginia law by engaging in appraisal work . . . [and] presenting himself in Court to testify as an expert witness after his temporary Virginia license had expired." The requirement of a Virginia license in real estate or real property appraisals is clear under section 54.1-2011(A) of the Virginia Code, which makes it unlawful to "engage in the appraisal of real estate or real property for compensation or valuable consideration in this Commonwealth without first obtaining a real estate appraiser license."

The circuit court stated that trial judges must be "advers[e] to exercising a power which will serve to promote illegal conduct." Accordingly, the trial judge decided that he should not have recognized Fandl as an expert in real estate values without a Virginia license, and struck the entirety of Fandl's testimony.

The circuit court then turned to Portsmouth's counterclaim asserting a higher fair market value than the real property tax assessment. The court noted that the city's appraiser, John Soscia, had no prior experience in appraising a marine container terminal and had relied heavily on other "experts" who did not appear as trial witnesses. Additionally, Soscia was not able to explain specialized reference resources relating to marine container terminals, made an $8,000,000 math error on several crane fixtures, did not appraise specific individualized improvements, and valued the complete terminal, consisting of 457 acres of developable land at $375,000 per acre, even though only twenty-one of the acres abutted the river. Soscia's appraisal approach also failed to "take into account the actual uses, to which the land [was] being employed." The court concluded Soscia's valuation failed to establish the fair market value of the real property, so the city did not meet its burden of proof on its counterclaim.

On the personal property case, the court noted no appraiser license was required. The court took note of section 58.1-3503(B) of the Virginia Code, which permits the Portsmouth Commissioner of the Revenue to assess the value of personal property by using a percentage of original cost. When a percentage of the original cost renders a value the taxpayer believes is greater than fair market value, the Commissioner may reduce the value if presented with credible and independent evidence (i.e., an appraisal). Experts for both parties testified "that there [was] no market in the world for [used automated stacking cranes]" because they were new technology for which infrastructure was still rare. The court held Gateway was unable to meet its burden of proof that the personal property assessment was erroneous, and the court "decline[d] to make adjustment to the subject assessment."

C. Rulings of the Tax Commissioner

1. Property Used for Personal and Business Purposes. P.D. 17-213 (December 20, 2017). A taxpayer appealed an assessment of business tangible personal property taxes where the taxpayer valued the property based upon a ratio of business to personal use. The locality valued the property solely on the basis of original cost without any ratio. The Tax Department upheld the assessment as the Code of Virginia does not provide for the use of a ratio such as the one the taxpayer used.

2. Statute of Limitations. P.D. 18-6 (January 18, 2018). A taxpayer appealed a local determination over four years from the date of the locality's final determination in 2013. The taxpayer contended that it did not receive the final determination until 2017. The locality provided an affidavit from an employee that the appeal was mailed in 2013. Therefore, the Tax Department determined that it did not have jurisdiction to consider the appeal.

3. Valuation. P.D. 18-8 (January 18, 2018). A taxpayer appealed a local determination contending the boat in question was valued too high. The Tax Department stated that it lacks jurisdiction to consider the appeal as § 58.1-3983.1(D)(5) prohibits the Tax Commissioner from making determinations regarding valuation.

4. Jurisdiction. P.D. 18-9 (January 18, 2018).). A taxpayer appealed a local determination contending the tax assessed on a personal vehicle should have been prorated. The Tax Department stated that it lacks jurisdiction to consider the appeal as § 58.1-3983.1(D) does not grant it the authority to consider appeal of the tangible personal property tax assessed on personal motor vehicles.

5. Jurisdiction. P.D. 17-219 (December 22, 2017). A taxpayer appealed a local determination contending the tax assessed on a personal vehicle was too high. The Tax Department stated that it lacks jurisdiction to consider the appeal as § 58.1-3983.1(D) does not grant it the authority to consider appeal of the tangible personal property tax assessed on personal motor vehicles.

6. Jurisdiction. P.D. 18-14 (February 26, 2018). A nonprofit organization appealed a local determination contending that the tax assessed on personal property was

erroneous as it should have been classified as exempt. The Tax Department declined to hear the appeal as it was appealed under § 58.1-3980 not § 58.1-3983.1.

7. Exempt Property. P.D. 18-41 (March 30, 2018). A taxpayer appealed a local determination contending that the assessment of merchants' capital tax and business personal property tax was erroneous. The merchants capital tax was assessed on agricultural products which the taxpayer contended were exempt under § 58.1-3505. The Tax Commissioner agreed and determined the assessment to be erroneous. The business personal property tax was assessed on certain agricultural equipment. Again, the taxpayer contended the equipment was exempt under § 58.1-3505. The Tax Commissioner quoted several AG opinions and remanded the appeal back to the locality to consider the opinions. **Comment:** Isn't the point of appealing to the Tax Commissioner to obtain an opinion from the Tax Commissioner on the taxability of the property? The constant "remanding" frustrates the intent of the General Assembly.

8. Soft Drink Manufacturing and Packaging. P.D. 18-133 (June 29, 2018). The taxpayer is a soft drink manufacturer located in the City. The City adjusted the taxpayer's M&T tax returns for the 2014 and 2015 tax years and issued assessments. The taxpayer appealed the assessments to the City and at the same time submitted amended returns for the 2012 and 2013 tax years consistent with the list of taxable equipment it submitted for the 2014 and 2015 tax years. In its final determination, the City upheld the assessments and denied the refunds. The City concluded that the assets the taxpayer had excluded from its list of taxable equipment for the 2012 through 2015 tax years were used in its manufacturing process and thus were subject to the M&T tax. The taxpayer appealed to the Tax Department contending that certain categories of equipment, namely shipping and packaging equipment, storage systems and warehouse equipment were not used in its manufacturing process and thus were properly excluded from its list of taxable equipment.

The shipping and packaging equipment included equipment that packaged the products into units larger than the consumer unit. The Tax Department determined that this equipment was not used in the manufacturing process and not subject to the M&T tax. As for storage systems, those used to store raw materials were determined by the Tax Department not to be used in the manufacturing process and not subject to the M&T tax. However, other storage systems was needed for the functioning of bottle molding equipment was directly involved in the manufacturing process and thus subject to the M&T tax as determined by the Tax Department. Last, the Tax Department determined that the taxpayer's representations regarding the warehouse equipment was inconclusive and therefore upheld the M&T assessment with regard to those items.

9. Exempt Property. P.D. 18-137 (July 11, 2018). The taxpayer, a hospital organized as a limited liability company (LLC), operated at a definite place of business in the City. The City issued BTPP tax assessments to the taxpayer for the 2014 through 2017 tax years on tangible personal property acquired after 2003. The City issued a final determination denying the taxpayer's appeal on the basis that no ordinance had been passed exempting the tangible property. The taxpayer appeals the City's final local determination, contending that the tangible property at issue was exempt from the BTPP tax. The City argued that because the property was acquired after 2003 that it could not be exempt from property tax based on law adopted prior to

2003 as in 2003 authority to create property tax exemption shifted from the state to localities. The City argued that since it has never adopted an exemption that the property was taxable. The Tax Commissioner disagreed, citing both a circuit court and the attorney general, determined that the exemption (which is grandfathered) does not exist for specific property but rather it applies to the classification and designation exemptions. Therefore, the Tax Commissioner ordered that the locality adjust the assessments.

10. Hospital Exemption. P.D. 18-138 (July 12, 2018). The taxpayer is a nonstock, nonprofit charity exempt from taxation under IRC § 501(c)(3). It operates as a hospital that is exempt from the BTPP tax. In 2013 and 2014, the taxpayer acquired and operated a number of medical practices. The City issued BTPP tax assessments for the 2015 and 2016 tax years on the tangible property located at the acquired practice sites. The taxpayer paid the assessments and appealed contending that it was exempt from the BTPP tax because it owned the tangible property located at the medical practice sites. The City issued a final determination denying the taxpayer's appeal. It asserted that no ordinance had been passed exempting the tangible property located at the medical practices and the medical practices were not part of the hospital. The taxpayer appeals the City's final local determination contending that the tangible property at issue was exempt from the BTPP tax because it belonged to the Hospital.

For the same reason as described above in P.D. 18-137, the Tax Commissioner determined that it was not necessary for the City to have adopted an ordinance. However for the property to be exempt, the Tax Commissioner applied the three part test from *Smyth County Community Hospital v. Town of Marion,* 259 Va. 328 (2000). The test is (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. The Tax Commissioner determined that each of the three tests is satisfied and the property should be exempt. Therefore, the Tax Commissioner ordered that the locality adjust the assessments.

11. Hospital Exemption Reconsideration. P.D. 18-149 (August 3, 2018). In an as yet unpublished February 8, 2018 determination, the Tax Department held that the taxpayer had not provided clear and cogent evidence that the tangible property at issue belonged to and was actually and exclusively occupied and used by a wholly owned exempt hospital. It further stated that the taxpayer would need to show that the property of a physical therapy office that it operated was actually owned by the hospital. In addition, the Department determined that if the physical therapy office was a separate legal entity or if the taxpayer in fact owned the tangible property at issue, the tangible property located at the physical therapy office would not qualify for an exemption from the BTPP tax. The taxpayer seeks a reconsideration contending that the Department's determination letter misstated facts and used the incorrect standard in its remand to the City.

Despite clearly stating in the initial appeal that there was only one legal entity, the Tax Department used three different terms to describe the one entity. When this was pointed out to the Tax Department in the reconsideration request, the Tax Department responded that there was no "clear evidence of the taxpayer's corporate structure…" in the initial appeal. In the initial determination, the Tax Department required the hospital to show "that tangible property located at the physical therapy office 'was actually owned by the hospital'." This is however not the test required in *Virginia Code* § 58.1-3606(A)(5). This section requires that the property "belong to" the hospital. The Supreme Court of Virginia in *Board of Supervisors of Wythe County v. Medical Group Foundation, Incorporated*, 204 Va. 807 (1964), determined that "belong to" as used in this statute requires that the hospital have some interest or estate in the property, not absolute ownership. In both the initial appeal and the reconsideration request, this was pointed out to the Tax Department. Ultimately, the Tax Department remanded the case back to the City and required the taxpayer to provide proof that the property belonged to it.

Comment: This reconsideration is the culmination of a major error by the Tax Department. The request for reconsideration did not raise any new issues or assert any new facts or law that had not been previously asserted. Instead, it pointed out the errors that the Tax Department made in making its initial determination. The City agreed that there was a factual error as there is only one legal entity. The reconsideration tries to state that this was not the fault of the Tax Department despite the fact that it was clearly stated in the initial appeal. Then the Tax Department applied the wrong legal test in the initial determination despite it being included in the initial letter from the taxpayer, i.e., "belonging to" versus actual ownership. In the reconsideration, the Tax Department applied the correct test ("belonging to") and acknowledged that it means less than absolute ownership. This appeal shows why taxpayers should be wary of appeals to the Tax Department. The constant remanding of local tax appeals when the point of this process is to obtain an impartial opinion is a problem. Now in a single appeal, the Tax Department is showing that it misinterprets facts and misapplies the law. The remanding and mistakes hurt taxpayers.

D. Rulings of the Attorney General

1. No recent opinions.

VIII. MISCELLANEOUS TAXES

A. 2018 Legislation

1. <u>Motor Fuels Sales Tax Floor</u>. House Bill 768 (Chapter 798) amends §§ 58.1-2292, 58.1-2295, 58.1-2299, 58.1-2299.10, and 58.1-2299.14 to create a floor on the 2.1 percent sales tax imposed on motor vehicle fuels sold in Northern Virginia and Hampton Roads. The floor is imposed through a minimum tax base of statewide average wholesale price of a gallon of unleaded regular gasoline or diesel fuel. This legislation would be effective on July 1, 2018.

2. <u>Motor Vehicle Sales and Use Tax: ATVs</u>. House Bill 1441 (Chapter 838) and Senate Bill 249 (Chapter 840) exempt all-terrain vehicles, mopeds, and off-road motorcycles from the Retail Sales and Use Tax and instead subject them to the Motor Vehicle Sales and Use Tax. The tax rate charged and the distribution of the revenues would not change. This legislation would be effective on July 1, 2018.

3. Merchant’s Capital Tax. House Bill 119 (Chapter 23) amends § 58.1-3510.02 to create a separate classification for purposes of the local tax on merchants’ capital for certain merchants' capital of wholesalers that is reported as inventory and is normally located in a structure that contains at least 100,000 square feet, with at least 100,000 square feet used solely to store such inventory. This legislation is effective on July 1, 2018.

B. Recent Court Decisions

No recent court decisions.

C. Rulings of the Tax Commissioner

1. Communications Sales and Use Tax: Regulatory Fees. P.D. 17-199 (December 13, 2017). Department determines that Federal Communications Commission regulatory fees and Public Education Government grant fees, which are separately stated on an invoice issued by a communications service provider to the taxpayer, are exempt from the communications sales and use tax only if such fees are required to be added to the sales price billed to customers. Governmental fees that are allowed to be passed on to the customer are subject to the communications sales tax, even if separately stated.

2. Communications Sales and Use Tax: Under-reported Franchise Fees. P.D. 17-206 (December 13, 2017) and P.D. 17-205 (December 13, 2017). In response to a complaint that a cable provider under-reported its franchise fee, Department determined that such under-reporting would result in an increased distribution to the locality only when the fee owed to the locality exceeds its percentage distribution from the Communications Sales and Use Tax Trust Fund. The Department stopped short of determining whether such locality was due any additional money.

3. Jurisdiction. P.D. 17-218 (December 22, 2017). The Tax Department declined to consider an appeal of a local meals tax as the Code of Virginia does not provide it with jurisdiction to consider such appeals.

4. Withholding Tax: Information Sharing and Employee vs. Independent Contractor. P.D. 18-107 (June 6, 2018). The taxpayer appealed an assessment of withholding taxes arguing that the Tax Department did not have authority to obtain the information from the Virginia Employment Commission. The Tax Commissioner determined that that the Code of Virginia authorized the information to be exchanged but that the auditor failed to properly test the ultimate determination of employee versus independent contractor as required by tax regulations. Therefore, the Tax Commissioner sent the assessment back to the auditor to be reviewed and directed the taxpayer to provide information necessary for such review.

5. Fiduciary Income Tax: Bankruptcy. P.D. 18-128 (June 26, 2018). In May 2016, a bankruptcy trustee filed a 2012 income tax return and requested a prompt determination. In February 2017, the Tax Department denied a credit and issued an assessment which was appealed by the trustee. The Tax Commissioner abated the assessment as federal law

requires that the assessment should have been issued within 60 days of the filing of the return upon the request of a prompt determination.

D. Rulings of the Attorney General

1. Meals Tax. No. 17-034; 2017 Va. AG Lexis 27 (December 7, 2017). The attorney general opined that the exemption under § 58.1-3833 that exempts meals served in restaurant where meals are included in rental fees for age-restricted apartment complexes is not limited to just the meals included in rental fees. All meals at such a restaurant were exempt from the meals tax.

2. Electric Utility and Natural Gas Consumption Taxes. No. 17-027 (June 15, 2018). The attorney general opined that community service boards and behavioral health authorities are divisions or agencies of local government and thus exempt from electric utility and natural gas consumption taxes.