Recent Tax Developments in Virginia: September, 2000-2001

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I. CORPORATE INCOME TAX

A. Cases

Pauley v. Department of Taxation, Cir. Ct. City of Richmond (Law No. LF-2597-4) (June 1, 2001). Upholds the Department of Taxation's position that Virginia residents are allowed to claim a credit against their Virginia income tax liability only for "income taxes" paid to other states. No credit is allowed for franchise taxes or excise taxes. Credit for taxes paid to California, Michigan, New York, Tennessee, Texas and Utah not allowed under Virginia Code § 58.1-332.

B. Rulings of the State Tax Commissioner

1. Apportionment/Financial. P.D. 01-21 (March 21, 2001). Taxpayer elected to treat asset sale under IRC § 338(h)(10). Although previously filing under one factor financial apportionment, effect of this election is to throw it into three factor apportionment. Observation: This appears to confirm that a corporation will change its apportion methodology from year to year depending upon a strict application of the formula.

2. Coalfield Tax Credits. P.D. 00-171 (September 22, 2000). Taxpayer attempts to push the envelope on PD 97-359 which allowed a credit for coal mined in a neighboring state and conveyed to Virginia when the coal exited a portal in Virginia. Commissioner holds that no credit allowed if coal is stockpiled in another state before being conveyed to Virginia, or trucked to a stockpile before being conveyed to Virginia. Observation: In applying these rulings, be careful to distinguish between stockpiling in another state and a coal transfer point where a conveyor system changes direction.

3. Coalfield Tax Credits. P.D. 00-186 (October 11, 2000). When affiliates of a coal mining group are organized on a functional basis, Commissioner will allow the coalfield employment credit to be used to offset certain Virginia taxes paid by any member of the affiliated group 80% of the gross receipts of which are derived from mining, processing or distributing coal. Ruling outlines order in which credits are used within the affiliated group.
4. **Qualified Equity and Subordinated Debt Investment Tax Credits.** P.D. 00-205 (November 28, 2000). Taxpayer failed to apply for its share of the qualified equity and subordinated debt investments tax credits by the April 1, 2000 deadline. **Held:** Taxpayer loses benefit of the credit entirely, both for 1999 and subsequent years. **Observation:** Although there is no statutory authority for this deadline, Commissioner will clearly assert that one had to be applied administratively in order to administer this credit.

5. **Electric Coops.** P.D. 01-1 (January 4, 2001). Discusses how otherwise tax exempt electric cooperatives will be subject to a modified Virginia new income tax effective January 1, 2001.

6. **IRC § 1396 Deductions.** P.D. 00-166 (September 6, 2000). No Virginia deduction allowed for wages not allowed in computing federal taxable income because of taxpayer’s election to utilize the Empowerment Zone Employment Credit.

7. **Nexus/Allied-Signal.** P.D. 00-206 (December 13, 2000). In applying the **Allied-Signal** test, Virginia continues to look to how proceeds are utilized. Very few taxpayers have succeeded in removing interest from apportionable income. This taxpayer succeeded in part because there was no unitary relationship between borrower and lender, taxpayer had no long term debt and cash and accounts receivable were sufficient to cover total current liability.

8. **Nexus/PL 86-272.** P.D. 01-70 (May 25, 2001). Virginia activities of sales staff went beyond those protected by PL 86-262 (i.e., activities ancillary to solicitation of sales or activities *de minimis* in nature). The offending activities included: consulting with dealers on product support; providing input for dealer business plan development; sales coverage analysis; dealer operations studies; assessing dealer management capabilities; assessing sales personnel; technical training to customers.

9. **Consolidated Return/Filing Change.** P.D. 00-185 (October 6, 2000). Unless consolidated filing is elected in the first year that two or more members of the affiliated group are subject to Virginia income tax, forget it. The Commissioner has never seen “an extraordinary circumstance” that will permit a change to consolidated status subsequently.

10. **NOL Carryovers.** P.D. 00-181 (October 5, 2000). Losses incurred in a prior year cannot increase NOL in a current year. The same rule applies in a combined return setting.

11. **Tax Conformity.** P.D. 00-157 (August 23, 2000). Taxpayer not entitled to net tax overpayments and underpayments in order to reduce interest charged. The Commissioner’s ruling contains the following statement: “**Virginia’s conformity to federal law is limited to the actual use of a specific term in a Virginia statute. Conformity does not extend to terms, concepts, or principles**
not specifically provided in the Code of Virginia. Thus, Virginia tax law does not conform with federal tax law unless the law is expressly stated in the Code of Virginia. Query: Is this consistent with the legislative purpose of conformity to simplify the tax system and utilize federal law to provide both the tax collector and taxpayer with a consistent body of well-known authority?

II. INDIVIDUAL INCOME TAX

A. Cases

Burkholder v. Commonwealth, 2001 Va. App. Lexis 57 (2001). After reading the book “Vultures in Eagles’ Clothing,” Burkholder concluded that he was not a citizen of the United States, but a citizen of “these United States” who had no taxable income. He filed false withholding exemption certificates with his employers, and filed no Virginia income tax returns. The Court of Appeals held that Burkholder’s arguments went to the issue of “willfulness,” and did not support a “claim of right” defense that would completely negate criminal intent. “Like defendants in criminal cases in other contexts who ‘willfully’ refuse to comply with the duties placed upon them by law, he must take the risk of being wrong.”

B. Rulings of the State Tax Commissioner

1. Actual Resident. P.D. 00-167 (September 8, 2000). Graduate student was domiciled in another state but attended Virginia school. Although he passed the licensing examination in the other state, he failed to obtain a job there, continued to live in Virginia, and was employed in Washington, D.C. Because he was an actual resident for 183 days or more a year, he was a Virginia resident taxable on all of his income, credited only with taxes paid elsewhere. A “resident’s” income does not have to be “Virginia source income” to be taxable.

2. Actual Resident. P.D. 00-170 (September 15, 2000). Taxpayer and wife lived in Virginia while in the military and for several years thereafter. Even though he claimed to be a domiciliary of another state, actual residence in Virginia full-time after leaving the military made him subject to Virginia income tax. Facts also supported his being a domiciliary of Virginia after the years of his actual residency.

3. Actual Resident/Medical Care. P.D. 00-180 (October 5, 2000). Taxpayers held to be Virginia residents because they spent more than 183 days here. Just because those days were spent in the hospital undergoing critical medical care did not affect the conclusion.

4. Actual Resident/Nursing Home Resident. P.D. 00-197 (October 25, 2000). Taxpayer was moved by his children to a Virginia nursing home where he resided for more than 183 days during the taxable year. Held: (1) Although
not a domiciliary resident, he was an actual resident of Virginia except for the year of his death when he lived fewer than 183 days in Virginia; (2) his living
trusts which were administered by his children in Virginia were subject to fiduciary income taxation by Virginia; but, (3) he owed no Virginia estate tax because he was not a domiciliary resident.

5. **Double Taxation.** P.D. 00-194 (October 23, 2000). Taxpayer recognized gain on sale of property in another state, but the gain was deferred to federal income tax purposes. Taxpayer was not allowed to claim the other state’s income tax as a credit against his Virginia income tax that was payable in a different year.

6. **Part-year Deductions.** P.D. 00-212 (December 7, 2000). Taxpayer, a part-year resident of Virginia, made a charitable contribution before moving to Virginia. This contribution was not allowed in any part as an itemized deduction against Virginia taxable income.

7. **Prorated Compensation.** P.D. 01-27 (March 28, 2001). Non-resident who worked in company offices, one in Virginia and one outside Virginia, correctly prorated his income between those two offices based on days spent in each.

8. **Foreign Source Income.** P.D. 00-199 (October 30, 2000). Taxpayers received wages from their corporation which operated in Canada, and paid Canadian income tax. No deduction as “foreign source income” was allowed against Virginia source income which must be income from “property.” US/Canada tax treaty does not apply to state taxes.

9. **Amended Returns/Federal Audit.** P.D. 00-198 (October 27, 2000). Taxpayer delivered amended returns to Virginia one year and six weeks after the conclusion of a federal audit. The federal audit apparently produced several “timing adjustments” so that the Virginia amended return reflected both additional tax due (for some years) and refunds for others. The additional payments were gladly accepted by Virginia, and the refunds were denied based on the one year statute of limitations.

10. **VPEP Contracts.** P.D. 00-216 (December 7, 2000). Reviews in great detail the Virginia College Savings Plan and the income tax deduction allowed for the purchase of such contracts.

11. **Non-Filer.** P.D. 00-178 (October 5, 2000). Tax Department regularly receives information from IRS with respect to income taxability of potential Virginia residents. When an apparent Virginia resident has not filed a return and refuses to file one, the Department has the authority to make an estimated assessment, and the burden is then the taxpayer’s to prove that the assessment is wrong.
12. **Tax Protest.** P.D. 00-189 (October 11, 2000). An “American National Non-Immigrant Natural Born Free Citizen” was nevertheless subject to Virginia income taxation. It is interesting to note that taxpayer was given the opportunity to file returns and pay tax, penalty and interest within thirty days to avoid a 100% fraud penalty.

III. RETAIL SALES & USE TAXES

A. **Legislation:** 2001 Session

1. **Industrial Exemptions.** The exemption for certified pollution control equipment and facilities and for various materials and equipment used in the production of oil and natural gas is extended until July 1, 2006.

B. **Court Decisions**

1. **Reynolds Metals Company v. Commonwealth,** (Augusta Cir. Ct., March 21, 2000) (pet. for app. denied). Reynolds Metals claimed a “dealer discount” for sales and use taxes remitted under its direct pay permit. The Court rejected the Department’s argument that the discount is not allowed to direct pay permit holders, reasoning that the discount provision of § 58.1-622 is part of the tax rate set by the General Assembly, and, further, that only the General Assembly is authorized to take the discount away.

2. **Chesapeake Hospital Authority v. Commonwealth,** (Chesapeake Cir. Ct., June 15, 2000) (argued in S. Ct. of Virginia 9/14/2001). The Hospital is both a political subdivision of the Commonwealth and a hospital operated on a not-for-profit basis. Despite this status, the Tax Department assessed use tax with respect to food that the Hospital provided free of charge to attendees at staff meetings, physicians’ meetings, Hospital Authority meetings, and various other meetings that the Hospital conducted. The Hospital claimed exemption from the use tax under two sections of the Virginia Code: § 58.1-609.1(4) (exemption for tangible personal property for use or consumption by the Commonwealth or any political subdivision); and § 58.1-609.7(4) (exemption for tangible personal property for use or consumption by a non-profit hospital). The Court ruled that the food was “directly related to the primary issue of the Hospital’s main purpose,” and, therefore, that the food was exempt.

C. **Rulings of the State Tax Commissioner**

1. **Advertising/Direct Mail.** P.D. 00-176 (October 5, 2000). Direct mail advertising which is printed and mailed to recipients, free of charge, every 6 to 8 weeks does not qualify as a tax-exempt publication.

2. **Advertising/Folding Machine.** P.D. 00-213 (December 7, 2000). Taxpayer provides direct mail marketing services and some printing services. It uses a
folding machine separate from the printing presses to fold customer-provided materials as well as materials it prints. The Commissioner ruled that the machine is exempt to the extent it is handling items printed by the taxpayer and taxable to the extent that it is handling items provided by the customers. Its status will be determined based upon the preponderance of its use.

3. **Advertising.** P.D. 01-22 (March 21, 2001). Where advertising brochures were printed by a printer located outside of Virginia, delivered by that printer to an out-of-state mailing house, delivered by that mailing house to the U.S. Postal Service, and ultimately delivered to customers across the U.S., including customers in Virginia, no use tax applied because the advertiser/retailer exercised no control over the brochures in Virginia.

4. **Advertising/Customer Data.** P.D. 01-49 (April 26, 2001). Data cards shipped to customers buying product were held to be administrative supplies, not printed materials advertising tangible personal property for sale. The data cards provided information to the manufacturer for its use in later marketing activities.

5. **Agricultural Exemptions.** P.D. 00-183 (October 6, 2000). Equipment used 10% of the time to mow grass between rows of vines qualifies for agricultural exemption because grass is considered a “cover crop” planted for the purpose of controlling erosion of soil in which the vines have been planted.

6. **Agricultural Exemptions.** P.D. 00-207 (December 4, 2000). Plastic film used to protect plants during winter months is taxable or exempt depending on its use. If it is stretched over the greenhouse piping structure such that it actually becomes a part of the greenhouse, then it is taxable. If it is used as ground covering to protect plants from the winter weather, then it is exempt.

7. **Airlines.** P.D. 00-195 (October 26, 2000). The Commissioner reviews the status (taxable or exempt) of items used in the airline’s business, under Commonwealth v. United Airlines, 219 Va. 374 (1978). Modems used to support the reservations and flight operations system terminals at ticket counters and gates are exempt. Vacuum cleaners used to clear debris from boarding areas, while a practical necessity, are not indispensable to the rendition of common carrier service; therefore, they are taxable. Lintless towels used to clean the interior of the aircraft are exempt. Tax applies to shipping charges that are not separately stated. Bar service items which are resold to passengers are exempt. Timetables provided to passengers are for convenience, and are not essential to the airline’s operation; therefore, they are taxable.

8. **Charitable Organizations.** P.D. 01-31 (March 29, 2001). Taxpayer, a non-profit membership association comprised of persons specializing in clinical oncology, was organized to promote cancer research relating to tumor diseases. As such, it qualifies for the exemption under Va. Code § 58.1-
609.8(23) available to 501(c)(3) entities organized for the purpose of eliminating cancer. The Commissioner notes that the exemption does not apply to the purchase of taxable services, such as meals and lodging.

9. **Computer Software/Electronic Transfer.** P.D. 01-61 (May 15, 2001). Transaction was not taxable when computer software was uploaded electronically from vendor to customer. This was so even though customer was given a tangible customer service manual. The Commissioner held that the true object of the transaction was the computer program services, not the manual.

10. **Computer Software.** P.D. 01-45 (April 16, 2001). When contract for sale of software upgrades did not provide that software would be transferred only by electronic means, Commissioner assumed that tangible copies of software were available and therefore that the sale was taxable (at 50% because it was a “maintenance agreement”). Laboratory equipment used to test prototypes and products of both the taxpayer and other manufacturers was not covered by the R&D exemption because that exemption applies only to property used exclusively in testing a person’s own equipment.

11. **Contractor/Kitchen Cabinets.** P.D. 01-60 (May 15, 2001). Taxpayer did not have a showroom where it made retail sales of the cabinets it produced; rather, it fabricated kitchen cabinets both for resale and for its own use in performing real estate construction contracts. As such, it was taxable on the cost of its raw materials at the time purchased for use in real estate construction contracts and at the time of withdrawal from inventory used in such contracts. Because of the time of imposition of the tax, this does not include the cost of labor to fabricate.

12. **Out-of-State Contractor.** P.D. 01-39 (April 12, 2001). When out-of-state contractor uses equipment leased in Tn. and used in Virginia, credit will be given for Tennessee tax only if that tax was properly paid on the entire amount of the lease agreement at the time the equipment was delivered in Tennessee. If monthly payments are required, then credit will not be allowed for months during which the equipment was in Virginia. Charges for crushing rock are charges for fabrication which are subject to sales and use taxation.

13. **Dredging.** P.D. 01-2 (January 3, 2001). The Commissioner reviewed the tax treatment of certain items used in taxpayer’s dredging business in inter-coastal and interstate waterways. Food and safety and support supplies furnished by taxpayer to the crew for use or consumption aboard the dredges or attendant vessels are generally exempt. Land-based supporting equipment and other supplies used or consumed away from the dredge and attendant vessels are taxable. Equipment and supplies used for general yard maintenance are not exempt, but equipment used to repair the dredge is exempt. For items used for both taxable and exempt activities, tax must be prorated.
14. **Durable Medical Equipment.** P.D. 00-215 (December 7, 2000). Braces and collars purchased by a neurosurgery practice for use in treating its patients did not qualify for the exemption accorded durable medical equipment. The practice purchased these items in bulk and dispensed them to patients on an as-needed basis. Because the braces and collars were not purchased for specific patients, the Commissioner ruled the exemption inapplicable.

15. **Durable Medical Equipment.** P.D. 01-19 (March 16, 2001). Specialized hospital beds sold to acute care patients with specific medical problems on a physician’s prescription qualify as exempt durable medical equipment.

16. **Farming.** P.D. 01-81 (June 15, 2001). Ruling reviews a broad range of items purchased by a major commercial farming operation. One such item was propane used to heat employee housing. Although this fuel was used to warm individuals, it was purchased by a corporation and therefore the entity purchasing it did not purchase it for “individual consumption.” Accordingly, the propane was taxable.

17. **Finance Charges.** P.D. 01-67 (May 25, 2001). Centralized purchases are resold to affiliates which are charged a fee to cover administrative and maintenance costs. The Commissioner holds that this fee is part of the taxable “sales price” and not a “finance charge.”

18. **Food Tax Reduction Program.** P.D. 00-202 (November 17, 2000). Oxygen-enriched water which is intended to be mixed with regular water or juice for human consumption is deemed an “accessory food” for human consumption, and is subject to the reduced tax rate.

19. **Food Tax Reduction Program.** P.D. 00-203 (November 20, 2000). Taxpayer’s dietary supplements and herbal products are not regarded as food or intended as a substitute for food. Therefore, they are not eligible for the reduced tax rate. Likewise, the taxpayer’s bath additive does not qualify for the nonprescription drug exemption.

20. **Food Tax Reduction Program.** P.D. 01-10 (February 20, 2001). Food purchased by a healthcare management company and used in preparing meals for residents of nursing homes qualifies for the program.

21. **Food Tax Reduction Program.** P.D. 01-20 (March 14, 2001). Shipping and handling charges that are included in the sales price of food qualifying for the exemption are also taxed at the reduced rate.

22. **Government Contracts.** P.D. 01-59 (May 15, 2001). All equipment utilized in a service contract with the Government is subject to use taxation in Virginia even if delivered to the Government outside Virginia. Taxpayer’s burden is to show no basis for Virginia tax.
23. **True Object/IDIQ Contract.** P.D. 01-6 (January 4, 2001). The Commissioner made a “limited departure” from the traditional true object test applied to government contracts. The contract in issue was a fixed price indefinite delivery/indefinite quantity contract for the provision of various information processing goods and services. Significantly, the Commissioner observed that the contract was not sufficiently detailed to allow him to conclude whether its true object was the sale of tangible personal property or the provision of services, and, further, that the government could not ascertain at the time of contracting what goods and services it would require thereunder. Accordingly, the Commissioner ruled that the true object test would be applied to each individual delivery order under the contract rather than to the contract as a whole, *i.e.*, if the true object of the order was the sale of tangible personal property, the charge would be exempt; if it was the provision of a service, the taxpayer would be the taxable user of the tangible personal property used in providing the service. Note: the Commissioner has expressly limited the application of this approach to the particular contract that was the subject of the ruling.

24. **Hospitals/Administrative Expenses.** P.D. 01-63 (May 15, 2001). Non-profit corporation operated three non-profit hospitals as divisions and maintained a division that provided administrative services to the entire group. The Commissioner holds that the administrative division cannot make purchases exempt of sales and use tax because it is not, itself, a hospital or part of a hospital even though it is not separately incorporated.

25. **Internet/Access Services.** P.D. 01-29 (March 29, 2001). Taxpayer provides internet access, information, e-mail, personal home page and proprietary content services. As an internet service provider, taxpayer’s equipment used for storing, processing and retrieving end-user subscriber requests is tax-exempt as of July 1, 1999. The exemption does not extend to equipment used by taxpayer to design, create or produce content because that equipment is not used to provide internet access.

26. **Leases and Rentals.** P.D. 00-188 (October 11, 2000). Effective July 1, 1999, the term “sales price” does not include separately stated property taxes,” and tax does not apply to those charges. Tax erroneously collected on such amounts must be remitted to the Department unless it is refunded to the customer/lessee. Similarly, as to tax collected on these amounts and remitted to the Department, a refund will be made only to the customer/lessee unless the taxpayer/lessor can establish that it refunded the tax to its customer/lessee.

27. **Leases and Rentals.** P.D. 01-13 (March 5, 2001). The Commissioner reviews the tax treatment of various lease arrangements. Taxpayer failed to establish that leased recycling equipment qualified for the industrial exemption, and notes that the baling of products does not constitute industrial manufacturing. A consulting fee agreement is not taxable, even though the fee is based on a percentage of the gross equipment lease. The Commissioner determined that
the agreement was for the provision of services only. Taxpayer is taxable with respect to pots and equipment furnished to its customers in connection with its coffee service contracts. Taxpayer’s customers do not pay consideration for using the coffee equipment.

28. Leases and Rentals. P.D. 01-16 (March 9, 2001). The lease of portable chemical toilets is taxable. Tax also applies to the charges for pumping and cleaning services because those services are included under the lease.

29. Leases. P.D. 01-42 (April 13, 2001). Department’s longstanding position has been that leases of tangible personal property, even if security agreements under the UCC, are subject to sales and use taxation on the gross lease proceeds.

30. Manufacturer/Dealer Discount. P.D. 01-58 (May 14, 2001). Based on the circuit court holding in Reynolds Metals v. Commonwealth, the Commissioner allows a dealer discount to a manufacturer with a direct pay permit on two conditions: (1) direct pay permit holder must have a Certificate of Registration and (2) discount allowed only on timely filed returns, Form ST-6.

31. Manufacturing/Direct Use. P.D. 01-50 (April 26, 2001). Cleaner used to avoid contamination of dyeing equipment was exempted on a pro rata basis reflecting use on such equipment (a quality control function) versus use on other production equipment (a maintenance function). Equipment that inspected finished product for grading and pricing was not used directly in manufacturing and was not exempt. Packaging equipment utilized in a warehouse at a production facility on product made at that facility and other facilities would be exempted only if 50% or more of the product packaged came from that facility. Observation: The Department’s application of the so-called “plant site test” appears to be “balkanizing” the direct use exemption instead of applying it to an integrated manufacturing process along functional lines.

32. Manufacturing/Climate Control. P.D. 00-177 (October 5, 2000). Compressed air dryers and moisture separators used to keep compressed air lines dry in the furniture manufacturing process are not “used directly” in manufacturing, and, therefore, are not exempt. Although the equipment might be “essential” to creating the desired product, it does not “act upon” the product and is not an “immediate part” of the production process. The Commissioner cited the Virginia Supreme Court’s decision in Webster Brick Co. v. Department of Taxation, 219 Va. 81, 245 S.E.2d 252 (1978) for the propositions that only those items that are “an immediate part of actual production” are “used directly” in the production and that the exemption does not apply to “essential items which are not an immediate part of actual production.”
33. **Manufacturing/Bar Code Machines.** P.D. 01-52 (April 30, 2001). Bar coding equipment utilized after production is complete for the purpose of tracking goods, as required by federal law for purposes of possible recalls, not directly used and not exempt. Previous rulings with bar coding distinguished. In those cases, bar coding was applied prior to conveying products to finish goods inventory.

34. **Manufacturing/Pallets.** P.D. 00-169 (September 13, 2000). Reusable pallets do not qualify for manufacturing exemption because they are not “bound to the items they carry” (such as by shrink-wrapping). Additionally, packaging activity must occur at the manufacturing site to qualify for the exemption.

35. **Manufacturing/CDs.** P.D. 01-48 (April 24, 2001). Although manufacturer of compact discs was held to be qualified for the manufacturing direct use exemption, equipment used in the data preparation department was held to be used in a pre-production function, before actual production of the CD began. This was not exempt. **Query:** Why doesn’t this qualify as “handling and storage of raw material” which is part of “direct use” as defined in the statute?

36. **Publishing.** P.D. 00-214 (December 7, 2000). The Commissioner ruled that equipment used in the taxpayer’s “electronic pre-press activities” would be exempt as equipment used directly in manufacturing so long as the preponderance of its use was in exempt activities.

37. **Publishing.** P.D. 01-24 (March 21, 2001). Taxpayer had an “integrated front-end news-gathering and pagination system” designed to integrate the production process with the front-end news-gathering function. Some traditional pre-press activities were eliminated as a result (manual typesetting, cutting and pasting). The Commissioner ruled that equipment used solely to perform typesetting and pagination functions qualify for the industrial manufacturing exemption while equipment used in reporting, news-gathering and editing remain taxable. Upon total integration of the taxpayer’s systems, newly acquired equipment will be evaluated and its taxable status determined according to the preponderance of use rule. No credit will be available for tax paid with respect to equipment currently in use.

38. **Publishing.** P.D. 00-192 (October 17, 2000). The Commissioner ruled that the “preponderance of use” test would apply to certain of the taxpayer’s newspaper publishing equipment. The equipment, a number of computers and computer-related items, performed a variety of functions including, reporting, editing, pagination, and transmission. The equipment also converted the newspapers to digital signals which were transmitted via satellite to the taxpayer’s regional printing sites, where the newspapers were printed, packaged and distributed. The Commissioner observed that the equipment was used for both taxable functions (e.g., news gathering and editing) and exempt functions (e.g., pagination, typesetting, pre-press). The Commissioner ruled that if the equipment was used at least 50% of the time in non-exempt
activities, then it would be taxable in full; if it was used at least 50% of the
time in exempt activities, then it would be exempt in full.

39. **Processing/Gravel.** P.D. 01-1 (January 3, 2001). The taxpayer mined and
manufactured gravel, sand and concrete for sale or resale. A video-
conferencing unit purchased by a foreign parent and shipped to a Virginia
subsidiary is not eligible for credit against the use tax. Credit is available only
with respect to taxes paid to other states. Gravel used to build access roads
from public road to mine sites it put to a taxable use by taxpayer even though
the gravel may ultimately be resold to a third party. Taxpayer’s purchase of
subsidiaries that had low compliance ratios on pre-purchase audits is not
entitled taxpayer to first-generation audit treatment because the manner of
conducting the business remained the same.

40. **Processing/Embroidering.** P.D. 01-35 (April 10, 2001). Taxpayer engaged
predominantly in custom screen printing of apparel and embroidery of
garments. The Commissioner held that this was not “industrial processing”
because it was essentially a service business and not classified in the SIC
codes in the industrial classifications.

41. **Media-Related Exemptions.** P.D. 01-30 (March 29, 2001). The
Commissioner reviews the scope of § 58.1-609.6(6), which applies to certain
audio and visual works. He concludes that videotapes used by governmental
and corporate entities for training purposes do not qualify for the exemption
because they are not licensed, distributed, broadcast or commercially
exhibited for viewing by the general public.

42. **Nexus.** P.D. 00-193 (October 20, 2000). Taxpayer sells merchandise to
Virginia residents via telephone, catalog and website, but has no physical
presence in Virginia. The third-party fulfillment service provider which
merely accepts orders is considering locating its call center in Virginia.
Whether this will cause the taxpayer to be a dealer, obligated to collect tax on
sales to Virginia customers, will depend upon whether the fulfillment service
provider is an agent of the taxpayer. If the taxpayer has the right to control
the work of the fulfillment services provider, then the taxpayer will be deemed
to have sufficient nexus to require it to register to collect and remit Virginia
tax.

43. **Photographs.** P.D. 01-55 (May 15, 2001). Photographs taken by a personal
investigator and sold to a law firm as part of investigative services held to be
sale of taxable tangible personal property.

44. **Printing.** P.D. 01-12 (March 5, 2001). Taxpayer, a graphic designer and
communications company, contends it should be audited as a retailer, not as
an advertiser. Taxpayer provides custom printing to the public and private
sectors. The Commissioner agreed that it should be audited as a retailer.
45. **Procedure/Exemption Certificates.** P.D. 01-84 (June 28, 2001). Taxpayer sold aerial platforms to churches. Because various letters from churches showed that some of these platforms were used in church services, the taxpayer was held to have taken the exemption certificates in good faith. Sales tax was imposed only on sales for which there were no exemption certificates.

46. **Procedure/Sampling Error.** P.D. 01-51 (April 27, 2001). Invoices will not be removed from the error sample when the taxpayer shows that use tax had been appropriately accrued by its customer.

47. **Procedure/Sampling.** P.D. 01-36 (April 11, 2001). In order to remove items from the same period, the taxpayer must show that the transaction was isolated and not a normal part of the taxpayer’s sales. The mere fact that taxpayer makes sales to a person only once does not show that similar sales are not made on a recurring basis. When taxpayer can show that items purchased exempt by a customer, without being charged sales tax, were self-assessed with use tax by the customer, a credit is allowed in the audit. These items are not removed from the sample period. **Query:** Is this fair, especially for small businesses that may routinely rely on the fact that their larger more sophisticated customers do file monthly use tax returns?

48. **Procedure/Sampling.** P.D. 01-28 (March 28, 2001). An item will not be removed from samples absent a showing that the transaction was isolated in nature and was not a normal part of the taxpayer’s operations.

49. **Procedure/Urban Enterprise Zone Credit.** P.D. 00-201 (November 20, 2000). Taxpayer is entitled to a refund of taxes invoiced in 1998 but not paid until 1999 so long as taxpayer was certified by the Department of Housing and Urban Development in 1998.

50. **Procedure/Bracket System.** P.D. 01-65 (May 21, 2001). Although “excess” sales tax collections must generally be remitted to the Department, this does not apply to any excess produced by application of the “bracket system.” Those taxes may be retained by the retail merchant.

51. **Procedure/Separate Documentation.** P.D. 01-37 (April 11, 2001). A transaction for the sale of tangible personal property that includes services is entirely taxable except for separately stated installation services. Similarly, services with respect to real property are not taxable unless intermingled with the sales of tangible personal property for which no separate documentation is available. In both instances, Commissioner will permit taxpayer to submit documentation separately identifying exempt proportions.

52. **Procedure/Bad Debts/Statute of Limitations.** P.D. 01-34 (April 9, 2001). Membership retail outlet was unable to “compare bad debts to the corresponding original sale” so used a formula approach that compared
taxable and exempt sales. The bad debt deduction was denied by the Commissioner. **Query**: Is this a change in position by the Department? Why should a retail merchant be taxable with respect to payments it never received?

When taxpayer received a “secondary copy of the original assessment” that it had requested, that copy was printed by the Department on March 17 even though the statute of limitations had been extended only to February 29, 2000. Although the Department could not prove the date of the original mailing (or even that it was mailed), the Commissioner relies on the Department’s “standard procedures” to assert that the assessment was timely. **Query**: Should steps be taken in connection with the multi-million dollar computer upgrade at the Department to create a record of when tax assessments are mailed?

53. **Processing Fees/Manufacturers' Discount.** P.D. 00-184 (October 6, 2000). Processing fees charged by a financing company unrelated to the taxpayer are not part of the taxpayer’s charges for the sale, and, therefore, are not subject to tax. The manufacturers’ discount amount is actually received by the taxpayer, therefore, the amount is not to be deducted from the amount on which tax is computed.

54. **Public Service Corporations/Telephone Company.** P.D. 01-69 (May 23, 2001). Company was entitled to a direct use exemption because its wireless communication service was authorized by the FCC. Ruling analyzes particular items for which exemption is available.

55. **Public Service/Telecommunications Services.** P.D. 01-3 (January 3, 2001). Taxpayer provides radio paging services. The exemption applies only to property used in the rendition of public services. Because taxpayer is classified by the FCC as providing private mobile radio services, it is not eligible for the exemption. Taxpayer is not eligible for the broadcasting exemption because its signals are available only to subscribers.

56. **Public Service Corporations/Paging Services.** P.D. 01-33 (April 9, 2001). Taxpayer’s previous exemption as a public service corporation is no longer recognized because, with deregulation of radio common carriers and cellular mobile radio communications carriers, the SCC stopped issuing certificates of convenience and necessity to paging companies effective July 1, 1995.

57. **Real Property Contractors.** P.D. 00-182 (October 5, 2000). Certain construction materials provided to contractor by a public service corporation for use in constructing an electrical substation held taxable to the contractor. The utility charged the materials to Account 362 (Uniform System of Accounts). Under the Department’s regulation, structural materials charged to this account are exempt only if they are “an immediate part of the production of electricity.”
58. Real Property Contractors. P.D. 01-23 (March 21, 2001). Taxpayer’s provision of services to maintain wastewater systems constitutes service of real property fixtures. Therefore, taxpayer is a real property contractor, and the taxable user and consumer of all materials used in performing its maintenance contracts.

59. Real Property Contractors. P.D. 01-26 (March 28, 2001). A taxpayer engaged in building athletic tracks is a real property contractor because the tracks are affixed to the realty. It is taxable with respect to all equipment used in performing its contracts. Equipment that was shipped to a Virginia location and subsequently was taken out-of-state is subject to tax at the first use occurred in Virginia.

60. Real Property Contractors/Manufacturing. P.D. 01-76 (June 13, 2001). This ruling continues the Department’s difficulties of determining when structural steel and other components of a single purpose structure are “directly used” and exempt from sales taxation. The Department’s position in Webster Brick and Wellmore Coal, in which it prevailed, was that the structural steel components of a single purpose facility were taxable because “indirectly used.” The problem with that winning position was that the trial court had found in Wellmore Coal that the structural steel was part of a “single purpose machine” so how do you administer the exemption? How do you distinguish between taxable and exempt parts of a single purpose machine? In P.D. 01-76, the Department now rules that the structural steel “used solely for the purpose of supporting exempt equipment” is “directly used” and exempt. QUERY: Is this a practical test? How does one prove that structural steel used in, for example, a coal processing plant or stone crushing facility is used exclusively to support equipment and has no role in supporting, for example, catwalks and roofing?

61. Real Property/Telecommunication Towers. P.D. 01-62 (May 16, 2001). Based on the apparent intent of the parties, certain steel telecommunications towers and supporting buildings were held to be part of the real estate and not tangible personal property. Fees paid for the use of such towers and facilities held not to be taxable.

62. Real Property Contractor/Interstate. P.D. 01-80 (June 15, 2001). Contractor purchasing construction materials which were temporarily stored in Virginia prior to transportation to New Jersey where they could have been purchased tax exempt held to be exempt in Virginia.

63. Repair/Travel Expenses. P.D. 01-78 (June 14, 2001). Travel expenses of repairmen billed to customers held to be taxable. They were not part of the “services” rendered by the repairmen and were not exempt transportation charges. Accordingly, such charges were part of the “sales price” for the repair parts.
64. Resale/Sale to Subsidiaries. P.D. 01-24 (March 21, 2001). A taxpayer purchased computer hardware and software on behalf of its subsidiaries, configured the computers in Virginia and transferred them to the subsidiaries. The Commissioner ruled that the resale exemption did not apply because taxpayer is not registered to collect and remit sales tax and is not a retailer, wholesaler or manufacturer of tangible personal property. Query: a resale is a resale. Did the taxpayer just not prove its case?

65. Resale/Demonstrators. P.D. 01-77 (June 21, 2001). Coffee machines withdrawn from inventory and loaned to potential customers as “demonstrators” continued to be held for resale. Those machines would either be sold to customers, leased to customers or returned to inventory.

66. Research and Development. P.D. 01-9 (February 6, 2001). Taxpayer provided engineering support to NASA in connection with the development of communications packages for certain NASA systems. Taxpayer claimed that this constituted a research and development contract. The Commissioner reviewed the scope of work and the individual task orders and concluded that the taxpayer’s role “was limited to satisfying specific customer requirements using standard engineering practices, rather than searching for and advancing new knowledge in a particular technological field.” The R&D exemption was denied.

67. Research and Development. P.D. 01-15 (March 9, 2001). Taxpayer designed, fabricated and installed a wind tunnel at NASA’s facilities for use by NASA in research and development projects. The Commissioner ruled that if the wind tunnel is not permanently affixed to the realty, then taxpayer may purchase it tax-exempt as it is being re-sold to NASA. If the wind tunnel is affixed to the realty, and if it will be used by NASA exclusively for research and development, then taxpayer may purchase the tunnel equipment and materials under the R&D exemption. Foundation and support structures would be taxable.

68. School Rings. P.D. 01-14 (March 8, 2001). No tax applies with respect to the sale of school rings. The taxpayer remitted a commission on each ring sold to the non-profit school that the purchaser attended.

69. Shipping Charges. P.D. 00-173 (September 28, 2000). Shipping charges, to the extent that they are billed to the customer at actual cost and separately stated on the invoice, are not subject to sales tax. Similarly, shipping charges that “are not billed at actual cost but are intended to approximate actual shipping charges” are not taxable provided that they are separately stated on the invoice and there is no “intent to generate revenues” in excess of actual shipping charges. However, if the shipping charges are “marked up” to generate additional revenue over the actual shipping costs, then the charges are taxable, regardless of whether they are separately stated. Note: any costs
labeled as “shipping and handling” will be treated as taxable because the are not limited to “shipping.”

70. **Ship Towing.** P.D. 01-82 (June 22, 2001). No exemption was allowed for “safety items” that were used on board a ship used to tow other vessels in intra-state and inter-state commerce.

71. **Ships and Vessels.** P.D. 01-7 (January 4, 2001). The Commissioner reviewed the treatment of various categories of property used aboard ships engaged in foreign commerce when such property was initially delivered to a warehouse based in Virginia prior to pick-up by the ship. Installed equipment and repair parts, replacement parts and other tangible personal property used directly in the building, conversion or repair of ships is exempt. Other supplies were deemed taxable because they were not delivered directly to the ship and there was no indication of intercoastal or foreign trade between Virginia ports and other ports.

72. **Services/Computer Sales.** P.D. 01-73 (May 31, 2001). Taxpayer who sold computer hardware and software to the Commonwealth was held to be taxable on components that it used to staff a “help desk” under the contract. In addition, it was held taxable with respect to a master computer software license which it copied onto computers that were sold. The Department apparently takes the position that only an industrial manufacturer can benefit from a resale exemption with respect to such software licenses.

73. **True Object/Pesticide Application.** P.D. 01-17 (March 13, 2001). Contract with state highway department for application of pesticides has the provision of services as its true object. Taxpayer is taxable with respect to items used and consumed in the performance of the contract. Sales of pesticides to the state, independently of the contract are exempt.

74. **True Object/Artwork.** P.D. 01-18 (March 14, 2001). Contract pursuant to which a graphic artist provided graphic artwork (included concept, writing, graphic design, mechanical art and other services) to taxpayer deemed to have the transfer of tangible personal property as its true object. Therefore, the contract is taxable.
IV. BUSINESS LICENSE TAX

A. Court Decisions

1. Arlington County v. Mutual Broadcasting System, Inc., 260 Va. 434 (2000). The Supreme Court of Virginia affirmed the trial court’s conclusion that the taxpayer was a “radio broadcasting service” and thus was entitled to the exemption from license tax afforded by Va. Code § 58.1-3703(B)(3). In doing so the Court expressly rejected the County’s arguments on appeal that the absence of an FCC license and the fact that the taxpayer did not own the equipment used in the transmission of its radio signal rendered it not a radio broadcasting service.

B. Opinions of the Attorney General

1. Opinion number 00-066, 2001 Va. AG Lexis 17 (May 30, 2001). Virginia Code § 58.1-3731 authorizes local license taxation of “telephone companies” but excludes from taxable gross receipt “charges for long distance telephone calls.” In the case of a mobile telephone company, no deduction is allowed for calls that may be “long distance” but for which no long distance charge is made. The opinion does not address whether a mobile telephone company is in fact a “telephone company.”

C. Rulings of the State Tax Commissioner

Nexus:

1. Definite Place of Business. P.D. 00-208 (December 5, 2000). Taxpayer engaged in construction, architecture, engineering and surveying established a convenience facility for its field surveyors where equipment was stored. The surveying crews used the facility’s restrooms and to prepare their time sheets and telephone the main office. Commissioner holds that this is a “definite place of business” and that receipts must be apportioned to the office. Query: If this is not a place where the taxpayer holds itself out to do business with the public, why is this not an “administrative office” that is not taxable under the Commissioner’s rulings?

2. Definite Place of Business/Internet Service Provider. P.D. 01-43 (April 16, 2001). Subsidiary of an electric cooperative was not exempt for that reason, but the location of a server in a locality does not constitute a “definite place of business” required for the payment of BPOL taxes.

3. Definite Place of Business/Independent Contractor. P.D. 01-53 (April 30, 2001). Individual musician derived income from work at a college, playing with a local symphony, and providing private performances with a musical group. She was an employee of the college and the symphony, but an independent contractor with respect to the musical group. Although receipts from her employees were not taxable, receipts as an independent contractor
are taxable. The musician, however, conducted all her business affairs from her office at the college, as documented by business cards, etc. Commissioner holds that locality could not tax these receipts because musician did not have an office in the locality, either at her home or otherwise.

4. Renting Real Estate/LLC. P.D. 01-89 (July 11, 2001). LLC was formed for the sole purpose of holding title to real estate and leasing it to one tenant under a long-term lease. Activities were limited to receiving monthly rent check which was deposited to bank account and used to pay debt. In jurisdiction where BPOL taxation of real estate is authorized, Commissioner nevertheless held that this entity was not "engaged in business" and was not licensable. OBSERVATION: This ruling correctly notes the distinction between a license tax, imposed for the privilege of engaging in business, and an income tax. Not all sources of income are taxable. Although Commissioner cites City of Portsmouth v. Citizens Trust Company, 219 Va. 903 (1979) as example of a lessor who was engaged in business, a careful review of the history of that case will show a decision from the City of Richmond (Beltway Properties et al v. City of Richmond) in which the Supreme Court of Virginia denied a petition for appeal based on the trial court's finding of fact that the City intended to tax renting real estate without regard to a finding of engaging in business.

Classification

1. Car Wash. P.D. 01-88 (July 12, 2001). Car wash was properly classified as a business service even though it sold soap and other items through vending machines.

2. Contractor/Cabinetmaker. P.D. 01-64 (May 17, 2001). Person engaged in the business of installing custom made cabinets was clearly a contractor and taxable as such. It was unclear from the facts presented whether this person also engaged in making retail sales of cabinets and, if so, whether such sales were sufficiently great in number to constitute an independent trade or business that was separately licensable.

Apportionment

1. Professional Services Apportionment. P.D. 01-5 (January 4, 2001). Consultant maintains a continuing presence at the offices of various clients, both within and without Virginia. Held that the client office in Virginia is a definite place of business to which receipts should be apportioned using only the payroll information for personnel directly participating in the licensable activity (i.e., not office personnel). The out-of-state office was not sufficient to constitute a definite place of business, but receipts attributable to that office must be deducted because they are included in Pennsylvania taxable income.
2. **Professional Corporation.** P.D. 01-57 (May 14, 2001). Virginia Code § 13.1-554 makes the BPOL taxation of professional corporations unique. The corporation is not taxable. The professional shareholders of the corporation are taxable based on their (i) salary and (ii) share of corporation's net receipts after deducting salaries paid to all licensed employees.

3. **Professional Corporation.** P.D. 01-83 (June 27, 2001). Professional corporation of a mental health care provider charged independent contractors with expenses of providing them with office space, telephone service, etc. The Department holds that these charges are a part of the gross receipts of the professional corporation which is prohibited by law from engaging in any other business. Ruling also states that there is no other provision of law to "authorize the taxpayer to exclude these amounts from its taxable gross receipts." **Observation:** Given the structure of the BPOL tax since 1997, it is questionable analysis to imply that a taxpayer has the burden to prove that its receipts are not taxable. In response to the taxpayer's argument that it was engaged in a second business, ruling was adequately founded on statute prohibiting a professional corporation from engaging in any other business than the one that was licensed. In other cases, the question should be whether the income in question was "ancillary" to the licensed privilege. **See** Virginia Code § 58.1-3732 (only receipts attributable to exercise of a licensable privilege are taxable) and § 58.1-3703.1A(6) (information sought by assessor must establish that receipts are "directly related" to exercise of a license privilege).

**Exclusions, Exemptions and Reductions**

1. **Taxable Privilege/Administrative Offices.** P.D. 99-300 (November 18, 1999). Pharmaceutical manufacturer planned to move certain administrative functions (finance, transportation, info technology and customer service) to off-site offices. Is new office taxable? No. Support services for business generate no taxable receipts. As to sales revenues, facts show that there would be no sales solicitation at new office, and contracts would continue to be accepted at plant.

2. **Affiliated Entities.** P.D. 00-168 (September 13, 2000). Two PCs formed a professional LLC to facilitate joint operation of a plastic surgery center. The LLC is reimbursed by the two PCs for its cost. **Held:** Until recent legislation defining "affiliates" to include LLCs becomes effective, receipts between affiliated entities are fully taxable. **Comment:** Although this appears to be the Commissioner's consistent analysis, the conclusion is questionable given the purpose of the "reform" legislation to restrict BPOL taxation to persons engaging in business with the public. **Query:** Is the solution to this taxpayer's problem to put its "office" in a jurisdiction without a BPOL tax?

3. **Town Employees.** P.D. 00-209 (December 5, 2000). Town leased its excavating equipment to certain employees who performed jobs for third
parties. **Held:** Employees potentially licensable as contractors depending upon the scope and frequency of their activities with third parties.

4. **Agency/Advertising.** P.D. 01-38 (April 12, 2001). Advertising agency not taxable on funds used by it, as agent, to purchase media. Agency was proved by terms of contract and by establishment of separate “reserve account” from which media buys were made.

5. **Agency/Timeshare Condo.** P.D. 01-68 (May 22, 2001). Condominium association was taxable on fees received from managing, cleaning and renting units for members. Exclusions applicable to agency relationships and affiliated transactions found not to apply.

6. **Manufacturing/Food Products.** P.D. 01-41 (April 13, 2001). Blending of ingredients to create salad dressing, barbeque sauce, coleslaw dressing, and tarter sauce held to be manufacturing because resulting products had a substantially different character from the original materials. **Query:** how does this differ from the blending of ingredients to make feed and fertilizer held to be processing and not manufacturing in Commonwealth v. Orange Madison Cooperative, 220 Va. 655 (1980). For example, are ingredients (e.g., eggs) cooked?

7. **Truck Leasing.** P.D. 01-71 (May 30, 2001); P.D. 01-72 (May 30, 2001). Receipts from leasing a tractor truck to a trucking company and operating the vehicle as an independent contractor held taxable. Exemption applicable to motor carriers formerly certified by the ICC not applicable.

8. **Subcontractors.** P.D. 01-46 (April 23, 2001). Payments to independent subcontractors are not excludable from the tax base. Double taxation is generally no defense to a BPOL assessment.

9. **Gross Receipts: Deferred Compensation.** P.D. 00-174 (October 5, 2000). Deferred compensation received by an independent contractor is subject to local BPOL taxation in the year of receipt. Portions of deferred compensation attributable to forfeitures by other plan members analogized to investment income and not taxable.

10. **Real Estate Agents.** P.D. 00-210 (December 6, 2000). Referral fees paid to a real estate broker may be deductible from gross receipts even though not paid to an “agent”, so long as fee is a percentage of the commission. Deduction is allowed only if the person to whom the commission is paid is subject to license taxation (and his locality in fact imposes a license tax).

11. **Real Estate Brokers.** P.D. 01-44 (April 17, 2001). Real estate broker was paid a monthly fee by agents and, in other circumstances, a transaction fee. The Commissioner holds that monthly fees are taxable gross receipts, but transaction fees are not because the broker had already included in the full
commission in taxable receipts so that further taxation of the transaction fee would be double counting. Interest income is excludable from gross receipts only when it does not arise in the regular course of business. Here, the interest payments derived from otherwise taxable transactions and so were taxable. The fact that taxpayer had not been taxed on these items in previous years and audits did not prevent locality from taxing those items now but might provide a basis for waiver of penalties.

12. **Gross Receipts: Real Estate Contractors.** P.D. 01-47 (April 23, 2001). Contractor could not reduce gross receipts base of its “home locality” by receipts earned in a locality to which it paid a fee, not a tax based on gross receipts.


V. **PROPERTY TAXES**

A. **Legislation: 2001 Session**

1. The City of Fairfax is authorized to classify improvements to land and underlying land separately, and to tax the improvements at a lower rate than the underlying land. The Bill authorized this treatment for the period July 1, 2002 through July 30, 2008.

B. **Court Decisions**

1. **Gray & Gregory v. GTE South Inc.**, 261 Va. 67 (Jan. 12, 2001). It was error for the trial court to exclude evidence concerning rental income received by a condemning party for the parcels in issue. Those parcels had been leased to the telephone company under 15 year leases for a lump sum paid in the first year. Although remote in time from the condemnation proceeding, the leases were still in effect. It was error to exclude that evidence from consideration.

2. **Russell v. Commonwealth**, 261 Va. 617 (2001). In a condemnation proceeding, the expert witness for the land owner had previously appraised that property (and all other property in Lee County) as part of a “mass appraisal” for real estate tax purposes. His tax appraisal three years before had been $1,000 an acre. His appraisal for condemnation purposes was $12,538 per acre. The Commissioners awarded $5,140 per acre. The question on appeal was whether the tax appraisal was a “prior inconsistent statement” that could be used to impeach the witness’s credibility. In a 4 - 3 decision written by Senior Justice Whiting, the Court held that the trial judge did not abuse his discretion in allowing the tax appraisal to be used to impeach the witness’ credibility. In response to the majority’s position that fair market
value is fair market value, the dissent argues that the uniformity requirements of the Constitution result in a different standard than strictly applied concepts of fair market value.

3. **Smyth County Community Hospital v. Town of Marion**, 259 Va. 328, 527 S.E.2d 401 (2000). The Virginia Supreme Court held that property owned by a tax-exempt nonprofit hospital and operated as a nursing home (an intermediate care nursing facility) is exempt from property tax. The nursing home had its own administrator, but was governed by the hospital’s board of directors, and was not organized as a separate legal entity. The services provided at the nursing home were provided by hospital employees who worked at both the hospital and the nursing home. The Virginia Supreme Court held that the nursing home would not be covered by the Va. Code § 58.1-3606(A)(5) exemption unless it belonged to the hospital and was actually and exclusively occupied and used by the hospital. It concluded that the nursing home was actually and exclusively occupied and used by the hospital, and, therefore, that the exemption applied. It reached this conclusion even though the nursing home was a separate reporting entity for financial reporting purposes and held a license separate from that of the hospital.

4. **Board of Supervisors v. HCA Health Services of Virginia**, 260 Va. 317 (2000). The Supreme Court of Virginia affirmed the trial court’s determination that the County’s assessment of the taxpayer-hospital’s real property was erroneous in that it was excessive. Significantly, the Court concluded that the County had used the depreciation cost reproduction approach as the sole approach to valuation, and that this was improper because the County failed to establish that it had considered and properly rejected other valuation methods. Because of the County’s error, the assessment was not entitled to the usual presumption of correctness.

5. **Richmond Memorial Fdn v. City of Richmond**, Cir. Ct. City of Richmond (Case No. LF 20-1, August 16, 2001). Two charitable hospital organizations agreed to a joint venture/merger in order to replace existing hospital with a new hospital in adjacent county. During “wind down” of operations of old hospital, all assets, employees, etc. of that facility were leased to a new nonstock, nonprofit entity which operated it on a not for profit basis. Lease payments were designed to accomplish a sharing of expenses, and were limited to reimbursing owner of physical facilities for depreciation. City argued that hospital lost its tax exempt status because it was a source of revenue or profit. City also argued that GAP rules should not apply to this determination. Trial Court held that the lease was not a source of net revenue or profit because only an expense was reimbursed, and depreciation is an allowable expense. **Query**: on what basis would hospital property, owned by a hospital, operated as a hospital by a hospital, all on a not for profit basis, be taxable?
Trial Court also rules in hearing on Motion for Final Order (i) that property exempt on the January 1 tax date is exempt for entire tax year absent statutory authority for City to make a pro-rated assessment and (ii) interest must be paid on refund from date of payment to City, even though that payment and the assessments pre-dated July 1, 1999, the effective date of legislation allowing interest on refunds. Attorney General’s opinion had held that interest is payable only from July 1, 1999 on refunds ordered after that date.

C. Opinions of the Attorney General

1. **Conservation of Land.** 2000 Va. AG LEXIS 57, Op. No. 00-050 (September 25, 2000). Localities do not have the authority to allow a credit against property tax for property devoted to agricultural or forestal production within agricultural or forestal districts or subject to conservation easements.

VI. MISCELLANEOUS TAX ISSUES

A. **Legislation: 2001 Session**

1. **Revision of State Tax Code.** House Joint Resolution 685 establishes a joint subcommittee to study the comprehensive revision of the state tax code (affecting both state taxes and local taxes). The resolution charges the subcommittee with twelve distinct tasks, including clarifying the definition of a “manufacturer” for business license tax purposes, considering the business license tax treatment accorded manufacturers by other states, and determining the “loss” in sales tax revenues due to Internet purchases. The subcommittee will complete its work and submit written findings and recommendations to the Governor and 2003 General Assembly by November 30, 2002.

B. **Court Opinions**

1. **Clinchfield Coal Company v. Robbins,** 261 Va. 12 (2001). The Supreme Court of Virginia, reversing the trial court’s decision, held that the Commissioner of the Revenue for Dickenson County cannot use a private accounting firm, or employees of that firm, to conduct severance tax audits in the county. The Commissioner of the Revenue had attempted to get around the confidentiality provisions under Virginia law which essentially precludes the use of contract auditors in Virginia by “deputizing” the employees of the private accounting firm, and thereby making them his “statutory employees.” The Court rejected the Commissioner’s position, citing the maxim “a person may not do indirectly what he cannot do directly.”

2. **Shelor Motor Company v. Miller,** (Record No. 001073, April 20, 2001). Shelor was a retail dealer of automobiles, located in the town of Christianburg in Montgomery County. Shelor’s inventory of automobiles constituted “merchant’s capital” subject to tax by the County. In December, 1998, Shelor moved its retail inventory to various locations outside of the County, where it
continued to offer the inventory for sale. After January 1, 1999, Shelor moved
the unsold inventory back to its location within the County, thus ensuring that
none of its inventory was within the County on “tax day’ January 1, 1999.”
Shelor sought a declaratory judgment that (i) inventory located outside of the
County on tax day is not subject to the County’s tax on manufacturers’ capital,
and (ii) that situs of property for purposes of the tax is the physical location of
the property. The Virginia Supreme Court agreed with Shelor and entered
final judgment for Shelor “declaring that the taxation situs for merchants’
capital is the county, district, town or city in which the property may be
physically located on the ‘tax day,’ January 1.”

C. Opinions of the Attorney General

   County may not use taxes imposed on telephone users for establishment and
   maintenance of E-911 system to pay a volunteer rescue squad to contract with
   an independent contractor for the provision of emergency medical services.

D. Ruling of State Tax Commissioner

1. Watercraft Sales & Use Tax. P.D. 00-196 (October 27, 2000). The
   Commissioner considered the application of the Watercraft Sales and Use Tax
   to the purchase of new yachts. The tax does not apply in the case of a vessel
   which has “a valid marine titling document issued by the United States Coast
   Guard.” In the case of the subject yachts, application for Coast Guard titling
   documents is made at the time of purchase, but the documents are not received
   until several weeks after the sale. Accordingly, the Commissioner concluded
   that the tax applied because the vessel did not have the requisite Coast Guard
   titling documents at the time of purchase. Note: the Watercraft Sales & Use
   Tax is 2% of the sales price with a maximum of $2,000.

Dated: 10/10/2001