Recent Developments In Virginia Taxation

Craig D. Bell

William L.S. Rowe

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A Discussion of Tax Legislation, Recent Court Decisions, Tax Department Rulings, and Opinions of the Attorney General from October 1, 2010 Through September 30, 2011

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

William L.S. Rowe
Hunton & Williams
951 E. Byrd Street
Richmond, Virginia 23219
wrowe@hunton.com
Telephone: (804)788-8410
Facsimile: (804)788-8218
RECENT DEVELOPMENTS IN VIRGINIA TAXATION

A discussion of Virginia tax legislation, court decisions, Tax Commissioner rulings, and Attorney General opinions from October 1, 2010 through September 30, 2011.

I. CORPORATE INCOME TAX

A. 2011 Legislation

1. Federal Conformity. House Bill 1874 (Chapter 2) and Senate Bill 1384 (Chapter 866) advanced Virginia's date of conformity to the Internal Revenue Code (IRC) from January 22, 2010 to December 31, 2010. Virginia will continue to disallow:
   - any bonus depreciation allowed for certain assets under federal income taxation and any five year carry-back of NOLs allowed for NOLs generated in either taxable year 2008 or 2009;
   - deductions for applicable high yield discount obligations under IRC § 163(e)(5)(f); and
   - tax exclusions under IRC § 108(i) related to cancellation of debt income realized in connection with a reacquisition of business debt at a discount after December 31, 2008, and before January 1, 2011. However for the 2010 taxable year, a taxpayer may elect to recognize the income ratably over a three year period.

   Virginia will continue to allow the federal deduction for qualified domestic production activities under IRC § 199 at a level equal to two-thirds of the federal deduction. In addition, this legislation reconforms the Virginia Code to a 2009 law that temporarily increased the federal earned income tax credit (EITC) for taxable year 2010, and repeal the provision adopted in the 2010-2012 Appropriations Act that disallows the deduction for qualified motor vehicle taxes. The bills contain an emergency clause which states that it would be in force from its passage. In addition, the legislation makes the repeal of provisions relating to the federal EITC and the deduction for qualified motor vehicle taxes retroactive to taxable years beginning on and after January 1, 2010.

2. Research & Development Tax Credit. House Bill 1447 (Chapter 742) and Senate Bill 1326 (Chapter 745) created a refundable individual or corporate income tax credit (Va. Code § 58.1-439.12:08) for qualified research and development expenses paid or incurred during the taxable year. The credit amount is equal to (i) fifteen percent of the first $167,000 in Virginia qualified research and development expenses; or (ii) twenty percent of the first $175,000 in Virginia qualified research and development expenses if the research was conducted in conjunction with a Virginia public college or university, to the extent the expenses exceed the Virginia base amount for the taxpayer. The total amount of tax credits available for all taxpayers who qualify is limited to $5 million for each fiscal year. If the total amount of tax credits applied for is less than the $5 million limit, the credits will be prorated and allocated to the taxpayers.
who applied for the credit on a pro rata basis. This credit is effective for taxable years beginning on or after January 1, 2011, but before January 1, 2016.

3. Telework Tax Credit. House Bill 2197 (Chapter 409) and Senate Bill 1335 (Chapter 417) created an individual and corporate income tax credit (Va. Code § 58.1-439.12:07) for employers who incur eligible telework expenses. The credit is equal to the eligible telework expenses incurred during the 2012 and 2013 calendar years, not to exceed $50,000 per employer. The maximum amount of expenses that could be used to determine the amount of the credit would be $1,200 per employee. This legislation also creates an individual and corporate income tax credit for employers who conduct telework assessments. This credit is equal to the costs of preparing the assessment, but would be limited to $20,000. In addition, this credit may only be claimed one time by an employer. The amount of these credits is not allowed to exceed the tax liability of the taxpayer. To be eligible for either of the above credits, the employer will not be allowed to deduct the qualified expenses in any taxable year. The taxpayer will also not be eligible for this tax credit if any other income tax credit is also claimed. The total aggregate amount of credits approved by the Tax Commissioner will not exceed $1 million for credits earned in taxable years 2013 and 2014. Taxpayers will be required to apply to the Department of Taxation for an allocation of the credit. If the applications for the credit exceeded the cap, the credits would be allocated to employers on a pro rata basis. This credit will be effective for taxable years beginning on and after January 1, 2013 but before January 1, 2015. However, taxpayers will be required to apply for the credits between September 1 and October 31 of the year proceeding the taxable year for which the tax credit is to be earned.

4. Barge and Rail Usage Tax Credit. House Bill 2385 (Chapter 820) and Senate Bill 1282 (Chapter 861) created an income tax credit (Va. Code § 58.1-439.12:09) for transporting additional containers on a barge or by rail. The amount of the credit for any international trade facility will be equal to $50.00 per 20-foot equivalent unit moved by barge or rail rather than by trucks or other motor vehicles on Virginia’s highways. The credit will be allowed against the individual income tax, the corporate income tax, the tax on estates and trusts, the bank franchise tax, the insurance premiums tax, and the tax on public service corporations. No more than $1.5 million in tax credits will be issued in any fiscal year. The credit is effective for taxable years beginning on and after January 1, 2011, but before January 1, 2015. No tax credits may be issued after the fiscal year ending June 30, 2015.

5. Virginia Port Volume Increase Tax Credit. House Bill 2531 (Chapter 831) created an individual income tax and corporate income tax credit (Va. Code § 58.1-439.12:10) for taxpayers engaged in manufacturing goods or the distribution of manufactured goods that uses port facilities in the Commonwealth and increases its port cargo volume at these facilities by a minimum of five percent in a single calendar year over its base year port cargo volume. The credit is equal to an amount determined by the Virginia Port Authority. The Virginia Port Authority may waive the requirement that port cargo volume be increased by a minimum of five percent over base year port cargo volume for any taxpayer that qualifies as a major facility. The maximum amount of tax credits allowed to all qualifying taxpayers may not exceed $3.2 million for each calendar year. Generally, a qualifying taxpayer may not receive more than $250,000 for each calendar year. The credit is effective for taxable years beginning on and after January 1, 2011, but before January 1, 2016.
6. **International Trade Facility Tax Credit.** Senate Bill 1136 (Chapter 49) created an individual income tax and corporate income tax credit (Va. Code § 58.1-439.12:06) for either capital investment in an international trade facility or increasing jobs related to an international trade facility. The amount of the credit is equal to $3,000 per new qualified full-time employee that results from increased qualified trade activities by the taxpayer or two percent of the amount of capital investment made by the taxpayer to facilitate the increased eligible trade activities. taxpayers may elect either credit, but will not be entitled to claim both credits in the same taxable year. No more than $250,000 in tax credits will be issued in any fiscal year. If the amount of tax credits requested exceeds $250,000, the credits will be allocated proportionately among all qualified taxpayers. The amount of the credit is limited to fifty percent of the taxpayer's tax liability for the taxable year. Any unused credit amount could be carried forward for ten years. This bill is effective for taxable years beginning on and after January 1, 2011, but before January 1, 2015; however no credits will be issued after the fiscal year ending June 30, 2015.

7. **Clean Fuel Vehicle and Advanced Cellulosic Biofuels Job Creation Tax Credit.** Senate Bill 1236 (Chapter 176) extended the sunset date for the Clean Fuel Vehicle and Advanced Cellulosic Biofuels Job Creation Tax Credit from taxable years beginning on and before December 31, 2011 to taxable years beginning on and before December 31, 2014.

8. **Coal Employment and Production Incentive Tax Credit.** Senate Bill 1111 (Chapter 294) extended the sunset date for the redemption or refund provision of the Coal Employment and Production Incentive Tax Credit by a person with an economic interest in the coal on which the credit was earned from July 1, 2011 to July 1, 2016.

**B. Recent Court Decisions**

No recent court decisions.

**C. Recent Virginia Tax Commissioner Rulings**

1. **Captive REITs.** P.D. 10-246 (October 26, 2010). The taxpayer requested a ruling on the application of Virginia's addback requirement pertaining to Captive Real Estate Investment Trusts ("REITs"). A limited partnership (the "Fund") owns membership interests in three separate REITs, which are organized as limited liability companies. One of the REITs ("REIT 1") derives a portion of its income from properties located in Virginia. REIT 1 owns a 99.9 percent limited partnership interest in REIT OP. REIT OP owns single member limited liability companies ("SMLLCs") that are treated as disregarded entities for federal tax purposes and other joint venture interests. It is these SMLLCs and joint ventures that hold the property and income that is sourced to Virginia. The remaining 0.1 percent general partnership interest in REIT OP is owned by REIT 1's wholly owned subsidiary, REIT GP. REIT GP is taxed as a corporation for federal income tax, purposes. The Fund's general partner is a wholly owned subsidiary of the taxpayer which is a C corporation. General Partner holds no units in the Fund; but as the general partner of the Fund, General Partner can make certain decisions for the Fund that do not require votes from the rest of the owners. The limited partners of the Fund are tax-exempt entities, including state and local governmental pension plans exempt under Internal...
Revenue Code ("IRC") § 115, corporate and multi-employer (Taft-Hartley) pension plans exempt under IRC § 501, and foundations and endowments exempt under IRC § 501. The Fund has over 200 partners and no one partner owns more than a 50 percent share in the Fund.

Virginia Code § 58.1-402(B)(10) requires a Captive REIT to add to its federal taxable income the dividends paid deduction allowed under the Internal Revenue Code. A REIT is considered a Captive REIT if it meets the following conditions:

1. It is not regularly traded on an established securities market;

2. More than 50 percent of the voting power or value of beneficial interests or shares of which, at any time during the last half of the taxable year, is owned or controlled, directly or indirectly, by a single entity that is (i) a corporation or an association taxable as a corporation under the Internal Revenue Code; and (ii) not exempt from federal income tax pursuant to § 501 (a) of the Internal Revenue Code; and

3. More than 25 percent of its income consists of rents from real property as defined in § 856(d) of the Internal Revenue Code.

The taxpayer conceded that REIT 1 meets the first and third conditions listed above, but contended that it does not meet the second condition. The Tax Commissioner examined the ownership and control of REIT 1 and determined that it does not meet the second condition and is not a captive REIT for purposes of the addition. None of the partners in the Fund, including the General Partner, own more than 50% of the Fund. The Tax Commissioner therefore determined that no one entity has control over the REIT.

2. Nexus. P.D. 10-252 (November 10, 2010). The taxpayer, based in State A, coordinates on demand repair and maintenance services for customers that have locations in multiple states including Virginia. When the taxpayer receives a call from one of its customers, it will engage and dispatch a third party service provider located near the customer's facility to perform the required repairs and maintenance. The third party service provider bills the taxpayer for the services performed, and the taxpayer bills the customer for the service call and the logistical service. The taxpayer is registered to do business in Virginia, but does not own or lease either tangible or real property, retain employees, or store inventory in Virginia. The taxpayer does not perform any marketing activities in Virginia but estimates it generates approximately $2,000,000 in revenues resulting from activities conducted by third party service providers located in Virginia. The taxpayer requests a ruling as to whether the services provided by third party providers in Virginia would subject the taxpayer to Virginia income tax. The Tax Commissioner did not have enough information regarding the taxpayer's relationship with the third party service providers to determine if the taxpayer is subject to Virginia income tax. The Tax Commissioner did say that if the third party service providers are independent contractors then the taxpayer is purchasing services from a vendor and reselling them to its customers and would not have nexus. However if the third party service providers are not independent...
contractors, then the activities may exceed the P.L. 86-272 protections and create nexus for the taxpayer.

3. **Nexus: Activities of Related Members.** P.D. 10-279 (December 22, 2010). The taxpayer, a corporation commercially domiciled outside Virginia, is the parent corporation of four subsidiaries (S1, P1, P2, and P3). The taxpayer has no property or payroll in Virginia. In addition to providing administrative and management functions on behalf of the corporate family, the taxpayer owns and manages certain intangible assets (trademarks, patents, manufacturing know-how, and other intellectual property) used by members of the corporate family. The taxpayer licenses intangible assets to S1 for an arm's length royalty fee. S1 uses the intangible assets in connection with the packaging, marketing and sales of its products. All four subsidiaries are commercially domiciled outside Virginia. P1, P2, and P3 manufacture products that are sold by S1 and have no property, payroll, or sales in Virginia. S1 imports, manufactures, markets, and sells products in the United States, including Virginia. Its activities in Virginia are limited to two employees that solicit orders for S1's products for approval at an office outside Virginia. The taxpayer requested a ruling that the activities of the corporate family in Virginia are not sufficient to create nexus. The Tax Commissioner opined that based on the facts presented, none of the subsidiaries have nexus.

4. **Guidelines and Rules for the Virginia Motion Picture Production Tax Credit.** P.D. 10-281 (December 21, 2010). The Tax Commissioner issued guidelines and rules for the Virginia motion picture production tax credit.

5. **Fixed Date Conformity Tax Bulletin.** P.D. 11-22 (February 18, 2011). The Tax Commissioner issued Virginia Tax Bulletin 11-1 to provide instructions to taxpayer for complying with House Bill 1874 and Senate Bill 1384 which updated Virginia’s date of conformity with the Internal Revenue Code.

6. **Alternate Method of Apportionment.** P.D. 11-52 (April 5, 2011). The taxpayer acquired stock in Corporation A through four separate transactions made in 1996 through 1998. In connection with one of the transactions, the taxpayer granted Corporation A an exclusive license to use technology to produce a product developed by the taxpayer. Corporation A used the monetary proceeds from the other transactions to build a plant to manufacture the product. During the taxable years at issue, the taxpayer sold its stock in Corporation A, recognizing a capital gain. The taxpayer subtracted this gain on its Virginia corporate income tax returns as nonbusiness income. Pursuant to an audit, the Tax Department disallowed the subtraction of the capital gain and assessed additional tax and interest. The taxpayer appealed and contended it did not have a unitary relationship with Corporation A, and its ownership in Corporation A stock was not operational in nature. The taxpayer requested a refund of Virginia income tax paid for the taxable years ended December 31, 1999 through 2001, and November 30, 2002. The Tax Commissioner treated the taxpayer’s appeal as a request for an alternate method of apportionment and denied the taxpayer’s request.

In any proceeding with the Tax Department, the taxpayer bears the burden of showing that the imposition of Virginia's statute is in violation of the standards enunciated by the United States Supreme Court in Allied-Signal, Inc. v. Director, Division of Taxation, 504 U.S.
768 (1992). In this matter, the taxpayer was required to demonstrate that its investments are not operational assets involved in a unitary business. In considering the existence of a unitary relationship, the Supreme Court has focused on three objective factors: (1) functional integration; (2) centralization of management; and (3) economies of scale. (See Mobil Oil Corp. v Commissioner of Taxes, 445 U.S. 425 (1980); F. W. Woolworth Co. v. Taxation and Revenue Dept. of N.M., 458 U.S. 352 (1982); and Allied-Signal.) The Tax Commissioner agreed that the taxpayer did not have a unitary relationship with Corporation A based on these criteria. However, the Tax Commissioner determined that the taxpayer’s relationship with Corporation A was operational rather than a passive investment function which means that the gain is subject to Virginia income tax. The Tax Commissioner noted that while not functionally integrated, the taxpayer did agree to provide Corporation A with technical assistance, training, and instruction in order to enable Corporation A to design, construct, start-up, test, and operate a manufacturing facility for the taxpayer’s product. As a result of the taxpayer’s investments, Corporation A was able to build a plant to manufacture and sell the product, and its gross revenues increased by more than 1,600 percent from the 1996 through 1999. The technology license agreement required the taxpayer to provide technical assistance at Corporation A’s manufacturing facility. The agreement also allowed Corporation A employees to observe procedures in the taxpayers’ fabrication line and afforded Corporation A support for the its fabrication process, device modeling, quality control and reliability testing. Based on the agreement and information provided, the Tax Commissioner determined the taxpayer was able to significantly influence Corporation A’s operations.

7. Interest Add-Back and Net Operating Loss. P.D. 11-57 (April 12, 2011). The taxpayer, commercially domiciled outside Virginia, files a consolidated corporate income tax return with its subsidiaries for federal income tax purposes. In Virginia, the taxpayer and a number of affiliated entities file separate returns. The taxpayer was audited for the 2003 and 2004 taxable years, resulting in numerous return adjustments and an assessment for the 2004 taxable year. The taxpayer filed an appeal contesting: (1) the add back of interest expense from the intercompany loan with one of its affiliates for the 2004 taxable year, and (2) the auditor’s adjustments to net operating loss deductions (NOLDs) carried forward into the audit period. The Tax Commissioner adjusted the assessment. First, the Tax Commissioner determined that the taxpayer was not required to add back interest expense paid to the related entity pursuant to Virginia Code § 58.1-402(B)(9)(a)(2) as the related entity held no intangible property. Virginia Code § 58.1-402(B)(9)(a)(2) requires a taxpayer to add back intercompany interest expenses and costs that are directly or indirectly related or connected to transactions involving intangible property.

On the second issue, the taxpayer incurred NOLs for the taxable years ended March 3, 2001 (2000 taxable year), March 2, 2002 (2001 taxable year), and February 28, 2004 (2003 taxable year). On its Virginia returns, the taxpayer carried the resulting NOLDs forward without carrying them back as required under IRC § 172. The taxpayer contended that because the Tax Department has never issued any guidance on how to elect to forego the carryback, the taxpayer's carry forward of an NOLD resulting from a net operating loss (NOL) incurred for the taxable year ended 2000 taxable year constituted a de facto election to forgo the carryback of the NOL. The Tax Commissioner disagreed and stated that the Tax Department had issued guidance in three separate rulings issued in 1988, 1993, and 2005. Ultimately, the Tax Commissioner
adjusted the auditor’s NOL computations while requiring the taxpayer to carryback the NOL. **Observation:** If there is a ruling that clearly shows why regular regulation development is desperately needed in Virginia, it is this one. While the taxpayer probably did not do the best job of indicating its election to forego the NOL carryback, the Tax Commissioner expected the taxpayer to search thousands upon thousands of rulings to find one of the three rulings issues in the last twenty-three years stating the Tax Department’s policy on how to elect to forego an NOL carryback. If the Tax Department promulgated a regulation with its policy on how to elect to forego an NOL carryback, this matter may have never occurred.

8. **Responsible Officer.** P.D. 11-73 (May 17, 2011). The taxpayer owned 10% of the stock of the Corporation and was its secretary and treasurer. The taxpayer's son (the "President") was president and owned a 60% share of the Corporation. The Tax Department issued assessments to the Corporation for withholding tax liabilities owed for the taxable periods October 2008 through March 2009. When the Corporation failed to pay the deficiencies, the Tax Department converted the assessments to the taxpayer and the other officers of the Corporation as permitted under Va. Code § 58.1-1813. The taxpayer paid the assessments and filed an appeal contending he should not be held personally liable for the unpaid withholding taxes of the Corporation because his sole responsibilities were as the Corporation's registered agent responsible for filing the annual report with the Virginia State Corporation Commission (SCC). The Tax Commissioner determined that the taxpayer was not a responsible office and ordered a refund of the taxes. The available evidence did not indicate whether the taxpayer had the authority to sign the Corporation's tax returns or to prevent the Corporation's failure to pay the tax liability.

9. **Statute of Limitations.** P.D. 11-111 (June 17, 2011). The taxpayer and its affiliates were audited for the 2006 and 2007 taxable years. Numerous adjustments were made, resulting in assessments of additional corporate income tax and interest. The taxpayer agreed to all of the adjustments except for the disallowance of net operating loss deductions (NOLDs) carried forward from the 2004 and 2005 taxable years. The auditor concluded that the taxpayer had failed to properly make an election to forgo the two-year carryback rule for the net operating losses (NOLs) incurred in 2004 and 2005. The auditor also determined that the taxpayer was barred by the statute of limitations from filing amended returns for the taxable years to which the NOLDs could have been carried back. The taxpayer appealed the audit results contending the auditor misapplied federal and state regulations and the taxpayer made a proper election by its actions. In the alternative, the taxpayer sought an equitable resolution to this matter by permitting a credit against the audit assessments for the amount of the refund the taxpayer would have received if it had carried the NOLDs back.

Under IRC § 172(b)(3) and Treas. Reg. § 301.9100-2T, a taxpayer is entitled to relinquish the carryback period by including a statement with the federal return or amended return. Under Title 23 of the Virginia Administrative Code (VAC) 10-120-325(B)(2), taxpayers are required to file a statement with the Virginia return for the taxable year in which the NOL occurred. The taxpayer contended that the purpose of this election is to commit a taxpayer to forgo the carryback period, so that the taxpayer cannot file an amended return to redistribute the NOLD to prior years. The taxpayer also argued that its filing history clearly demonstrates that it had no intent to file amended returns and redistribute the NOLDs. The Tax Commissioner
disagreed with this interpretation. Instead, he determined that because title 23 VAC 10-120-325 permits an election to forgo the carryback of an NOL independent of any federal election provided the taxpayer files its federal and Virginia returns on a different basis, Virginia's requirement that a taxpayer file a statement with the Virginia return in order to make the election would not be subject to the interpretation of a similar federal regulation. Therefore, the Tax Commissioner determined that the assessments were correct as the taxpayer did not indicate anywhere on its 2004 and 2005 Virginia tax returns that it intended to elect to forgo the carryback of the NOLDs incurred in those taxable years. As far as the equitable recoupment argument, the Tax Commissioner determined that equitable recoupment is not applicable to this situation as the taxpayer had an avenue for relief, but failed to act within the statute of limitations.

10. **Nexus.** P.D. 11-139 (August 2, 2011). The taxpayer, a corporation commercially domiciled in State A, provides engineering technology and consulting services. The taxpayer's affiliates filed a Virginia consolidated income tax return for the 2007 taxable year. Under audit, the Tax Department determined that the taxpayer had nexus with Virginia and included it in the Virginia consolidated return. The Tax Department issued an assessment for additional tax and interest. The taxpayer appealed the audit assessment contending the activities in Virginia were not sufficient to establish nexus. During 2007, the taxpayer had no property or sales in Virginia. The taxpayer did employ two employees who resided in Virginia. The taxpayer registered with Virginia to withhold income tax on behalf of the resident employees. The taxpayer was located outside Virginia and had no contracts to perform services in Virginia. The employees that lived in Virginia performed services pursuant to a contract in State B during 2007. The employees performed no activities on behalf of the taxpayer in Virginia. Therefore, the Tax Commissioner determined that the taxpayer did not have nexus with Virginia for the 2007 taxable year and should not have been included in the Virginia consolidated return.

11. **Kentucky Limited Liability Entity Tax.** P.D. 11-147 (August 10, 2011). For purposes of computing the taxable income of a corporation, Virginia requires an addition for income taxes and other taxes based on net income. A taxpayer requested a ruling as to whether the Kentucky Limited Liability Entity Tax, effective for taxable years beginning on or after January 1, 2007, is required to be added back. Virginia's modification under Va. Code § 58.1-402(B)(4) requires an addition for net income taxes and "other taxes, including franchise and excise taxes, which are based on, measured by, or computed with reference to net income, imposed by the Commonwealth or any other taxing jurisdiction, to the extent deducted in determining federal taxable income." The Tax Commissioner determined that because the Kentucky Limited Liability Entity Tax excludes almost all business expenses normally permitted in determining net income, the Tax Department would not consider it to be a tax based on, measured by, or computed with reference to net income. Therefore, the Kentucky Limited Liability Entity Tax is not required to be added back under Va. Code § 58.1-402(B)(4) when computing Virginia taxable income.

**D. Opinions of the Attorney General**

asked about the impact of Senate Bill 1111 and whether the proposed measure would allow unredeemed tax credits earned before 2006 to be sold, and/or whether the unused tax credits can be carried forward after 2016. The Attorney General did not address whether Senate Bill 1111 would allow unredeemed tax credits earned before 2006 to be sold. However, he stated that generators of electricity can continue to rely on these tax credits and continue to carry them over after July 1, 2016.

II. INDIVIDUAL INCOME TAX

A. 2011 Legislation

1. Land Preservation Tax Credit. House Bill 1820 (Chapter 212) and Senate Bill 1232 (Chapter 296) amended Va. Code § 58.1-512 to provide that the maximum amount of land preservation tax credits that may be issued in any calendar year is $100 million, adjusted for inflation, plus any credits that have been disallowed or invalidated by the Tax Department. These bills also clarify that, if within 30 days after an application for tax credits has been filed the Tax Commissioner provides written notice to the donor that the preparation of a second qualified appraisal is warranted, the land preservation tax credit application will not be deemed complete until the fair market value of the donation has been finally determined by the Tax Commissioner. The Tax Commissioner would then be required to make a final determination within 180 days of notifying the donor, unless the donor files an appeal. The donor would have the right to appeal any decision in accordance with the standard appeal process. The legislation was effective on July 1, 2011.

2. Land Preservation Tax Credit. Senate Bill 1153 (Chapter 377) amended Va. Code § 58.1-512 to clarify that a land preservation tax credit will not be reduced by the amount of unused credit that could have been claimed in a prior year but was unclaimed. In P.D. 04-190 (October 20, 2004), the Tax Commissioner ruled that when a taxpayer holds a recycling tax credit and (i) does not claim it on their tax return and (ii) the statute of limitations for amending the return expires, then the taxpayer may not carry over the portion of the credit he could have used. This legislation prevents application of the foregoing rule to unused land preservation tax credits. The legislation was effective on July 1, 2011.

3. Winery Tax Credit. House Bill 1837 (Chapter 214) and Senate Bill 1264 (Chapter 226) created an individual and corporate income tax credit (Va. Code § 58.1-339.12) for Virginia farm wineries and vineyards in an amount equal to 25 percent of the cost of all qualified capital expenditures made in connection with the establishment of new Virginia farm wineries and vineyards and capital improvements made to existing Virginia farm wineries and vineyards. The total amount of tax credits available for a calendar year would not be permitted to exceed $250,000. The legislation is effective for taxable years beginning on and after January 1, 2011.

4. Livable Home Tax Credit. House Bill 1950 (Chapter 365) amended Va. Code § 58.1-339.7 to expand the Livable Home Tax Credit to allow a licensed contractor who builds new residences or retrofits existing residences to improve accessibility to be eligible for the tax credit. This legislation increases the maximum credit amount from $2,000 to $5,000 for
the purchase or construction of each new residential structure or unit, or for retrofitting an existing residence. Any unused tax credits will be allowed to be carried over for seven taxable years or until the total amount of the tax credit issued has been taken, whichever is sooner. This legislation also bifurcates the existing cap of $1 million for credits earned each year. One-half of the $1 million will be reserved for the purchase or construction of a new residence, and one-half will be reserved for retrofitting or renovating an existing residence. Any portion of the $500,000 reserved for the purchase or construction of a new residence that is not used will be allocated to the remaining balance of tax credits authorized for retrofitting or renovating existing residences. Any portion of the $500,000 reserved for retrofitting or renovating existing residences that is not used will be allocated to the remaining balance of tax credits authorized for the purchase or construction of a new residence.

This legislation also provides that if the total amount of tax credits applied for exceeds the amounts allocated by the Department of Housing and Community Development ("DHCD") for the fiscal year, the credits will be prorated and allocated to the taxpayers on a pro rata basis. Under this legislation, DHCD will not be allowed to issue any tax credits for transactions or dealings between affiliated entities or to the same or different persons for the same retrofitting, renovation, or construction project. In addition, this legislation does not allow a tax credit for the purchase, construction, retrofitting, or renovation of a residential rental property. This legislation is effective for taxable years beginning on or after January 1, 2011.

5. **Refundable Agricultural Best Management Practices Credit.** Senate Bill 974 (Chapter 352) amended the individual income tax credits allowed for agricultural best management practices (Va. Code § 58.1-339.3) to make such credits refundable. The legislation permits a pass-through entity that allocates credits among taxpayers to designate a general partner, member-manager, or shareholder as the person that the Department would be required to first contact for the collection of taxes in the event any portion of the credit is disallowed in the future. The legislation also prohibits the costs used to determine this credit from being used to claim any other Virginia income tax credit. This legislation was effective on July 1, 2011.

6. **Neighborhood Assistance Act Tax Credit Expansion.** House Bill 2231 (Chapter 370) amended Va. Code §§ 58.1-439.18 and 58.1-439.21 to expand the types of business firms eligible for tax credits under the Neighborhood Assistance Act to include trusts. Under this legislation, a trust that makes a contribution to an organization that qualifies as a neighborhood organization will be eligible to receive an income tax credit from that neighborhood organization. This legislation was effective on July 1, 2011.

7. **Neighborhood Assistance Act Credit Extension.** Senate Bill 1129 (Chapter 317) amended Va. Code § 58.1-439.20 to extend the sunset date for the issuance of tax credits allowed under the Neighborhood Assistance Act from 2011 to 2014.

8. **Neighborhood Assistance Act Credit: Pharmacists.** Senate Bill 742 (Chapter 132) amended Va. Code § 58.1-439.22 to expand the health care services eligible for tax credits under the Neighborhood Assistance Act to include pharmacists donating pharmaceutical services to patients of a nonprofit free clinic when the services are performed at
the direction of an approved neighborhood organization that has received an allocation of tax credits from the Department of Social Services, regardless of where the services are delivered. This legislation was effective on July 1, 2011.

9. **Neighborhood Assistance Act: Impoverished People.** Senate Bill 863 (Chapter 312) amended Va. Code § 58.1-439.18 to change the definition of "impoverished people" for all purposes under the Neighborhood Assistance Act Tax Credit program to include individuals with family annual income not in excess of 200 percent of the current federal poverty guidelines. This legislation was effective on July 1, 2011.

**B. Recent Court Decisions**

No recent court decisions.

**C. Recent Virginia Tax Commissioner Rulings**

1. **Domicile.** P.D. 10-249 (November 4, 2010). The taxpayers, a husband and wife, maintain a residence in Virginia and a residence in State A. Beginning in 2005, the taxpayers began residing in State A for more than 183 days per year and qualified for State A's homestead exemption. The taxpayers renewed and continue to maintain their Virginia driver's licenses. They have four vehicles registered in Virginia. In 2003, the taxpayers registered to vote in State A and acquired State A identification cards. The taxpayers filed nonresident Virginia returns for the taxable years at issue and reported all passive income derived from Virginia based pass-through entities as Virginia source income. The auditor determined that the taxpayers were Virginia domiciliary residents for the taxable years at issue and issued assessments. The taxpayers appealed the assessments contending they successfully terminated their Virginia domicile and acquired a State A domicile. The Tax Commissioner disagreed finding that the taxpayers never abandoned their Virginia domicile.

2. **Domicile.** P.D. 10-255 (November 12, 2010). The Tax Department received information from the Internal Revenue Service (IRS) indicating that third-party financial documents for the 2007 taxable year were sent to the taxpayer at a Virginia address. A review of the Tax Department's records indicated that the taxpayer had not filed a Virginia individual income tax return. The Tax Department requested an explanation or a tax return from the taxpayer. When no response was received, an income tax assessment was issued. The taxpayer appealed the assessment, contending he was domiciled in State A during the 2007 taxable year. The facts the taxpayer provided the Tax Commissioner showed that he had been a long-time domiciliary resident of State A when he moved to Virginia in 2000. In November 2006, he returned to live in State A. He took a number of actions indicating an intent to reestablish his domicile in State A. He established a permanent place of abode and obtained a driver's license in State A. His business interests were located in State A. In addition, he spent the vast majority of his time in State A during 2007. The only evidence linking the taxpayer to Virginia for the 2007 taxable year was a Virginia address on the third-party information statements provided to the IRS. Based on this evidence, the Tax Commissioner abated the assessment.
3. **Domicile.** P.D. 10-256 (November 12, 2010). In June 2006, the taxpayer moved from Virginia to State A when he accepted an employment engagement under a one-year agreement. The taxpayer passed the State A bar exam and was admitted to practice in State A in May 2007. At the end of the one-year employment period, the taxpayer declined an offer to work for another one-year term and moved back to Virginia in June 2007. While in State A, the taxpayer leased several houses. He also continued to hold his Virginia driver's license and his car remained registered in Virginia. His federal and State A tax returns were filed using a Virginia address. The Tax Department obtained information from the Internal Revenue Service (IRS) indicating that the taxpayer received taxable income in 2006 and requested information to verify whether the taxpayer was subject to Virginia income tax. When the taxpayer failed to respond, an assessment was issued based on the available information. The taxpayer appealed the assessment, contending he took sufficient steps to establish residency in State A and all income earned in 2006 was earned in State A. The Tax Commissioner upheld the assessment as he determined that the taxpayer did not take sufficient steps to abandon his Virginia domicile.

4. **Land Preservation Credit.** P.D. 10-257 (November 15, 2010). The Tax Commissioner issued Tax Bulletin 10-11 announcing that the annual aggregate cap on the land preservation tax credit increased to $108,424,000.

5. **Adjustment to Federal Adjusted Gross Income.** P.D. 10-260 (December 2, 2010). The taxpayer, a resident of Virginia, was audited by the Internal Revenue Service (IRS) for the 2005 taxable year. As a result of the audit, the taxpayer's federal adjusted gross income (FAGI) was increased. The taxpayer amended his 2005 Virginia S Corporation return and included a letter stating he was advised by the IRS to report the income earned from the S Corporation on his individual income tax return. The taxpayer also stated in the letter that he did not believe the adjustment would affect his Virginia taxable income. The IRS notified the Tax Department of the change in the taxpayer's FAGI and the Tax Department issued an assessment to the taxpayer for additional tax and interest. The taxpayer appealed the assessment contending he reported the results of the audit to the Tax Department and provided the Tax Department with sufficient information to make adjustments to his Virginia income tax return. The Tax Commissioner disagreed and upheld the assessment. In this case, the taxpayer filed an amended return for the S-Corporation but failed to notify the Tax Department that the IRS had also adjusted his FAGI. The taxpayer included a note indicating the income had been "moved" but gave no information as to how the income affected his FAGI. The Tax Commissioner did not consider the taxpayer's submission to be of sufficient detail to accurately recompute his Virginia income tax liability for the 2005 taxable year.

6. **Domicile.** P.D. 10-265 (December 15, 2010). In 1991 the taxpayers, a husband and wife, moved from Virginia to State A and established their domiciliary residence. In 1996 the taxpayers sold their State A home when the husband was transferred to Country A. While in Country A, the taxpayers acquired Country A driver's licenses. In 2000 the taxpayers surrendered their State A driver's licenses and acquired Virginia driver's licenses. In 2003 the wife moved into a Virginia residence purchased by the taxpayers. During 2006, three vehicles were registered in Virginia in the wife's name. The taxpayers' daughter attended a Virginia university, and paid out-of-state tuition, and the taxpayers' son attended a private secondary school. A federal tax return was filed using the husband's employer's post office box located in
The wife registered to vote and has voted in Virginia. The husband has maintained his State A voter registration and votes in State A via absentee ballot. The taxpayers have continued to renew their Virginia driver's licenses and they remain current. The Tax Department obtained information from, the Internal Revenue Service (IRS) indicating the taxpayers received taxable income in 2006 and requested information to verify whether the taxpayers were subject to Virginia income tax. The Tax Department requested additional information from the taxpayers in order to determine their residence for the taxable year in question. Based on the information provided, the auditor concluded that the taxpayers were domiciliary residents of Virginia and issued an assessment for the 2006 taxable year. The taxpayers appealed and conceded that the wife was a Virginia resident during 2006, but contended that the husband remained a domiciliary resident of Country A. The Tax Commissioner agreed that the husband was not a domiciliary resident of Virginia as he did not abandon his domicile in Country A.

7. Domicile. P.D. 10-270 (December 16, 2010). The taxpayers, a husband and wife, moved to Virginia in the early 1990s. While residing in Virginia, the husband established and solely owned a business that operated in Virginia. In 2003, the taxpayers legally separated and the husband acquired a place of abode in State A. In November 2003, the husband acquired a State A driver's license, but did not surrender his Virginia license. The husband's Virginia driver's license was renewed in February 2006. While in State A, the husband became part owner of a business located in State B. He travels to and performs services in State A and State B on behalf of his State B business. He also performed services in Virginia and a neighboring state several days per month on behalf of his Virginia business. When he performed services on behalf of his Virginia business, he spent his nights in State C. During 2006 and 2007, the taxpayers had four vehicles jointly registered in Virginia. Joint federal tax returns were filed using the husband's State A address. The husband registered and voted in State A since November 2003, but did not end his Virginia voter registration. The wife registered and voted in Virginia. The taxpayers filed joint nonresident Virginia individual income tax returns using the husband's address. The taxpayers were audited and the auditor concluded that the taxpayers were both actual and domiciliary residents of Virginia. As a result, assessments were issued for additional tax and interest for the 2006 and 2007 taxable years. The taxpayers appealed and conceded that the wife was a Virginia resident during 2006 and 2007, but contended the husband was not an actual or domiciliary resident of Virginia. The Tax Commissioner reviewed the evidence provided and determined that the husband was present in Virginia for less than 183 days and was not an actual resident. The Tax Commissioner also determined that the husband was not a domiciliary resident despite the taxpayers numerous connections with Virginia. However given the fact that the wife remained in Virginia, the Tax Commissioner determined that it was reasonable under the specific facts and circumstances of this case that the Virginia residence and some of the taxpayers' joint possessions would remain for the benefit and use of the wife.

8. Statute of Limitations. P.D. 10-271 (December 16, 2010). The Tax Department received information from the Internal Revenue Service (IRS) that tax documents for the 2002 taxable year were sent to the taxpayer at a Virginia address. The taxpayer did not file a 2002 Virginia individual income tax return. The Tax Department requested additional information from the taxpayer in order to determine her domicile for that taxable year. When adequate response was not received, an assessment was issued in February 2005. In February
2008, the assessment was partially satisfied by an offset of the taxpayer's federal income tax refund. The taxpayer provided documentation on May 5, 2010, showing that she was a domiciliary resident of another state in 2002, and requested a refund of the offset payment. The Tax Department abated the remaining assessment, but did not issue a refund of the overpayment because the statute of limitations had expired. The taxpayer appealed the Tax Department's denial of the refund request, citing personal circumstances, and asked that the Tax Department make an exception to the statute of limitations in her case. The Tax Commissioner denied the taxpayer's request as he is bound by the law and not allowed to make exceptions to the statute of limitations.

9. **Mailbox Rule.** P.D. 10-272 (December 16, 2010). On December 29, 2006 the taxpayers took a distribution from an individual retirement account (IRA). The distribution was included in the taxpayer's 2006 federal adjusted gross income (FAGI). The taxpayers instructed the financial institution holding the IRA to mail checks for the entire amount of the distribution directly to the institution that administers the Virginia College Savings Plan (VCSP) for deposit into accounts set up for the taxpayers' children. The taxpayers claimed a deduction against their 2006 Virginia taxable income for the contributions, pursuant to Va. Code § 58.1-322 D(7)(a). Under audit, the auditor denied the deduction for the 2006 taxable year because the transferred funds were not posted until early January 2007. The taxpayers appealed the assessment contending the transfers were made within the 2006 taxable year under rules established by the Internal Revenue Service. The Tax Commissioner abated the assessment as the funds were mailed and postmarked on December 29, 2006 for unconditional delivery.

10. **Foreign Source Income.** P.D. 10-274 (December 16, 2010). During 2007, the taxpayer was a shareholder in a Virginia S Corporation (VSC). VSC wholly owned a C corporation (VDISC) that operated as a domestic international sales corporation (DISC) for federal income tax purposes. VDISC was subject to Virginia income tax on all of its Virginia taxable income for the 2007 taxable year. On its Virginia income tax return, VSC subtracted all of the dividends received from VDISC. The subtraction was passed through to the taxpayer, who subtracted the VDISC dividends in determining her Virginia taxable income. The Tax Department denied the subtraction, reduced the amount the overpayment claimed on the taxpayer's 2007 individual income tax return, and issued the reduced amount as a refund. The subtraction was denied because individual income taxpayers are no longer permitted to claim a foreign source income subtraction. The taxpayer appealed the assessment, contending that Va. Code § 58.1-390.2 provides that owners are only liable for tax on their separate individual capacities on income passed through to them. She reasons that, because the VDISC dividend subtraction is reflective of the income passed through to the shareholder, the taxpayer is entitled to the subtraction. In addition, the taxpayer asserts that Va. Code § 58.1-391 does not limit modifications to those permitted under 58.1-322. The Tax Commissioner upheld the assessment as Va. Code § 58.1-391 restricts subtractions that an individual may take to pass-through income to those in Va. Code § 58.1-322. As Va. Code § 58.1-322 does not permit a subtraction for foreign source income, the subtraction was not allowed. Virginia Code § 58.1-390.2 clarifies the owners' responsibility for the income tax liability of a pass-through entity and does not limit the amount of income for which an owner may be subject to tax.
11. **Actual Resident & Retirement Income.** P.D. 10-283 (December 28, 2010). The Tax Department received information from the Internal Revenue Service ("IRS") indicating the taxpayer had income from Virginia sources. The Tax Department requested that the taxpayer file the proper Virginia individual income tax return or provide an explanation concerning why the income was not taxable. When an adequate response was not received, the Tax Department issued an assessment based on the information provided by the IRS. The taxpayer appealed the assessment, contending she was not a domiciliary resident of Virginia during the 2005 taxable year and that most of the income was retirement income from her former employer in State A. The Tax Commissioner upheld the assessment. Based on the evidence provided by the taxpayer, the Tax Commissioner determined that she was present in Virginia for more than 183 days in 2005 and was an actual resident. As the taxpayer was a 2005 actual resident of Virginia, Virginia, not State A, is permitted to tax the retirement income under Public Law 104-95, as codified at Title 4 U.S.C.A § 114, which prohibits a state from imposing an income tax on any retirement income received by an individual who is not a resident or domiciliary of that state.

12. **Domicile.** P.D. 11-05 (January 11, 2011). The Tax Commissioner considered an appeal by an individual assessed with additional income tax for the 2006 and 2007 taxable years and determined that the individual was a Virginia domiciliary resident as he did not abandon his Virginia domicile. The taxpayer was relocated by his employer to State A. In State A, the taxpayer rented an apartment, received financial documents, and filed his federal income tax return from his State A address. However, the taxpayer continued to maintain his house in Virginia, owned motor vehicles registered in Virginia, and he held a Virginia driver's license that he renewed in November 2007. The taxpayer indicated that he kept his cars registered in Virginia because the insurance rate was lower than in State A. However, the Tax Commissioner considers a taxpayer's continued connections to Virginia for the purpose of taking advantage of favorable Virginia laws in order to gain the benefits of lower costs available to Virginia residents to be strong intent of a taxpayer's desire to be a domiciliary resident of Virginia.

13. **Marine Pilot's Pass-Through Income Subject to Virginia Income Tax.** P.D. 11-12 (January 21, 2011). A nonresident marine pilot requested a ruling on whether pass-through income he receives from an association of marine pilots that operates in Virginia is subject to Virginia income tax. The Tax Commissioner ruled that the pass-through income is not entitled to the federal exemption for wages paid to a marine pilot operating in more than one state. As the association has Virginia source income, the Tax Commissioner determined that the nonresident marine pilot should pay Virginia income tax on his portion of the association’s income.

14. **Subtraction for Death Benefits.** P.D. 11-14 (January 25, 2011). The beneficiaries of an estate received lump sum death benefit payments from four life insurance annuities following the death of their mother in 2008. Each beneficiary subtracted the death benefit payment on his 2008 Virginia individual income tax return. One beneficiary was audited and the subtraction for the death benefits was disallowed, which resulted in a reduction of refund claimed by the beneficiary and his wife on their 2008 Virginia return. A ruling on behalf of the beneficiaries of the estate was requested that each beneficiary was entitled to subtract the death benefit payments in accordance with Virginia Code § 58.1-322(C)(32). The Tax Commissioner
agreed that the beneficiaries should be allowed the subtraction. Virginia Code § 58.1-322(C)(32) allows a subtraction for death benefit payments if (i) the source of the payment is an annuity contract between a customer and an insurance company; (ii) the annuity payment was awarded to the beneficiary in a lump sum; and (iii) the payment was subject to taxation at the federal level.

15. **Residency of Spouse of Active Duty Military Service Member.** P.D. 11-16 (February 11, 2011). In June 2007, the taxpayer moved from State A to Virginia. In early 2009, she married a service member on active duty in the armed forces in Virginia. The service member, who had been stationed in State A, was deployed overseas in 2006 and reassigned to Virginia when he returned in late 2008. The taxpayer claimed the military spouse exemption from individual income taxation on her 2009 taxable year Virginia income tax return. Under review, the Tax Department disallowed the military spouse exemption because the documentation provided showed the taxpayer was not married to the service member when she moved to Virginia. The Tax Department concluded that she was a resident of Virginia and changed the 2009 filing to a resident return. The taxpayer appealed contending both she and her service member spouse were domiciliary residents of State A in 2009.

The Tax Commissioner denied the taxpayer’s appeal. First, the Tax Commissioner examined her facts and circumstances and determined that the taxpayer became a Virginia domiciliary resident in 2007 before she was married. The Tax Commissioner also examined the Servicemembers Civil Relief Act, codified at 50 U.S.C. App. § 571 et seq., as amended effective for the 2009 taxable year. Under the Act, a spouse can neither lose nor acquire domicile or residence in a state when the spouse is present in the state solely to be with the service member in compliance with the service member's military orders if the residence or domicile is the same for both the service member and spouse. The taxpayer did not acquire her Virginia domicile when her spouse was assigned to Virginia as she acquired her Virginia domicile based on her own actions prior to her marriage to the servicemember in 2009.

16. **Land Preservation Tax Credit: Receipt of Credits by a Personal Representative.** P.D. 11-20 (February 18, 2011). A mother and daughter (the "Donors") made a donation of land eligible for the Land Preservation Tax Credit in December 2006. The Daughter died in February 2007 and the mother died in May 2008. The taxpayer qualified as the personal representative on behalf of the estates of the Donors. In his capacity as personal representative, the taxpayer submitted an application for the credit and simultaneously filed a ruling request with the Tax Commissioner asking that he qualify to receive the credits. The Tax Commissioner determined that because the donation was made by the Donors before their deaths, the credit could be claimed on the final income tax returns of the Donors. However, any used credits may not be transferred by the taxpayer.

17. **Statute of Limitations on Reporting Federal Changes.** P.D. 11-29 (February 28, 2011). The taxpayers were audited by the Internal Revenue Service (IRS) for the 2005 and 2006 taxable years. The IRS adjusted the taxpayers' 2005 and 2006 federal income tax returns, resulting in a change to federal taxable income. The taxpayers did not file amended 2005 and 2006 Virginia income tax returns reflecting the IRS adjustments. As a result, the Tax Department issued assessments for the 2005 and 2006 taxable years. The taxpayers appealed the assessments, contending they were not issued within the three-year limitations period. The Tax
Commissioner upheld the assessments as Virginia Code § 58.1-311 requires any individual to report a change or correction in federal taxable income within one year of the final determination of such change or correction by filing an amended return with the Tax Department. If the taxpayer fails to file an amended return, Virginia Code § 58.1-312(A)(3) permits the Tax Department to assess the appropriate tax at any time.

18. Disability Subtraction. P.D. 11-32 (March 3, 2011) is a request for redetermination of P.D. 10-153. In P.D. 10-153, the Tax Commissioner determined that the taxpayers, a husband and wife, were not entitled to the disability income subtraction for the taxable years at issue because the husband, who received the income, was not permanently and totally disabled. The husband and former spouse was the individual for whom the disability income was approved. In P.D. 10-153, the Tax Commissioner found that an individual must meet two tests in order to be allowed a subtraction for disability income on the Virginia individual income tax return: (1) The individual must receive disability income, and (2) The individual must be absent from work because of a permanent and total disability. The taxpayers requested a redetermination, contending the payments qualified as disability income under Internal Revenue Code (IRC) § 22(c)(2)(B)(iii), and neither the Code of Virginia nor the IRC recharacterize this type of income once the permanently disabled person dies and subsequent payments are made to the spouse. The Tax Commissioner upheld the prior ruling. While the Tax Commissioner did not dispute the characterization of the income under the IRC, he determined that the deduction under Virginia Code sec. 58.1-322(C)(4)(b) can only be claimed by an individual who is permanently or totally disabled.

19. Land Preservation Credit: Claiming Credits Not Transferred To You. P.D. 11-33 (March 3, 2011). The taxpayers, a husband and wife, purchased land preservation credits to be claimed on their 2005 and 2006 Virginia income tax returns. At the time of the purchase of the credits, the notification form filed with the Tax Department indicated that the sellers retained the credits. The taxpayers jointly claimed the credits on their 2005 and 2006 returns. In 2008, the Tax Department devalued the credits on a pro-rata basis to all holders of the credits. The devaluation of the credits resulted in assessments of tax being issued to the taxpayers for the 2005 and 2006 taxable years. The taxpayers paid the assessments and filed an appeal contending they are entitled to claim credits that were retained by the sellers at the time of transfer. (WHAT???) Thankfully, the Tax Commissioner denied the taxpayers right to claim the other credits and noted that the Commonwealth is not a party to the transaction and cannot grant credits that were not transferred.

20. Business Expense v. Hobby Expense. P.D. 11-36 (March 7, 2011). The taxpayers, a husband and wife, operated an import business during the 2007 taxable year. The business incurred losses that were reported on federal Schedule C. Under review, the auditor determined that the business had reported consistent losses in prior taxable years and was not operated for profit. As a result, the auditor disallowed the deductions claimed on the Schedule C and issued an assessment for additional tax and interest for the 2007 taxable year. The taxpayers paid the assessment and filed an appeal contending they intended to make a profit from the operations of the business, but changing market conditions affected the viability of the business.
The Tax Commissioner agreed with the taxpayers and ordered an appropriate refund. The Tax Commissioner recognized that Treasury Regulation § 1-183-2(b) identifies nine factors that should be taken into account when determining whether an activity has a profit motive: (1) The manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation. All facts and circumstances in this regulation must be considered in determining if an activity is engaged in for profit. The regulation also states that no one factor is determinative and consideration is not necessarily limited to these nine factors. Using the nine factors, the Tax Commissioner determined that the taxpayers conducted their business for profit and allowed the deduction. Query: Did the auditor apply the nine factors? Based on the ruling, the auditor appeared to arrive at his conclusion based solely on the fact that the business was consistently reporting losses. If Virginia auditors are going to conduct audits based on federal laws, shouldn’t they understand and recognize federal law before they make any adjustments?

21. Income Earned by Indian Reservation Resident. P.D. 11-38 and 11-39 (March 14, 2011). During the taxable years at issue, the taxpayer, an Indian, resided on an Indian reservation. On his Virginia individual income tax return, the taxpayer claimed a subtraction for wages, interest, dividends, and retirement income in computing his Virginia taxable income, which was partially disallowed. The taxpayer was assessed with the difference. He appealed the assessments, contending the income resulted from activities conducted on an Indian reservation. In P.D. 10-156, the Tax Department upheld assessments because certain pension, dividend, and interest income received by the taxpayer and subtracted on his income tax returns did not result from pursuits conducted by an Indian residing on a reservation. The taxpayer requested a redetermination, contending the income at issue was received from pursuits conducted on the reservation or that the pension income at issue resulted from employment conducted by an Indian residing and working on the reservation. The Tax Commissioner upheld the prior ruling as the taxpayer did not show evidence that the dividend or interest income at issue was received from pursuits conducted on the reservation or that the pension income at issue resulted from employment conducted by an Indian residing and working on the reservation.

22. Sale of S Corporation and Personal Residence. P.D. 11-48 (March 31, 2011). A married couple (the "taxpayers") currently residing in Virginia own all of the shares of a Virginia S corporation (VSC). The taxpayers intend to sell VSC and their Virginia home and change their domiciliary residence to another state. The taxpayers are considering a proposal that require a buyer to make an initial payment at closing and contingent payments based on the S corporation's revenue in future years. The taxpayers requested a ruling as to their Virginia income tax liability on the contingent payments. In addition, the taxpayers sought guidance concerning any potential Virginia tax liability resulting from installment payments of principal and interest from the sale of their Virginia personal residence after they move out of Virginia. The Tax Commissioner opined that whether the contingent payments would be subject to Virginia income tax depends on how the taxpayers sell VSC. If the taxpayers sell the stock of VSC, any payments the taxpayers receive once they change their residency would not be taxable
by Virginia. However if the taxpayers sell the assets of VSC or sell the stock and make an election under IRC § 338(h)(10) to treat the stock sale as a sale of assets, all payments would be subject to Virginia taxation. The payments on the sale of the residence would only be subject to Virginia income tax to the extent that the payments are not excluded from federal income taxation.

23. **Credit for Taxes Paid to Other States.** P.D. 11-50 (April 4, 2011). The taxpayers are Virginia residents who claimed a tax credit on their Virginia individual income tax return for income tax paid to State A. The income tax due to State A was reduced by a credit for investing in a historic rehabilitation project (the "historic rehabilitation credit"). When filing their Virginia income tax return, the taxpayers claimed a credit for tax paid to another state based on the total amount of tax due to State A before application of the historic rehabilitation credit. Under audit, the auditor reduced the tax credit for tax paid to another state to the actual tax payment and issued an assessment for additional tax and interest. The taxpayers appealed the assessment contending the instructions for the Virginia income tax return states a taxpayer receives credit for the "amount of credit of tax paid to another state." The taxpayers asserted there is no law or regulation that requires reduction of the qualifying tax liability by the amount that State A properly granted as a credit for payment of the State A tax. Without citing any law and only a prior ruling of the Tax Commissioner, the Tax Commissioner determined that the assessment is correct as the credit is only for amounts paid to other states in cash, not credits.

24. **Domicile.** P.D. 11-58 (April 13, 2011). The taxpayers, a husband and wife, filed a Virginia part-year income tax return for the 2006 taxable year. The taxpayers performed a number of actions consistent with obtaining and maintaining a domicile in Virginia. The husband obtained a Virginia driver's license in 2004. In September 2005 the taxpayers leased an apartment in Virginia and filed a part-year Virginia return for the 2005 taxable year. They moved to another apartment in Virginia in 2006. The wife obtained her Virginia driver's license in 2006. They also had an automobile registered in Virginia in 2006. The only evidence provided showing a connection with another state is a 2006 part year return filed with State A. The taxpayers did not show that they established a permanent place of abode, engaged in employment for an indefinite period of time, registered property, or obtained drivers' licenses in any other state during 2006. Under review, the auditor determined the taxpayers were domiciliary residents of Virginia for the entire taxable year and issued an assessment. The taxpayers filed an appeal contending they filed a part-year resident return because they did not obtain employment in Virginia until October 2006. The Tax Commissioner upheld the assessment.

25. **Credit for Taxes Paid to Other States & Statute of Limitations.** P.D. 11-64 (April 21, 2011). The taxpayers are Virginia residents who owned rental property in State A. In February 2009, an audit by State A resulted in an income tax assessment. An amended 2004 Virginia income tax return was filed in March 2009 claiming a credit for income tax paid to State A. The Tax Department denied the refund because the return was filed beyond the statute of limitations. The taxpayers appealed the denial of the refund contending they could claim a refund within one year of State A's final determination. In the alternative, they argued that the State A assessment impacted their 2009 federal income tax return, thereby opening up the statute to allow them to file an amended return within one year of a final determination by the Internal
Revenue Service (IRS). The taxpayers also asserted that a refund could be permitted because the claim resulted from the payment of an assessment and their amended Virginia return raised issues solely related to the State A assessment. The Tax Commissioner denied the taxpayers' request for a refund. First, the alternative arguments were denied as the State A assessment did not require the taxpayer to file an amended federal return nor can it reopen the statute of limitations under the same provision that a Virginia assessment would.

On the primary argument, the Tax Commissioner referred to prior law and stated, “Under Va. Code § 58.1-1823A(v), a taxpayer has one year from the final determination of a change made by any other state to file an amended return to request a refund resulting from credits for taxes paid to other states. . . . This provision, however, clearly states that a taxpayer must have previously claimed a credit for taxes paid to such state tax pursuant to Va. Code § 58.1-332 in order to file an amended return claiming a refund resulting from an audit conducted by another state.” Prior to 2010, Virginia Code § 58.1-1823(A)(v) stated, “Any person filing a tax return or paying an assessment required for any tax administered by the Department of Taxation may file an amended return with the Department within the later of: . . . (v) one year from the final determination of any change or correction in the income tax of the taxpayer for any other state, provided that the taxpayer previously claimed a credit for such tax pursuant to § 58.1-332 and that the refund does not exceed the amount of the decrease in Virginia tax attributable to such change or correction.” Effective July 1, 2010, the requirement that a credit was claimed on the original return no longer exists.


27. Servicemembers Civil Relief Act. P.D. 11-66 (April 26, 2011). The taxpayer and her spouse, an active duty military servicemember, were assigned to a military duty station in State A in June 2005. In May 2008, the spouse received a change of duty station and transferred to a military installation in Virginia. The wife moved to Virginia with her husband. The taxpayer filed a nonresident claim for individual income tax withheld in February 2010, for the 2009 taxable year. In this claim the taxpayer attested that she and her spouse were domiciliary residents of State B. The claim was denied on the basis that the information provided supported the taxpayer's claim that her spouse is a domiciliary resident of State B, but it did not support her claim of domicile. The taxpayer filed an amended claim in August 2010, attesting that she was erroneously advised and should have claimed State A as their domiciliary residence. The Department agreed that the taxpayer maintained her domicile in State A, but determined her spouse did not abandon his State B domicile. Therefore they did not share the same domicile prior to being stationed in Virginia. The taxpayer filed an appeal, contending that she and her spouse shared domicile in State A, and she should be allowed a refund for individual income tax withheld in 2009.

The Tax Commissioner denied the claim as he determined that the spouse was domiciled in State B while the taxpayer was domiciled in State A. The Servicemembers Civil Relief Act (the "Act"), codified at 50 U.S.C. § 571 et seq., was amended, effective for 2009 taxable year.
and thereafter, to provide that a spouse can neither lose nor acquire domicile or residence in a state when the spouse is present in the state solely to be with the service member in compliance with the service member's military orders if the residence or domicile is the same for both the service member and spouse. Information provided to the Tax Commissioner showed that the spouse elected State B as his withholding state. He also maintained motor vehicles registered in State B and held a State B driver's license. The taxpayer provided the Tax Department with a copy of a State B driver's license issued January 2010. In addition, the service member and the taxpayer maintained a residence in State A and held State A identification cards issued in 2006. During the 2010 taxable year, while stationed in Virginia, the service member and the taxpayer transferred all vehicle registrations to State A. They registered to vote in State A. The service member reported an error in the withholding state to the Department of Defense, contending the withholding state should be State A, and was incorrect since 2005.

28. Tax Preparer Error. P.D. 11-78 (May 26, 2011) and P.D. 11-82 (May 31, 2011). The taxpayer is a Virginia resident who filed individual income tax returns for the 2007 and 2008 taxable years. Under audit, the Tax Department disallowed itemized deductions for charitable contributions, job expenses, and certain miscellaneous expenses. The Tax Department also adjusted the taxpayer's mortgage interest deduction. The taxpayer appealed the assessments contending he relied on the expertise of the tax preparer to complete the returns properly. The taxpayer conceded that the itemized deductions reported were incorrect but believes the tax preparer should be held responsible for the incorrectly completed returns. The Tax Commissioner upheld the assessment as he does not have the authority to assess the taxpayer's liability against the tax preparer. The Tax Commissioner noted that the taxpayer may have a cause of action against the tax preparer.

29. Domicile. P.D. 11-79 (May 26, 2011). The taxpayer filed a 2006 Virginia resident part-year return. In April 2006, the taxpayer was transferred by his employer to State A. In June 2006, he was transferred to Country A. He was then transferred to two other foreign countries in 2008 and 2010, respectively. The Tax Department received information from the IRS that tax documents for the 2007 taxable year were sent to the taxpayer at a Virginia address. The taxpayer did not file a 2007 Virginia individual income tax return. The Tax Department requested additional information from the taxpayer in order to determine his residence for that taxable year. Based on the information provided by the taxpayer, the Tax Department determined that he was a Virginia domiciliary resident during the 2007 taxable year and issued an assessment for individual income tax. The taxpayer appealed the assessment asserting that he abandoned his Virginia domicile when he was transferred to State A, and he was a resident of Country A during the 2007 taxable year. The Tax Commissioner upheld the assessment. The Tax Commissioner determined that the taxpayer failed to abandon his Virginia domicile as he maintained a Virginia driver's license and continued to use a Virginia address for mail purposes. Also, the taxpayer's employment contracts showed that his various assignments were only temporary and the taxpayer did not attempt to obtain a permanent residence after he left Virginia.

30. Domicile/Servicemembers Civil Relief Act. P.D. 11-90 (June 2, 2011). The taxpayer moved to Virginia from State A in February 2008. In April 2008, she married a military service member assigned to a duty station in Virginia. The taxpayer engaged in activities consistent with establishing domicile within Virginia. She obtained a permanent place
of abode and accepted employment in Virginia in February 2008 prior to her marriage to the service member. Her employer began withholding Virginia income tax from her salary. The taxpayer also maintained connections to State A. She continued to hold a State A driver's license and maintained a permanent place of abode. In 2008, the taxpayer updated her motor vehicle registration in State A to include the service member. The taxpayer filed a refund claim for withholding for the 2009 taxable year. The auditor denied the taxpayer's claim on the basis that the taxpayer established residence in Virginia prior to marrying the service member. The taxpayer appealed contending her only purpose in Virginia was to be with the service member. The Tax Commissioner ordered the taxpayer's withholding refunded and found that the taxpayer demonstrated her intent to maintain her State A domicile in 2008. The evidence further indicated to the Tax Commissioner that she did not establish a Virginia domicile in 2009 and the taxpayer and her service member spouse maintained their domicile in State A.

Observation: This ruling is an indictment of the Tax Department’s audit staff. If a Virginia resident maintained their Virginia home, driver’s license, and motor vehicle registration after moving to another state, they would have been assessed with Virginia individual income tax as a Virginia resident every time. Such an assessment would probably be upheld, depending on other facts, as individuals are required to abandon their previous state of domicile to change their domicile. Here however, the opposite facts exist. The taxpayer maintained significant connections with State A and the audit staff argued that she changed her domicile to Virginia, yet the auditor determined that the taxpayer had a Virginia domicile. Which is it?

31. D.C. Unincorporated Business Franchise Tax. P.D. 11-92 (June 2, 2011). A taxpayer representative requested a ruling on the application of the credit allowed by Va. Code § 58.1-332 for income taxes paid to other states to the D.C. Unincorporated Business Franchise Tax, ("UBFT") and whether Virginia policy has changed as a result of District of Columbia v. Bender, 906 A.2d 277 (2006). The representative's clients are a married couple living in Virginia. The husband is the sole member of a Virginia LLC that operates a consulting business located in the District. The LLC was subject to the UBFT. He asked if the couple can claim the Virginia credit for income taxes paid to other states for this tax. The policy for not allowing such a credit was most recently upheld by the Virginia Supreme Court in Mathy v. Commonwealth, 253 Va. 356, 43 S.E.2d 802 (1997). In doing so, the Virginia Court relied on the characterization of the tax by the DC Court in Bishop v. District of Columbia, 401 A.2d 955 (D.C. 1979), reinstated en banc, 411 A.2d 997, cert. denied 446 U.S. 996 (1980). The recent Bender case clarified the holding of the Bishop decision, and the representative claimed that it undercuts the rationale behind Virginia Supreme Court decision in Mathy. Therefore, the representative asserted that the Tax Department should ignore the Mathy decision and allow taxpayers to claim the income tax credit for the UBFT. The Tax Commissioner declined the invitation to administratively overrule the Virginia Supreme Court's decision in Mathy and reaffirmed Virginia's policy of interpreting Va. Code § 58.1-332 as not allowing credit for the UBFT. The Tax Commissioner declined to ignore the Virginia Supreme Court's holding in Mathy for several reasons as (1) decisions of the courts of other states are not binding on Virginia administrative agencies; (2) the Tax Department has consistently held administratively, and argued in court, its position that the UBFT does not, and never has, qualified for Virginia's credit for income taxes paid to other states; and, (3) he was not persuaded that the Virginia Supreme Court would reach a different result if the matter came before it again.
32. **Mortgage Interest Deduction.** P.D. 11-93 (June 3, 2011). The taxpayer claimed an itemized deduction for mortgage interest on his 2007 Virginia individual income tax return. Under audit, the Tax Department disallowed the mortgage interest deduction because the taxpayer's father was listed as the owner of the home and the payer of the interest on the federal information return, Form 1098. The taxpayer appealed contending that he is entitled to deduct the mortgage interest expense because he lived in and owned the home, made the payments on both mortgages, and paid the home maintenance expenses. The Tax Commissioner upheld the assessment as the information provided by the taxpayer did not clarify any of the outstanding issues. In this case, the taxpayer and his father share the exact same name. The federal information return reporting the mortgage interest bears the father's Social Security number. Based on the deed, it was unclear to the Tax Commissioner as to whether the taxpayer or his father had legal title to the residence. In addition, the mortgage documents, bank statements, and utility bills provided bear the name shared by the taxpayer and the father.

33. **Change in Federal Adjusted Gross Income.** P.D. 11-100 (June 9, 2011). The taxpayers, a husband and wife, were audited by the IRS for the 2005 and 2006 taxable years. The IRS shifted passive activity losses from 2006 to 2005, resulting in an increase in federal adjusted gross income (FAGI) in the 2006 taxable year and a decrease in the 2005 taxable year. As a result of the shift in income, the amount of Social Security benefits included in the taxpayers' FAGI was also adjusted. The taxpayers failed to file amended Virginia income tax returns for either the 2005 or 2006 taxable years reflecting the federal adjustments as required under Virginia law. As a result, the Tax Department issued an assessment for the 2006 taxable year. The taxpayers appealed the assessment contending the IRS adjustment to the passive activity losses did not affect the net Virginia tax liability for the 2005 and 2006 taxable years combined. In addition, the taxpayers asserted that the Tax Department included nontaxable Social Security benefits in computing their liability. The Tax Commissioner disagreed as Virginia law required the taxpayers to file an amended return to claim the 2005 refund. As the statute of limitation had expired, the taxpayers could not claim this refund and thus could not offset the 2006 tax due. However, the Tax Commissioner determined that the assessment did not include the subtraction for Social Security benefits and ordered that the assessment be adjusted.

34. **Domicile.** P.D. 11-101 (June 9, 2011). The taxpayer was a student at a university in State A during the 2007 taxable year. He resided in a fraternity house and paid State A tuition. The taxpayer was registered to vote in State A. During the 2007 taxable year, the taxpayer completed an internship in State A. The taxpayer filed a State A part-year resident return for 2007, reporting the income he earned from his internship. The taxpayer acquired a Virginia driver's license in 2002, which he renewed in January 2006 and January 2011. In 2008, he accepted full-time employment in State A to commence after his graduation with the company for which he interned in 2007. The Tax Department received information from the IRS that tax documents for the 2007 taxable year were sent to the taxpayer at a Virginia address. The taxpayer did not file a 2007 Virginia individual income tax return. The Tax Department requested additional information from the taxpayer in order to determine his residence for that taxable year. Based on the information provided by the taxpayer, the Tax Department determined that he was a Virginia domiciliary resident during the 2007 taxable year and issued an assessment for individual income tax. The taxpayer appealed the assessment contending he
took sufficient steps to establish residency in State A and all the income earned in 2007 was earned in State A. The Tax Commissioner disagreed and upheld the assessment as the taxpayer maintained all of his Virginia connections thus never abandoned his Virginia domicile.

35. **Servicemembers Civil Relief Act.** P.D. 11-104 (June 10, 2011). The taxpayer moved to Virginia in May 2003. She established a permanent place of abode, accepted employment at a Virginia company, and in October 2003, married a nonresident military service member serving at a Virginia duty station. Prior to moving to Virginia, both the taxpayer and the service member were domiciliary residents of State A. The taxpayer obtained a Virginia voter's registration card in 2008 and surrendered her State A driver's license and obtained a Virginia driver's license in 2009. The taxpayer filed a refund claim for nonresident withholding for the 2009 taxable year. Under review, the Tax Department concluded that the taxpayer was a resident of Virginia before she married the service member, denied the refund claim and issued an assessment for tax and interest. The taxpayer appealed the assessment contending she shared the same domicile as the service member prior to joining him in Virginia. The Tax Commissioner upheld the refund denial as the taxpayer took sufficient steps to abandon her domicile in State A and establish domicile in Virginia prior to marrying the servicemember. Thus, the protection afforded by the Servicemembers Civil Relief Act did not apply.

36. **Unreported Federal Adjustment.** P.D. 11-107 (June 14, 2011). The taxpayer was audited by the IRS for the 2006 taxable year. The IRS adjusted the taxpayer's 2006 federal adjusted gross income (FAGI). The taxpayer did not amend her Virginia income tax return to report the IRS adjustment. As a result, the Tax Department issued an assessment for the taxable year in question. The taxpayer appealed the assessment contending the preparer made an error when filing the income tax return. Specifically, the taxpayer contended that her accountant failed to properly report a deduction for education expenses, resulting in the adjustment to her federal taxable income. Due to personal issues at the time, the taxpayer indicated that she did not contest the IRS assessment. The Tax Commissioner upheld the assessment after refusing to go behind an IRC audit despite the authority to adjust FAGI. **Interesting quote:** “However, where the IRS has examined the federal taxable income of a taxpayer, the Department does not look behind the IRS's final determination.”

37. **Above the Line Audit.** P.D. 11-108 (June 14, 2011). The Tax Department audited the taxpayers' Virginia individual income tax returns for the 2007 and 2008 taxable years. The auditor adjusted the itemized deductions for the 2007 taxable year and disallowed the itemized deductions claimed for 2008 based on documentation provided by the taxpayers. The taxpayers appealed the assessments contending that many of the documents required to substantiate the itemized deductions were lost during a foreclosure proceeding. The Tax Commissioner upheld the assessment due to a lack of documentation.

38. **Actual Residency.** P.D. 11-109 (June 14, 2011). The Tax Department received information from the IRS indicating that third-party financial documents for the 2007 taxable year were sent to the taxpayer at a Virginia address. The Tax Department requested information to verify whether the taxpayer was subject to Virginia income tax. When the taxpayer failed to respond, an assessment was issued based on the available information. The taxpayer appealed the assessment contending he was domiciled in State A during the 2007.
Tax Commissioner reviewed the evidence provided by the taxpayer and determined that he was domiciled in State A in 2007. However, evidence also indicated that the taxpayer was present in Virginia for 190 days in 2007. The Tax Commissioner upheld the assessment and determined that the taxpayer was an actual resident.

39. **Domicile.** P.D. 11-113 (June 20, 2011). In 2006, the taxpayer and her spouse resided in State A. The couple also owned a house in Virginia, and the taxpayer held a Virginia driver's license. Her employer was based in State B, which borders Virginia. In early 2007, the spouse was transferred by his employer to Country A and the couple sold their home in State A. The taxpayer continued to work for her employer in State B and lived in the home in Virginia when she was not in Country A with her spouse. The Tax Department received information from the IRS indicating the taxpayer had income for the taxable year at issue. The taxpayer was requested to file a Virginia individual income tax return for the taxable year at issue, provide a copy of the return filed, or explain why she was not subject to Virginia income taxation. When an adequate response was not received, the Tax Department issued an assessment. The taxpayer appealed the assessment contending she changed her domicile to Country A in 2007, the income from her employment was exempt under federal law, and her income was insufficient to require filing. While never addressing the last two arguments, the Tax Commissioner determined that the taxpayer was domiciled in Virginia.

According to the Tax Commissioner, the taxpayer performed several actions consistent with an intent to change domicile in 2007. The home in State A was sold after the spouse was transferred to Country A and the taxpayer traveled to Country A with the spouse. However the Tax Commissioner also noted that the taxpayer also performed a number of actions indicating an intent to establish her domicile in Virginia. The taxpayer purchased a home, registered an automobile in Virginia, and obtained a Virginia driver's license prior to 2007. In addition, the taxpayer spent more days in Virginia than in Country A or State A in 2007. Based upon these circumstances, the Tax Commissioner upheld the assessment.

**Observation:** Ninety-nine times out of one hundred, the Tax Commissioner correctly decides residency appeals. This case is number one hundred based on the facts in this ruling. In fact, the outcome does not match the policy stated in this ruling. The ruling states,

“In order to change from one legal domicile to another legal domicile, there must be (1) actual abandonment of the old domicile, coupled with an intent not to return to it, and (2) an acquisition of a new domicile at another place, which must be formed by personal presence and an intent to remain there permanently or indefinitely. The burden of proving that the domicile has been changed lies with the person alleging the change.”

Based on the facts that the Tax Commissioner wrote, **nothing** was acquired in Virginia when the taxpayer sold the State A house. All of the taxpayer’s Virginia connections existed when she was presumably domiciled in State A. It is not clear based on the ruling if adequate steps were taken to establish domicile in Country A. However even if the steps weren’t adequate, the taxpayer did nothing to acquire a domicile in Virginia. Based on the facts cited in this ruling and
presuming that the actions taken to establish a domicile in Country A were not sufficient, the correct outcome would be to say that the taxpayer is still a domiciliary resident of State A.

40. **Servicemembers Civil Relief Act.** P.D. 11-114 (June 21, 2011). The taxpayer was a State A resident who attended college in Virginia. In March 2004, the taxpayer obtained a Virginia driver's license. After graduating in May 2004, the taxpayer returned to State A. In June 2005, the taxpayer returned to Virginia and married a nonresident military service member, who was domiciled in State A. The couple moved into a residence in Virginia because the service member was stationed in an adjacent state. The taxpayer obtained full-time employment and registered a motor vehicle in Virginia. The taxpayer renewed her Virginia driver's license and registered to vote in Virginia in 2008. In April 2010, the taxpayer transferred ownership of a motor vehicle to the service member and the vehicle was registered in State A. She also surrendered her Virginia driver's license for a State A driver's license while continuing to reside in Virginia. The taxpayer filed a claim for refund of nonresident withholding tax for the 2009 taxable year. The Tax Department denied the claim on the basis that the taxpayer abandoned her State A domicile in 2005, and no longer shared the same domicile as the service member. The taxpayer appealed the refund denial, contending she was complying with Virginia laws when obtaining a Virginia driver's license and registering to vote in Virginia, and she never intended to establish domicile in Virginia. The Tax Commissioner disagreed and upheld the refund denial.

The Servicemembers Civil Relief Act provides that military and naval personnel do not abandon their legal domicile solely by complying with military orders that station them in a different state or country whether permanently or temporarily. The Act did not apply to the spouses of military and naval personnel before 2009. The Tax Department has ruled that residency status of a taxpayer requires analysis separate from their military spouse. In Virginia Tax Bulletin (VTB) 10-1 (1/29/2010), the Tax Department explained that the domicile of a military spouse must be the same as the service member in order to be exempt from Virginia's income tax. The determination of a military spouse's domicile requires analysis of the facts and circumstances. The elements that may be examined include:

1. Whether the person claiming exemption is married to a service member who is present in Virginia pursuant to military orders.
2. The service member's domicile.
3. The spouse's domicile and the circumstances in which it was established.
4. The extent to which the spouse has maintained contacts with the domicile.
5. Whether the spouse has taken any action in Virginia that is inconsistent with maintaining a domicile elsewhere.

In his examinations of the taxpayer's facts and circumstances, the Tax Commissioner determined that the taxpayer took sufficient steps to establish a Virginia domicile while abandoning all relevant connections with State A by 2008.
41. **Servicemembers Civil Relief Act.** P.D. 11-119 (June 24, 2011). The taxpayer married a service member while they both served in the military in State A. Both were released from active duty, but the service member joined another branch of the military service in 2003. The taxpayer retired from his full-time employment in 2002. In July 2006, the service member was assigned to a duty station in State B, which borders Virginia. The taxpayer and the service member purchased a condominium, registered to vote, obtained driver's licenses, and registered a motor vehicle in Virginia. In late 2009, the service member was transferred to a duty station abroad. Before moving, both the taxpayer and the service member surrendered their Virginia driver's licenses and voter's registrations. They also moved all their personal items to State A. In December 2009, they obtained driver's licenses and registered to vote in State A. The Virginia condominium was sold in January 2010. The taxpayer filed a refund claim for nonresident withholding tax for the 2009 taxable year. Under review, the Tax Department disallowed the military spouse exemption because he was a domiciliary resident of Virginia. In addition, the Tax Department changed the 2009 Virginia income tax return to a resident return and issued an assessment. The taxpayer filed an appeal contending he was an eligible spouse of an active duty service member. The Tax Commissioner disagreed and upheld both the refund claim denial and the assessment. The basis for this decision was that the taxpayer was a domiciliary resident of Virginia in 2009. **Lesson:** Before you request a refund for a client, make sure your client is not vulnerable to an assessment. The request for refund may cost your client.

42. **Domicile.** P.D. 11-120 (June 30, 2011). The Tax Department was notified by the IRS that the taxpayer received financial statements at a Virginia address for the 2007 taxable year. Under audit, the Tax Department found that the taxpayer received financial statements at multiple post office boxes in Virginia and in State A. Because the taxpayer held a Virginia driver's license and owned motor vehicles registered in Virginia, the Tax Department concluded that the taxpayer was a domiciliary resident of Virginia. As a result, the Tax Department issued an assessment for tax, penalty and interest. The taxpayer appealed the assessment contending that during 2007 she and her husband were in transition between Virginia and State A while their Virginia home was under construction. The Tax Commissioner determined that the taxpayer was a resident of Virginia for the 2007 year. **Query:** There are not enough facts in this ruling to judge whether the correct decision was made. However, the presence of a key fact is never mentioned. The Tax Commissioner mentioned that there is no evidence that the home under construction was completed in 2007. Assuming it was not, did the taxpayers reside in Virginia? Was the taxpayer ever a domiciliary resident of State A?

43. **Domicile.** P.D. 11-129 (July 20, 2011). The taxpayer and his wife moved to State A in 1995. For many years, the wife had been diagnosed with a debilitating disease for which she has been receiving treatment in State B, which borders Virginia. The taxpayers maintained a residence in Virginia where they would return in order for the wife to receive treatments. Eventually, the wife moved to Virginia permanently while the taxpayer continued to travel back and forth to State A. The Tax Department audited the taxpayer and concluded that he established a domiciliary residence in Virginia. Assessments for additional individual income tax and interest were issued for the 2007 and 2008 taxable years. The taxpayer appealed the assessments contending he continues to maintain his domicile in State A. The Tax Commissioner agreed with the taxpayer and abated the assessment. Even though it was determined that the taxpayer rented his home in State A, he maintained all of his other
connections to State A. The Tax Commissioner determined that the taxpayer demonstrated no intent to abandon his State A domicile.

44. **Military Wages.** P.D. 11-133 (July 25, 2011). The taxpayer, a resident of Virginia, claimed subtractions from the federal adjusted gross income for National Guard and combat duty pay on his 2007 Virginia individual income tax return. He also claimed subtractions for National Guard compensation, combat duty pay, and basic military, wages on the 2008 return. Under audit, the Tax Department disallowed the subtraction for combat duty pay and National Guard compensation and allowed subtractions for basic military pay. As a result, the Tax Department issued assessments for additional tax and interest for the taxable years at issue. The taxpayer appealed the assessments contending that Virginia statutes allow a military servicemember who meets the qualifications to claim multiple military subtractions.

Title 58.1 of the Code of Virginia provides three subtractions for military compensation. Military servicemembers may be eligible for a subtraction for: (1) military pay and allowances earned while serving in a combat zone or qualified hazardous duty area (Va. Code § 58.1-322(C)(23)); (2) military basic pay for personnel on extended active duty for periods in excess of 90 days (Va. Code § 58.1-322(C)(21)); and (3) wages or salaries received for active and inactive service in the National Guard of the Commonwealth (Va. Code § 58.1-322(C)(11)). Servicemembers may be eligible for more than one subtraction, but the same income may not be included in more than one subtraction. In other words, a servicemember may not deduct the same income for both the military basic pay subtraction and the National Guard subtraction. All of the subtractions under Va. Code § 58.1-322(C) are prefaced by the words "To the extent included in federal adjusted gross income." No military compensation excluded from FAGI can be used to claim a military subtraction in computing Virginia taxable income.

After examining the taxpayer's records, the Tax Commissioner ordered certain adjustments to the audit. The taxpayer's W-2 provided detail of the excluded combat duty or qualified hazardous duty pay but did not provide the detail required to ascertain the officer's active service pay from any taxable combat duty pay. Without such detail, the Tax Commissioner could not determine if combat duty or a qualified hazardous duty pay was included in the FAGI. Therefore, the taxpayer was allowed to present such detail to the Tax Department within 30 days.

Virginia Code § 58.1-322(C)(11) allows a subtraction of wages or salaries received by any person for active and inactive service in the National Guard of the Commonwealth of Virginia. The amount of the subtraction is the lesser of the amount of National Guard income received not to exceed the amount of income from 39 calendar days of service, or $3,000. National Guard personnel may only claim the subtraction if their rank is captain (03) and below. The taxpayer provided evidence of his membership as a captain in the Commonwealth's National Guard; however the National Guard income subtraction was disallowed because the income basis was the same as the basis used to calculate the basic military pay. After calculating the taxpayer's military basic pay subtraction, the remaining military income exceeded the $3,000 subtraction. Although this income was included in the formula for calculating the military basic pay subtraction, it was not included in the amount actually subtracted. The Tax Commissioner determined that this remaining income was eligible for the National Guard subtractions and not
subject to double exclusion and the subtraction is in accordance with Va. Code § 58.1-322(C)(11).

45. **Itemized Deductions.** P.D. 11-140 (August 2, 2011). The Tax Department adjusted the taxpayers' itemized deductions reported on their 2010 Virginia income tax return resulting in a reduction of the taxpayers' refund. The taxpayers appealed the adjustments to the mortgage interest deduction, cash and non-cash charitable gifts, and unreimbursed employee expenses contending they provided adequate documentation to claim the deductions. The Tax Commissioner adjusted the assessment to allow the mortgage deduction and certain charitable gifts based on provided documentation. However, the non-cash gifts were disallowed as the taxpayers did not produce an appraisal which is required under Treas. Reg. § 1.170A-13(c)(1). (A taxpayer must obtain a qualified appraisal to substantiate the donation of similar items that have an aggregated value of greater than $5,000.) The Tax Commissioner also disallowed the deduction for mileage for the taxpayers commute to work.

46. **Innocent Spouse.** P.D. 11-144 (August 5, 2011). The taxpayer separated from her spouse during 2008 and divorced in 2010. The spouse electronically filed a joint Virginia individual income tax return for the 2008 taxable year and a refund was issued. The taxpayer filed a separate Virginia individual income tax return and paid the balance due. The Tax Department processed the taxpayer's return and issued an assessment to the taxpayer to recover the refund issued from the joint return. The taxpayer appealed the assessment contending she did not agree to file a joint 2008 return and is not liable for the balance due related to the filing of the joint Virginia return. The Tax Commissioner agreed and abated the assessment. Evidence provided by the taxpayer demonstrated that she never agreed to file a joint Virginia income tax return with her spouse. Because the joint return was filed without her permission and she appropriately filed a separate Virginia return reporting her separate tax liability, the taxpayer would not be jointly liable for any assessment resulting from the joint return.

47. **Carryback of Net Operating Loss Deduction.** P.D. 11-150 (August 26, 2011). The taxpayers incurred a net operating loss (NOL) on their 2008 federal income tax return. For federal income tax purposes, the taxpayers carried back the 2008 NOL to their 2004 through 2006 income tax returns. Because Virginia does not conform to this federal five-year NOL carryback rule, the taxpayers carried back the 2008 NOL to the 2006 taxable year. The Tax Department processed the 2006 amended return but could not issue a refund because the taxpayers had claimed a credit for taxes paid to State A on their original return and all taxes paid to Virginia had been refunded. The taxpayers requested permission to apply the 2008 NOL to the 2007 taxable year. The Tax Commissioner denied this request.

Under Virginia's conformity with federal statutes, the Tax Commissioner noted that the taxpayers properly carried the 2008 NOL back to the 2006 taxable year. The entire amount of the 2008 NOL was used to reduce the taxpayers' 2006 FAGI. As a result, the taxpayers' 2006 Virginia tax liability was reduced and the taxpayers did receive the tax benefit of the 2008 NOL according to the Tax Commissioner. The taxpayers asserted that the interaction between State A's tax laws and Virginia policy cause the taxpayers to lose the tax benefit of the NOL. Under State A's rules, nonresidents are required to make an addition for NOLs occurring in other states.
Thus, the taxpayers' 2006 State A tax liability was not reduced by the 2008 NOL. Likewise, because the out-of-state tax credit offset their Virginia liability in its entirety, the taxpayers were not able to claim a refund of Virginia income tax as a result of the 2008 NOL carryback. Because they did not receive the tax benefit from the 2008 NOL, the taxpayers asserted that they should be able to carry the NOL forward to the 2007 taxable year for Virginia income tax purposes.

The Tax Commissioner determined that under the federal statutes to which Virginia conforms, however, the 2008 NOLD would not be permitted to be carried forward because it was used in its entirety to reduce F AGI for the 2006 taxable year. The taxpayers did receive the benefit of a reduced Virginia income tax liability for the 2006 taxable year even though they did not realize an additional refund as a result of the credit for taxes paid to State A. Therefore, the taxpayers were not allowed to carry forward the 2008 NOL to their 2007 Virginia income tax return.

48. Land Preservation Credit Devaluation. P.D. 11-154 & P.D. 11-155 (August 30, 2011). VALLC purchased a large tract of undeveloped land in a rural Virginia locality in June 2002. At the time of purchase, the land was zoned for agricultural and low density single family residential uses. In December 2004, VALLC conveyed a conservation easement on approximately 64% of the tract to a nonprofit organization. Pursuant to the conveyance of the easement, VALLC registered its donation with the Tax Department for purposes of the Land Preservation Credit (the "Credit"). Subsequently, VALLC transferred a portions of the Credit to another pass-through entity based on an appraisal that valued the easement at approximately four times the purchase price of the entire property. The remaining portion of the Credit was passed through to VALLC's members.

Under examination, the Tax Department prepared an appraisal that reduced the value of the easement. The Tax Department revalued the Credit based on this appraisal and issued assessments against the entities that received the transferred Credits. VALLC appealed the revaluation of the Credit contending its appraiser followed the accepted professional standards and the easement was properly valued in VALLC's appraisal. Subsequent to VALLC's appeal, the Tax Department commissioned appraisals from two different third party appraisers. After examining the appraisals, VALLC amended its appeal, arguing that its appraisal most fairly valued the easement.

VALLC's appraiser appraised the value of the property prior to the easement at approximately $36 million and valued it after the easement at $5 million, resulting in the value of the easement at approximately $31 million. The appraiser used a "discounted cash flow analysis" to determine the value of the easement. The appraiser describes the "discounted cash flow analysis" as a combination of using the cost approach, the income approach and the sales comparison approach. The appraiser used individual waterfront lot sales in various counties throughout Virginia as sales comparisons. The appraiser estimated that the 81 lots would sell out in 2½ years while appreciating at two percent per month. The appraiser stated that infrastructure would be funded through a community development authority. The appraiser then added in the timber value. The Tax Department's examination revealed numerous problems with VALLC's appraisal. There were no sales comparisons with other large acreage sales as comparisons.
Instead, the appraiser used comparisons of individual waterfront lots located in other counties, incomplete sales data, and does not support his adjustments. The supporting documentation for proposed development costs was not complete and no support was provided to show that a community development authority would be formed or would fund such infrastructure. The land was part of a larger purchase that was acquired in 2002 for approximately $2,850 per acre. In December 2004, the appraiser's value of the property prior to conveyance of the easement is $22,300 per acre. Such an increase presumes that either VALLC purchased the property at significantly below its fair market value or the subject property appreciated by almost eight times the purchase price in approximately 2½ years. No evidence in the appraisal supported either conclusion.

The Tax Department commissioned two independent third party appraisals subsequent to VALLC's appeal. After reviewing these appraisals, the Tax Commissioner determined that the appraisal prepared by one of the third party appraisers most accurately reflected the value of the subject easement. The third party appraiser valued the property prior to the easement at $8,275,000 and valued it after the easement at $4,375,000, resulting in the value of the easement of $3,900,000. The third party appraiser used the sales comparison approach with four comparables that ranged in size form 298 to 653 acres with water frontage. The value per acre ranged from $3,272 to $8,551 before easement. The third party appraiser then looked at the sale of four comparable properties that sold with limited development potential. The third party appraiser then made some significant adjustments based on the location, size and physical characteristics of these properties. The range of the sales price before adjustments was $965 to $1,339 per acre. After the adjustments were made, the appraiser determined that the value of the property before the easement is $2,700 per acre. The third party appraiser's value of the property before the easement appeared reasonable to the Tax Commissioner and had the best comparables and best analysis in the Tax Commissioner's opinion. The value after the easement is well above the comparables, and the percentage of diminution appeared reasonable to the Tax Commissioner. Accordingly, the Tax Commissioner determined that the appraisal by the third party appraiser represented the most accurate valuation of the easement and upheld the assessments.

Comment: Based on the ruling, VALLC's appraisal sounded as if it had major flaws. In particular, the lack of an analysis using the sales comparison approach with comparable sales was likely fatal to this appraisal. The Tax Commissioner probably did not have a difficult decision on whether to reject VALLC's appraisal. However, language in the ruling is troubling for future appeals. The Tax Commissioner stated that the third party appraiser's value seemed reasonable. What is reasonable? Who in the Tax Department is qualified to make such a determination? When determining reasonableness, what is the standard? The Tax Department does not employ a licensed appraiser. This ruling gives a window into the analyses that should be included in an appraisal but also creates a question of how to determine what is reasonable.

49. **Hurricane Irene.** P.D. 11-156 (September 9, 2011). The Tax Commissioner issued Tax Bulletin 11-9 to provide a one week filing and payment extension to certain individuals and businesses affected by Hurricane Irene.
50. **Servicemembers Civil Relief Act.** P.D. 11-158 (September 16, 2011). The taxpayer, a resident of State A, married a military service member domiciled and stationed in State B in July 2001. In May 2006, the service member was assigned to a duty station in State C. The taxpayer and the service member moved to Virginia. The taxpayer filed a special claim for refund to receive her income tax withholding for the 2009 taxable year. The Tax Department denied the refund on the basis that the taxpayer did not share a domicile with her husband prior to residing in Virginia. Therefore, she did not qualify for the relief under the Servicemembers Civil Relief Act (the "Act"). The taxpayer appealed the denial of the refund contending that both she and the service member were domiciliary residents of State A. The Act provides that military and naval personnel do not abandon their legal domicile solely by complying with military orders that station them in a different state or country whether permanently or temporarily. The Act did not apply to the spouses of military and naval personnel before 2009. The Tax Department has ruled that residency status of a taxpayer requires analysis separate from their military spouse. In Virginia Tax Bulletin (VTB) 10-1 (1/29/2010), the Tax Department explained that the domicile of a military spouse must be the same as the service member in order to be exempt from Virginia's income tax. The determination of a military spouse's domicile requires analysis of the facts and circumstances. The Tax Commissioner examined the facts and circumstances of the taxpayer and her spouse and determined that her spouse was not domiciled in State A. The service member demonstrated his intent to abandon State B by registering his motor vehicles, registering to vote, and electing to withholding individual income tax in State A. However, the documents provided to the Tax Commissioner indicated he never physically resided in State A. Therefore he was never a resident of State A.

51. **Domicile.** P.D. 11-159 (September 19, 2011). The Tax Department received information from the IRS that the taxpayer received wages that may be subject to Virginia income tax. The Tax Department requested information from the taxpayer to determine her Virginia taxable income. When no response was received, the Tax Department issued assessments for the 2007 and 2008 taxable years. The taxpayer appealed the assessments contending that she was employed as a travel nurse and did not receive income from Virginia sources, nor did she reside in Virginia during the taxable years in question. The taxpayer admitted that she did not change her residency from Virginia, and she paid income tax to the states in which the income was earned. The Tax Commissioner upheld the assessments as the taxpayer failed to abandon her domicile.

**D. Opinions of the Attorney General**

No recent opinions.

**III. RETAIL SALES AND USE TAXES**

**A. 2011 Legislation**

1. **Registration with Local Commissioners of Revenue.** House Bill 2183 (Chapter 663) and Senate Bill 1226 (Chapter 674) amended Va. Code §§ 58.1-604.2 and 58.1-613 to authorize local commissioners of the revenue to allow dealers seeking to register for the general Retail Sales and Use Tax and out-of-state contractors who are subject to the special use
tax in Virginia the option of registering with the local commissioner of the revenue, rather than registering with the Tax Commissioner. The local commissioner would be required to follow the guidelines, rules, or procedures set forth by the Tax Commissioner in providing these services. This legislation was effective on July 1, 2011.

2. **Contractors: Sale and Installation of Financial Institution Security.** House Bill 1524 (Chapter 360) amended Va. Code § 58.1-610 to treat any business primarily engaged in the furnishing and installation of tangible personal property that provides electronic or physical security on real property used by financial institutions as a retailer of such property for the purpose of the Retail Sales and Use Tax. As a retailer, the business would be required to collect the tax from purchasers of the tangible personal property providing security, rather than the business paying the tax on its purchase of the materials, even in situations in which such property is installed on real estate that is not for the use of a financial institution. This legislation was effective on July 1, 2011.

3. **Farmers Market Exemption.** House Bill 1942 (Chapter 466) amended Va. Code §§ 58.1-609.2 and 58.1-1707 to provide an exemption from the Retail Sales and Use Tax for agricultural produce and eggs when such items are raised and sold by an individual at retail in local farmers markets and at roadside stands, provided that the annual sales by the agricultural producer do not exceed $1,000. The legislation also provides a litter tax exemption for individuals who raise and sell agricultural produce in local farmers markets and at roadside stands and individuals who sell eggs in local farmers markets or at roadside stands, and whose annual income from such sales does not exceed $1,000, provided that the container the producer provides to hold purchased items has been previously used. This legislation was effective on July 1, 2011.

4. **Spaceport Exemption.** Senate Bill 965 (Chapter 286) amended Va. Code § 58.1-609.3 to remove the sunset date of the Retail Sales and Use Tax exemption for space facilities, space propulsion systems, satellites, space vehicles, space stations, and related items used to conduct “spaceport activities.” The exemption was set to expire on July 1, 2011.

5. **Exemption for Certain Drilling Equipment.** Senate Bill 1343 (Chapter 183) amended Va. Code § 58.1-609.3 to extend the sunset date for the Retail Sales and Use Tax exemption for machinery, tools, and equipment used in the extraction of natural gas or oil from July 1, 2011 to July 1, 2016.

**B. Recent Court Decisions**

No recent court decisions.

**C. Recent Virginia Tax Commissioner Rulings**

1. **Aesthetic Injectable Implants.** P.D. 10-243 (October 21, 2010). The taxpayer requested a reconsideration of a prior appeal in which the Tax Commissioner determined that the sale of aesthetic injectable implants was subject to the sales tax. In its request for reconsideration, the taxpayer contended that the aesthetic injectable implants are
prescribed and used to treat lipoatrophy resulting from drug therapy used in the treatment in human immunodeficiency virus (HIV) patients. As such, the taxpayer contended the implants are used for medically necessary treatments and not only for cosmetic purposes. The Tax Commissioner upheld the prior determination. Virginia Code § 58.1-609.10(10) provides an exemption for "prosthetic devices and . . . other durable medical equipment and devices, and related parts and supplies specifically designed for those products . . . When such items or parts are purchased by or on behalf of an individual for use by such individual." Prosthetic devices are defined in Title 23 of the Virginia Administrative Code 10-210-940 to mean "devices which replace a missing part or function of the body and shall include any supplies physically connected to such devices." The Tax Commissioner was not persuaded by the taxpayer's argument. He determined that the aesthetic injectable implant used to enhance a patient's facial appearance by restoring the skin's volume does not qualify for exemption from the tax as the implant is a cosmetic treatment rather than the replacement of missing body part or function of the body for medical purposes.

2. Manufacturing Exemption: Purging Compounds. P.D. 10-244 (October 21, 2010). The taxpayer manufactures products made of plastic resins. The taxpayer utilizes molds and injection molding machinery in its production process. The injection molding machines are used to manufacture products of different colors and resin formulas. Each machine can produce different products and colors but only one product color or resin formula can be manufactured during a particular production run. Prior to a color or resin formula change for the next production run, the taxpayer uses purging compounds to purge or remove from the machines' injection lines the resin used in the previous production run. The cleaning of the injection lines occurs between production runs so production must be stopped before the cleaning takes place. The taxpayer was audited by the Tax Department and appealed an assessment of use tax on purchases of purging compounds used to clean production machinery. The Tax Commissioner determined that the purging compounds do not qualify for the manufacturing exemption as the cleaning process cannot be an integral part of the taxpayer's production process because production or manufacturing is not occurring when the cleaning is performed.

3. Credit for Use Tax Paid by Customers. P.D. 10-248 (November 4, 2010). The taxpayer is a furniture manufacturer. An audit resulted in the assessment of sales tax on untaxed sales. The taxpayer contests the tax assessed on sales made to two customers because it claims that these customers self-assessed the use tax owed on the untaxed sales made by the taxpayer during the audit period. The taxpayer asks for a credit equal to the use tax claimed to be paid by the two customers on the untaxed sales for the entire audit period. This requested credit would exceed the amount of the sales tax liability applicable only to the untaxed sales of the two customers in question. The Tax Commissioner denied the taxpayer's request for a credit as the information submitted to claim the credit was incomplete. The taxpayer did not provide a signed and dated statement from either customer certifying that (i) the listings provided show all of the untaxed sales made by the taxpayer during the taxpayer's audit period, (ii) such customer correctly reported and remitted all of the consumer use tax owed to the Department of Taxation on such untaxed sales for the audit period in question, and (iii) such remitted use tax was correctly computed based on the taxable sales price of all such untaxed sales of tangible personal property made by the taxpayer to such customer during the audit period in question.
4. **Refund of Sales Tax Charged on Hotel Rooms Rented for 90 continuous Days.** P.D. 10-251 (November 10, 2010). The taxpayer is a hotel that rents blocks of rooms on an ongoing basis to an airline. The airline provides the taxpayer with a monthly crew accommodation manifest that shows the number of rooms the airline's employees have occupied each day of the month. The number of occupied rooms may vary each day. Using this information, the taxpayer computes a sales tax credit for the exempt rooms occupied by the airline's employees and credits this amount on the monthly invoice issued to the airline. The taxpayer requested a ruling on the proper calculation of the credit. Title 23 of the Virginia Administrative Code 10-210-730 interprets Virginia Code § 58.1-609.5(8) which provides an exemption for hotel rooms rented for 90 or more continuous days. Section B of the regulation states:

The tax does not apply, however, to rooms, lodgings or accommodations supplied to a guest for a period of 90 continuous days or more. After a transient has occupied a room or received other accommodations for 90 continuous days or more, the dealer furnishing the room or other accommodations may refund any sales tax actually collected from the person. In filing a subsequent return with the Department of Taxation, the dealer may deduct from gross sales in the place provided the amount of the charges for which the tax was refunded.

Ultimately, the Tax Commissioner overruled a 1990 ruling (P.D. 90-76) that granted permission for the hotel to calculate sales tax refunds for exempt rooms on the first day of each month based on the least number of rooms occupied during the previous ninety day period. In essence, the method in P.D. 90-76 created a cutoff point on the first day of each month for counting the number of days that the hotel's rooms are occupied. In the instant ruling, the Tax Commissioner disagreed that ninety day periods can be set starting with the first day of each month for purposes of administering this exemption. The Tax Commissioner stated that under the statute, a room must be occupied for more than ninety continuous days to qualify for the exemption. The Tax Commissioner also noted that the statute does not state that a specific method should be used to count consecutive days and it does not limit the ninety continuous day requirement in any way.

5. **Mouth Guards.** P.D. 10-254 (November 12, 2010). The taxpayer sells a line of custom fitted sports mouth guards. In instances where a dental patient would like to purchase a mouth guard, the patient's dentist will take an impression of the patient's teeth and send the impression to the manufacturer of the mouth guards. The manufacturer will produce a mouth guard in one of three versions: a mouthpiece designed for the most comfortable fit to be used in non-contact sports; a mouth guard with a strap designed to offer additional protection for contact sports; a mouth guard without a strap to offer additional protection for contact sports. The taxpayer requested a ruling regarding whether one or more of these versions is an exempt dental service, a prescription medical device, a prosthetic device, or safety gear. If the provision of the mouth guards is deemed to be a sale of tangible personal property, rather than a dental service, the taxpayer inquires whether it can accept a resale exemption certificate from the dentist and whether the dentist should charge sales tax on the sale to the patient. The Tax Commissioner opined that the mouth guards do not meet the definition of durable medical equipment to qualify for an exemption. The mouth guards do not appear to serve a medical
purpose because they are not used to address some illness or injury; are for use by the patients in sporting events, not in the homes of the patients as required; and, are used to prevent injury to those participating in sports, and are also designed to improve athletic performance. On the taxpayer's second question, the Tax Commissioner responded that dentists should provide a resale exemption certificate and then charge sales tax on the sale to the patient.

6. **Charcoal Briquettes.** P.D. 10-259 (November 19, 2010). The taxpayer requested a ruling on whether charcoal briquettes qualify for the exemption provided under Va. Code § 58.1-609.10(1). Charcoal briquettes that are the subject of the ruling request are predominately sold in consumer sized bags at retail stores. They are advertised as fuel for use on an outdoor grill and are strictly meant for cooking. The ruling request stated that the charcoal briquettes are not used for heating a home, nor can they be used for cooking inside the home. The Tax Commissioner opined that the charcoal briquettes do not qualify for the exemption provided under Va. Code § 58.1-609.10(1). Virginia Code § 58.1-609.10 I specifically states the types of fuels that are subject to the exemption and do not provide for the exemption to apply to other products, such as charcoal briquettes, used as fuel for home heating purposes or for cooking and heating water.

7. **Pollution Control Exemption & Direct Pay Permits.** P.D. 10-262 (December 14, 2010). The taxpayer is a workwear and textile services company. As a result of an audit, the taxpayer was assessed the tax on untaxed sales and purchases. The taxpayer contests the tax assessed on (i) chemicals for use in the taxpayer's wastewater system, and (ii) sales for which the taxpayer had direct pay permits on file from its customers. The Tax Commissioner adjusted the assessment to remove sales for which the taxpayer had direct pay permits on file. The auditor initially included the sales because the permits were not valid. The Tax Commissioner accepted the same permits. The Tax Commissioner upheld the tax assessed on the purchase of the chemicals for use in the taxpayer's wastewater system as the chemicals were not certified as certified pollution control equipment as required by Virginia Code § 58.1-3660.

8. **Related Entity Purchases and Government Contract.** P.D. 10-263 (December 15, 2010). The taxpayer is an information technology services business that performs contract work for the federal government. The taxpayer was audited and assessed use tax on various purchases, some of which were made in connection with government contracts. The taxpayer appealed and maintained that the audit erroneously includes use tax assessed on purchases that were made by related but separate entities. The taxpayer contended that purchases made in connection with certain government contracts qualify for the resale exemption because the true object of the contracts was the sale of tangible personal property to the federal government. The Tax Commissioner upheld the assessment as the taxpayer did not provide sufficient information proving that the purchases were made by related entities and the true object of the government contracts were the purchase of tangible personal property.

9. **Information Services.** P.D. 10-264 (December 15, 2010). The taxpayer is engaged in providing commercial information about the financial condition of businesses. The taxpayer maintains a database for customers to access firmographic and financial information to evaluate credit and supplier risk. For the new service offering, a paying subscriber will be able
to access a global database via the Internet to perform searches and create customized reports of summary trade data, basic credit scores, legal filings, and general company information. The subscriber may also purchase upgraded data packages and workflow add-ons. For an additional fee, the taxpayer offers six upgraded data packages that provide access to various additional data for viewing online or using to generate a report. The additional fee for an upgraded data package is included in the total annual subscription fee if purchased simultaneously with the core service offering. If purchased at a later date, the upgraded data package is invoiced separately. In addition to upgraded data packages, the taxpayer offers workflow add-ons for an additional fee that is separately invoiced. The workflow add-ons are web-based tools providing a variety of functionalities for customers. Customers receive no software. The taxpayer requested a ruling on the sales tax implications of providing this service. The Tax Commissioner opined that the taxpayer is only providing nontaxable services to its customer and should not collect any sales tax. The Tax Commissioner also noted that the taxpayer will be liable for sales and use tax on purchases of tangible personal property that is used in providing these services.

10. Prescription Drug Exemption. P.D. 10-267 (December 16, 2010). The taxpayer operates a medical practice. The taxpayer was audited and assessed tax on untaxed purchases of tangible personal property for use in its practice. At issue is the tax assessed on the taxpayer's purchase of an injectable tuberculin antigen used to screen for tuberculosis. The auditor concluded that the tuberculin antigen is subject to the tax based on Public Document (P.D.) 91-178 (8/23/91). The taxpayer appealed and maintained that the injectable tuberculin antigen is exempt from the tax as are vaccines and other prescription drugs. The Tax Commissioner adjusted the assessment by removing the injectable tuberculin antigen after discovering the Food and Drug Administration (the "FDA") guidelines and the Virginia Board of Pharmacy classify it as a prescription drug.

11. Glass Sold With and Without Installation. P.D. 10-280 (December 22, 2010). The taxpayer is a glass and glazier contractor that also sells mirrors and other products at retail. The taxpayer maintains a retail shop where inventory of glass, hardware and various metal extrusions are maintained. The taxpayer sells windows, products for maintenance of glass and glass products, shower doors for replacement, and shower enclosures, many of which are special order items. All items are available for pickup by customers or may be installed by the taxpayer. The taxpayer indicates that all items become real property upon installation either by the customer or by the taxpayer. The taxpayer collects sales tax on retail sales of tangible personal property sold without installation. For all installed sales, the taxpayer remits the use tax on the cost of materials and supplies used. The taxpayer requested a ruling verifying that it was collecting, remitting, and paying the proper sales and use tax. The Tax Commissioner verified the taxpayer's tax collection practice and briefly discussed the sales and use tax rules concerning real property contractors.

12. Interstate Commerce: Contract Carrier or Common Carrier. P.D. 11-06 (January 14, 2011). The taxpayer is a manufacturer of concrete structural materials who was assessed with additional sales tax based on sales the taxpayer claimed were exempt. The taxpayer claimed that F.O.B. origin transactions held in the four-month sales sample constitute exempt sales in interstate commerce. According to the taxpayer, the carrier in these contested transactions is registered as an interstate carrier and delivered the taxpayer's product from the
taxpayer’s Virginia plant to its North Carolina customer. The taxpayer appealed the assessment and the Tax Commissioner upheld the assessment. In the appeal, the Tax Commissioner found that the shipping terms for the taxpayer’s products were F.O.B. shipping point in Virginia and the buyer assumed all costs and liabilities related to the shipping of the products. However, the taxpayer argued that the products were shipped to the buyer via common carrier as the carrier is registered as an interstate carrier with the Federal Motor Carrier Safety Administration. The Tax Commissioner determined that there is no evidence that such carrier operated in the capacity of a common carrier under the common definitions of a “common carrier.” Instead, the Tax Commissioner determined that the carrier operated as a contract carrier for the contested deliveries based on the facts presented.

13. **Fancy Soap is not Medicine.** P.D. 11-07 (January 20, 2011). A taxpayer requested a ruling on whether the sale of antibacterial gels, soaps, and sanitizers, including antibacterial hand soaps, antibacterial hand gels, antibacterial hand sprays, antibacterial hand lotions, antibacterial hand wipes, hand gel sanitizers, conditioning hand sanitizers, hand sanitizers, and antibacterial hand foams are exempt under the exemption for nonprescription drugs and proprietary medicines. The Tax Commissioner had previously opined in a Tax Bulletin that the exemption does not apply to cosmetics, toilet articles, devices, food products and supplements, or vitamins and mineral concentrates sold as dietary supplements (except when sold pursuant to a written prescription by a licensed physician). The Tax Commissioner determined that the taxpayer’s antibacterial products are deemed cosmetics or toiletry articles and are subject to the sales tax.

14. **Burden of Proof.** P.D. 11-08 (January 20, 2011). In an exceptionally long determination, the Tax Commissioner adjusted an audit on a variety of issues. In this appeal, there was no overriding issue. However, the one point that can be learned is that the taxpayer has the burden of proof when appealing an assessment. Pursuant to Va. Code section 58.1-205(1), any assessment issued by the Department is deemed prima facie correct. In addition, a taxpayer has the burden of proving an exemption from a tax regardless of whether the transaction is for the sale or purchase of tangible personal property. Convincing evidence must be provided to the Tax Department in support of any exemption claim.

15. **Fabrication.** P.D. 11-09 (January 21, 2011). A professional longarm quilter who owns an industrial sized quilting machine requested a ruling on whether the service it provides is subject to sales tax. The taxpayer’s clients bring completed quilt tops to the taxpayer, along with the backing fabric and batting that goes in between the two layers. The taxpayer puts the three pieces together by quilting all three layers in a design agreed upon with the clients. The quilted piece is returned to the clients with one edge still open. The clients place binding around the perimeter of the quilt after the quilt is returned to them by the taxpayer. The taxpayer stated that the majority of the total cost to its clients is for labor. The only material used by the taxpayer is thread, which represents about 2 to 3 percent of the total cost. In instances where the taxpayer provides the batting to its customers, the taxpayer charges its customers separately for the batting. The Tax Commissioner determined that the services provided by the taxpayer should be considered fabrication and subject to sales tax. Title 23 of the Virginia Administrative Code (VAC) 10-210-560(A) defines “fabrication” as “An operation which changes the form or state of tangible personal property . . .” Furthermore, Title 23 VAC 10-210-560(B) states, “A
person regularly engaged in the fabrication of tangible personal property for sale at retail must collect and pay the tax on the sales price of the property.”

16. **Government Contractor.** P.D. 11-10 (January 21, 2011). The taxpayer was assessed with sales tax on charges for the hosting and maintenance of a database website for use by the government and for charges for exhibits furnished to a federal agency. The Tax Commissioner reviewed each of the contracts and determined that sales tax was not due on the charges and removed them from the audit. For the hosting and maintenance charges, the Tax Commissioner determined that the true object of the task orders was for the provision of exempt services to the federal government. As a service provider, a taxpayer is generally liable for sales tax on its purchases of tangible personal property used or consumed in the performance of such services. However, the Tax Commissioner found that the taxpayer did not purchase any tangible personal property to use in the provision of the services and therefore did not owe any additional sales and use tax as a result of providing these services. As to the charges for the exhibits, the Tax Commissioner reviewed the contract and determined that it was a contract for the provision of tangible personal property despite the incidental services that were provided with the exhibits.

17. **Manufacturing Exemption.** P.D. 11-11 (January 21, 2011). The taxpayer was assessed with additional sales and use tax on various expenses and fixed asset purchases that the taxpayer claimed were exempt under the manufacturing exemption. The Tax Commissioner determined that none of the items qualified for the manufacturing exemption and upheld the assessment. Each group is addressed below:

- The auditor determined that the forklifts were being used to perform construction renovations at a new facility owned by the taxpayer. Despite the taxpayer's argument that the forklifts would be used in an exempt activity upon the opening of the new facility, the Tax Commissioner found that the forklifts were being used in a taxable manner.

- The Tax Commissioner also concluded that floor scrubbers are not exempt under the manufacturing exemption even if they are essential to the cleanliness of the facility.

- The taxpayer used storage racks to store finished products. As the products were finished, the Tax Commissioner determined that the storage racks were not used directly in the manufacturing process.

- Purchases of various items such as tools, cleaners, lubricants, floor brushes, light bulbs, maintenance supplies, and construction materials were deemed taxable as they were also not used directly in the manufacturing process.

In addition to the manufacturing exemption issues, the Tax Commissioner determined that the purchase of desks and tables was taxable purchases of tangible personal property, not real property.
18. **Valid Exemption Certificates.** P.D. 11-15 (February 11, 2011). A taxpayer was audited and assessed sales tax on sales reported as tax exempt but not supported by valid exemption certificates. The taxpayer protested the assessment and presented exemption certificates to substantiate the assessed sales. The Tax Commissioner accepted the exemption certificates after determining each was valid and removed the associated exempt sales from the audit.

19. **Late Filing Penalty.** P.D. 11-18 (February 11, 2011). The Tax Department audited the taxpayer and assessed the taxpayer for the underpayment of sales tax based on collected but unremitted sales tax. Based on its financial capability, the taxpayer filed all returns and paid some of the returns under the 2009 amnesty program. For the unpaid returns, the taxpayer was assessed with tax, interest, and penalty for late filing. The taxpayer entered a payment plan and appealed the assessment of the late filing penalty. The Tax Commissioner denied the taxpayer’s appeal as the taxpayer did not present cause sufficient to allow for a waiver of the late filing penalties.

20. **Tangible Personal Property Sold with Birthday Party Packages.** P.D. 11-24 (February 25, 2011). The taxpayer sells party packages primarily for birthday parties, but also for other special events for children. The parties include a meeting room, a party coordinator, party set-up, games, a t-shirt for the host child, pizza, cake, and invitations, as well as clean-up. The taxpayer requested a ruling regarding whether it should charge the retail sales and use tax on sales of its party package services. The Tax Commissioner determined that the taxpayer is selling party services and that the tangible personal property provided at the parties is incidental to the service. Furthermore, the Tax Commissioner determined that the taxpayer should pay sales and use tax on its purchases of tangible personal property to be provided with the parties.

The taxpayer also requested a refund of remitted sales tax if the Tax Commissioner determined that the sale of party services were not taxable. The taxpayer stated that a flat fee is charged to the customer, but the sales tax is not passed on to the customer for the service requested. Instead, the assumed tax remittance amount is calculated as an accounting function. The Tax Commissioner determined that in order to receive a refund, the taxpayer would need to provide documentation demonstrating that either the tax was paid by the taxpayer directly, or that the taxpayer has refunded to its customers the sales tax paid at the time the purchases took place. The taxpayer would need to file amended returns with the Tax Department as part of the refund process.

21. **Food Samples.** P.D. 11-26 (February 28, 2011). The taxpayer is a food grocer headquartered out-of-state with stores located in Virginia. Food items are selected (either by the corporate office or an individual store) for demonstration in the taxpayer's stores. Once selected, the food item is removed from the taxpayer's resale inventory and prepared for distribution as samples to the taxpayer's customers. The taxpayer requested a ruling on whether the eligible food items given away as samples by the taxpayer in Virginia are subject to the full tax rate or the reduced rate. Relying solely on a 1999 tax bulletin (Tax Bulletin 99-11, October 1, 1999), the Tax Commissioner opined that samples of eligible food products removed from the
taxpayer's resale inventory are subject to the reduced sales and use tax rate. **Query:** In 12 years, why has the Tax Department never promulgated regulations on the reduced sales tax rate for food?

22. **Manufacturing Exemption.** P.D. 11-35 (March 4, 2011). The Tax Commissioner continued the Tax Department’s questionable practice of ignoring the Virginia Tax Code regarding the manufacturing exemption for sales and use tax. This ruling involved a taxpayer who fabricates and installs granite, metal, and concrete countertops. The taxpayer cuts, forms and shapes the raw materials into custom countertops that it installs in real property. The auditor concluded that the taxpayer is a fabricator and a real estate construction contractor. The auditor assessed the use tax on the taxpayer's purchases of machinery used in its fabrication of custom countertops. The taxpayer protested the auditor's conclusion that it is a fabricating contractor and cites the definition of manufacturing in Virginia Code sec. 58.1-602, which provides that businesses classified in SIC code group 32 qualify as "industrial in nature".

Virginia Code sec. 58.1-602 establishes that "industrial in nature" for purposes of the manufacturing exemption “shall include, **but not be limited to,** those businesses classified in codes . . . 20 through 39 published in the Standard Industrial Classification Manual . . .” The Tax Commissioner decided that the taxpayer was not eligible to receive the manufacturing exemption solely on the basis of what he perceives is the proper industry classification of the taxpayer. The Virginia Tax Code clearly states that whether a manufacturer is industrial in nature is not limited to its industry classification. However, the Tax Commissioner did not include any analysis in his ruling other than stating what he perceived as the taxpayer’s industry classification.

**Rant:** The definition itself is clearly problematic as it includes the Standard Industrial Classification manual codes which were replaced in 1997 by the North American Industry Classification System. The translation between the two industrial classification code sets can be confusing for both businesses and the state. However, this is not an excuse for the Tax Commissioner to ignore, not misinterpret, the words in the statute. Unfortunately, this “reading” is not new. I suspect that if this issue is ever litigated, the Tax Department’s policy will change.

23. **Used Car Cutoff Units.** P.D. 11-40 (March 14, 2011). The taxpayer is a car dealership that sells used cars. The taxpayer purchases cutoff units which are installed in cars purchased by customers with less than acceptable credit. An audit by the Department resulted in an assessment for use tax on the purchase of the cutoff units on the belief that the cutoff units remain the property of the taxpayer after the associated vehicle is sold. The taxpayer protested the use tax contending that these units are resold to the customer and taxable to such customers. The Tax Commissioner examined the contract between the taxpayer and its customers and found that the contract specifically considered the cutoff unit to remain the property of the taxpayer after the vehicle purchase. Based on this language, the Tax Commissioner upheld the assessment.

24. **Printed Materials.** P.D. 11-43 (March 17, 2011). The taxpayer is a strategic marketing firm that functions primarily as the marketing department for its clients. The taxpayer provides strategy, creativity and production management services for its clients for
media advertising and non-media campaigns. The taxpayer was audited and assessed with additional sales and use tax for numerous items. The Tax Commissioner upheld the majority of the appeal as the taxpayer did not provide sufficient information on some issues and the purchase of printed materials the taxpayer claimed was exempt was taxable. For the purchase of printed materials to be exempt from sales tax, the materials must be stored in Virginia for 12 months or less and distributed outside of Virginia.

25. **Sale of Compressed Air.** P.D. 11-46 (March 24, 2011). The taxpayer sells and repairs scuba diving equipment. The taxpayer also offers scuba tank fill-ups. The tanks are filled with compressed air using specialized machinery that reduces air volume while increasing its pressure inside the tank. As part of the fill-up, the taxpayer may also check the tanks for safety and perform pressure tests. As a result of an audit by the Tax Department, the taxpayer was assessed the tax on sales of compressed air. The auditor relies upon Title 23 of the Virginia Administrative Code (VAC) 10-210-660, which states that the sale of oxygen is taxable. The auditor also cites Title 23 -VAC 10-210-560, which addresses taxable fabrication labor. The taxpayer protested the assessment and disputed the application of the cited regulations. The taxpayer contends the sale of compressed air was not held taxable in the prior audit. P.D. 87-158 addressed the taxability of tire inflation services through the sale of compressed air. The taxpayer in this case is not selling a service and the authorities cited by the auditor were found to be correct.

26. **Government Contract.** P.D. 11-56 (April 11, 2011). The taxpayer provides information technology services to federal, state, and local governments, as well as to industry clients. The taxpayer appealed an assessment of tax on tangible personal property purchased pursuant to a contract with an agency of the federal government. The taxpayer maintained the contract was for the sale of tangible personal property to the federal government agency, and the purchase of the tangible personal property at issue is exempt of the tax pursuant to the resale exemption. The taxpayer also maintained that the transactions at issue relate to a single order placed by the federal government pursuant to an indeterminate purpose contract. The taxpayer stated that the order directed the taxpayer to acquire office furniture, and the taxpayer enjoyed the resale exemption with respect to these transactions. The taxpayer disagreed with the audit findings that the furniture was purchased pursuant to a real property construction contract. The Tax Commissioner upheld the assessment as the taxpayer did not provide the indeterminate purpose contract. Instead, the Tax Commissioner reviewed the taxpayer’s order, SOW and proposed contract line item number with the government agency to determine the application of the tax on the purchases at issue. The Tax Commissioner determined that the furniture was purchased under a real property construction contract.

27. **Maintenance Contract.** P.D. 11-60 (April 15, 2011). The taxpayer sells new and used motorcycles and operates an in-house parts and repair facility. The taxpayer also sells related goods, such as helmets, clothing, and bike accessories. The taxpayer appealed an assessment of tax on the purchase of software support made during the audit period. The taxpayer contended that the audit staff erroneously assumed a bill that listed a monthly software support fee was for a maintenance contract that provides parts and labor subject to the tax.
pursuant to Title 23 of the Virginia Administrative Code (VAC) 10-210-910. The taxpayer maintained the bill is for remote software support, and the vendor never replaces tangible personal property as part of this support. The taxpayer also maintained that the contract is for labor services only and provided a copy of the service agreement entered into with its vendor. The Tax Commissioner reviewed the service agreement and disagreed with the taxpayer. The Tax Commissioner noted that the service agreement provides for loaner equipment to be provided to the taxpayer as needed. As the maintenance agreement provided for both tangible personal property and services, the Tax Commissioner determined that the assessment was correct.

28. **Trade Name v. Legal Name.** P.D. 11-67 (May 6, 2011). The taxpayer is a wholesaler of medical devices and primarily sells to hospitals, clinics, and nursing homes. As a result of an audit, an assessment was issued for a sale made exempt of the tax. The auditor denied the certificate of exemption because the name on the certificate of exemption for the customer was inconsistent with the purchaser's name on the invoice. The auditor held the sale taxable. The taxpayer protested the tax assessment and asserted that the sale qualifies for exemption. The Tax Commissioner abated the assessment as documentation provided by the taxpayer showed that the taxpayer's legal name is shown on the exemption certificate while the taxpayer's trade name is shown on the invoice.

29. **Medical Exemptions.** P.D. 11-68 (May 11, 2011). The taxpayer purchases a medical food product (VSL#3) that is used for the dietary management of patients with ulcerative colitis, irritable bowel syndrome or an ileal pouch. The medical food product consists of live freeze dried lactic acid bacteria in powder or capsule form and is intended for use under the supervision of a physician. The medical food product is used to maintain adequate and balanced functioning of the human gastrointestinal tract of a patient who, because of chronic medical needs, cannot achieve such by the modification of the normal diet alone. The supplier ships the medical food product directly to the taxpayer and charges the applicable Virginia use tax on the invoice. The taxpayer requested a ruling that the medical food product is exempt from the retail sales and use tax. The Tax Commissioner determined that the medical food product does not qualify for an exemption and is subject to the retail sales and use tax. The Tax Commissioner discussed two exemptions: the medicine and drug exemption and the nonprescription drug exemption. The medical food product does not qualify for the medicine and drug exemption as it does not contain a drug as defined under the Virginia Drug Control Act the federal Food Drug and Cosmetic Act. The medical food product does not qualify for the nonprescription drug exemption as it is not a drug and it does not cure, mitigate, treat, or prevent a disease in human beings. Lastly, the Tax Commissioner noted that the medical food product also does not qualify for the reduced food tax rate as it is not defined as food under the federal Food Stamp Act of 1977.

30. **Real Property Contractor and Seller of Tangible Personal Property.** P.D. 11-69 (May 11, 2011). The taxpayer is a steel fabrication and erection business that was audited by the Department. The taxpayer contracts with general contractors to fabricate and install structural steel for commercial real property construction projects. In addition, the taxpayer fabricates construction materials and supplies ("deliver only items") that are delivered to the job site for use by other contractors. The contract terms and pricing for the deliver only items are
included in the same contracts that require the taxpayer to perform real property construction services. The taxpayer contested the audit assessment of retail sales tax on the deliver only items. The Tax Commissioner upheld the audit and determined that the taxpayer is a real property contractor and a seller of tangible personal property. As a retailer, the Tax Commissioner determined that the taxpayer should have collected and remitted sales tax on its sale of “deliver only” items.

31. Insufficient Documentation. P.D. 11-70 (May 11, 2011). The taxpayer offers information technology solutions and consulting to its customers. The taxpayer offers comprehensive technology solutions to include server, storage, software, application solutions, services and financing to its customers. The Tax Department audited the taxpayer and issued an assessment for additional tax and interest on untaxed sales. The taxpayer disagreed with certain exceptions included in the sales exceptions list and appealed. The Tax Commissioner upheld the assessment. The Tax Commissioner determined that the taxpayer provided insufficient documentation to prove that the taxpayer’s sales were of nontaxable services to that the federal government was the purchaser. Also in several cases, the documentation provided by the taxpayer, such as statements of work, contradicted the taxpayer’s arguments, and indicated that the taxpayer was also selling tangible personal property.

32. Satellite Television Programming Provider Subcontractor. P.D. 11-71 (May 11, 2011). The taxpayer is a subcontractor for a satellite television programming provider (the "programming provider"). The taxpayer installs satellite dish equipment for the programming provider’s customers. The taxpayer purchases the satellite equipment from an affiliate of the programming provider exempt of the tax pursuant to the resale exemption. The taxpayer maintains that once the equipment is installed, and the customer signs a contract with the programming provider, the equipment is transferred to the programming provider and becomes the property of the programming provider. The taxpayer states that it is reimbursed by the programming provider, dollar for dollar, for the equipment installed. The taxpayer maintains that the programming provider charges its customers sales tax on the lease of the equipment. As a result of the Department's audit, the taxpayer contested the use tax assessed on the satellite equipment purchases. The taxpayer contended that it is not liable for the tax because ownership of the property rests with the programming provider. To support its position, the taxpayer provided documentation of its agreement and reimbursement arrangement with the programming provider. The Tax Commissioner upheld the assessment. The Tax Commissioner determined that the programming provider was selling services to its customers and the equipment was incidental to the services. Therefore, the taxpayer’s sale to the programming provider was a taxable sale not eligible for a resale exemption.

33. Accelerated Sales Tax Guidelines. P.D. 11-72 (May 11, 2011). The Tax Commissioner issued revised accelerated sales tax guidelines and rules to reflect changes made by 2011 House Bill 1500 (Chapter 890) which increases the annual threshold for dealers and direct payment permit holders who are required to make an accelerated sales tax payment from $1 million of taxable sales and/or purchases to $5.4 million of taxable sales and/or purchases.

34. Road Service Charges. P.D. 11-74 (May 17, 2011). The taxpayer is a motor vehicle repair business that specializes in retail tire sales and repairs. The taxpayer
performs off-site tire repair and replacement services for commercial vehicles. In a typical transaction, the taxpayer receives a service request and dispatches a service technician to assist the customer. The service technician drives to the customer's site and makes the vehicle operational by repairing or replacing one or more tires on the vehicle. The taxpayer bills the customer a labor charge as a separate line item on the sales invoice. The labor charge may be listed on the sales invoice as "Road Service Call," "Road Service Per Hour" or "OTR Road Service Per Hour." The labor charge is based on the total amount of time taken by the service technician to perform the service call for each customer. The taxpayer does not charge retail sales tax on the road service charges. A separate tire dismounting and mounting charge is also billed on the customer's sales invoice. The taxpayer was audited and assessed sales tax on the road service charges. The taxpayer appealed and argued that the charges are not taxable because they are for the technician's direct labor, which varies for each call. The Tax Commissioner upheld the assessment as he determined that when the taxpayer sold a tire to a customer and included road service charges, the road service charges were taxable as they were incidental to a sale of tangible personal property.

35. Biological Soft Tissue Products. P.D. 11-75 (May 18, 2011). The taxpayer is a manufacturer and seller of two biological soft tissue products. The taxpayer sells the soft tissue products (allograft tissue and a xenograft product) to hospitals and medical service providers used in the treatment of individual patients suffering from damaged soft tissue. The products are used in the repair or replacement of missing or permanently malfunctioning body parts. The FDA classifies the allograft tissue as "banked human tissue" subject to the rules and regulations under the American Association of Tissue Banks. The Virginia Board of Pharmacy concurs with the FDA classification and deems the allograft tissue as a Schedule VI controlled substance under the Virginia Drug Control Act. The xenograft product is porcine dermis that has been processed to form an acellular tissue matrix and supports the repair of damaged tissue by allowing rapid revascularization and cell repopulation required for tissue regeneration. The FDA classifies the xenograft product as a medical device. The Virginia Board of Pharmacy concurs with the federal classification and deems the xenograft product as a Schedule VI medical device under the Virginia Drug Control Act. The taxpayer requested a ruling that the biological soft tissue products qualify for exemption under the provisions of Va. Code § 58.1-609.10(10) and 23 VAC 10-210-940(A).

The Tax Commissioner determined that the allograft tissue is a Schedule VI controlled substance, not a medical device, the sale of which is exempt from sales and use tax. Pursuant to Va. Code § 58.1-609.10(9), the taxpayer may sell the allograft tissue exempt of the tax to a licensed physician, optometrist, licensed nurse practitioner, or licensed physician assistant for use in his professional practice. The taxpayer may also sell the allograft tissue exempt of the tax to a licensed hospital, nursing home, clinic, or similar corporation not otherwise exempt under this section. The Tax Commissioner also determined that the xenograft tissue is a medical device. The taxpayer may only sell the xenograft product exempt of the tax when such product is purchased by or on behalf of an individual for use by such individual.

36. Fabrication. P.D. 11-77 (May 26, 2011). The taxpayer cuts bricks that are used by masonry contractors to construct brick arches. The contractors purchase and furnish the bricks that the taxpayer cuts to their specifications. The taxpayer returns the cut bricks to the
contractors and the bricks are then used to construct arches. The Tax Department audited the 
taxpayer and assessed retail sales tax on the labor charges billed to the contractors for cutting the 
bricks. The Tax Department treated the taxpayer's charges to cut the bricks as taxable fabrication 
labor. The taxpayer appealed and argued that the cutting of bricks does not constitute fabrication 
as the term is defined in the dictionary and that the cutting of bricks is an exempt service. The 
Tax Commissioner upheld the assessment. 23 VAC 10-210-560(A) defines fabrication as "[a]n 
operation which changes the form or state of tangible personal property . . ." The Tax 
Commissioner determined that the "fabrication" definition in the regulations was the proper 
definition of "fabrication" and that the cutting of bricks by the taxpayer was fabrication.

37. **Diplomatic Exemption.** P.D. 11-81 (May 26, 2011). The taxpayer 
operates a restaurant. An audit resulted in the assessment of use tax on various items including 
untaxed purchases of tangible personal property. Sales tax was also assessed on untaxed meals 
sold to churches and foreign diplomats. The taxpayer appealed the tax assessed on meals sold to 
foreign diplomats and asserted that it complied with the Department's diplomatic exemption 
regulation. The taxpayer further asserts that the diplomatic exemption was disallowed by the 
auditor because copies of the diplomat's exemption cards were not in the restaurant's files. The 
Tax Commissioner agreed with the taxpayer. 23 VAC 10-210-694 provides the diplomatic 
exemption and states, "No exemption certificate is required; however, the record of the sale must 
indicate the exemption card number of the purchaser." The taxpayer kept a record of the 
diplomats' exemption card numbers. Also, the taxpayer contested the amnesty penalty applied to 
the assessment. Per P.D. 09-140 (September 28, 2009), as amended by P.D. 09-175 (October 29, 
2009), the 20% post-amnesty penalty does not apply to any uncontested liability that is paid 
within 30 days from the date of assessment and payment for any contested liability remaining 
upon resolution of an appeal under Va. Code § 58.1-1821 that is paid within 30 days from the 
date of the Tax Commissioner's final determination. Based on this language, the Tax 
Commissioner agreed to waive the penalty pending payment of the uncontested liability within 
30 days.

38. **Reconsideration: Coordination with Tennessee Sales Tax.** P.D. 11-86 
(June 2, 2011). The taxpayer is a Virginia business that leases or rents construction equipment 
from a Tennessee lessor for use in Virginia projects. Pursuant to an audit, the taxpayer was 
assessed Virginia use tax on such equipment rentals on the basis that the Tennessee sales tax had 
been erroneously charged and collected on the month-to-month rentals. The taxpayer appealed 
such assessment but the Tax Department upheld it. The taxpayer seeks reconsideration of the 
Tax Department's prior determination. The Tax Commissioner overruled the prior 
determination. The prior determination applied Virginia's long-standing policy with respect to 
the treatment of rentals transported between two states. Under Virginia's policy, each monthly 
invoice is treated as a separate rental and subject to taxation by the state in which the property is 
located. However, Tennessee does not treat the rentals at issue as separate transactions. Instead, 
Tennessee taxes the initial rental agreement and subsequent month-to-month rentals. The Tax 
Department made inquiries with the legal department of the Tennessee Department of Revenue 
(TDOR). Based on a review of some of the taxpayer's redacted rental agreements, the TDOR 
concluded that such rental agreements are taxable in Tennessee because the rental agreements 
are executed in Tennessee, the property is delivered to the customer in Tennessee, and the rental 
period is for a continuous period (*i.e.*, without interruption from the pick up of the property in
Tennessee to the return of the property to the Tennessee lessor). Based on these facts, the Tax Commissioner determined that Tennessee has the first right of taxation. Accordingly, while the rented equipment used in Virginia remains subject to taxation in Virginia, the Tax Commissioner allowed a credit pursuant to Va. Code § 58.1-611 for the Tennessee sales tax paid on the rentals at issue.


40. **Common Carrier Exemption.** P.D. 11-99 (June 9, 2011). The taxpayer is a common carrier of freight and passengers by rail. An audit resulted in the assessment of consumer use tax on various items of tangible personal property purchased for use or consumption in the taxpayer’s operations. The taxpayer appealed the assessment on two types of items assessed in the audit: portable cab heaters and an event recorder. The cab heaters were purchased to repair or replace the heaters on locomotives. The taxpayer contended that the primary operational function of a cab heater is to defrost the windshield of the locomotive. Without a properly, functioning heater, the taxpayer maintained that the locomotive cannot be safely operated when the windshield is fogging. An event recorder is used to record incoming and outgoing phone and radio transmissions with the rail traffic controller. The voice recordings are stored indefinitely on compact discs in the event of a railroad incident requiring investigation. These recordings are also used to conduct efficiency tests of rail traffic controllers to determine whether proper procedures were followed. The taxpayer argued that these items are exempt pursuant to the railway common carrier regulation set out in 23 VAC 10-210-382. The Tax Commissioner agreed that the cab heaters should be exempt, but disagreed that the event recorders should also be exempt. To be exempt under 23 VAC 10-210-382, property must be used directly in the rendition of the service provided by the common carrier. The Tax Commissioner determined that while both items may be essential to providing the transportation service, only the cab heaters were used directly in the rendition of the service.

41. **Unremitted Sales Tax and Reduced Food Tax Rate.** P.D. 11-106 (June 14, 2011). The taxpayer operates a restaurant. The taxpayer collected sales tax at the 5% rate on its sales of food and remitted tax at a 2.5% rate to the Tax Department. The taxpayer was assessed for the difference between its collected and unremitted sales tax. The taxpayer appealed and contended that it only sells food for home consumption and is being assessed as a restaurant in error. In addition, the taxpayer states that it was confused as to the correct filing procedures and believes its reporting error should have been discovered earlier by the Tax Department, thereby avoiding the assessment of penalties and interest. The Tax Commissioner upheld the assessment. The Tax Commissioner determined that the food sold by the taxpayer was not eligible for the reduced food tax rate as the food sold was hot take-out meals. In addition, the taxpayer was required to remit all tax collected under Va. Code § 58.1-625.

42. **Software Purchases.** P.D. 11-112 (June 20, 2011). The taxpayer provides satellite mobile communications. An audit resulted in the assessment of use tax on untaxed purchases of software that the taxpayer contended were electronically downloaded and therefore
not subject to taxation. The Tax Commissioner ultimately adjusted the assessment. The taxpayer provided evidence that the first purchase of software was electronically downloaded, however the Tax Commissioner noted numerous other references to a compact disc or physical delivery. As the totality of the evidence was not clear, the Tax Commissioner upheld the assessment with regard to this purchase. The taxpayer failed to provide requested documentation on the second purchase and the Tax Commissioner upheld the assessment with regard to this purchase as well. The Tax Commissioner removed the third purchase of software from the audit because if it was delivered in a tangible state, the taxpayer's evidence showed that it was delivered to a location outside of Virginia. Thus it was not subject to Virginia sales tax.

43. Toilet Pumping. P.D. 11-118 (June 23, 2011). The taxpayer leases or rents portable toilets. The Tax Department's audit disclosed that during the audit period, the taxpayer charged for pumping services that were not taxed as part of the gross proceeds reported on monthly sales tax returns. The taxpayer disagreed with the application of the tax to pumping services contending these services are optional and have been separately charged. The taxpayer submitted additional documentation stating that the untaxed rentals were treated properly and appealed the assessment. The Tax Commissioner disagreed and upheld the assessment. The issue of whether toilet pumping is subject to sales tax has already been address by the Virginia Supreme Court in LZM Inc. v. Department, 296 Va. 105, 606 S.E.2d 797 (2005). Title 23 of the Virginia Administrative Code 10-210-4040(D) states that the true object of the refuse disposal operations is the actual pickup and removal of the refuse from its customers. However, the true object of the taxpayer's portable toilet operation was the provision of the tangible personal property, the portable toilet, not the waste removal pumping services. Customers would have no need for pumping services without the provision of the portable toilets. Accordingly, the pumping services were incidental to the provision of the tangible personal property.

44. Installation Charges. P.D. 11-127 (July 6, 2011). The taxpayer installs home theatre systems for both residential and commercial customers. The taxpayer was assessed with sales tax on separately stated installation charges. Citing Virginia regulation Title 23 VAC 10-210-4040(C)(3) which provides, "[s]eparately stated labor or service charges for the repair, installation, application or remodeling of tangible personal property are not subject to the tax," the Tax Commissioner determined that the separately stated charges were exempt and removed the charges from the audit.

45. Government Contractor. P.D. 11-128 (July 6, 2011). The taxpayer is a general contractor located in Virginia. An audit resulted in the assessment of consumer use tax on various purchases of construction materials and other tangible personal property used or consumed by the taxpayer. The taxpayer contests the use tax assessed on tangible personal property used or consumed in connection with its real property construction contracts with a local public school system to provide materials, labor, equipment, and supplies to construct a bus garage addition at a public school and a canopy at an existing bus garage. The taxpayer appealed contending that materials used in the performance of such contracts are not subject to taxation as the local government was exempt from sales tax. The Tax Commissioner upheld the assessment as the governmental exemption only applies to tangible personal property purchased directly by the government.
Government Mandated Purchases. P.D. 11-130 and P.D. 11-131 (July 21, 2011). The taxpayer is a public water service corporation. Following an audit by the Department, the taxpayer was assessed use tax on purchases of materials and equipment. The taxpayer protested the assessment and argues that the purchases are exempt under the manufacturing exemption. The taxpayer also asserted that the purchases should be exempt of the tax because they were required by the Virginia Department of Health. The Tax Commissioner did not have enough information to determine if the manufacturing exemption was applicable and sent the audit back to the auditors. However, the Tax Commissioner determined that the purchases were not exempt due to their mandate by the Virginia Department of Health. Title 23 VAC 10-210-920(B) instructs that the requirements of federal, state or local law do not automatically render the purchases made under such requirements tax exempt. Although certain purchases by the taxpayer may be required by the Virginia Department of Health, those requirements do not make the purchases at issue exempt from the retail sales and use tax.

Transportation Charges. P.D. 11-134 (July 26, 2011). The taxpayer is a contract furniture dealer. The taxpayer purchases furniture from manufacturers for contract customers and has the furniture shipped (transportation-in) to an independently owned and operated warehouse. The independent service contractor delivers and installs the furniture for the taxpayer's customers. In this case, the taxpayer passed the transportation-in charge on to its customers as a separate charge on the sales invoice but did not collect the sales tax on such charge. An assessment was issued on these charges. The taxpayer contended the auditor characterized the transportation-in charges as shipping and handling and erroneously taxed such charges. The Tax Commissioner disagreed and upheld the audit. Title 23 of the Virginia Administrative Code 10-210-6000 interprets Va. Code § 58.1-609.5(3) and provides that the tax does not apply to transportation or delivery charges added to a taxable sale, provided such transportation charges are separately stated on the invoice to the customer. Such charges, commonly known as "transportation-out," are charges for the delivery of the tangible personal property from the seller to the purchaser. Exempt transportation and delivery charges do not include charges from a manufacturer to a retailer's place of business, commonly known as "transportation-in" relating to purchases for resale.

Spray Paint Booths. P.D. 11-135 (July 26, 2011). The taxpayer manufactures wood cabinets, tables and similar products. The taxpayer was audited by the Tax Department and assessed use tax on the purchase of two paint spray booths. The taxpayer appealed contending that the paint spray booths qualify for the manufacturing exemption. The taxpayer contended that the paint spray booths are used directly in its production process and are an indispensable and immediate part of its manufacturing process. The paint spray booths are enclosed spaces that create a special environment for the controlled application of finishes. The paint spray booths allow adjustments to be made to drying times, temperature and humidity and limit the amount of dust particles and other airborne contaminants that can potentially degrade the finishes that are applied to products. The taxpayer states that the use of the paint spray booths insures the integrity and uncompromised quality of the taxpayer's finished products.

Relying on previously issued rulings, the Tax Commissioner determined that certain components of the taxpayer's paint spray booths may qualify for the manufacturing exemption. However, the paint spray booths are not fully exempt. While the paint booths at issue employ
new technology that enhances the quality of the products produced by the taxpayer, the structural components do not play a direct role in and are not an immediate part of the production process. In this case, the walls, ceiling, and floor of the paint booths are not constructed of special materials or built in a manner that rises to the specialized nature and use of the insulated panels, lead doors or the clean room framework discussed in the public documents cited by the taxpayer.

49. **Breast Implants.** P.D. 11-141 (August 3, 2011). The taxpayer performs cosmetic and reconstructive breast surgery for (i) post mastectomy patients, (ii) patients, with a lumpectomy or partial removal of a segment of the breast and (iii) patients with significant abnormalities in development that result in very little or no breast volume, or significant differences between one breast and the other. As a result of the Tax Department's audit, the taxpayer was assessed the tax on breast implants used in breast augmentation. Breast implants deemed to have been purchased for reconstructive surgery were not taxed. The taxpayer appealed asserting that the contested implants are used to replace a missing body part and are exempt. Virginia Code § 58.1-609.10(10) provides that the retail sales and use tax does not apply to durable medical equipment. “Durable medical equipment is equipment that (i) can withstand repeated use, (ii) is primarily and customarily used to serve a medical purpose, (iii) generally is not useful to a person in the absence of illness or injury, and (iv) is appropriate for use in the home.” In order to qualify for the durable medical equipment exemption, the contested breast implants must meet the criteria established in Va. Code § 58.1-609.10(10). Based on the information provided on the taxpayer's web site, breast implants for breast augmentation are typically performed to enlarge small or underdeveloped breasts, restore the natural breast volume that may have decreased as a result of pregnancy, weight loss, aging or for women that desire improved breast balance when each breast is a different size. The Tax Commissioner determined that the contested breast implants can withstand repeated use and are appropriate for use in the home. However, he also determined that the final two criteria are not met because the breast implants used in breast augmentation do not appear to serve a medical purpose and because they are not used to address some illness or injury. Therefore, the Tax Commissioner upheld the assessment.

50. **Manufacturing Exemption.** P.D. 11-142 (August 5, 2011). The taxpayer manufactures absorbent materials for fluid control. The taxpayer's products are used in food packaging, hygiene products, decorating and filtration. The taxpayer protested the use tax assessed on a tensile testing system and a metal detector.

The tensile testing system is used in conjunction with another machine that produces the absorbent pouches used in food packaging and hospital bed protection. The seals on the pouches must meet pre-determined standards to ensure they do not burst during customer use. The machine uses rolls of film to produce the pouches. Each time a new roll of raw film is readied for use, it is tested for sealant strength using the tensile testing system. Based on test results, the machine operator will make the necessary adjustments to the machine's sealant bars to bring the seal strength to acceptable levels. The tensile testing system is also used to test the final product. The taxpayer stated that the tensile testing system sits next to the machine on the production line. However, the auditor observed the tester in a separate area behind the machine. The tester was held taxable because the auditor concluded that the machine was not part of manufacturing based
on its location away from the main production area and its performance of tests on raw materials and finished products.

The metal detector is used to test metal levels in completed sanitary pad and diaper products. Because Food and Drug Administration regulations forbid metal contaminants in these products, the manufacturer discards the product if metals are discovered. The metal detector sits in the production area and testing takes place on completed and bagged products that have not been packaged and sealed into boxes for sale. The metal detector was held taxable as the auditor concluded that the testing of the final completed product was outside the manufacturing production process.

The Tax Commissioner determined that both the tensile testing system and a metal detector qualified for the manufacturing exemption and were therefore exempt from use tax. The tensile tester was held taxable as the auditor determined film testing took place before actual production. The auditor believed that the film testing at issue in this case is pre-production and not a part of the manufacturing process. The strength test takes place after the film has been stored at the plant site for use in production. As discussed in Va. Code § 58.1-602, production includes the "storage and handling" of raw material. In P.D. 99-291, the Tax Commissioner determined that testing of raw materials qualifies as "handling" and is part of the production process. The metal detector is used to determine if the final product is acceptable for packaging and shipment. This testing determines if the product is suitable for sale based on pre-set standards. Although the products are bagged, they are not packaged for final sale. The definition of "manufacturing" in Va. Code § 58.1-602 states that production ends when the product is completed for sale and conveyed to a warehouse at the production site. Because the tested products have not yet been packaged for final sale and shipped to the warehouse, this testing also takes place within the scope of the production process.

51. **Government Contractor.** P.D. 11-146 (August 10, 2011). The taxpayer provides various products, systems, and services to prime contractors who are engaged in classified or unclassified contracts with the federal government. An audit resulted in the assessment of sales tax on untaxed sales of tangible personal property made to federal government contractors and use tax on untaxed purchases of tangible personal property used or consumed by the taxpayer. Due to insufficient documentation, the Tax Commissioner either upheld the related portion of the assessment or gave the taxpayer a second chance to produce sufficient documentation. On the portion of the assessment involving classified contracts, the Tax Commissioner acknowledged that the Tax Department failed to provide an auditor with adequate security clearance to view the classified contracts. The Tax Commissioner sent this portion back to audit and directed an auditor with adequate security clearance to contact the taxpayer.

52. **Internet Café.** P.D. 11-148 (August 12, 2011). The taxpayer operates an Internet cafe. The taxpayer was assessed sales tax on unreported sales of prepaid telephone access cards. The taxpayer was also assessed use tax on fixed assets, food, and software licensing purchases. The taxpayer protested the assessed amounts as unrepresentative of its business activity. The Tax Commissioner adjusted the assessment for certain issues. Despite the taxpayer's argument that the access cards solely provided Internet access, the Tax Commissioner
cited evidence that the cards may also be used for telephone calls. As Virginia Code § 58.1-602 defines tangible personal property to include "telephone calling cards upon their initial sale," the Tax Commissioner upheld the portion of the assessment related to the access cards. The taxpayer also argued that its food purchases were exempt from sales and use tax as the food was provided on a complimentary basis to the taxpayer's customers. The Tax Commissioner determined that the food purchases were subject to the use tax because they were used by the taxpayer to provide complimentary food to its customers. However, the assessment applied the use tax at the full 5% rate, not the reduced 2.5% food tax rate. The Tax Commissioner ordered this correction. The assessment of use tax on asset purchases was upheld as the taxpayer failed to provide sufficient information. Finally, the taxpayer protested the assessment of sales tax on software fees. The taxpayer stated it is not in the business of selling tangible personal and is leasing the software from a third party for its own use. The Tax Commissioner examined the pertinent contracts and determined that the taxpayer was in fact leasing tangible personal property, not licensing software, under the contract. The Tax Commissioner upheld this portion of the assessment.

53. Internet Service Provider Exemption & Amnesty Penalty. P.D. 11-149 (August 17, 2011). The taxpayer is a provider of business solutions. An audit resulted in the assessment of sales tax on sales of maintenance contracts and other tangible personal property and use tax on incorrectly taxed purchases. The taxpayer contested several sales held in the audit. One of the contested sales involved the purchase of equipment under the Internet service provider exemption. Per Va. Code § 58.1-602, a taxpayer must provide proprietary content to be eligible to receive the exemption. The Tax Commissioner examined evidence from the taxpayer's website and the quarterly report and determined that the taxpayer solely provided Internet access and no proprietary content. Therefore, the Tax Commissioner upheld this portion of the audit. The remaining contested sales were resolved by an examination of evidence. The taxpayer also requested abatement of post-amnesty penalties, which the Tax Commissioner agreed to. The Tax Commissioner determined that the taxpayer paid the uncontested portion of the assessment 31 days after the date of assessment as directed in writing by the Tax Department. The amnesty guidelines require payment of any uncontested liability within 30 days from the date of assessment to be eligible for a penalty waiver. Despite the failure to pay this portion of the liability within the timeline provided by the guidelines, the Tax Commissioner waived the penalty as the taxpayer complied with the Tax Department's written instructions.

D. Opinions of the Attorney General

No recent opinions.

IV. PROPERTY (AD VALOREM) TAXES

A. 2011 Legislation

1. Appeals of Tax Assessments to Boards of Equalization & Circuit Courts. House Bill 1588 (Chapter 232) and Senate Bill 1350 (Chapter 184) amended Va. Code §§ 58.1-3331, 58.1-3379, and 58.1-3984 to provide that on appeal the taxpayer has the burden of rebutting the presumption that the valuation determined by the assessor is correct and showing
by a preponderance of the evidence that the property is valued at more than its fair market value.

In any appeal of an assessment by an owner of real property containing less than four residential units, the assessor will be required to provide written notice to the owner at least 45 days before the appeal informing him of his right to review the assessment records and to have the assessor make a physical examination of the property. The assessor will have 15 days from the written request of the taxpayer in an appeal to provide such assessment records or would be required to present at the hearing: i) copies of the records, ii) testimony to explain methodologies to determine the assessed value of the property, and iii) testimony that states that the assessed value was arrived at in accordance with generally accepted appraisal practices. In appeals to a circuit court, the taxpayer will be required to make the written request for assessment records no later than 45 days prior to trial, unless otherwise ordered by the court.

Under current law, a property owner may appeal to a Board of Equalization or a circuit court seeking relief from an erroneous real property assessment. In all such cases, the taxpayer has the burden of proving that the property in question is valued at more than its fair market value, that the assessment is not uniform in its application, or that the assessment is otherwise not equalized. In order to receive relief, the taxpayer must produce substantial evidence that the valuation determined by the assessor is erroneous. This legislation will be effective for tax years beginning on or after January 1, 2012.

2. Statements of Income and Expense. House Bill 1526 (Chapter 200) amended Va. Code § 58.1-3294 to clarify that statements of income and expense may be used in a complaint before a Board of Equalization as long as the statements are submitted to the Board of Equalization no later than the appeal filing deadline of the Board. Under current law, the failure to present statements of income and expense to the assessor bars the owner of the property from introducing such information in any judicial action to correct an erroneous assessment. This legislation was effective on July 1, 2011.

3. Judicial Sale of Certain Real Estate. Senate Bill 1478 (Chapter 324) enacted Va. Code § 58.1-3965.2 to authorize localities to provide for proceedings to conduct a judicial sale of certain real property located in a community development authority or on abutting property within a community development authority when a special tax or special assessment imposed on the property is delinquent on the first anniversary of the date on which the tax or assessment became due. Under current law, when taxes are delinquent on the last day of the year following the two-year anniversary date on which such taxes were due, localities are authorized to sell the real estate for the purpose of collecting all delinquent taxes on such property. The legislation contains an emergency clause and has been in force from the date of its passage.

4. Transfer of Certain Tax-Delinquent Properties to the Locality. House Bill 1532 (Chapter 688) amended Va. Code § 58.1-3970.1 to lower the threshold percentage of taxes and other liens, together with penalty and accumulated interest, on property from 50 percent to 35 percent of the assessed value of the parcel for real estate in the Cities of Norfolk, Richmond, Hopewell, Newport News, and Petersburg for a special commissioner to convey the property to the locality in lieu of a public sale at auction. The legislation would also lower the threshold percentage, if only taxes, from 25 percent to 15 percent of the assessed value of the parcel for a
special commissioner to convey real estate in the Cities of Norfolk, Richmond, Hopewell, Newport News, and Petersburg to the locality. This legislation was effective on July 1, 2011.

5. **Membership of Boards of Equalization.** House Bill 1470 (Chapter 10) amended Va. Code §§ 58.1-3371, 58.1-3373, and 58.1-3374 to authorize circuit courts for any locality to appoint up to two alternate board members to serve on local boards of equalization if a member of the board is absent or abstains. Under the terms of the legislation, the alternate members would have the same terms, qualifications, and compensation as those of regular board members. The chairman of the board would be authorized to select one of the appointed alternates to serve in the absent or abstaining member’s place and to vote on any proceeding in which a regular member is absent or abstains. The number of alternate members the circuit court would be authorized to appoint would differ, depending upon whether the alternates were appointed to a permanent board of equalization, whether the alternates were appointed in a county operating under a county executive or county manager form of government, or whether the alternates were elected to a temporary board. Under current law, local governing bodies are required to appoint a board of equalization of real estate assessments for the year following any year a general reassessment or annual or biennial assessment is conducted, unless a permanent board of equalization is in place in that locality. The Board must consist of three or five members, depending upon the type of board of equalization to which the board member is appointed. This legislation was effective on July 1, 2011.

6. **Furnishing Statements of Income and Expense to Assessor.** Senate Bill 784 (Chapter 137) amended Va. Code § 58.1-3295 to clarify that a real estate assessor may require an owner of real property with four or fewer residential units that is operated in whole or in part as affordable rental housing to furnish to the assessor a statement of the income and expenses attributable to the property when the owner applies to the locality to have the real property assessed as affordable rental housing. This legislation was effective on July 1, 2011.

7. **Collection of Taxes By Town and County Treasurers.** House Bill 2019 (Chapter 475) and Senate Bill 909 (Chapter 431) amended Va. Code § 58.1-3910 to authorize county treasurers and the treasurers of any towns located within these counties to enter into reciprocal agreements, with the approval of the respective governing bodies, authorizing the town treasurer to collect real and personal property taxes owed to the county, and the county treasurer to collect real and personal property taxes owed to the town. Each treasurer collecting taxes under the agreement is required to account for and pay over whatever amount is owed to the other locality. This legislation was effective on July 1, 2011.

8. **Disabled Veteran Exemption.** House Bill 1645 (Chapter 769) and Senate Bill 987 (Chapter 840) enacted Va. Code §§ 58.1-3219.5 and 58.1-3219.6 to provide the necessary statutory authorization required by the constitutional amendment to Article X, § 6 of the *Constitution of Virginia*, adopted by voters authorizing the General Assembly to exempt from taxation for tax years beginning on or after January 1, 2011, real property that is the principal residence of a veteran (or widow or widower of a veteran) if the veteran has been determined by the United States Department of Veterans Affairs or its successor agency pursuant to federal law to have a 100 percent combat-related, permanent, and total disability. The surviving spouse of a veteran is eligible for the exemption, so long as the death of the veteran occurs on or after
January 1, 2011, the surviving spouse does not remarry, and the surviving spouse continues to occupy the real property as his or her principal place of residence. The legislation also provides that the veteran or surviving spouse claiming the exemption must file with the commissioner of the revenue in which the property is located, on forms to be supplied by the locality, an affidavit or written statement setting forth the name of the veteran and spouse, if any, whether the real property is jointly owned, and certifying that the property is occupied as the veteran's principal place of residence. The veteran must also provide documentation from the U.S. Department of Veterans Affairs or its successor agency pursuant to federal law to have a 100 percent combat-related, permanent, and total disability. This legislation contains an emergency clause and has been in force from the date of its passage.

9. Partial Exemption for Structures in Redevelopment or Conservation Areas or Rehabilitation Districts. House Bill 1899 (Chapter 460) and Senate Bill 785 (Chapter 423) amended Va. Code §§ 58.1-3219.4 and 58.1-3220 to require the local governing body of a locality in which partial exemptions for structures in redevelopment or conservation areas or rehabilitation districts are available to provide written notification to the property owner of the amount of the assessment of the property that will be exempt from real property taxation and the period of such exemption. The legislation also clarifies that the exempt amount is a covenant that runs with the land for the period of the exemption, and would prohibit local governing bodies from reducing that amount during the period of the exemption. This legislation contains an emergency clause and has been in force from the date of its passage.

10. Separate Classification for Certain Historic Buildings. House Bill 1851 (Chapter 571) and Senate Bill 860 (Chapter 581) enacted Va. Code § 58.1-3221.5 to classify buildings listed on the Virginia Landmarks Register, not including the real estate or land on which they are located, as a separate class of real property from all other real estate and authorizes localities to tax such property at a lower rate than the general class of real property, so long as the building is maintained in a condition such that it retains the characteristics for which it was listed on the Virginia Landmarks Registry. Under current law, generally all real estate is considered to be one class of property subject to the same rate of tax. This legislation was effective on July 1, 2011.

11. Real Property Tax Relief for Elderly or Disabled. House Bill 2278 (Chapter 496) and Senate Bill 1073 (Chapter 438) amended Va. Code §§ 15.2-936, 15.2-2407, 21-118.4, 58.1-3211.1, 58.1-3212, 58.1-3213, and 58.1-3215 to provide the necessary statutory authorization required by the constitutional amendment to Article X, § 6(b) of the Constitution of Virginia, adopted by voters authorizing the General Assembly to permit local governments to establish their own income or financial worth limitations for purposes of granting property tax relief for homeowners who are 65 years of age or older, or permanently and totally disabled. The legislation also requires that if the governing body establishes a net financial worth limitation, net financial worth must be computed by adding together the total net financial worth, including the present value of all equitable interests, as of December 31 of the immediately preceding calendar year, of the owners, and of the spouse of any owner, of the dwelling. The provisions of this legislation is effective for tax years beginning on or after January 1, 2011. The legislation contains an emergency clause and has been in force from the date of its passage.
12. **Real Property Tax Relief for Residences with Chinese Drywall.** Senate Bill 942 (Chapter 46) amended Va. Code § 58.1-3284.2 to provide that an owner of residential property containing defective drywall may request the commissioner of the revenue or other assessing official where the property is located to reassess the property. After confirmation by the local building official of the presence of defective drywall, the commissioner of the revenue or other assessing official will (i) determine the amount by which the defective drywall has reduced the assessed value of the property, (ii) provide written notice to the owner of the reduction in value, and (iii) reassess the value of the property accordingly. The local building official will confirm the presence of defective drywall only after a review of the test results submitted to him from a testing agency that is approved by the building official and procured by the owner of the residential property. The local governing body may, by ordinance, designate the residential property containing defective drywall as a rehabilitation district for purposes of granting the owner a partial real estate tax exemption. This legislation was effective on July 1, 2011.

13. **Land Use Valuation.** House Bill 1672 (Chapter 12) amended Va. Code § 58.1-3237.1 to add James City County to the list of localities permitted to enact an ordinance to exclude land lying in planned development, industrial or commercial zoning districts established prior to January 1, 1981 from its land use assessment program. James City County will also be permitted to provide that property subject to its land use assessment would no longer be eligible for land use assessment and would be subject to roll-back taxes at the time the zoning is changed, at the owner's request, to a more intensive nonagricultural use. However, agriculturally zoned property that is subsequently rezoned to a more intensive use which is complementary to agricultural use will not lose its eligibility, provided that the agricultural activity continues to be operated on the property and the property continues to be owned by the same owner. This legislation was effective on July 1, 2011.

14. **Improvements to Real Property: City of Poquoson.** Senate Bill 957 (Chapter 146) amended Va. Code § 58.1-3221.1 to reclassify improvements to real property located in the City of Poquoson as a separate class of real property. As a result of this reclassification, Poquoson is authorized to impose a real property tax on improvements to real property at a rate of tax which is different than the rate applicable to all other real property and is not zero. The bill authorizes Poquoson to levy the real property tax on improvements after publishing a notice in a newspaper having general circulation in the locality at least seven days before the levy is made and giving the citizens an opportunity to appear before, and be heard by, the local governing body on the subject. This legislation was effective on July 1, 2011.

**B. Recent Court Decisions**

1. **Riverside Owner, L.L.C. v. City of Richmond,** 282 Va. 62 (2011). The taxpayers sued the City of Richmond in the Circuit Court of the City of Richmond, under Va. Code § 58.1-3984, for relief from a real property tax assessment. The City and the taxpayer's predecessor entered into a development agreement ("Agreement") in 2003. The Agreement called for the construction of a mixed-use building with a parking garage through the rehabilitation of power plant buildings. In exchange for the rehabilitation of the power plants, the City promised that "the [Property] shall qualify for the full benefit of the Rehabilitated Real
The Rehabilitated Real Estate Program ("Program") provides a partial exemption from real estate taxes for qualifying rehabilitated property. The taxpayer's predecessor applied for the Program in 2002. At that time, the City Assessor's office determined that the power plants each had a base value of $500. Construction on the Property began in 2003 and was completed two years later at a cost of approximately $63.8 million. In August 2005, the Property was sold to the taxpayer for $85 million. One month later, the City Assessor's office conducted its final inspection of the Property and determined that, based on the cost of the rehabilitation, its office space had a value of $63.8 million. In May 2006, the City Assessor's office revised that amount to roughly $45.2 million for purposes of the Program. The difference in the two amounts was due to the application of the "Chandler policy."

In 1981, former City Assessor Richard A. Chandler established a new policy for determining a property's initial rehabilitated assessed value under the Program. Pursuant to the policy, he explained in an internal memorandum, "[t]he final estimate of value for rehabilitation credit will be determined as of the date of the application and computed only on the information which was available at the time the base value was established." The purpose of the policy, he further explained, was "to eliminate from the final estimate of value any enhancement created by something other than rehabilitation or physical improvement." The policy was not published in the Program's materials until 2006. So, in accordance with the Chandler policy, the City Assessor's office took the value of the Property's office space as of 2005, when the rehabilitation was completed, and backdated it to 2002, when the Property's former owner, Richmond Power Plant, applied for the program. Because of this backdating, the value of the office space was reduced from $63.8 million to approximately $45.2 million for purposes of the Program.

The taxpayer paid its 2006 real estate tax bill for the Property under protest and appealed to the City Assessor, challenging the Chandler policy. The City Assessor denied the appeal, concluding that the Chandler policy was consistent with Virginia Code § 58.1-3221 and City Code § 27-83, and was therefore "correct and legal." In 2008, the taxpayer filed a "Complaint and Application for Relief from Erroneous Assessments of Taxes Upon Real Property" pursuant to Virginia Code § 58.1-3984. The taxpayer alleged that the Chandler policy was "ultra vires and an improper usurpation of legislative power by the City Assessor, and such policy [was] an improper methodology for setting the assessed value of rehabilitated improvements, and otherwise illegal." The taxpayer sought a refund of the excess taxes paid because of the application of the Chandler policy, interest on the overpayments, and attorney's fees. The trial court held the policy used to assess the property departed from Virginia Code § 58.1-3221 and former Richmond, Va., City Code § 27-83, and ruled in favor of the taxpayers, but denied their request for attorneys' fees. The city and the taxpayers appealed.

Virginia Code § 58.1-3221 provides:

A. The governing body of any county, city or town may, by ordinance, provide for the partial exemption from taxation of real estate on which any structure or other improvement no less than twenty years of age, or fifteen years of age if the structure is located in an area designated as an enterprise zone by the Commonwealth, has undergone substantial rehabilitation . . . subject to such conditions as the ordinance may prescribe . . . . The governing body of a county,
The city or town may establish criteria for determining whether real estate qualifies for the partial exemption authorized by this provision and may require the structure to be older than twenty years of age, or fifteen years of age if the structure is located in an area designated as an enterprise zone by the Commonwealth, or place such other restrictions and conditions on such property as may be prescribed by ordinance.

B. The partial exemption provided by the local governing body may not exceed an amount equal to the increase in assessed value resulting from the rehabilitation as determined by the commissioner of revenue or other local assessing officer.

City of Richmond Code § 27-83, which was adopted pursuant to Code § 58.1-3221, in pertinent part, provides:

(a) Exemption authorized. Partial exemption from real estate taxes is provided for qualifying property rehabilitated if eligible according to the terms of the Constitution, the Code of Virginia and the provisions of this section and Section 27-86.

(b) When deemed rehabilitated. For the purposes of this section, commercial or industrial real estate shall be deemed to be substantially rehabilitated when a structure has been so improved by renovation, reconstruction or replacement as to increase the assessed value of the structure by no less than forty (40) percent. Upon receipt of an application for tax exemption, the Assessor shall determine the assessed value (hereafter referred to as base value) of the structure prior to commencement of rehabilitation. Such assessment shall serve as a basis for determining whether the rehabilitation undertaken increases the assessed value of such structure by at least forty (40) percent. The application to qualify for tax exemption shall be effective until December 31 of the third calendar year following the year in which the application is submitted. When it is determined that a forty-percent increase in assessed value has occurred, the tax exemption shall become effective beginning on January 1 of the next calendar year.

(g) Commercial or industrial structures in enterprise zones. Commercial or industrial structures that are qualified under this section shall be entitled to a fifteen-year period of exemption in the full amount of the difference in taxes computed upon the base value and the initial rehabilitated assessed value of the property for each year of the fifteen (15) years.

The City argued that "initial rehabilitated assessed value" does not mean the first assessed value after rehabilitation, i.e., the first value after rehabilitation that is determined by an appraiser for tax purposes. The Court disagreed. Contrary to the City's contention, the parenthetical in City of Richmond Code § 27-83 does not define "initial rehabilitated assessed value," but rather describes what remains when the base value is subtracted from the initial rehabilitated assessed value, which is then used to calculate the amount of the tax credit to which an owner is entitled.
under the Program. Accordingly, the Court read "initial rehabilitated assessed value" to mean what it says: the first assessed value after rehabilitation and that the Chandler Policy is inconsistent with Virginia Code § 58.1-3221 and former Richmond, Va., City Code § 27-83.

C. Recent Virginia Tax Commissioner Rulings

1. Local Mobile Property Tax. P.D. 10-282 (December 27, 2010). The taxpayer, a resident, of the County, purchased Federal Aviation Administration (FAA) titles for two antique aircraft. The County determined that the taxpayer owned the two aircraft and assessed property tax for the 2009 tax year using the valuation provided in an aircraft blue book. The taxpayer appealed the assessment to the County, contending he did not actually own the aircraft or any tangible airplane parts. He asserted that all he actually owned was FAA titling documents that would permit him to rebuild the aircraft and use the "N" number from the original aircraft, which had long been destroyed or scrapped by their owners. In its final determination, the County concluded that the taxpayer owned two aircraft based on the FAA information and upheld the assessment. The taxpayer appealed the County's determination to the Tax Department contending he did not have any tangible aircraft in the County during that tax year at issue. For the County to impose property tax on the aircraft based on their blue book value, the aircraft must be in a tangible form and sitused in the County. The Tax Commissioner was unable to conclude that the taxpayer owned tangible aircraft subject to the tax in the County and remanded the case back to the County in order for it to determine whether the taxpayer's aircraft were physically located in the County during the 2009 tax year.

D. Opinions of the Attorney General

1. Transfer of Duties to Assessor. 2010 Op. Va. Att'y Gen. 10-042 (December 17, 2010). The Commissioner of the Revenue for the City of Suffolk asked whether the devolution of the Commissioner of the Revenue's duties with respect to the assessment of real estate to a city real estate assessor transfers to the assessor the Commissioner's responsibility under section 58.1-3984(B). Section 58.1-3984(B) provides that, under certain circumstances, the Commissioner of the Revenue of a locality must apply to the appropriate court for the correction of an erroneous assessment. However, the City of Suffolk's charter transferred all of the duties with respect to the assessment of real estate for taxation from the Commissioner of Revenue to the City Assessor. The Attorney General opined that the charter transfers the Commissioner of the Revenue's responsibility under section 58.1-3984(B) to the extent section 58.1-3984(B) applies to assessments of real property to city real estate assessor.

2. Separated Spouse Information Required on Exemption Application. 2010 Va. Att'y Gen. 10-062 (November 5, 2010). The Commissioner of the Revenue for Loudoun County asked whether a married person, applying for a real property tax exemption must include his or her spouse's net worth when calculating net combined financial worth to satisfy the condition set forth in section 58.1-3211(2) if the spouse's name does not appear on the deed to property and such spouse either has separated from or abandoned the applicant. Section 58.1-3211 imposes restrictions on granting property tax exemptions including, in pertinent part, that "[t]he net combined financial worth, including the present value of all equitable interests...of the owners, and of the spouse of any owner... shall not exceed $200,000." The Attorney General
opined that the spouse's net worth must be included on the application irrespective of whether such spouse has separated from or abandoned the applicant or whether the spouse's name appears on the deed.

3. **Meaning of “Substantial Gainful Activity”.** 2010 Va. Att’y Gen. 10-107 (October 22, 2010). The County Attorney for Arlington County asked whether an applicant for property tax relief under section 58.1-3210, who has obtained a signed statement from a doctor stating that the applicant is permanently incapacitated, yet who has been a fulltime employee of a governmental agency for over a decade, where he currently earns an annual salary of $44,000, is engaged in "any substantial gainful activity." The Attorney General opined that an individual who is employed full-time and who continues to earn a substantial salary is engaged in "substantial gainful activity" and is, therefore, ineligible for tax relief under section 58.1-3210.

4. **Exemption for Veterans and Their Surviving Spouses.** 2011 Va. Att’y Gen. 11-061 (July 15, 2011). Four members of the General Assembly asked twelve questions regarding the property tax exemption for veterans and their surviving spouses of veterans if the veteran is disabled due to service connected injuries. The Constitution of Virginia was amended in 2010 to include this exemption. The first question was when the exemption was effective. The Attorney General opined that it became effective on January 1, 2011. A number of questions asked whether a surviving spouse would qualify for the exemption if the deceased spouse passed away prior to the effective date. In each different scenario presented, the Attorney General opined that a surviving spouse would not qualify for the exemption if the deceased spouse passed away prior to the effective date regardless of the scenarios presented. Furthermore, there are no additional legal means to extend the exemption to these surviving spouses other than amending the Virginia Constitution again. Among the other conclusion reached by the Attorney General:

1. The local Commissioner of the Revenue is responsible for administering the exemption;
2. The General Assembly may enact legislation authorizing the Commissioner of the Virginia Department of Veteran Services to promulgate rules and regulations regarding the administration and/or implementation of the exemption;
3. Real property includes both land and a dwelling;
4. The exemption is not available to a veteran who has placed his property into a revocable inter vivos trust with or without his spouse or an irrevocable trust; and
5. The exemption does not follow a surviving spouse if the spouse chooses to relocate.

V. **PROCEDURAL**

A. **2011 Legislation**

1. **Reduced Accrual of Interest on Appeals.** Senate Bill 1152 (Chapter 295) amended Va. Code § 58.1-1822 to provide that once a tax liability has been assessed and an application for correction has been filed by the taxpayer, the amount of the tax paid by the taxpayer shall accrue interest at the normal Virginia interest rate until nine months from the date of assessment. After nine months, the amount shall accrue interest at the “Federal short-term
rate” established pursuant to § 6621(b) of the Internal Revenue Code. If the Tax Commissioner determines that any portion of the assessment is correct, interest would resume accruing at the rate prescribed by Va. Code § 58.1-15 thirty days after the date of the Tax Commissioner’s determination. This legislation is effective for administrative appeals filed on or after July 1, 2011.

2. Judicial Notice. House Bill 2145 (Chapter 800) amended Va. Code §§ 2.2-4031, 58.1-204, and 58.1-205 to provide that tax bulletins, guidelines, and other published documents, published by the Tax Department are accorded judicial notice. The legislation also requires the Tax Department to publish tax bulletins and guidelines and would include posting the documents on the Tax Department’s website as a permitted publication method instead of distribution to national and state tax services. The provisions of this legislation are effective in proceedings commenced on and after July 1, 2011.

3. Local Tax Collection. House Bill 1425 (Chapter 383) amended Va. Code § 58.1-3919.1 to reduce the period of delinquency before which private collection agents may be used to collect delinquent local taxes from six months to three months. This legislation also removes the exclusion of real estate taxes from the local taxes that a treasurer may refer to private collection agents for collection. This legislation was effective on July 1, 2011.

4. Filing Tax Returns By Commercial Delivery. House Bill 2141 (Chapter 368) amended Va. Code § 58.1-9 to recognize that tax returns or payment of taxes remitted by means of a commercial delivery service, in an envelope or sealed container bearing a confirmation of shipment on or before midnight of the day the return is due, are timely filed. Under current law, a tax return or payment remitted by mail and bearing a postmark from the United States Postal Service on or before the due date is considered timely filed, regardless of when the taxing entity actually receives it. This legislation was effective on July 1, 2011.

5. Fillable Forms. Senate Bill 1450 (Chapter 680) enacted Va. Code § 58.1-202.3 to require the Department of Taxation to make all state tax forms fillable in portable document format (PDF) for periods beginning on and after January 1, 2012 on the Department of Taxation’s website. The Department of Taxation would begin making fillable forms available no later than January 1, 2012 and would make all fillable forms available no later than March 1, 2013.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Live Chat. P.D. 10-247 (October 28, 2010). The taxpayer appealed an assessment of unreported sales and use taxes from auctions conducted by the taxpayer. The Tax Commissioner ultimately upheld the assessment. However, the taxpayer claimed that it received erroneous advice via the Tax Department’s Live Chat function on its website. The taxpayer received the advice after the audit so the Tax Commissioner did not consider it. However if the
taxpayer received erroneous advice via Live Chat before he did not collect sales tax, it is conceivable that the Tax Department would be precluded from assessing additional tax.

2. Incomplete Appeal & Amnesty Penalty. P.D. 11-21 (February 18, 2011). The Tax Commissioner determined that a taxpayer is barred from filing an application for correction of an assessment issued on July 13, 2010. The taxpayer filed a notice of intent to appeal on September 21, 2010, but did not file a complete appeal by October 11, 2010. Furthermore, the Tax Commissioner noted that the amnesty penalty assessed against the taxpayer was correct. For certain assessments, the amnesty penalty is not imposed if (1) the audit is the taxpayer’s first audit, (2) no penalty was applied to the tax deficiency, (3) any uncontested liability is paid within 30 days from the date of assessment, and (4) payment for any contested liability remaining upon resolution of an appeal under Virginia Code sections 58.1-1821 or 58.1-1825 is paid within 30 days from the date of the Tax Commissioner’s or the court’s final determination. As the taxpayer never established that it was contesting all or a portion of the liability at issue by filing a complete appeal, the uncontested tax was not paid within 30 days of the date of assessment and the imposition of the amnesty penalty was determined to be correct. See also P.D. 11-25 (February 28, 2011).

3. Failure to Furnish Information. P.D. 11-28 (February 28, 2011). The taxpayer claimed multiple itemized deductions on his Virginia individual income tax return. Under audit, the auditor requested supporting documentation to substantiate the deductions claimed. When the information was not received, the auditor disallowed the deductions and issued an assessment for additional tax and interest. The taxpayer appealed the assessment, stating that he would provide documentation to substantiate the deductions. The Tax Commissioner upheld the assessment as the taxpayer failed to provide the promised documentation.

4. Filing of Tax Returns and Payments by Commercial Delivery Service. P.D. 11-96 (June 8, 2011). The Tax Commissioner issued Tax Bulletin 11-5 to provide information regarding the filing of tax returns and payments by commercial delivery service.

5. Failure to Provide Information. P.D. 11-126 (July 6, 2011). The taxpayer manufactures and distributes pipes. An audit by the Tax Department resulted in the assessment of additional sales tax on combined shipping and handling charges. The taxpayer appealed and contended that the charges are mislabeled on the invoices and are for shipping only. The taxpayer argued that the invoiced shipping and handling charges are for shipping services only that are provided by third party common carriers. Additionally, the taxpayer stated that any amount it charges above its shipping costs are not for handling, as those costs are included in the sales price of the product. However, the taxpayer presented no documentation to support its position. Because this was the taxpayer’s first audit, the Tax Commissioner gave the taxpayer an additional 30 days to provide documentation supporting its position with the audit returned to the audit staff. Observation: Apparently taxpayers who are audited for the first time can appeal their assessment without providing any documentation and taking a position that is inconsistent with precedent and still get 30 additional days to make their case.
6. **Written Guidance.** P.D. 11-132 (July 21, 2011). The taxpayer sells and repairs tires. The taxpayer was assessed sales tax on tire disposal fees related to the sale of tires. The taxpayer protests the assessment on the basis that it was given the incorrect guidance by the Tax Department when it requested instructions as to the correct application of the tax. During its initial registration with the Tax Department, the taxpayer stated it was verbally instructed that tire disposal fees were not subject to the tax and did not collect sales tax on the fees based on this guidance. When the taxpayer was subsequently assessed during the audit for failure to collect sales tax on tire disposal fees, it contacted the Department via "Live Chat." Transcripts of "Live Chat" document the taxpayer being advised that tire disposal fees are not subject to sales and use tax. The Tax Commissioner upheld the assessment. Per Virginia Code § 58.1-1835, taxpayers may only rely upon written advice from the Tax Department. As the “Live Chat” session occurred after the assessment was issued, the taxpayer did not rely on the advice given.

D. **Opinions of the Attorney General**

1. **Issuance of Refunds of Local Taxes to taxpayers.** 2010 Op. Va. Att’y Gen. 10-094 (December 22, 2010). The Commissioner of the Revenue for Spotsylvania County requested an Opinion of the Attorney General on (i) what a local commissioner of the revenue is required by Virginia law to tender to the board of supervisors in order to "certify" the commissioner’s determination that a local tax assessment was erroneous; (ii) what is the role of a county attorney in providing his "consent" to the commissioner of the revenue's determination and to what extent the commissioner of the revenue's determination may provide an affected taxpayer's local tax filings, with attached business and financial records to the county attorney; and, (iii) whether a county attorney's review of and consent to a downward adjustment of a local real estate tax assessment by the county's board of equalization is a necessary predicate to the county's issuance of a refund of excess taxes that a taxpayer initially paid.

The Attorney General responded that (i) a county commissioner of the revenue's "certification" of a correction of a local tax assessment means that the commissioner should provide written verification that he has determined that the original local tax assessment paid by the affected taxpayer was erroneous; (ii) § 58.1-3(A)(2) authorizes a county commissioner of the revenue to supply to the attorney for his county any information that is necessary to enable the attorney to make an informed decision as to whether to consent to the commissioner of the revenue's determination; and (iii) that a county attorney's consent to a reduction of a real estate tax assessment by a county board of equalization is not a prerequisite to the county's issuance of a refund of excess taxes.

VI. **BUSINESS LICENSE TAXES**

A. **2011 Legislation**

1. **Imposition of BPOL Tax on Taxable Income.** House Bill 1437 (Chapter 685) amended Va. Code § 58.1-3702 to allow localities the option to impose the Business, Professional and Occupational License ("BPOL") tax on either the gross receipts or the Virginia taxable income of a business. The BPOL tax is a tax on businesses for the privilege of engaging in business at a definite place of business within a Virginia locality. Currently, the measure or
basis of the BPOL tax is the gross receipts of the business. This legislation was effective on July 1, 2011.

2. **Business License Incentive Program.** House Bill 1587 (Chapter 25) amended Va. Code § 58.1-3703 to clarify that localities may provide an exemption, refund, rebate, or other relief from the BPOL Tax for a period not to exceed 2 years for businesses locating for the first time in a locality. The bill also provides that a business would not be deemed to locate for the first time in a locality on the basis of merger, acquisition, similar business combination or a change in business form. This legislation was effective on July 1, 2011.

3. **Unprofitable Businesses.** Senate Bill 1408 (Chapter 188) amended Va. Code § 58.1-3703 to authorize localities to exempt BPOL tax or fees of any business that loses money and does not have a profit for the taxable year. The business will be required to offer its income tax return to the local commissioner of the revenue as proof of the losses. Eligibility will be determined annually, and it would be the obligation of the business owner to submit the applicable income tax return. This legislation will be effective for taxable years beginning on or after January 1, 2012.

**B. Recent Court Decisions**

1. **Ford Motor Credit Company v. Chesterfield County, Supreme Court of Virginia Record No. 092158 (March 4, 2011).** The Supreme Court of Virginia again dealt with a locality imposing the BPOL tax on gross receipts generated outside its geographical boundaries. The taxpayer, Ford Motor Credit Company, (hereinafter “FMCC”), is a financial services provider primarily to the automobile, purchase or loan lessee environment. Until its closing in 2007, the Chesterfield County branch was one of FMCC's 300 sales branches and, at one time, was one of three operating in Virginia. Approximately 75 percent of the Chesterfield County branch's business was consumer financing for the purchase of vehicles. The Chesterfield County branch was tasked with contacting and training dealers to increase vehicle sales and the number of loans made by FMCC, approving loan applications, determining loan interest rates, and providing programs and training for dealers concerning FMCC's financing programs. During the period in question, the Chesterfield County branch reported to a regional office located elsewhere in Virginia, while offices in Baltimore, Maryland; Nashville, Tennessee; Omaha, Nebraska; Mesa, Arizona; and Livonia, Michigan also played a role in managing and administering loans that originated in FMCC's Chesterfield County branch. FMCC also had centers that dealt with loans originating in the Chesterfield County branch, and elsewhere, that subsequently went into default.

Typically, the Chesterfield County branch reviewed loan applications from customers who sought to purchase a vehicle from a Ford dealership, and decided whether or not to approve the loan based on procedures set out by FMCC headquarters in Dearborn, Michigan. While the Chesterfield County branch determined interest rates, sometimes approving a lower rate for a customer with a good credit score, most of the interest rates were set by the headquarters in Michigan. When the Chesterfield County branch approved a loan application, it notified the dealership, where the customer actually executed the installment loan contract. The
headquarters in Michigan wired funds electronically to the dealership's bank account which were used to finance the customer's purchase. After the documents were signed and returned to the Chesterfield County branch, all of the documents were forwarded to an office outside of Chesterfield County, which then serviced the loan. The Chesterfield County branch did not handle any aspect of the loan after forwarding the documents to another office.

The local Commissioner of Revenue determined that all of the gross receipts of FMCC's loans were generated by the Chesterfield County branch and were not apportionable. Pursuant to Virginia Code sections 58.1-3702 and -3703(A), and Chesterfield County Code sec. 6-4, the locality levied BPOL taxes against FMCC in the amounts of $327,137.85, $306,435.65, $432,620.96, and $449,740.59 for the tax years 2001, 2002, 2003, and 2004, respectively. FMCC paid the taxes and applied for a refund, which was denied. FMCC then filed suit in Chesterfield County Circuit Court and argued that the gross receipts should have been apportioned to Chesterfield County to reflect the limited contribution of the Chesterfield County branch to FMCC's nationwide business. Ultimately, the circuit court rejected FMCC's arguments by finding that the Chesterfield County branch's marketing and closing operations generated the gross receipts in the form of interest and fees and the other FMCC locations merely serviced and collected the gross receipts.

FMCC appealed the circuit court's ruling to the Supreme Court of Virginia based on three issues. First, FMCC argued that the Chesterfield County branch's gross receipts are subject to apportionment. FMCC also argued that the gross receipts must be apportioned by payroll, per Virginia Code section 58.1-3703.1(A)(3), as it is impractical or impossible to determine to which definite place of business gross receipts should be attributed. Finally, FMCC argued that it is entitled to a deduction under Code § 58.1-3732(B)(2) as that statute provides that receipts attributable to business conducted in another state in which the taxpayer is liable for an income or other tax based upon income should be deducted from gross receipts that would otherwise be taxable.

The Supreme Court of Virginia agreed with FMCC that the gross receipts are subject to apportionment and should be apportioned by payroll. While FMCC's Chesterfield County operations could not produce 100% of its gross receipts, the locality essentially argued that gross receipts were derived from the exercise of FMCC's licensed privilege to conduct a financial services business as the gross receipts were generated when a loan was made to a customer. The Court said that, "To accept the County's position . . . would mean that all services necessary to FMCC's deriving gross receipts from its consumer installment and inventory financing operations were provided at the [Chesterfield County] Branch." Clearly, these were not the facts of the case. The Court rejected the locality's argument noting that only a receivable was created in Chesterfield County and no gross receipts were yet generated.

Next, the Court dealt with whether it was impractical or impossible to determine to which definite place of business gross receipts should be attributed. An expert provided by FMCC at trial testified that there was no way to take one payment or one dollar of interest and distribute it among all of the activities that may come into play on a loan. The locality did not

1 Ford Motor Credit Company v. Chesterfield County, Supreme Court of Virginia, Record No. 092158 at P. 25.
2 The BPOL tax is imposed on gross receipts, not receivables.
contradict this testimony at trial. The expert’s testimony led the Supreme Court of Virginia to conclude that it would be impossible or, at least, impractical to perform that process on every one of the approximately 20,000 loans processed annually by the Chesterfield County branch.

C. Recent Virginia Tax Commissioner Rulings

1. Definite Place of Business. P.D. 10-275 (December 16, 2010). The taxpayer, a contractor, leased space at a self-storage facility in the City where it stored five commercial vehicles and all its equipment. The facility was owned by an unrelated third party and provided storage space for vehicles and equipment for the general public. Every work day, the taxpayer’s employees met at the facility to get assignments and start their work day. Construction jobs were assigned and the trucks were loaded at the facility. The owner conducted all business by mobile phone. The taxpayer did not receive mail (e.g., bills, tax returns, or payments) at the storage facility, and no administration functions were performed in the City. The County examined the taxpayer and determined that it did not have a definite place of business in the City for the tax years at issue. As such, the County issued BPOL tax assessments to the taxpayer for the 2006 and 2007 tax years because the taxpayer's sole owner resided in the County. The County also determined that some of the taxpayer's commercial vehicles garaged at the storage facility weighed less than 10,000 pounds. The County assessed these vehicles to the owner's home in the County and assessed BTPP tax for the tax years at issue. The taxpayer paid the assessments and appealed the County's assessments, contending its definite place of business was located in the City and that all of its vehicles weighed more than 10,000 pounds. In its final determination, the County determined that the taxpayer's definite place of business was not directed or controlled from the facility in the City and, by default, the taxpayer's definite place of business reverted to the County under Va. Code § 58.1-3700.1. The County also held that the taxpayer was liable for the BTPP tax on any vehicles that weighed less than 10,000 pounds because they were directed and controlled from the definite place of business in the County. The taxpayer filed an appeal with the Tax Commissioner contending it did not have a definite place of business in the County and that none of its vehicles were subject to the BTPP tax in the County. The Tax Commissioner upheld the assessment. According to the Tax Commissioner, characteristics that may help determine whether the location is a definite place of business include, but are not limited to, the following on-site activities: (1) a continuous presence; (2) having an office with a phone; (3) the reception of mail; (4) having employees; (5) record keeping; (6) and advertising or otherwise holding oneself out as engaging in business at the particular location. The taxpayer’s facility in the County was only used for storage and as a meeting place for employees which was not sufficient enough for the Tax Commissioner to determine that it is a definite place of business. The Tax Commissioner did not have enough information to determine if the automobiles weighed more than 10,000 pounds and remanded that issue to the County.

2. Definite Place of Business. P.D. 10-277 & P.D. 10-278 (December 22, 2010). The taxpayer is a government contractor with a definite place of business in City A. The taxpayer is primarily engaged in providing repair services at military installations in City A and surrounding localities. City A has classified the taxpayer as a business service and has assessed BPOL tax based on the gross receipts generated from the services directed and controlled from the definite place of business within its borders. The taxpayer is currently performing repair
services on vehicles at a military base located in City B. The taxpayer leases a trailer located on
the base that is furnished with desks and computers. Repair personnel use the trailer for
meetings and to interact with the City A facility. Clerical staff employed at the trailer provide
administrative support and organize technical documentation. A telephone land line is installed
in the trailer, but the phone number is not advertised to the public. The name of the taxpayer is
not posted on any signage on or near the trailer pursuant to military requirements. The taxpayer
does not negotiate any contracts or solicit any business from the trailer. The taxpayer did not
receive mail at the trailer and contracts performed at the base list the City A office as the
taxpayer’s address and place of contact.

City B contacted the taxpayer concerning its business license obligations to City
B. City B believes the activities conducted by the taxpayer as the military base are subject to
licensure in City B. City A avers that the taxpayer does not have a definite place of business in
City B, and all the services conducted at the base are directed and controlled from the office in
City A. Cities A and B requested an advisory opinion as to whether the taxpayer is subject to
the BPOL tax in City B. The Tax Commissioner opined that the taxpayer’s definite place of
business is City B. According to the Tax Commissioner, characteristics that may help determine
whether the location is a definite place of business include, but are not limited to, the following
on-site activities: (1) a continuous presence; (2) having an office with a phone; (3) the reception
of mail; (4) having employees; (5) record keeping; (6) and advertising or otherwise holding
oneself out as engaging in business at the particular location. The determination was based on
prior rulings. In P.D. 10-104 (7/18/2010) and P.D. 02-153 (12/11/2002), the Tax Department
opined that contractors that maintained a trailer at a particular site on a daily and continuous
basis for 30 days may have established a definite place of business at the locality in which the
trailers were located. The Department found that the contractor’s physical presence, along with
having some of the characteristics of having a definite place of business, such as having a phone
was indicative of having a definite place of business.

taxpayer appealed a determination by a county commissioner of the revenue that it should have
been paying BPOL tax to the County. The taxpayer is a corporation that performs tree and
stump removal, tree pruning, landscaping and tree planting, grinding and recycling, mulch
supply and commercial land clearing. The taxpayer also performs demolition projects and is
engaged in the construction of buildings, additions, and retaining walls. These jobs are
performed in various Virginia localities as well as outside Virginia. The taxpayer holds a Class
A construction license and is licensed as a contractor for BPOL purposes in the City. The
taxpayer’s operates from a facility leased in the City. Its sales staff and business estimators work
from the City facility, and all of its equipment is located and dispatched from the City. The City
facility includes a machine shop operated to maintain all of the taxpayer's equipment. The
taxpayer has a phone at its City facility and holds itself out as operating from the City on its
business cards. The taxpayer's president directs the operations of the taxpayer from his office at
the City location or from his home, which is also located in the City.

In addition to its City office, the taxpayer also has an office in the County. The
taxpayer's office in the County has four individuals that perform record keeping and
administrative functions. Business documents, including license applications and tax returns,
reflect the County address. The telephone directory and the taxpayer's Internet web page provide the County phone number and the address of the County facility. Under audit, the County issued assessments for the 2006 through 2009 taxable years. In its final determination addressing the taxpayer's local appeal, the County concluded that the taxpayer was subject to BPOL tax because it had a definite place of business within its jurisdiction. The County also concluded that the taxpayer should be classified as a business service provider rather than a contractor. The taxpayer appeals the final local determination to the Tax Commissioner contending: (1) it should be classified as a contractor; (2) it does not have a definite place of business in the County; and (3) all of its business was directed and controlled from the City facility.

The Tax Commissioner determined that the taxpayer should be classified as a business service provider as tree surgeons, trimmers, and removal services are listed as business services under Title 23 VAC 10-500-500. The fact that the taxpayer holds a contractor's license has no bearing on its classification for BPOL tax purposes. However based on other tasks performed by the taxpayer, the Tax Commissioner noted that the taxpayer might be operating multiple businesses which may require more than one license. The Tax Commissioner also determined that the taxpayer had a clear definite place of business in the County. Despite having a definite place of business, the activities performed in the county (administrative functions) were merely ancillary. However, if the taxpayer is conducting its contracting activities within County, and these activities generate more than $25,000 in gross receipts in any year, the Tax Commissioner determined that the County may require that the taxpayer get a business license and assess a tax on those gross receipts.

4. Imposition of County BPOL in Town. P.D. 11-03 & 11-04 (January 7, 2011). A county and a town jointly requested an advisory opinion as to whether the county is permitted to impose the BPOL tax on lessors of real property within the town. The Tax Commissioner determined that a county may not impose a BPOL tax on businesses operating in a town that lie within its borders unless it has the town's permission. Specifically, a county may only impose a BPOL tax on the lessors of real property within a town that lies within the county, if the town gives them such permission.

5. Deduction for Gross Receipts Attributable to Business in Other States. P.D. 11-13 (January 21, 2011). The taxpayer is a provider of computer-based services with multiple locations in the locality and throughout the world. The taxpayer apportioned its gross receipts based on payroll as it was impossible or impractical to determine the situs of its gross receipts under the general situs rules. The taxpayer calculated its gross receipts by first deducting from its total world wide gross receipts those gross receipts generated from each state in which it filed an income tax return and then multiplied applied the payroll apportionment percentage. The locality audited the taxpayer and disallowed the deduction for the gross receipts. The taxpayer appealed the assessments to the locality, contending it was not permitted a deduction for gross receipts attributable to business conducted in other states. Ultimately, the locality upheld the audit assessment, concluding that the deduction afforded by Va. Code § 58.1-3732 B 2 is not applicable to the taxpayer because the taxpayer was not otherwise taxable by the locality. The taxpayer appealed the locality's final determination to the Tax Commissioner, claiming it has been denied the deduction for gross receipts attributable to its business conducted in other states or foreign countries.
The Tax Commissioner determined that the taxpayer was entitled to the deduction per Virginia Code sec. 58.1-3732(B)(2) provided it can show some evidence that employees from the definite place of business in the locality earn, or participate in earning, receipts attributable to customers in other states where the taxpayer filed an income tax return. The amount of any deduction would be determined by multiplying the total out-of-state tax receipts by the same payroll factor used to determine situs of gross receipts. Before reaching this conclusion however, the Tax Commissioner noted that the taxpayer's method of claiming the deduction was incorrect. The statutory construction of Virginia Code sec. 58.1-3732 establishes that the taxable measure of gross receipts must first be determined before any deduction is, granted. In other words, receipts must first be assigned or sitused to a definite place of business. Then, from those assigned receipts, a taxpayer may take the deduction. The taxpayer was taking the deduction before apportionment.

6. Change in Form of Entity. P.D. 11-27 (February 28, 2011). The taxpayer, a single member limited liability corporation, began operating in the City in March 2009. Prior to establishing the taxpayer, the single owner operated the same business as a sole proprietorship. The taxpayer continued to operate under the original business license issued to the sole proprietorship during 2009. As the result of an audit, the City issued a license fee to the taxpayer for the 2009 tax year based on the City's finding that the taxpayer was a new business. The taxpayer appealed the assessment to the City. The taxpayer also claimed that the license fee should have been prorated based on the number of months it was in operation during 2009. In its final determination, the City upheld the assessment, concluding that the change in the taxpayer's legal status created a new and separate business, and Virginia law does not provide for the proration of license fees. The taxpayer appealed to the Tax Commissioner by offering the same arguments presented in its appeal to the City. In addition, the taxpayer requested the fee be waived due to personal and financial hardship. The Tax Commissioner upheld the imposition of the fee. Because the taxpayer, a limited liability company, is an entity different from a sole proprietorship, it must be regarded as a beginning business in 2009 and subject to a license tax or fee for the 2009 tax year. Furthermore, the Tax Commissioner noted that it is in the sole discretion of local taxing authorities to accept offers in compromises such as the reduced fee the taxpayer is requesting from the Tax Commissioner.

7. Motor Carriers. P.D. 11-42 (March 16, 2011). During the tax years at issue, the taxpayer, a resident of the City, was a tractor trailer driver that owned a commercial tractor that was leased to a business (the motor carrier) located in State A. The taxpayer operated the truck as an independent contractor on behalf of the State A company. The City determined the taxpayer was engaged in a licensable business activity within its jurisdiction for the tax years at issue. As such, the City issued BPOL tax assessments to the taxpayer for the 2009 and 2010 tax years. The taxpayer appealed the City's assessments. In its final determination, the City determined that the taxpayer's residence was his definite place of business because he was engaged in business but maintained no definite place of business elsewhere. The taxpayer filed an appeal with the Tax Commissioner contending he did not have a definite place of business in the City and he was not engaged in a licensable business activity within the City. In addition, he
argued that the motor carrier is exempt from the BPOL tax. The Tax Commissioner disagreed and upheld the assessment. The Tax Commissioner stated that while motor carriers who were formerly certified by the Interstate Commerce Commission or presently registered for insurance purposes with the Federal Highway Administration are exempt, the drivers are not exempt unless they hold the same licenses. The Tax Commissioner also determined that the taxpayer's home was his definite place of business and that his gross receipts would be sitused there. The Tax Commissioner cited P.D. 99-84 which said that the home of truck driver who owned his truck, but leased it to an out-of-state business and operated the truck as an independent contractor, would be considered to be a definite place of business if he did not maintain a definite place of business elsewhere. Finally, the Tax Commissioner sent the appeal back to the City to determine if the leasing of the taxpayer's tractor constituted a separate licensable business.

8. Definite Place of Business. P.D. 11-49 (April 4, 2011). The taxpayer is a limited liability company with four members. The taxpayer formed as a joint venture in State A and took over federal contracts from one of the members (Member A) to perform business services for the federal government. The services are performed by employees of Member A at Member A's facilities in Virginia and other states. Member A bills the taxpayer for the services it performs, which in turn, bills the federal agency for the services plus a markup. The taxpayer's corporate address was at Member A's definite place of business for nine months in 2009. While the taxpayer's business address was in Virginia, it had no employees or property. It did not have a phone number or an address listed in the phone book. It did not have its name on the building or listed in the building directory. The taxpayer's business records were kept at a facility in State B. In January 2010, the taxpayer's address was changed to the State B facility. The taxpayer requested an advisory opinion as to whether it has a definite place of business in Virginia. The taxpayer asks whether it had a BPOL filing requirement for the nine months in 2009 that it was located in the Virginia locality. Finally, the taxpayer asks how it should situs gross receipts without employees if it is subject to BPOL tax. The Tax Commissioner determined that the presence of the taxpayer at Member A's office does not constitute a "regular and continuous" business activity. The mere sharing of office space with an entity in a Virginia locality without having employees, property, phone, or in any way advertising or holding itself out as engaging in business in that particular location is not sufficient to create a definite place of business.

9. Statute of Limitations & Business Classification. P.D. 11-83 (June 2, 2011). The taxpayer is a corporation with two shareholders. One shareholder is a certified interior designer licensed as such by the Commonwealth. The taxpayer provides design, consultation and similar services to its customers. The taxpayer maintains a small showroom where it displays household furnishings as well as the catalogs, samples and swatches. The showroom is closed to the public when the certified interior designer is out of the office. Customers can also order items through catalogs and procure installation and upholstery services from a third-party source. Catalog prices are not made available for client review. Items that are purchased by the taxpayer at wholesale prices are marked up and resold to customers. The taxpayer takes title to all items prior to their resale. Along with the sale of the furniture and furnishings, the taxpayer provides design consultation services, which are not separately charged. The taxpayer does charge an hourly fee for design, consulting, or other services with respect to items of property that it does not sell. The information presented indicated these separate
charges for design services represented less than 1% of the taxpayer's total gross receipts for the tax years at issue.

The taxpayer appealed its classification and argued that it should properly be classified as a retail merchant for BPOL tax purposes for the 2004 through 2009 tax years as 99.5% of its gross receipts come from the sales of goods, wares, and merchandise for use or consumption of the purchaser. In the alternative, the taxpayer argued that if separately stated services constitute a separate business, then it should be required to have multiple licenses pursuant to Va. Code § 58.1-3703.1(A)(1). The City contended that because the taxpayer holds itself out to the public as an interior decorator and is marketed to the public as an interior designer in advertisements, newspaper articles and other seminar and event announcements, it should be classified as a business service. The City also argued that the NAICS description describes interior designers as services providers and Title 23 of the Virginia Administrative Code (VAC) 10-500-500 defines interior decorating as a business service.

Before addressing the issues appealed by the taxpayer, the Tax Commissioner addressed whether the tax years were open for appeal. The City received the taxpayer's initial request for reclassification in February 2007 and responded by initiating an audit. The final local determination issued in September 2007 affirmed the original assessments for the 2004 through 2007 tax years. The last day of the tax year for which the 2004 assessment was made was December 31, 2004. As such, the taxpayer would have needed to file the amended return for the 2004 tax year by December 31, 2007 to meet the limitations period. Likewise, the last day the taxpayer could have filed a refund claim for 2005 was December 31, 2008. The taxpayer filed refund claims for the 2004 and 2005 tax years in September 2009, well after the period of limitations had expired for making such a claim. As the statute of limitations had expired, the Tax Commissioner declined to review the claims for these years. Also, the Tax Commissioner declined to review the claim for the 2006 and 2007 years as those years were reviewed in a prior ruling and the taxpayer did not submit new evidence.

For the 2008 and 2009 tax years, the Tax Commissioner determined that the taxpayer is not a retail merchant and was properly classified by the City as a business service based on facts discussed in the appeal. The taxpayer is not open for regular business hours, but is closed randomly depending on when the owner has consulting appointments away from the definite place of business. Furthermore, the taxpayer holds itself out as an interior design service in the local online and print telephone directory. The Tax Commissioner noted that these advertisements leave little doubt that the taxpayer is advertising the expertise in interior design as its primary business. The Tax Commissioner stated that the taxpayer may be classified as separate businesses however. The Tax Commissioner determined that the taxpayer would have to establish the existence of two separate business activities by providing documentation of gross receipts attributed to each of the following business activities: (1) interior design consulting fees not associated with the purchase of home furnishings; (2) consulting fees and associated purchases of furnishings; and (3) home furnishing purchases from either the showroom samples or the manufacturer's catalogs. The taxpayer indicated to the Tax Commissioner that no consulting fees were charged in association with the purchase of home furnishings. Therefore, the Tax Commissioner determined that the taxpayer would only need to provide documentation
of gross receipts attributed to (1) interior design consulting fees and (2) home furnishing sales from either the showroom samples or catalogs.

10. Vertically Integrated Manufacturer. The taxpayer operates a business in the City that processes poultry, soybeans and grain products, soybean meal and oil, and animal feed. The taxpayer had been filing BPOL tax returns classified as a business service. In December 2008, the taxpayer filed refund requests for the 2005 through 2008 tax years asserting that it was a vertically integrated manufacturer entitled to the manufacturer's exemption from the BPOL tax. In its final local determination, the City concluded that the taxpayer's operations were properly classified as a business service and upheld the original assessments. The taxpayer appealed the local determination to the Tax Commissioner contending it was a vertically integrated manufacturer that was not subject to tax on its wholesale sales. It also avered that it transferred all of its assets and operations located in the City to VALLC, a separate but affiliated entity, in April 2007 and was no longer subject to the BPOL tax after that time.

In its response to the appeal to the Tax Commissioner, the City raised an astonishing number of baseless objections and ignored prior rulings. First, the City asserted that the Tax Department lacks jurisdiction to address the taxpayer's appeal because there was no appealable event at the local level. The City contended that the taxpayer's appeal was filed pursuant to Va. Code § 58.1-3983.1, and the taxpayer's appeal was not timely filed in accordance with Va. Code § 58.1-3703.1(A)(6). The Tax Commissioner disagreed as the taxpayer was denied a refund because the City declined to change the taxpayer's classification. Such a determination constitutes an appealable event under Va. Code § 58.1-3703.1(A)(5). Also, Va. Code § 58.1-3703.1(A)(6) provides that any taxpayer may appeal a final local determination to the Tax Commissioner within 90 days of the issuance of a final local determination. The City issued its final local determination on July 13, 2010. The 90th day for filing an appeal fell on October 11, 2010, which was a federal and state holiday. Therefore, the taxpayer had until the next business day, or October 12, 2010, to file its appeal. The appeal was delivered to the Tax Department on October 12, 2010, which was within the 90-day period. Therefore, the Tax Commissioner determined that the appeal was timely filed.

The Tax Department previously addressed the issue as to whether the taxpayer is a vertically integrated manufacturer with regard to the business tangible personal property tax and machinery and tools tax in P.D. 08-80. Despite this ruling, the City maintained that the taxpayer's soybean processing operations are separate and distinct from its grain import and export business and, therefore, subject to a separate BPOL tax. (Second bite at the apple, anyone?) The Tax Commissioner considered the American Woodmark decision to determine if the taxpayer is vertically integrated or multiple businesses as the City argued. Ultimately the Tax Commissioner stated that if the taxpayer is a vertically integrated business, the activities that occurred at the taxpayer's facility in the City are not the sole consideration for the purposes of BPOL taxation. If the taxpayer can show that it conducted substantial manufacturing activities as a single business, the facility in the City would be considered to be part of a manufacturing business.

In addition to ignoring P.D. 08-80, the City argued that the Tax Commissioner may not rely on other public documents because the facts are not exactly the same as the facts in the
taxpayer's situation. The City relied upon Article X, § 1 of the Constitution of Virginia which provides that all taxes must be uniform upon the same class of taxpayers. The Tax Commissioner summarily dismissed this argument and stated that the Tax Department will continue to cite and rely on its previous opinions and determinations interpreting the tax laws unless and until they are modified or reversed by a court or the General Assembly.

As to whether the taxpayer is classified as a manufacturer and not subject to BPOL, the Tax Commissioner referred back to P.D. 08-80. In P.D. 08-80, the Tax Commissioner determined that for the 2002 through 2006 tax years, the taxpayer was a manufacturer for property tax purposes. This determination was made by applying the same three-part test enumerated in BBC Brown Boveri that is applied in determining whether a taxpayer is a manufacturer for purposes of the BPOL tax. The Tax Commissioner then did not issue an opinion but instead opined that the taxpayer would be a manufacturer for purposes of the BPOL tax provided that the City finds that the taxpayer's facts and circumstances were the same as they were in the 2002 through 2006 tax years.

In the final argument, the taxpayer contended that even if it were not exempt from the BPOL tax, its BPOL liability in the City would have ended in April 2007 because it transferred all of its business assets and operations to VALLC. Oddly, the Tax Commissioner failed to address this issue. In a possible rope-a-dope, the City objected and argued that since this issue was not raised in the initial appeal that the Tax Commissioner cannot consider this argument. The Tax Commissioner cited Title 23 VAC 10-500-760 in which a locality is permitted 30 days from the date of the receipt of an appeal to the Tax Commissioner to file a written response to such appeal or a written request to address new issues raised by the taxpayer. Per the regulation, localities are not required to make such a request. In this case, the City only objected to the issue being considered and did not request to address the new issue. Based on the regulation and lack of a request from the City, the Tax Commissioner said he could consider the issue. Of course, then he failed to do so.

Observation: Based on this ruling, it is quite clear that the City was being as difficult as possible. Given that fact, the Tax Department did a disservice to the taxpayer by sending the appeal back to the City to consider additional information. After reading this ruling, is there any basis to consider whether the City will objectively consider the information provided by the taxpayer? The City obviously ignored one previous ruling from the Tax Commissioner. Why should we think the City will do anything less with this ruling? It is a fair bet that a third ruling will have to be issued from the Tax Commissioner finally resolving these issues. On a side note, it would be very helpful to the business community to know which of Virginia’s 150+ localities takes frivolous positions in appeals like this. For any business looking to locate in Virginia, such knowledge would be very valuable.

11. Situs of Gross Receipts. P.D. 11-95 (June 7, 2011). The taxpayer operated a call center in City A. The call center performed customer service, took telephone orders and performed various other customer support activities for unrelated third party customers. The taxpayer also operated a fulfillment center in the County). The fulfillment center performed distribution services, such as receiving, pick-pack-ship, returns handling, cycle counts, gift wrapping, package inserts and various other distribution services for unrelated third
party customers. Customers contracted with the taxpayer for services that were provided by
either the call center or the fulfillment center, or services that were performed by both the call
center and the fulfillment center. City A audited the taxpayer for the 2007
and 2008 tax years. City A was unable to verify the situs of gross receipts based on the
taxpayer's records and determined Virginia sales reported in the sales factors on the taxpayer's
Virginia corporate income tax returns represented the total gross receipts. Because the IT center
 generated no gross receipts, City A and the County orally agreed to evenly divide the total gross
receipts resulting in an assessment of BPOL tax for the 2007 and 2008 tax years. The taxpayer
filed an appeal with City A contending that City A included all gross receipts in its assessment
including those that came from the fulfillment center in the County. In its final local
determination, City A upheld that audit assessment, concluding that the taxpayer did not provide
conclusive evidence of the situs of its gross receipts. The City determined it had the authority to
apportion gross receipts pursuant to an apportionment agreement with the County. The taxpayer
appealed City A's final determination to the Tax Commissioner contending it accurately reported
the gross receipts attributable to the call center on its 2007 and 2008 BPOL returns. The
taxpayer also asserted that the City erroneously included gross receipts attributable to the
fulfillment center in the County when issuing its assessment.

Ultimately, the Tax Commissioner punts this appeal back to the City. The Tax
Commissioner noted that it could not determine why the City and County agreed to the 50%
apportionment method instead of payroll apportionment after talking to both localities. Neither
the taxpayer nor City A provided conclusive evidence with regard to the situs of the gross
receipts. Because the issues involving the taxpayer's records are a matter of fact, the Tax
Commissioner stated that a determination as to whether such records adequately indicate the
proper situs of gross receipts remains the prerogative of City A. Accordingly, he remanded the
case to City A in order to review any evidence the taxpayer can provide concerning the amount
of gross receipts derived from the call center. If sufficient evidence for determining the situs of
the gross receipts is not provided, the County and City A may determine to apportion gross
receipts by agreement. Any agreement must rationally relate gross receipts to the licensable
activities transacted within each locality. If such agreement cannot be reached, gross receipts
should be apportioned to City A using the payroll of only those employees who directly
participate in the businesses' licensed activity.

12. Untimely Appeal. P.D. 11-124 (July 1, 2011). In August 2008, the
County issued a BTPP tax bill for the first half of 2008 to the taxpayer. On August 19, 2008, the
taxpayer appealed the BTPP assessment, contending certain equipment that the County classified
as business tangible personal property was actually machinery and tools. This letter did not
reference a 2008 BPOL assessment or any 2007 assessments. The County investigated the
taxpayer's operations and verbally indicated in December 2008 that the taxpayer was not a
manufacturer. Subsequently, the taxpayer paid its 2007 and 2008 BPOL and BTPP tax
assessments. On April 14, 2010, the taxpayer paid its 2010 BPOL tax under protest, stating that
it was a manufacturer and that it intended to file a protest with the Tax Commissioner. The
County issued a letter that was received by the taxpayer on May 3, 2010. In this letter, the
County concluded that the taxpayer was not a manufacturer based on its analysis done in
September 2008. On March 2, 2011, the taxpayer filed an appeal with the County, contending it
was a manufacturer for purposes of the BTPP and BPOL taxes. On April 14, 2011, the County issued a letter concluding that the taxpayer's appeal was not timely filed.

The Tax Commissioner determined that no appeal of BTPP tax has been filed with the County for the 2007 through 2010 tax years. Therefore, he lacked the jurisdiction to make a determination concerning the BTPP tax issues at this time. However, if the taxpayer files refund requests with the County pursuant to Va. Code § 58.1-3980, the County would be required to issue a determination as to whether the refunds were valid. If the County denies the refunds, the taxpayer would be eligible to appeal pursuant to the procedures set forth under Va. Code § 58.1-3983.1. In the alternative, the County would have the discretion to issue a final determination in response to the taxpayer's requests for refund in order to expedite the appeals process. With regard to BPOL tax, the Tax Commissioner determined that Tax Department is prohibited from addressing the taxpayer's appeal of BPOL taxes for the 2007 through 2010 tax years at this time. The taxpayer may, however, seek correction of its assessments with the County as permitted under Va. Code § 58.1-3980. Again, the County's response to such claims would be considered to be an appealable event under Va. Code § 58.1-3703.1(A)(5)(a).

13. Definite Place of Business. P.D. 11-161 (September 20, 2011). The taxpayer provides technology products and services to clients in Virginia and throughout the United States. It performs "around the clock" infrastructure support and maintenance services to a client located in the County. The taxpayer's employees are located and perform all activities at the client's facility. The taxpayer does not own or lease any real or tangible property in Virginia. The taxpayer does not maintain a telephone, it does not advertise to the public, and all administrative functions are performed at the headquarters location in State A. The taxpayer requested an opinion as to whether its activities within the County are sufficient to establish a definite place of business, and therefore subject the taxpayer to BPOL filing obligations. Pursuant to Title 23 Virginia Administrative Code 10-500-200, when a service provider performs services at a location away from its established or principal office and does not maintain a continuous presence for more than 30 consecutive days at the other location, its definite place of business remains the established or principal office. In 1978-79 Op. Va. Att'y Gen 279, the Attorney General determined that a continuous and regular course of dealings at a location would seem to constitute a definite place of business in such location when employees are "more or less" permanently assigned to such a location. The taxpayer's employees are at the client's location in the County 365 days a year. Based on this fact, the Tax Commissioner determined that the taxpayer has a definite place of business at the client's location and may be subject to the BPOL tax in the County.

D. Opinions of the Attorney General

1. Pass-Through of BPOL Tax to Customers. 2010 Va. Att'y Gen. 10-038 (August 24, 2010). Del. Calvin C. Massie, Jr. requested an opinion regarding who may be liable for payment of local business, professional, and occupational license ("BPOL") taxes and in which instances Virginia law permits businesses subject to BPOL taxation to invoice separately and charge their customers for the businesses' BPOL taxes. Specifically, Del. Massie asked whether motor vehicle dealers remain liable for payment of BPOL taxes when the dealer invoices BPOL taxes imposed on its sales separately from the base charges pursuant to Va. Code
§ 58.1-3734, or whether the tax liability then attaches to customers. Del. Massie also inquired whether Va. Code § 58.1-3734 provides the sole legal basis upon which motor vehicle dealers may pass their BPOL tax on to consumers, and if not, whether a BPOL taxpayer other than a motor vehicle dealer, such as a telecommunications service provider, may demand payment from its customers of charges that it separately invoices as "local gross receipts tax" or "local business license surcharge." The Attorney General opined that liability for payment of BPOL taxes always lies with the persons engaged in businesses, professions, or occupations upon which localities levy such taxes, and not with their customers. Also under Va. Code § 58.1-3734, only motor vehicle dealers may recover from their customers by way of a surcharge the BPOL taxes attributable to the gross receipts generated by sales to those customers without the surcharge also being included in the gross receipts and subjected to the BPOL tax.

VII. TANGIBLE PERSONAL PROPERTY AND MACHINERY AND TOOLS TAXES

A. 2011 Legislation

1. Machinery & Tools Tax – Classification for National Defense. House Bill 1822 (Chapter 875) and Senate Bill 999 (Chapter 877) amended Va. Code § 58.1-3245.12 and enacted Va. Code §§ 58.1-3508.4 and 58.1-3853 to create a separate class of property for purposes of the Machinery and Tools Tax for machinery and tools designed and used directly in manufacturing materials and equipment for national defense. Localities would be authorized to levy a tax on this separate class of property at a different rate from that levied on other machinery and tools, but which would not exceed the rate for the general class of machinery and tools. Additionally, the legislation authorizes local governing bodies to create, by ordinance, one or more defense production zones, inside which localities would be permitted to grant tax incentives and provide certain regulatory flexibility for a maximum period of twenty years. The legislation also authorizes the adoption of a development taxation program for the defense production zone, regardless of whether the zone has been designated by the Governor as an enterprise zone, and would make the laws that apply to enterprise zones also applicable to defense production zones. This legislation was effective on July 1, 2011.

B. Recent Court Decisions

No recent court decisions.

C. Recent Virginia Tax Commissioner Rulings

1. Business Tangible Personal Property Tax: Distinguishing Between Real Property and Tangible Personal Property. P.D. 11-02 (January 5, 2011). A taxpayer appealed a determination by a locality that refrigeration units installed in a building were tangible personal property, not real property. The taxpayer owned a warehouse in the City that included refrigerated space. The taxpayer leased a portion of the warehouse including the refrigerated space to a tenant on a seasonal basis. The refrigerated space is divided into three rooms capped by four ceiling-mounted refrigeration units, each weighing fifteen tons. In 2005, the taxpayer installed new refrigeration units. Installation of the refrigeration units required cutting a hole in the building's roof and using a crane to hoist the units atop the refrigerated area. The locality...
assessed the refrigeration units as tangible personal property, not part of the real property. On appeal, the locality determined that that the refrigeration units could be removed without damage to the property or the units themselves and, therefore, they remained tangible personal property.

On appeal to the Tax Commissioner, the Tax Commissioner applied the three part test enunciated in Danville Holding Corp. v. Clement, 178 Va. 223, 232, 16 S.E.2d 345, 349 (1941). The three tests are: (1) the annexation of the chattel (property) to the realty, actual or constructive; (2) its adaptation to the use or purpose to which that part of the realty to which it is connected is appropriated; and (3) the intention of the parties, i.e., the intention of the owner of the chattel to make it a permanent addition to the freehold. In order for the rules to apply, it is presumed that the property is annexed to the realty in some form. In its decision, the Supreme Court noted that the "intention of the party making the annexation is the paramount and controlling consideration."

The overriding characterization of the taxpayer's appeal is that no objective evidence was provided. For instance, the taxpayer indicated in its appeal that the process of installing the new units was a complicated process that involved removing a section of the roof of the building in order to have the 15 ton units placed properly. The taxpayer, however, did not provide any objective evidence concerning the installation process. Likewise, the locality stated that the refrigeration units were used to refrigerate an area used by the tenant, and were not used to provide climate control for the building. The taxpayer argued that the heat removed by the refrigeration units was exhausted into the nonrefrigerated area and was the only source of heat for the area of the building leased by the tenant. Again no objective evidence was provided to support these assertions. Lastly, the locality asserted that under the lease agreement, the intention of the parties is to allow the tenant to use the refrigerated space in its business. Based on this analysis, the locality concluded that the refrigeration units were used as equipment in a business process and, therefore, subject to BTPP tax. The taxpayer argued that it replaced existing units that had been on the building and provided no evidence.

Ultimately, the Tax Commissioner concluded that the taxpayer failed to provide objective evidence concerning the annexation of the refrigeration units or their adaptation to the building's purpose. In addition, the Tax Commissioner determined that the locality erred in determining the units were tangible personal property based on the tenant's use in a production process. The Tax Commissioner remanded the case to the locality so that the locality may evaluate the taxpayer's evidence concerning annexation and adaptation of the refrigeration units and consider the taxpayer's intent for installing the units, consistent with the tests enunciated in the Danville Holding case. The Tax Commissioner required the taxpayer to provide the locality with evidence concerning the annexation and adaptation of the refrigeration units.

**Practice Point:** This appeal does not break any new ground regarding the tests for determining whether property is tangible personal property or real property. However if the descriptions of the annexation and adaptation in the appeal are correct, it is easy to imagine that the taxpayer should have prevailed on this appeal. Why didn't the taxpayer prevail on this appeal? No evidence was provided with the appeal. Do not forget that a taxpayer has the burden of proof in an appeal of an assessment. If a taxpayer does not carry that burden, the taxpayer will not prevail.
2. **Ownership and Valuation of Tangible Personal Property.** P.D. 11-17 (February 11, 2011). The taxpayer owned and operated a motel in a locality. In addition, the taxpayer’s parent entity owned furnished apartments and rental homes in the sale locality. Under audit, the locality determined that the taxpayer underreported both the amount and value of its business tangible personal property and issued assessments for the tax years at issue. The taxpayer appealed assessments contending the locality included property owned by the taxpayer’s parent and its valuation exceeded fair market value. The locality, citing a fixed asset listing provided by the taxpayer's accountant, issued a final determination upholding its assessment. The taxpayer appealed the local final determination to the Tax Department.

The Tax Commissioner realized that the controlling factor in Virginia property taxation is who is to determine the legal owner of the property identified for taxation. Therefore, only the property owned by the taxpayer in the locality is subject to the BTPP tax in the locality. The Tax Commissioner did not render an opinion regarding the valuation as the Virginia Code charges local commissioners of the revenue with the responsibility of assessing property at FMV and it is incumbent upon the taxpayer to prove to the satisfaction of the local taxing authority that the taxpayer properly reported the value of its property on its BTPP returns.

3. **Aircraft Hangared in Locality for Less Than Six Months are Not Subject to BTPP Tax.** P.D. 11-34 (March 4, 2011). During the 2009 tax year the taxpayer owned and operated an aircraft for the purpose of transporting employees on company business. The aircraft weighed more than 10,000 pounds, and when not in use, the aircraft was housed in a hangar at an airport located in the City. The City concluded that the aircraft was situs within its jurisdiction and issued a BTPP tax assessment to the taxpayer for the 2009 tax year. The taxpayer appealed the assessment to the City, and in its final determination, the City found that the aircraft was located in the taxpayer’s state of domicile (Virginia) and was normally garaged at the airport in the City when in Virginia. The taxpayer filed an appeal with the Tax Commissioner, contending the City did not apply the proper test for assessing the BTPP tax on the aircraft. The taxpayer asserted that the aircraft spent less than six months at the hangar in the City. Accordingly, the taxpayer requests correction of the assessment issued by the City for the 2009 tax year and a refund of any tax collected.

The Tax Commissioner agreed with the taxpayer and determined that the assessment was erroneous. The Attorney General of Virginia has issued several opinions regarding the ability of a locality to tax certain tangible personal property, such as automobiles, boats, and aircraft. In 1979-1980 Op. Att'y. Gen. 353 (2/1/1980), the Attorney General stated, "If the boat is not 'normally garaged, docked or parked' in any one locality for a significant portion of the year (e.g., six months), it is then taxed in the jurisdiction in which the owner resides." Based on the Attorney General opinions and the fact that the aircraft spent less than six months at the hangar in the City, the Tax Commissioner determined that the assessment was incorrect.

4. **Definition of "Manufacturer."** P.D. 11-44 (March 23, 2011). The taxpayer operates a facility in the County that assembles prefabricated components that are used to construct homes. These components were sold exclusively to the taxpayer's parent company.
and delivered to the Parent's job sites. The Parent, a general contractor of single family homes, employed third-party subcontractors to install the finished components. The taxpayer had reported all of its assets on business tangible personal property (BTPP) tax returns for the 2005 through 2008 tax years. The taxpayer filed an administrative appeal with the County seeking to reclassify itself as a manufacturer and as such, have its assets that are used in the process of manufacturing taxed at the machinery and tools tax rate and have all other business assets exempt from local tax. The County issued a final determination denying the taxpayer's amended returns on the basis that the taxpayer was a contractor subject to the BTPP tax on all of its tangible personal property. The taxpayer appealed the County's final determination contending it is a manufacturer. The County countered that the taxpayer is not a manufacturer and, therefore, is subject to tax on its, tangible business personal property at the BTPP tax rates. The Tax Commissioner determined that the taxpayer is a manufacturer and subject to the machinery and tools tax, not BTPP tax.

The Tax Commissioner applied the definition of "manufacturer" as determined by the Virginia Supreme Court. The Virginia Supreme Court’s test involves three essential elements to determine whether a manufacturing activity is being undertaken. These elements are: (1) original material, referred to as raw material; (2) a process whereby the original material is changed; and (3) a resulting product, which by reason of being subject to such processing, is different from the original material. County of Chesterfield v. BBC Brown Boveri, 238 Va. 64 (1989). For local tax purposes, a manufacturer is one engaged in a processing activity, whereby the original materials are transformed into a product that is substantially different in character from the original materials. It does not matter whether the transformation is a step in getting the product ready for market or it is a complete process. What matters for purposes of local taxation is whether the transformation of the material takes place in the locality. See Commonwealth v. Meyer, 180 Va. 466, 23 S.E.2d 353 (1942).

The taxpayer used raw materials such as wood, nails, brackets, glue, steel, insulation, sheathing, concrete and aggregates in a number of processes that result in concrete moisture residential foundation walls, open-web floor truss systems, structured insulated external wall panes, and steel framed interior walls. Based on this, the Tax Commissioner determined that raw materials were transformed by an assembly process into a new products that were substantially different in character from the original materials. The County also argued that the taxpayer’s non-manufacturing activities were too substantial for the taxpayer to be considered a manufacturer. However, the Tax Commissioner determined that the taxpayer’s non-manufacturing activities only accounted for 25% of its receipts and therefore permitted the taxpayer to be classified as a manufacturer for purposes of the machinery and tools tax and the BTPP tax.

5. Business Tangible Personal Property Tax: Leasehold Improvements. P.D. 11-47 (March 28, 2011). The taxpayer operates a restaurant in a shopping center located in the County. It retains a leasehold interest in the premises. The taxpayer filed a 2008 BTPP return that reported leasehold improvements, such as concrete, masonry, doors and windows, woods and plastics, plumbing, HVAC, electrical insulation, trim, and certain built-in furnishings, and BTPP. The taxpayer subsequently filed an amended 2008 BTPP return reclassifying items originally classified as BTPP as leasehold improvements. The County disallowed the taxpayer's
amended return and assessed BTPP tax based on the original return. The taxpayer filed an appeal with the County contending that property it reclassified as leasehold improvements is real property. In its final decision, the County affirmed its conclusion that the reclassified property is subject to BTPP tax based on the taxpayer's intent. The taxpayer appealed to the Tax Commissioner asserting that the property it reclassified as leasehold improvements on its amended 2008 BTPP return is realty. The Tax Commissioner determined that the leasehold improvement were real property and not subject to BTPP tax. The County argued that the taxpayer's lease expressed his intention for the improvements to remain tangible personal property as the lease gives the taxpayer the option to keep all additions and improvements at the end of the lease. Upon reviewing the lease, the Tax Commissioner disagreed and found that the overall intent of the taxpayer and its landlord is that all additions, alterations, and improvements attached to or installed on the property become the landlord's property.

6. **Machinery & Tools Tax: Property Removed from Facility.** P.D. 11-54 (April 7, 2011). In 2005, the taxpayer acquired a manufacturing facility in the City. In April 2009, the taxpayer filed amended returns with the City for the 2006 through 2008 tax years to report equipment that had been shipped to another facility. The City requested additional information, toured the plant, and examined the property at issue. In its final determination, the City agreed to remove assets that were transferred to other locations with proof of shipment. Because the taxpayer failed to provide verification of disposals and additional transfers of assets, the City did not issue a refund to the taxpayer related to these assets. The taxpayer appealed the City's final determination contending that the property was not located at the plant during one or more of the tax years at issue. The Tax Commissioner determined that the taxpayer must provide sufficient documentation to the City to show when it disposed of the property in question and returned the appeal to the City for such a determination.

7. **Machinery & Tools Tax: Notification of Idle Machinery.** P.D. 11-84 (June 2, 2011). The taxpayer operates a manufacturing plant in the County. The plant had seven manufacturing lines at the end of 2007. One line operated continuously since 2007. Three of the seven lines were never placed in service. Three other lines were placed in service in 2007, but were shut down prior to January 1, 2008. The lines were then placed back in service in 2010 when demand increased for the product that the equipment produced. The taxpayer did not file M&T tax returns with the County for the 2008 through 2010 tax years. As a result, the County issued assessments for M&T tax. The taxpayer appealed to County claiming that a six of the seven manufacturing lines were not subject to the M&T tax for the tax years at issue. The County issued a final determination concluding that the line that was in continuous operation from 2007 was subject to the M&T tax and the three lines that were never put into service were not subject to the M&T tax. The County's final determination also held that the three lines put in service in 2007, but ceased production prior to 2008 were not idle machinery because the taxpayer had failed to provide written notice that these lines were idled prior to April 1 of the previous tax year. The taxpayer appealed the County's final determination to the Tax Commissioner, contending that the three manufacturing lines at issue should have been classified as idle machinery for the 2009 and 2010 tax years. The Tax Commissioner upheld the County's final determination. The taxpayer conceded that the manufacturing lines at issue were not idle machinery for the 2008 tax year because they were not out of service for an entire year, and the County was not notified in writing that these lines had been withdrawn from service prior to
April 1, 2007. The taxpayer contended, however, that the lines qualified as idle machinery for the 2009 and 2010 tax years because they were discontinued in use for at least one year prior to any tax day. The County concluded that the lines were not idle machinery and tools because the taxpayer failed to provide written notice by April 1 of the prior year. As Virginia Code § 58.1-3507(D) requires taxpayers to provide written notice of idle machinery, the Tax Commissioner upheld the assessment.

8. Machinery and Tools Tax: Pollution Control & Recycling Equipment Exemptions; Modification Costs. P.D. 11-110 (June 17, 2011). The taxpayer, a manufacturer located in the County, filed amended M&T tax returns for the 2007 through 2009 tax years requesting removal of certain equipment included on the original returns as machinery and tools. The County did not remove all of the equipment and issued a partial refund. The taxpayer appealed the County's final determination contending certain equipment was incorrectly classified by the County as machinery and tools. It argued that certain pollution control and recycling equipment were not machinery and tools. In addition, the taxpayer disagreed with the County's treatment of replacement costs for certain assets. The taxpayer believed the County should not be permitted to assess M&T tax on both the original equipment cost and the replacement parts that are necessary for the continuing operations of the equipment.

The pollution control equipment at issue was used to remove fumes from the taxpayer's manufacturing facility caused by certain processes in the manufacturing process. Specifically, they were used to control particulates, volatile organic compounds and carbon monoxide emissions. This equipment was located on the roof of the facility. In this case, the pollution control equipment was used to control particulates and emissions into the air. However, it was not clear to the Tax Commissioner what happens to the waste materials generated by the pollution control equipment. There is some indication that the taxpayer is permitted to use the waste materials to provide power and heat for the manufacturing plant. If the particulates and emissions were in fact used to provide power to the manufacturing machinery, the pollution control equipment could be classified as machinery and tools. The Tax Commissioner remanded this matter to the County with the instructions that it consider any other documentation the taxpayer may be able to provide to demonstrate that the pollution control equipment was not used to produce power and heat for the manufacturing plant.

The taxpayer contended that the recycling equipment, a fines bin, met the standards of the exemption under Va. Code § 58.1-3661. The exemption for certified recycling equipment and facilities is a general property tax exemption offered as an option to localities. However as the County did not adopt such an ordinance, the Tax Commissioner determined that the exemption did not apply.

The taxpayer capitalized certain modifications to items of machinery. Most of the modifications involved replacing significant parts on original equipment. The taxpayer asserted that these capitalized costs should be classified as repairs for purposes of the M&T tax and not included in the cost of the machinery. The taxpayer believed that assessing the refurbishment costs resulted in some equipment being taxed on both the original cost and the replacement cost, which is essentially double taxation. The County countered that allowing for the removal of all replacement costs fails to consider the value added to the upgraded equipment. The Tax
Commissioner noted that the taxpayer provided no objective evidence that the County's method of valuing the modified machinery exceeds fair market value or results in double taxation and did not adjust the return, but allowed the taxpayer to provide additional evidence to the County as to the fair market value of the modified machinery.

9. **Business Tangible Personal Property Tax: HVAC Units.** P.D. 11-117 (June 22, 2011). The taxpayer is engaged in business at a facility in the City. The facility is owned by the taxpayer. Under audit, the City found a number of items of property that were not listed on the taxpayer's BTPP returns. The property included that two heating, ventilation and air conditioning (HVAC) units with related HVAC "fit outs" and a backup generator with a related transfer switch. The taxpayer filed an appeal with the City, contending the HVAC systems and backup generator were real property. In its final determination, the City concluded that the HVAC equipment was tangible personal property used to cool computers, and the generator and transfer switch were subject to BTPP tax because they were placed in service after the taxpayer began operating the building and their removal would not impact the value of the building. The taxpayer appealed to the Tax Commissioner, contending the HVAC systems and generator were permanently affixed to the real property and it would be economically infeasible to remove any of the equipment. The taxpayer also asserted that the HVAC equipment was used to cool the building and not the computers. Furthermore according to the taxpayer, the generator and transfer switch were part of the realty because they were a necessary part of the technical nature of the taxpayer's business and would not be removed if the taxpayer left the building.

The Tax Commissioner considered both the taxpayer's position and the City's position. He applied the three tests enunciated by Danville Holding Corp. v. Clement, 178 Va. 223, 232, 16 S.E.2d 345, 349 (1941), to determine whether property is real property or tangible personal property. The three tests are: 1) the annexation of the chattel (property) to the realty, actual or constructive; (2) its adaptation to the use or purpose to which that part of the realty to which it is connected is appropriated; and (3) the intention of the parties, i.e., the intention of the owner of the chattel to make it a permanent addition to the freehold. The Tax Commissioner determined that although the equipment was annexed to the building, he could not determine whether its use part of the building or if it was the owner's attention to make it part of the building. According to the ruling, there is disagreement as to whether the equipment was used to cool the building or computers. Accordingly, the tax Commissioner sent the appeal back to the City to determine whether the HVAC units are necessary for the cooling of the building or the computers. However the tax Commissioner did determine that the backup generator and transfer switch were necessary for the taxpayer's operations and therefore are taxable as tangible personal property.

**D. Opinions of the Attorney General**

No recent opinions.

**VIII. MISCELLANEOUS TAXES**

**A. 2011 Legislation**

1. **Aircraft Sales and Use Tax: Exemption for Qualified Companies Headquartered in Virginia.** House Bill 2221 (Chapter 492) and Senate Bill 1188 (Chapter 443)
amended Va. Code § 58.1-1505 to provide an exemption from the aircraft sales and use tax beginning July 1, 2011 and ending December 31, 2014 for any aircraft sold or leased by a qualified company that is an aviation-related company, limited liability company, partnership, or a combination of such entities that have a common ownership interest. Persons qualifying for the proposed exemption will also be entitled to a refund for any aircraft sales and use tax paid between January 1, 2011, and before July 1, 2011. The two bills also exempt aircraft sold in the Commonwealth and registered outside of the Commonwealth from the aircraft sales and use tax so long as the aircraft is removed from the Commonwealth within 60 days of the date of purchase on the Bill of Sale. If the aircraft is removed within 60 days of the date of purchase, the time between the date of purchase and the removal of the aircraft will not be counted for purposes of determining whether an aircraft is required to be licensed in the Commonwealth. This bill was effective on July 1, 2011.

2. **Tire Recycling Fee Collection.** Senate Bill 1431 (Chapter 649) amended Va. Code § 58.1-640 to impose the tire recycling fee on individuals who perform installation of tires in Virginia pursuant to an agreement with a person who makes a retail sale of such tires, but does not collect the tax. Under current law, every retailer of tires in Virginia is subject to the tire recycling fee. "Retailer of tires" means any person engaged in the business of making retail sales of tires, whether new or used, in Virginia. This legislation was effective on July 1, 2011.

3. **Insurance Premiums Tax: Retaliatory Tax Credit.** House Bill 2335 (Chapter 817) and Senate Bill 1359 (Chapter 863) amend Va. Code § 58.1-2510 to increase the maximum annual retaliatory tax credit refund amount for the insurance premiums tax from $1.6 million to $7 million for qualified companies receiving a credit in taxable year 2000 that file a refund application with the State Corporation Commission for taxable years beginning on and after January 1, 2011. It also allows taxpayers to carry forward any unused credits until the entire credit amount is used. This legislation requires that all refunds be made after July 1 following the filing of the refund application. Finally, the legislation limits the amount of the credit for qualified companies not receiving a credit for the 2000 taxable year to 60 percent of the retaliatory costs paid to other states. The limitation provision is retroactive to license years beginning on and after July 1, 2006 and taxable years ending on and after December 31, 2006, which is the effective date of the same provision in the Appropriation Act. The effective date for the refund date and carryover portions of this legislation was July 1, 2011.

4. **Fuels Tax: Commercial Watercraft.** Senate Bill 1137 (Chapter 165) amends Va. Code §§ 58.1-609.1 and 58.1-2201 to clarify that the definition of commercial watercraft includes watercraft owned by a private business and used in the conduct of its own business or operations, including but not limited to the transport of persons or property. This legislation was effective on July 1, 2011.

5. **Insurance Premiums Tax: Administration.** Senate Bill 1124 (Chapter 850) amends and enacts numerous sections in the Virginia Code to transfer the administration of the insurance premiums tax from the State Corporation Commission ("SCC") to the Tax Department. The duties transferred include the processing of tax returns, the handling of payments and billing, customer service functions, collections, and auditing duties. The Tax Department would also be responsible for administering the retaliatory costs assessment on
certain foreign insurance companies, as well as the retaliatory costs tax credit for domestic insurance companies. The SCC would continue to be responsible for the licensing of insurance companies and the administration of the maintenance fund. This legislation also makes certain changes to the taxation of surplus lines brokers to ensure that their tax is based on direct gross premiums from Virginia insureds as required by a recently enacted federal law. This legislation is effective for taxable years beginning on and after January 1, 2013, except that certain provisions related to surplus lines brokers were effective on July 1, 2011.

6. **Motor Vehicle Rental Tax: Transfer of Administration.** House Bill 1798 (Chapter 405) and Senate Bill 1132 (Chapter 639) amends and enacts numerous sections in the Virginia Code to transfer the administration and collection of the Motor Vehicle Rental Tax from the Department of Motor Vehicles to the Department of Taxation. The revenues from the 2% rental fee on daily rental vehicles will continue to be dedicated to pay the debt service on the bonds issued for the Statewide Agencies Radio System. This legislation was effective on July 1, 2011.

7. **Cigarette Tax: Enforcement Working Group.** House Bill 2038 (Chapter 366) and Senate Bill 1085 (Chapter 293) requires the Tax Commissioner to convene a working group to review the current policies on i) appeals of penalties related to the cigarette tax assessed on wholesalers and retailers; ii) the desirability of having a single stamp for state and local taxes; iii) methods of determining the validity of partially visible cigarette tax stamps; and iv) other related issues. The working group will consist of representatives the Virginia Wholesalers and Distributors Association, Virginia Retail Merchants Association, the Retail Alliance, the Virginia Petroleum, Convenience and Grocery Association, the Northern Virginia Cigarette Tax Board, the Virginia Municipal League, those counties that levy a local cigarette tax, and other individuals as deemed necessary. The legislation requires the working group to begin as soon as possible after the conclusion of the 2011 General Assembly Session and provide a report and recommendations to the chairmen of the Senate and House Committees on Finance no later than December 1, 2011.

8. **Combined Transient Occupancy and Food Tax.** House Bill 1451 (Chapter 192) amends Va. Code § 58.1-3842 to authorize Madison County to levy a combined transient occupancy and food and beverage tax on the aggregate charges for rooms and meals in bed and breakfast establishments when such charges are not separately stated. Madison County would be authorized to impose the tax at a maximum rate of four percent of the total amount charged for the occupancy of the room and for the food and beverages. Madison County would only be permitted to levy this tax if a food and beverage tax has been approved in a referendum within the county. Under current law, Rappahannock County is the only county that is authorized to levy a combined transient occupancy and food and beverage tax on the aggregate charges for rooms and meals in bed and breakfast establishments, provided the requirements set forth above are met. This legislation was effective on July 1, 2011.

9. **Transient Occupancy Tax.** House Bill 1452 (Chapter 385) and Senate Bill 984 (Chapter 606) amend Va. Code § 58.1-3819 to add the counties of Accomack (HB 1452 only), Brunswick (HB 1452 only), Madison, and Washington to the list of localities that are currently authorized to impose a transient occupancy tax at a maximum rate of five percent.
Revenues from the portion of the tax in excess of two percent would be required to be used solely for tourism or marketing of tourism. This legislation was effective on July 1, 2011.

B. Recent Court Decisions

1. AMG National Trust Bank v. Commonwealth of Virginia, Civil Docket No.: CL10-3031 (Norfolk Circuit Court; April 7, 2011 and July 6, 2011). See also P.D. 11-151, 11-152, & 11-153. The Circuit Court for the City of Norfolk determined that a trust company was exempt from the Virginia corporate income tax and instead subject to the Virginia bank franchise tax. The trust company is chartered as a national banking association yet did not accept any deposits at its Virginia location. In addition, the Circuit Court declined a request from the Virginia Tax Commissioner (the “Tax Commissioner”) to determine how the trust company should apportion its net capital for purposes of the Virginia bank franchise tax.

The taxpayer, AMG National Trust Bank (“AMG”), was chartered as a national banking association pursuant to the National Bank Act, 12 U.S.C. sec. 21, et seq. in August 2001 and maintained that charter and held itself out to the public as engaged in the banking business continuously throughout 2004 through 2009. During this time period, AMG had an office located in Norfolk known as Old Dominion Trust Company. Through this office, AMG offered trust services and investment management services, which AMG and the Commonwealth agreed are traditional and historical parts of banking. AMG neither solicited nor accepted deposits at its Virginia office from January 1, 2004 through January 31, 2008. After January 31, 2008, AMG solicited deposits and loans from its Virginia office, but did not accept deposits or loans at that location. Deposits and loans were accepted at its main banking office in Boulder, Colorado.

In 2009, the Tax Department rejected AMG’s 2009 bank franchise tax return on the ground that AMG did not meet the definition of a “bank” contained in the Virginia Bank Franchise Act (the “Act”). The Tax Commissioner determined that AMG was not conducting banking business in Virginia because the Virginia branch did not accept deposits. Therefore, she ruled that AMG was not subject to the bank franchise tax and instead subject to the corporate income tax. Based on this conclusion, the Tax Commissioner directed AMG to file corporate income tax returns for all the years that its trust office operated in Virginia. As a result, AMG filed suit and asked the Circuit Court to determine that it is a “bank” within the meaning of the Act.

The Act requires every bank to pay annual franchise taxes based on the net capital of the taxpayer. This tax is paid in lieu of all other state or local taxes. Va. Code § 58.1-1202. The Act provides four separate definitions of a “bank,” plus a fifth exclusionary clause:

"Bank" means:
(1) any incorporated bank, banking association, savings bank that is a member of the Federal Reserve System, or trust company organized by or under the authority of the laws of the Commonwealth and
(2) any bank or banking association organized by or under the authority of the laws of the United States, doing business or having an office in the
Commonwealth or having a charter which designates any place within the Commonwealth as the place of its principal office, and

(3) any bank which establishes and maintains a branch in this Commonwealth under Article 6 (§ 6.2-836 et seq.) of Title 6.2 or Article 7 (§ 6.2-849 et seq.) of Title 6.2, whether such bank or banking association is authorized to transact business as a trust company or not, and

(4) any joint stock land bank or any other bank organized by or under the authority of the laws of the United States upon which the Commonwealth is authorized to impose a tax.

(5) The term shall exclude all corporations organized under the laws of other states and doing business in the Commonwealth, corporations organized not as banks under the laws of the Commonwealth and all natural persons and partnerships. Va. Code § 58.1-1201.

The Circuit Court determined that AMG met the definition of a “bank” under the second and fourth clauses of the definition above. The Circuit Court also determined that AMG was not excluded by the exclusionary clause in the definition.

The Tax Department made two arguments to the Court that AMG should not be considered a “bank” for purposes of the Act. Both arguments were based on the fact that AMG did not accept deposits in Virginia. First, the Tax Department argued that because the statute uses the word “bank” to define “bank,” the Court should also consider the definition of “bank” which is included in the Virginia Banking Act. The Virginia Banking Act defines “bank” as “a corporation authorized by statute to accept deposits and to hold itself out to the public as engaged in the banking business in this Commonwealth.” Va. Code § 6.2-800. Based on this definition, the Tax Department argued that AMG should not be classified as a “bank” in Virginia as AMG did not accept deposits in Virginia. The Tax Department’s second argument was that the “doing business or having an office in the Commonwealth” in the second clause of the definition in the Act requires AMG to conduct the business of banking in the Commonwealth. In support of this argument, the Tax Department pointed to the section of the Act (Virginia Code sec. 58.1-1204.1) that provides a treatment for banks that were only present in Virginia for part of the calendar year. Virginia Code sec. 58.1-1204.1 defines “transacting business” as “accepting deposits from customers in the regular course of business.”

The Circuit Court rejected both arguments by focusing on the definition of a “bank” in the Act. First, the Circuit Court noted that the definition of a “bank” in the Virginia Banking Act is shorter and less detailed that the definition of “bank” in the Act. Citing Lynchburg Div. of Soc. Servs. v. Cook, 276 Va. 465, 481, 666 S.E.2d 361, 369 (2008), the Circuit Court followed the principle that when two statutes address the same subject, the two statutes should be harmonized, if possible, and the more specific statute should prevail when they conflict. Based on this principle, the Circuit Court concluded that the definition in the Act did not require AMG to accept deposits in Virginia to be considered a “bank.” The Circuit Court recognized that if the General Assembly had intended for such a requirement to be in effect, it would have included the requirement in the Act. Therefore, the Circuit Court determined that AMG met the definition of a “bank” under the Act and was subject to the bank franchise tax, not the corporate income tax.
Following this determination by the Circuit Court, the Tax Department asked the Circuit Court to reconsider its ruling or, in the alternative, clarify its ruling regarding the proper method the Tax Department should use to apportion AMG’s net capital. The Circuit Court did not reconsider its determination that AMG is a "bank" and instead focused on the Tax Department’s request for clarification. After some discussion of the issue, the Circuit Court declined to give guidance on the proper method the Tax Department should use to apportion AMG’s net capital as the Tax Department did not file a declaratory action itself.

The Tax Department requested guidance on apportionment because the Act fails to provide a method for apportionment of a multi-state bank’s net capital as is required by the U.S. Constitution. To adapt for this lack of a statutory apportionment method, the Tax Department has required banks present in Virginia to apportion net capital based on the location of deposits. However for banks who do not accept deposits, the Tax Department requires such banks to request permission to use an alternative method for apportionment. As AMG fell into this latter category, it properly requested an alternative apportionment method based on its cost of performance.

The Tax Department argued to the Circuit Court that under the Act AMG’s tax liability is zero as the Tax Department never approved an alternative apportionment method. Ergo, AMG was not “subject” to the bank franchise tax and was subject to the corporate income tax. The Circuit Court rejected this argument and stated that while AMG might have a bank franchise tax liability of $0, it is still subject to the bank franchise tax and exempted from the corporate income tax. The Circuit Court added that if AMG’s tax liability is indeed zero, it is only because the Tax Department failed to approve an alternate method of apportionment.

2. Buchanan County v. Equitable Production Company, Case No. 1:11CV00004 (United States District Court for the Western District of Virginia, March 28, 2011 and June 1, 2011). Buchanan County filed a collection action in the Circuit Court of Buchanan County, Virginia, against defendants Equitable Production Company, Equitable Resources, Inc., and EQT Production Company (collectively, “EQT”) to collect unpaid coal severance tax. In its Complaint the County sought a declaratory judgment rejecting certain deductions it alleged EQT took in calculating the amount of coal severance tax due to the County. It also sought monetary relief in the form of taxes owed from previous years. The case was removed by EQT to federal court, with subject-matter jurisdiction based on diversity of citizenship and amount in controversy.

The County moved to remand the case back to state court pursuant to the Tax Injunction Act, 28 U.S.C.A. § 1341, or based on abstention doctrine or the principles of comity. EQT opposed the motion. The Tax Injunction Act provides that “[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.” 28 U.S.C.A. § 1341. It applies to actions for anticipatory relief and actions for declaratory relief. California v. Grace Brethren Church, 457 U.S. 393, 408 (1982). The Court also noted that the Tax Injunction Act does not bar federal jurisdiction over tax collection actions or over defenses to such actions based on Jefferson County, Alabama v. Acker, 527 U.S. 423, 435 (1999). Despite the County’s arguments that because of the declaratory nature of the relief sought the Tax Injunction Act
prohibited the Court from considering this case, the Court opined that such a prohibition did not exist as this case sought declaratory and monetary relief.

The County also asserted that the case should be remanded under principles of abstention and comity. Abstention is an insufficient basis for declining jurisdiction. The County argued that abstention doctrines apply because the state law issues are both important and complex and because the case involves state taxes and would affect government revenues. However, the Court noted that abstention is the exception, not the rule, and only applies in exceptional circumstances. The Court determined that the only exceptional circumstance plausibly applicable to this case would exist when a difficult question of state law of substantial public importance whose importance would transcend the ultimate result in the case is presented. As the County did not allege such a circumstance, the Court rejected the County’s assertion that the case should be remanded under principles of abstention.

The Court also rejected the County’s comity argument. Under the principle of comity, the Court would remand the case to avoid interference with state laws. The Court determined however that there is no challenge to the state tax law, and federal jurisdiction will not result in federal interference with the state’s administration of its taxing authority.

After its first motion to remand the case was rejected, the County filed a second motion to voluntarily dismiss the case without prejudice in order to refile it in state court with additional nondiverse defendants so that it cannot be removed to federal court. In other words, the County tried to publicly do an end-run around the first ruling. The County intended to refile the action in the Circuit Court of Buchanan County and add local business defendants so as to make the case nonremovable. The Court denied this motion as it would have been prejudicial to EQT. The Court noted that the case had been pending for well over a year, and EQT expended considerable resources in bringing it to the current point. In addition, the joinder of additional taxpayers would likely add extra procedural hurdles and prolong the resolution of the dispute, to the prejudice of EQT. Furthermore, the County did not show that Virginia procedure would permit the joinder of multiple taxpayers in a single collection lawsuit. The Court said that while there may be common questions of law to collect the coal severance tax from multiple Buchanan County taxpayers, the facts supporting the claims are likely to be different and would not arise out of the same transaction or occurrence. Each defendant’s ultimate liability would depend upon its particular business operation and tax returns. For these reasons, the Court rejected the second motion. According to the second opinion issued by the Court, this case is set for trial in December 2011.

C. Recent Virginia Tax Commissioner Rulings

1. Recodation Tax: Related Entities & Value of Property. P.D. 10-266 (December 15, 2010). In June 2008, Corporation A and Corporation B merged their United States operations into a combined entity that commenced operating as the taxpayer. Corporation A and Corporation B maintained a 58% and 42% interest in the taxpayer, respectively. As part of this merger, real property located in the County was transferred from Corporation B to the taxpayer and recodation taxes were paid. The taxpayer requested a refund of the recodation taxes paid, contending that the transfer of the property was exempt from recodation tax as
transfers between certain related parties under either Va. Code §§ 58.1-811(A)(8), 58.1-811(A)(9), or 58.1-811(A)(10). The taxpayer also disputed the value of the property the tax was levied on as less than 100% of each parcel was conveyed. The Tax Commissioner determined that the information submitted with the appeal was insufficient to determine if any of the exemptions apply. The Tax Commissioner did forward the taxpayer's concerns about the value that was conveyed to the circuit court clerk.


4. Recordation Tax: Refinancing Exemption. P.D. 11-19 (February 18, 2011). The taxpayer's original 2006 home mortgage was held by Lender A. In February 2010, the taxpayer refinanced his mortgage and recorded the refinanced deed of trust in the County. The County's deed of receipt shows the taxpayer refinanced with Lender B. The County determined that the taxpayer was not entitled to the recordation tax exemption pursuant to the provisions under Virginia Code § 58.1-803(D) for refinancing with the same lender because Lender A and Lender B did not qualify as the same lender. The taxpayer appealed to the State Tax Commissioner contending that the refinanced loan was made through the same lender. The Tax Commissioner agreed with the County and determined that Lender A and Lender B are separate legal entities despite the fact that the lenders were related. Therefore, the taxpayer was not entitled to the exemption for refinancing a debt with the same lender as the taxpayer's refinancing did not occur with the same lender as required by Virginia Code § 58.1-803(D).

5. Recordation Tax: Refinancing Exemption. P.D. 11-23 (February 24, 2011). The taxpayer refinanced her mortgage and recorded the refinanced deed of trust in the County. The County determined that the taxpayer was not entitled to the recordation tax exemption pursuant to the provisions under Virginia Code § 58.1-803(D) for refinancing with the same lender. The taxpayer appealed to the State Tax Commissioner contending that the refinanced loan was made through the same lender. The Tax Commissioner ultimately upheld the tax as imposed as the taxpayer did not respond to several written attempts by the Tax Department to obtain the information necessary to verify that the taxpayer refinanced her deed of trust with the same lender.

6. Recordation Tax: Value of Parcel. P.D. 11-41 (March 14, 2011). In May 2010, the taxpayer presented a deed for recordation to the County. The County assessed recordation tax based on the assessed value of the property, which was greater than the consideration for the conveyance of the real property interest. The taxpayer appealed the assessment and contended that the state and local recordation taxes should have been based on the consideration paid. The taxpayer presented an appraisal that values the subject property at less than the consideration of the conveyance in support of its position. The Tax Commissioner did not issue a decision as he stated that the responsibility for placing a value on real estate is
entirely a factual determination that is best made by one who is thoroughly familiar with the property itself and local market conditions that lies with the Clerk.

7. **Consumer Utility Tax: Pipeline Distribution Company.** P.D. 11-51 (April 5, 2011). The taxpayer is a parent holding company for numerous subsidiaries, including “Energy.” Energy performs fuel management services for all of the taxpayer's operating facilities. Energy purchases various types of fuel from utilities and other vendors, sells the fuel to the taxpayer and its subsidiaries, and facilitates the delivery of the fuel to operating facilities. In 1997, the taxpayer acquired a facility (the "Plant") that generates electric power in the City. Soon thereafter, Energy began purchasing and managing natural gas for use in the Plant's operations. The natural gas was transported by pipelines owned by a pipeline distribution company to a pipeline owned by the City. The City-owned pipeline connected the Plant and other natural gas consumers to the pipeline distribution company's line. The taxpayer paid the City a fee for transporting natural gas through the pipeline. In 2004, the City initiated an audit and determined that the taxpayer was subject to consumer utility tax on the natural gas used at the Plant. Assessments were issued for the January 2001 through December 2004 tax periods. The taxpayer timely filed an appeal of these assessments in March 2005. A subsequent audit resulted in assessments for the January 2005 through February 2008 tax periods followed by another timely appeal filed by the taxpayer. In August 2009, the City issued its final determination in both cases. The City found that: (1) the taxpayer was a consumer of natural gas subject to the consumer utility tax; (2) Energy was a pipeline distribution company required to collect the tax; (3) the City's assessment did not conflict with the "revenue neutrality" amendments enacted by the General Assembly in 2000. The taxpayer appealed the City's final determination to the Tax Commissioner. The taxpayer argued the consumer utility tax applies only to natural gas provided by a pipeline distribution company or gas utility.

The Tax Commissioner determined that the taxpayer is a pipeline distribution company and subject to the tax. For purposes of the consumer utility tax on natural gas, Va. Code § 58.1-3814(J) provides that the term "pipeline distribution company" has the same meaning as provided in Va. Code § 58.1-2600. Under this code section, a pipeline distribution company is "a corporation, other than a pipeline transmission company, which transmits, by means of a pipeline, natural gas, manufactured gas or crude petroleum and the products or by-products thereof to a purchaser for purposes of furnishing heat or light." In this case, Energy purchased natural gas from utilities and other suppliers and contracted with a pipeline company to deliver the gas to the City's pipeline where the gas was sold to the Plant. The taxpayer argued that Energy did not transmit or deliver gas to the Plant by means of a pipeline or otherwise and did not operate any natural gas pipeline. The City, on the other hand, concluded that Energy was a pipeline distribution company because it transmitted the gas through a pipeline to the Plant. The City points out that the statutes do not require a pipeline distribution company to physically deliver the gas to a purchaser. For purposes of the consumer utility tax, the Tax Commissioner determined that a pipeline distribution company could include a corporation that transmits or causes to be transmitted natural gas through a pipeline, whether owned or operated by such corporation or not, to a purchaser for purposes of furnishing heat or light.
8. Merchants' Capital Tax: Consignment Inventory. P.D. 11-63 (April 21, 2011). The taxpayer is an artist who produces works of art in her studio located in the County A. The taxpayer sells her work on consignment in a gallery located in the County B. County B imposes a merchants' capital tax in lieu of the Business, Professional, and Occupational License (BPOL) tax on merchants' gross receipts located in County B. The taxpayer asked whether art is inventory for purposes of the merchants' capital tax and sought an explanation of art inventory valuation. The Tax Commissioner said that the art would not be subject to merchants' capital tax. Citing 1972-1973 Op. Att'y General 407, the Tax Commissioner stated that inventory that is in possession of a dealer is subject to the merchants' capital tax if it is owned by the dealer, not if the dealer is holding the inventory on consignment for an owner. Citing 1990 Op. Att'y General 262 and 1988 Op. Att'y General 560, the Tax Commissioner stated that art that is inventory would be valued at 100% of the cost.

9. Watercraft Sales and Use Tax: Unreported Sales. P.D. 11-76 (May 23, 2011). The taxpayer sells, rents, and services boats and other watercraft. In addition, the taxpayer sells watercraft accessories. The Tax Department conducted an audit of the taxpayer's business as a result of an investigation by the Department of Game and Inland Fisheries. As a result of the Tax Department's audit, the taxpayer was assessed the retail sales and use tax on untaxed sales, asset and expense purchases. In addition, the taxpayer was assessed the watercraft sales and use tax on untaxed watercraft sales. The taxpayer contested the audit assessments and claims that it had no sales during the audit period. The Tax Commissioner upheld the assessment as the taxpayer's records that it made sales and rentals during the audit period and the taxpayer did not provide any evidence to the contrary.


12. Wireless E-911 Fee: Prepaid Phone Cards. P.D. 11-115 (June 21, 2011). An individual who represents approximately 48 clients who sell prepaid phone cards at retail requested a ruling regarding the application of the Prepaid Wireless E-911 Fee on such prepaid phone cards. The prepaid phone cards can be used for both landline and mobile phones and are not specifically for wireless calling service. The individual contended that the phone cards are not subject to the prepaid wireless E-911 fee. The Tax Commissioner disagreed as Virginia Code § 56-484.17:1 provides that a $0.50 prepaid wireless E-911 charge shall be collected by the dealer from the end user on each purchase of "prepaid CMRS" from a dealer for any purposes other than resale. "Prepaid CMRS" is defined as CMRS, or mobile telecommunications service, that allows a caller to dial 911 to access the 911 system, which CMRS service is required to be paid for in advance and is sold in predetermined units or dollars of which the number declines with use in a known amount.
13. **Recordation Tax: Refinancing Exemption.** P.D. 11-160 (September 19, 2011). The taxpayers refinanced their home mortgage in November 2007 through a broker, (the "Broker"), a subsidiary of the "Bank," in the County and paid the recordation tax. Mortgage payments under the agreement were made to the Bank's mortgage servicing center. In May 2010, the taxpayers again refinanced their mortgage through the Broker. When the deed was submitted for recording, the County concluded that the taxpayers were not entitled to the recordation tax exemption for refinancing with the same lender because the mortgage payments were made to the Bank rather than the Broker. The taxpayers paid the recordation tax based on the entire amount of the refinanced mortgage and filed an appeal contending the refinanced loan was made through the same lender.

Virginia Code § 58.1-803(A) imposes the recordation tax on deeds of trust, mortgages, and supplemental indentures. Under Va. Code § 58.1-803(D), when a deed of trust is used in refinancing an existing debt with the same lender and the tax has been previously paid on the original deed of trust securing the debt, the recordation tax will only apply to the portion of the deed of trust that exceeds the amount originally secured by the original debt. The Tax Department has defined "existing debt with the same lender" to mean that the lender providing the refinancing must be the same as the lender now holding the existing debt being refinanced. In other words, in order to qualify for the exemption provided in Va. Code § 58.1-803(D), a taxpayer must refinance his debt with the mortgage lender that holds the deed of trust. According to the evidence provided to the Tax Commissioner, the taxpayers refinanced their mortgage with the Broker in November 2007. The documentation indicated that the Broker sold its entire interest in the mortgage to the Bank. The Tax Department did not consider the Broker to be the same lender for the purposes of Va. Code § 58.1-803(D) when the taxpayers refinanced the mortgage in May 2010 as the Broker retained no interest in the original mortgage. Accordingly, the Tax Commissioner determined that the taxpayers were not entitled to the exemption from recordation tax for refinancing a mortgage with the same lender.

D. **Opinions of the Attorney General**

1. **Recordation Tax: Calculation of Tax.** 2011 Va. Att’y Gen. 11-073 (May 27, 2011). The Circuit Court Clerk of Henrico County inquired about how to calculate the recordation tax on deeds of trust when the amount secured under the deed is greater than the fair market value of the property subject to the deed. The Attorney General opined that when the amount secured by a deed of trust is known, the Clerk of Court should calculate the recordation tax based on the amount of indebtedness rather than the fair market value of the encumbered property. Prior opinions of the Attorney General have concluded that the measure of the recordation tax is the amount of the obligation secured, and that Va. Code sec. 58.1-803(A) provides that the tax is assessed on the basis of the fair market value of the property only where the amount of the obligation cannot be ascertained from the face of the instrument. This is so even where the amount of the loan secured is considerably less than the fair market value of the property. Furthermore, where the question presented was whether the tax should be based on the maximum amount authorized under the line of credit or the fair market value of the property, the Attorney General determined that the proper tax should be based upon the maximum amount for which the owners may be held liable under their guaranty. That maximum is the same maximum
amount which is authorized under the line of credit line and not the fair market value of the property conveyed.

2. **License Tax on Gas Producers.** 2011 Va. Att’y Gen. 10-110 (August 5, 2011). The Commissioner of the Revenue for Tazewell County inquired whether Va. Code § 58.1-3712, which authorizes localities to impose a license tax on gas producers, permits a taxpayer to deduct expenses and production costs from the gross receipts upon which the tax is imposed, when the receipts are for gas produced by means not in connection with coal mining. The Commissioner also inquired regarding the scope of the Commissioner’s ability to conduct audits relating to the collection of severance taxes authorized under Va. Code § 58.1-3712. The Attorney General opined that Va. Code § 15.2-3712 allows persons engaged in the production and operation of severing gas from the earth not in connection with coal mining to take certain deductions when the sale occurs at a point outside the county or city where the gas was extracted and the producer has incurred additional expenses for the gas to reach its destination. Those deductions might include, but are not limited to, depreciation, compression, maintenance, transportation fees, and personal property taxes; however, persons who are engaged in the production and operation of severing gas from the earth in connection with coal mining may not take such deductions. The Attorney General also opined that Commissioners of the Revenue are authorized to perform audits in connection with their duty to assess license taxes.
Local Tax Appeals
January 1, 2011 through September 20, 2011
10 Determinations

Taxpayer Wins*
9

Taxpayer Loses
1

Treatment on Remand

- No discretion (complete win)
  1

- Discretion on some issues**
  2

- Discretion on all issues***
  6

* A "win" is a ruling that does not completely affirm the locality's position(s).
** Taxpayer won on all issues not remanded.
*** One ruling (PD 11-51) remanded one issue; taxpayer lost on second issue.
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