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Annual Survey of Virginia Law: Taxation

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TAXATION

*Carle E. Davis**

In contrast to tax reform efforts in the federal arena, the Virginia General Assembly made relatively few changes to Title 58.1 of the Code of Virginia (the "Code"). The General Assembly enacted a number of miscellaneous bills, the most important of which affected the sales and use tax, and the real estate and recordation taxes. The Virginia Supreme Court and the Court of Appeals for the Fourth Circuit were likewise quiet in the area of Virginia taxation and rendered only three decisions, none of which is of major significance. After publishing numerous regulations in 1985, the Virginia Department of Taxation also reduced its volume of regulatory action. The only regulatory measure with continuing validity taken by the Department of Taxation involved net operating losses.

This article covers legislative and regulatory changes, and judicial decisions affecting Virginia taxation from July 1985 to July 1986. Its purpose is to alert Virginia's tax practitioners, as well as general practitioners, to these decisions and changes.

I. LEGISLATIVE ACTIVITY IN 1986

A. *Changes Affecting Virginia's Income Tax*

The General Assembly passed only one bill in its 1986 session affecting the income tax. House Bill 370 allows a taxpayer to deduct an additional \$1,000 for each child residing in his home under a permanent foster care placement.¹ This deduction is available for

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1. VA. CODE ANN. § 58.1-322(D)(4) (Cum. Supp. 1986). "Permanent foster care placement" is defined as in Chapter 10 of Title 63.1 of the Code of Virginia:

"Permanent foster care placement" means the place of residence in which a child resides and in which he or she has been placed pursuant to the provisions of §§ 63.1-56 and 63.1-206.1 with the expectation and agreement between the placing agency and the place of permanent foster care that the child shall remain in the placement until he or she reaches the age of majority unless modified by court order or unless

taxable years beginning on and after January 1, 1986.²

B. *Changes Affecting Real Estate and Recordation Taxes*

The General Assembly passed several bills in 1986 modifying real estate and recordation taxes. Previously, certificates and notices affecting federal tax liens had to be filed in the appropriate deed book in the office of the clerk of the circuit court where the real property subject to the federal tax lien is located.³ Pursuant to Senate Bill 157, certificates of redemption affecting federal tax liens must also be filed in the same manner.⁴ This change became effective on July 1, 1986.⁵

House Bill 554 amended sections 58.1-3220 and 58.1-3221 of the Code of Virginia relating to the exemption from real estate taxation available to residential, commercial, and industrial real estate.⁶ Before this amendment, the exemption commenced on January 1 of the year following the completion of the rehabilitation.⁷ The amendment allows the exemption to commence either on the date of the completion of the rehabilitation or on January 1 of the year following completion of the rehabilitation.⁸

In addition, the General Assembly amended section 58.1-3213 of the Code relating to tax relief for permanently and totally disabled individuals.⁹ The amendment eliminated the requirement that a person under the age of sixty-five must obtain certification of his disability from the Social Security Administration in order to qualify for relief from property taxation.¹⁰

House Bill 221 added the City of Virginia Beach to the list of jurisdictions that may require deeds and other instruments conveying or relating to interests in real property to bear a tax map

removed pursuant to § 16.1-251 or § 63.1-248.9. A permanent foster care placement may be a place of residence of any natural person or persons deemed appropriate to meet a child's needs on a long term basis.

Id. § 63.1-195.

2. 1986 Va. Acts 1005, 1007.

3. VA. CODE ANN. § 55-142.1(a) (Repl. Vol. 1986).

4. *Id.* § 55-142.1 (Cum. Supp. 1986). The General Assembly also removed the anachronistic reference to corporation courts. 1986 Va. Acts 502, 502.

5. VA. CODE ANN. § 55-142.1 (Cum. Supp. 1986).

6. *Id.* §§ 58.1-3220, -3221.

7. *Id.* §§ 58.1-3220, -3221 (Repl. Vol. 1984).

8. *Id.* §§ 58.1-3220, -3221 (Cum. Supp. 1986).

9. *Id.* § 58.1-3213.

10. *Id.*

reference number in the left margin of the first page.¹¹ Previously, the list included the following jurisdictions: (1) Arlington County; (2) Fairfax County; (3) the City of Alexandria; (4) the City of Fairfax; and (5) the City of Falls Church.¹² House Bill 221 also allows each of the listed jurisdictions to require the parcel identification number in lieu of the tax map reference number.¹³ These changes became effective on July 1, 1986.¹⁴

The General Assembly also provided relief to purchasers of real property who do not receive the tax bill because it is mailed to the former owner of the property. To solve this problem, the General Assembly amended section 58.1-3916 of the Code to include the following provision:

In the event a transfer of real property ownership occurs after January 1 of a tax year and a real estate tax bill has been mailed pursuant to §§ 58.1-3281 and 58.1-3912, the treasurer, or other appropriate local official designated by ordinance of the local government body in jurisdictions not having a treasurer, upon ascertaining that a property transfer has occurred, may invalidate a bill sent to the prior owner and reissue the bill to the new owner as permitted by § 58.1-3912, and no penalty for failure to pay any tax for any such assessment shall be imposed if the tax is paid within 2 weeks after the notice thereof is mailed.¹⁵

This provision became effective on July 1, 1986.¹⁶

C. *Changes Affecting the Sales and Use Tax*

In both its 1985 and 1986 sessions, the General Assembly passed several bills exempting certain items and sales from the sales and use tax effective July 1, 1986.¹⁷ Included among the exempted items and sales are: (1) certain printed material such as brochures,¹⁸ (2) advertising,¹⁹ (3) tangible personal property sold

11. *Id.* § 17-79.3.

12. *Id.* § 17-79.3 (Repl. Vol. 1982).

13. *Id.* § 17-79.3 (Cum. Supp. 1986).

14. *Id.*

15. *Id.* § 58.1-3916.

16. *Id.*

17. All of these exemptions are amendments to either § 58.1-602 or § 58.1-608, or both, of the Code of Virginia.

18. VA. CODE ANN. § 58.1-608(30) (Cum. Supp. 1986). As amended, this section exempts the following printed materials from the sales and use tax:

Catalogs, letters, brochures, reports, and similar printed materials, except administra-

to certain foundations involved in crime prevention or training and educating employees of governmental law enforcement organizations;²⁰ (4) high speed electrostatic duplicators and certain other duplicators purchased or leased by persons primarily engaged in the printing or photocopying of products for sale or resale;²¹ (5) tangible personal property withdrawn from inventory and donated either to a charitable organization or the Commonwealth of Virginia or any of its subdivisions, schools, agencies, or instrumentalities;²² (6) tangible personal property purchased by a Parent Teacher Association or similar group;²³ (7) computer "custom programs" specifically designed and developed for one customer;²⁴

tive supplies, the envelopes, containers and labels used for packaging and mailing same, and paper furnished to a printer for fabrication into such printed materials, when stored for twelve months or less in the Commonwealth and distributed for use without the Commonwealth. As used in this subdivision, "administrative supplies" shall include, but not be limited to, letterhead, envelopes, and other stationery, invoices, billing forms, payroll forms, price lists, time cards, computer cards, and similar supplies.

Id. This provision is only effective until June 30, 1990. 1985 Va. Acts 729, 733.

19. VA. CODE ANN. § 58.1-602(23). Advertising is defined as "the planning, creating, or placing of advertising in newspapers, magazines, billboards, broadcasting and other media, including, without limitation, the providing of concept, writing, graphic design mechanical art, photography and production supervision." *Id.*

20. *Id.* § 58.1-608(62). This section limits the exemption to sales made to non-profit foundations. *Id.* The foundation must *exclusively* provide "either training and education of any type or duration for employees of governmental law-enforcement and corrections agencies or education of the public in citizen cooperation with public authorities in crime prevention and solution." *Id.*

21. *Id.* § 58.1-608(65). The duplicators must have a capacity of 4,000 or more impressions per hour. *Id.*

22. *Id.* § 58.1-608(59). A charitable organization is one exempt from taxation under I.R.C. § 501(c)(3). *Id.* In addition, House Bill 26 included a provision exempting purchases by certain charitable organizations at Christmas from the sales and use tax:

Tangible personal property purchased by an organization which is exempt from taxation under § 501(c)(3) of the Internal Revenue Code and which is organized primarily to distribute, during the Christmas season, food, toys, and clothing to persons in financial need, provided such tangible personal property is distributed at no cost to financially needy persons.

Id.

23. *Id.* § 58.1-608(63). The PTA or other group must be associated with a primary or secondary school which is operated not for profit. The property must be purchased for fundraising activities, and the net proceeds must be contributed directly to the school or used to purchase "certified school equipment." *Id.* "Certified school equipment" is defined as equipment for which the PTA or other group has received certification from the school that it will accept the property. *Id.*

24. *Id.* § 58.1-602(19). The combining of two or more pre-written programs does not constitute a custom computer program. "Pre-written programs" are those held for general or repeated sale or lease, including programs developed for in-house use and subsequently sold or leased to unrelated third parties. *Id.* Pre-written programs that are modified to any degree remain pre-written programs and do not become custom programs. *Id.*

(8) tangible personal property purchased for use or consumption by residential youth shelter organizations;²⁵ (9) tangible personal property purchased by non-profit American Indian organizations for nationwide charitable distribution purposes;²⁶ (10) tangible personal property purchased with food coupons or pursuant to the Virginia Special Supplemental Food Program for Women, Infants, and Children (WIC drafts);²⁷ (11) tangible personal property purchased by baptistries;²⁸ and (12) bulletins, programs, newspapers and newsletters not containing paid advertising that are used in carrying out the work of the church.²⁹ Any watercraft purchased by or for the use of a volunteer sea rescue squad is exempt from the watercraft sales and use tax.³⁰

D. *Miscellaneous*

1. Alcohol Fuel Production Incentive Program Fund

The General Assembly enacted a new article to be included in Title 58.1, creating an Alcohol Fuel Production Incentive Program Fund.³¹ Under this legislation, a producer of anhydrous ethyl alcohol receives a monthly grant if certain requirements are met. The anhydrous ethyl alcohol must be distilled: (1) in Virginia; (2) from agricultural, forestry or waste products; and (3) in a plant which does not use natural gas or a petroleum-based product as a primary fuel.³² The anhydrous ethyl alcohol must also be: (1) denatured; (2) produced for resale; and (3) intended for blending with

25. *Id.* § 58.1-608(61). The residential youth shelter organization must be exempt from taxation under I.R.C. § 501(c)(3) and must be "organized exclusively for maintaining and operating group homes for the shelter and care of abused and neglected children in the Commonwealth on a long-term or short-term basis." *Id.* § 58.1-608(61).

26. *Id.* § 58.1-608(58). The organization must be exempt from taxation under I.R.C. § 501(c)(3) and must be organized (i) to care for the spiritual needs of American Indians, (ii) to communicate to the non-Indian the values, customs, philosophy, and special needs of the American Indian, (iii) to meet the urgent needs of American Indians through nationwide charitable distribution programs, and (iv) to encourage awareness of American Indian arts, crafts, and customs. *Id.*

27. *Id.* § 58.1-608(66). These acts also amended § 58.1-3840 of the Code of Virginia to provide that cities or towns may not impose excise taxes on cigarettes, admissions, transient room rentals, meals and travel campgrounds purchased with such food coupons or WIC drafts.

28. *Id.* § 58.1-608(38).

29. *Id.*

30. *Id.* § 58.1-1404(F).

31. *Id.* §§ 58.1-2127.1 to -2127.6.

32. *Id.* § 58.1-2127.2.

motor fuels.³³

If these requirements are met, the producer is entitled to the monthly grant at the statutory rate. From July 1, 1986 to June 30, 1988, the rate of the grant is sixty cents per gallon. From July 1, 1988 to June 30, 1990, the rate decreases to forty cents per gallon. From July 1, 1990 to June 30, 1992, the rate again decreases to twenty cents per gallon.³⁴

2. Local Tax Penalties and Assessment of Omitted Taxes

Effective July 1, 1986, the penalties for failure to pay a local tax or file a local tax return cannot exceed the amount of tax due or tax assessable, as the case may be.³⁵ In addition, if a taxpayer receives an erroneous refund, the Virginia Department of Taxation may not assess a penalty or interest if the refund is remitted to the Department within thirty days of the date of the tax bill.³⁶ If the taxpayer does not remit the tax within thirty days, interest accrues from the date of assessment until payment.³⁷

Criminal penalties may now be asserted against a taxpayer for "willful failure or refusal to file" a local tax return on time or "for making false statements with intent to defraud" on a local tax return.³⁸ The penalty is the same as a Class 3 misdemeanor "if the amount of the tax lawfully assessed in connection with the return is \$1,000 or less."³⁹ If more than \$1,000, the penalty is that prescribed for a Class 1 misdemeanor.⁴⁰

3. Collection of Taxes

House Bill 494 authorizes any county or city treasurer or his deputy to institute suits against and to prosecute delinquent tax-

33. *Id.*

34. *Id.*

35. *Id.* § 58.1-3916. Under previous law, the amount of the penalty for failing to file a local tax return or to pay a local tax was the greater of \$10 or 10% of the tax owed or assessable. *Id.* § 58.1-3916 (Repl. Vol. 1984).

36. *Id.* § 58.1-1812(B) (Cum. Supp. 1986). An "erroneous refund" is "any refund of tax resulting solely from an error by the Department of Taxation which results in the taxpayer receiving a refund to which the taxpayer is not entitled." *Id.*

37. *Id.*

38. *Id.* § 58.1-3916.1. As previously written, this section referred to an "intentional failure to file" a local tax return.

39. *Id.*

40. *Id.*

payers.⁴¹ Such appearance may be in person or by counsel.⁴² Furthermore, such county and city treasurers may now use distress, as set forth in section 58.1-3919 of the Code, to collect delinquent taxes.⁴³

4. Summoning Taxpayers

House Bill 481 limits the power of the Commissioner of the Revenue when summoning taxpayers for interrogation.⁴⁴ This act amends section 58.1-3110 of the Code so that a taxpayer can be interrogated about the tax liability of other persons only if the Commissioner "specifically" identifies any taxpayer whose tax liability is in question.⁴⁵

5. Corporate Registration Fees

The General Assembly repealed the annual franchise tax on domestic corporations.⁴⁶ The annual registration fee is no longer computed based on the amount of the authorized capital of a corporation. Instead, the annual registration fee is determined according to the number of authorized shares.⁴⁷ If the number of authorized shares is 5,000 or less, the annual registration fee is \$50. If a corporation has more than 5,000 authorized shares, the annual registration fee is \$50 plus \$15 for each 5,000 shares or fraction thereof in excess of 5,000, up to a maximum of \$850. For example, if a corporation has 6,000 authorized shares, the annual registration fee is \$50 plus \$15 for the additional 1,000 shares. Thus, the total fee is \$65. These changes became effective on January 1, 1986.⁴⁸

Practitioners should take these new annual registration fees into account when incorporating small businesses, as the number of shares authorized can significantly affect the tax cost to the corporation.

41. *Id.* § 58.1-3919.

42. *Id.*

43. *Id.* § 58.1-353.

44. *Id.* § 58.1-3110.

45. *Id.*

46. *Id.* § 58.1-2804; *see id.* § 58.1-2808 (Cum. Supp. 1985).

47. *Id.* § 58.1-2804 (Cum. Supp. 1986).

48. 1986 Va. Acts 1, 2.

6. Setoff Debt Collection Act

House Bill 179 makes several definitional amendments to the Setoff Debt Collections Act and authorizes the Tax Commissioner to issue rules relating to the notice requirements under this Act.⁴⁹ Under these amendments, the "mailing date of notice" as used in the Act means the date appearing on the notice.⁵⁰ Section 58.1-525 of the Code is amended to require a claimant agency to mail written notification to the debtor at his last known address and to send evidence of such notification to the Department of Taxation "in the manner required by rules promulgated by the Tax Commissioner."⁵¹

7. Enforcement and Collection of Motor and Special Fuel Taxes

The amendments made by House Bill 555 authorize any person assessed with any tax administered by the Department of Motor Vehicles to apply for relief to the Commissioner within thirty days of the assessment.⁵² The application must be in the form prescribed by the Commissioner and must set forth all relevant facts, the grounds upon which the taxpayer is relying and any additional information, testimony or documents that the Commissioner deems necessary.⁵³ The Commissioner shall refrain from collecting the tax upon receipt of a written notice of intent to apply for relief until the time for filing has expired.⁵⁴ If the Commissioner believes the collection of the tax is in jeopardy during this time, the amendments set forth the requirements and procedure for making a jeopardy assessment.⁵⁵

49. VA. CODE ANN., §§ 58.1-520, -521, -525.

50. *Id.* § 58.1-520.

51. *Id.* § 58.1-525.

52. *Id.* § 58.1-2131.1. An "assessment" is "a written determination by the Department of Motor Vehicles of the amount of taxes owed by the taxpayer." *Id.* § 58.1-2101. Assessments are deemed to be made "when a written notice of assessment is delivered to the taxpayer by the Department of Motor Vehicles or is mailed by certified or registered mail to the taxpayer at his last known address." *Id.*

53. *Id.* § 58.1-2131.1.

54. *Id.*

55. *Id.* § 58.1-2132.1. The statute relating to jeopardy assessments provides:

If the Commissioner is of the opinion that the collection of any tax or any amount of tax required to be collected and paid under this chapter will be jeopardized by delay, he shall make an assessment of the tax or amount of tax required to be collected and shall mail or issue a notice of such assessment to the taxpayer together with a demand for immediate payment of the tax or of the deficiency in tax declared to be in jeopardy including penalties and interest. In the case of a tax for a current period, the

Once taxes, including penalties or interest, are delinquent or past due, the Commissioner may file a memorandum of lien in the clerk's office of the circuit court in the city or county where the taxpayer's place of business is located or where the taxpayer resides, or, if neither is located in the Commonwealth of Virginia, in the Circuit Court of the City of Richmond.⁵⁶ The memorandum may also be filed in any county or city where the taxpayer owns real estate.⁵⁷

II. JUDICIAL DECISIONS

A. *Local Taxation of Alcoholic Beverages*

In *City of Virginia Beach v. Virginia Restaurant Association, Inc.*,⁵⁸ the Virginia Supreme Court held that the proscription against local regulation of alcoholic beverages is limited to the exercise of local police powers, and not local taxing powers. The City of Virginia Beach, by ordinance, imposed a six percent retail sales tax on all foods sold in city restaurants. Food included "any and all refreshments and nourishment, liquid or otherwise."⁵⁹ The Virginia Restaurant Association filed a petition for declaratory judgment asking that the trial court void the tax as it applied to the sale of alcoholic beverages.

The trial court determined that section 4-96 of the Code, which precludes a locality from "regulating" the sale of alcoholic beverages, prohibits a locality from taxing such sales.⁶⁰ On appeal, the

Commissioner may declare the taxable period of the taxpayer immediately terminated and shall cause notice of such finding and declaration to be mailed or issued to the taxpayer together with a demand for immediate payment of the tax based on the period declared terminated and such tax shall be immediately due and payable, whether or not the time otherwise allowed by law for filing a return and paying the tax has expired. Assessments provided for in this section shall become immediately due and payable, and if any such tax, penalty or interest is not paid upon demand of the Commissioner, he may proceed to collect the same by legal process, including but not limited to filing a memorandum of lien pursuant to § 58.1-2132.2, or, in his discretion, he may accept surety bond or other security deemed sufficient to ensure full payment of the amount of tax, penalty and interest assessed against the taxpayer.

Id.

56. *Id.* § 58.1-2132.2. The memorandum of lien will be recorded in the judgment docket book and will have the effect of a judgment in favor of the Commonwealth of Virginia. A writ of fieri facias may be issued any time after the memorandum is filed. *Id.*

57. *Id.* The lien on the real estate is effective at the time the memorandum is filed in the jurisdiction where the real estate is located. *Id.*

58. 231 Va. 130, 341 S.E.2d 198 (1986).

59. Virginia Beach City Code § 35-136 (1981).

60. *Virginia Restaurant Ass'n, Inc.*, 231 Va. at 131, 341 S.E.2d at 198; see VA. CODE ANN.

Virginia Supreme Court reversed the trial court's decision. The court examined section 4-96 and concluded that the term "regulation" does not include "taxation." "[R]egulation is based on the police power while taxation is based on the taxing power."⁶¹ Since the ordinance's purpose was to raise general revenues, it was an exercise of the city's taxing power and not its police power.⁶²

B. *Railroad Revitalization and Regulatory Reform Act of 1976*⁶³

In *Richmond, Fredericksburg and Potomac Railroad Co. v. State Corporation Commission*,⁶⁴ the Virginia Supreme Court held that local tax assessments of parcels of railroad property did not violate the anti-discrimination provisions of the Railroad Revitalization and Regulatory Reform Act of 1976 (the "Act") because the railroad's property was assessed and taxed in the same manner as other commercial and industrial property in the county.⁶⁵ Arlington County assessed, and Richmond, Fredericksburg and Potomac Railroad Co. (R, F & P) paid, a tax on real property over which R, F & P had easements at a rate of ninety-nine cents per \$100 of assessed valuation based on an assessment of 100 percent of the property's fair market value. Because all real property in Arlington

§ 4-96 (Repl. Vol. 1983), which states in relevant part, "[n]o county, city or town shall, except as otherwise provided in § 4-38 or § 4-97, pass or adopt any ordinance or resolution regulating or prohibiting the manufacture, bottling, possession, sale, distribution, handling, transportation, drinking, use, advertising or dispensing of alcoholic beverages in Virginia."

61. *Virginia Restaurant Ass'n, Inc.*, 231 Va. at 134, 341 S.E.2d at 200.

62. *Id.*

63. 45 U.S.C. §§ 801-855 (1982).

64. 230 Va. 260, 336 S.E.2d 896 (1985).

65. Section 306(1)(b) of the Railroad Revitalization and Regulatory Reform Act of 1976 provided:

The following acts unreasonably burden and discriminate against interstate commerce, and a State, subdivision of a State, or authority acting for a State or subdivision of a State may not do any of them:

- (1) assess rail transportation property at a value that has a higher ratio to the true market value of the rail transportation property than the ratio that the assessed value of other commercial and industrial property in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.
- (2) levy or collect a tax on an assessment that may not be made under clause (1) of this subsection.
- (3) levy or collect an ad valorem property tax on rail transportation property at a tax rate that exceeds the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.
- (4) impose another tax that discriminates against a rail carrier providing transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title.

49 U.S.C. § 11503(b) (1982).

County was assessed at 100 percent of its fair market value, and all commercial and industrial property was taxed at a rate of ninety-nine cents per \$100 of assessed value, the court held that Arlington County did not discriminate against R, F & P in violation of the Act.⁶⁶

In a similar case brought by R, F & P in federal court, the Fourth Circuit Court of Appeals held that Virginia's net income tax did not discriminate against railroads in violation of the Act.⁶⁷ Virginia imposes a corporate net income tax on commercial and industrial corporations, including railroads. This tax is based on the corporation's federal taxable income after certain adjustments.⁶⁸ Before 1978, railroads had been subject only to a franchise tax based on their gross transportation receipts, which did not include income from other sources, unlike Virginia's corporate net income tax.⁶⁹ In 1978, railroads in Virginia were subjected to the Virginia net income tax and relieved of the franchise tax.⁷⁰ The court held that section 306 of the Act applied to Virginia's corporate net income tax, but that this tax did not discriminate against railroads.⁷¹

III. REGULATIONS

A. *Sales and Use Tax*

The Virginia Department of Taxation enacted Regulation VR 630-10-3 regarding the production of commercial advertisements. Under VR 630-10-3, the production of commercial advertisements is deemed to be the production of tangible personal property and therefore is subject to the sales and use tax.⁷² This regulation expired on June 30, 1986, when contrary legislation enacted by the 1985 General Assembly became effective.⁷³

66. *Richmond, F.&P. R.R.*, 230 Va. at 262, 336 S.E.2d at 897.

67. *Richmond, F.&P. R.R. v. Department of Taxation*, 762 F.2d 375 (4th Cir. 1985).

68. VA. CODE ANN. §§ 58.1-400 to -421 (Repl. Vol. 1984 & Cum. Supp. 1985).

69. *See id.* § 58-519 (Repl. Vol. 1974) (amended by 1978 Va. Acts 1343).

70. 1978 Va. Acts 1343.

71. *Richmond, F.&P. R.R.*, 762 F.2d at 380-81.

72. Va. Dep't of Tax'n Reg. VR 630-10-3 (1986).

73. *See supra* note 14 and accompanying text.

B. *Net Operating Losses*

Regulation VR 630-2-311.1, enacted by the Virginia Department of Taxation, deals with the Virginia income tax treatment of federal net operating losses. Since there is no express statutory authority for a separate Virginia net operating loss, the amount of federal net operating loss is the starting point in computing the amount of the deduction allowed on a Virginia return. The amount of federal net operating loss is increased or decreased by an amount that equals the sum of the modifications required by the Code in the loss year. This net amount of Virginia modification in the loss year is to be reported as a separate item and a proportionate share of its sum will follow the federal loss to the year in which the loss is utilized.⁷⁴

74. Va. Dep't of Tax'n Reg. VR 630-2-311.1 (1986).