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TAXATION

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In an effort to coordinate Virginia's income tax with the federal income tax as amended by the federal Tax Reform Act of 1986, the Virginia General Assembly passed several bills amending the individual and corporate income tax provisions of title 58.1 of the Code of Virginia (the "Code"). In addition, the General Assembly enacted several miscellaneous bills, the most important of which covered changes to the sales and use tax and the real estate and recordation taxes.

As in the past, the Virginia Supreme Court and the federal courts in Virginia were relatively quiet in the area of Virginia taxation and rendered only four decisions, none of which is of major significance. The Virginia Department of Taxation finalized numerous regulations involving the income tax and sales and use tax and also adopted proposed and emergency regulations regarding the sales and use tax.

This article covers legislative and regulatory changes and judicial decisions affecting Virginia taxation from July, 1986 to July, 1987. Its purpose is to alert Virginia's tax practitioners, as well as general practitioners, to these changes and decisions.

I. Legislative Activity

A. *Changes Affecting Virginia's Income Tax*

1. Individual Income Tax

Senate Bill 421 and House Bill 1043 amended the provisions of the Code regarding the payment of estimated taxes by individuals to comply with the change in the federal law requiring 90% rather than 80% of individual income tax to be remitted by estimated

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and withholding payments.[1] Thus, resident and nonresident individuals in Virginia must remit 90% of their individual income tax by means of estimated or withholding payments to avoid a penalty.[2] Alternatively, as under past and present federal law, payment of 100% of the previous year's tax liability avoids the penalty.[3] In addition, the Tax Commissioner is authorized to establish, by regulation, the amount an individual's taxable income must exceed before the individual is required to declare and pay estimated taxes.[4]

To determine the interest rate on estimated tax underpayments by an individual filing other than on a calendar year basis, the underpayment rate which applies during the third month following the close of such taxable year also applies during the first fifteen days of the fourth month following the close of the taxable year. In the case of an individual filing on a calendar year, the underpayment rate for the third month after the close of the calendar year applies until May 1.[5] These provisions are effective beginning January 1, 1987.[6]

The General Assembly also amended Virginia's individual income tax structure. More specifically, it increased the minimum individual income filing threshold, the standard deduction, the personal exemption and the income level at which an individual becomes subject to the maximum tax rate.[7] Under section 58.1-320 of the Code, the individual tax rates and brackets for 1987, 1988, 1989 and thereafter are:[8]

1987			
$	0 -	$ 3,000	2%
$	3,001 -	$ 5,000	3%
$	5,001 -	$14,000	5%
	Over	$14,000	5¾ %

1. VA. CODE ANN. § 58.1-492(A)(1) (Cum. Supp. 1987).
2. *Id.*
3. *Id.* § 58.1-492(C)(1)(a).
4. *Id.* § 58.1-490(A).
5. *Id.* § 58.1-15(B).
6. 1987 Va. Acts 648, 991, 1006.
7. 1987 Va. Acts 13, 14-16 (codified as amended at VA. CODE ANN. §§ 58.1-320 to -322 (Cum. Supp. 1987)).
8. VA. CODE ANN. § 58.1-320.

1988		
$ 0	- $ 3,000	2%
$ 3,001	- $ 5,000	3%
$ 5,001	- $15,000	5%
Over	$15,000	5¾ %

1989		
$ 0	- $ 3,000	2%
$ 3,001	- $ 5,000	3%
$ 5,001	- $16,000	5%
Over	$16,000	5¾ %

After 1989		
$ 0	- $ 3,000	2%
$ 3,001	- $ 5,000	3%
$ 5,001	- $17,000	5%
Over	$17,000	5¾ %

The minimum threshold of adjusted gross income that must be met before an individual must file a return and before which no tax is owed is raised from $3,000 to $5,000 for single individuals and from $3,000 to $8,000 for married individuals filing jointly. The threshold for married individuals filing separately is $4,000.[9] The standard deduction is increased beginning in 1987 as follows:[10]

Filing Status	1987	1988	After 1988
Single	$2,000	$2,700	$3,000
Married filing jointly	$2,000	$5,000	$5,000
Married filing separately	$1,000	$2,500	$2,500

For 1987, every taxpayer is entitled to a $700 personal exemption.[11] After 1987 the personal exemption increases to $800.[12] For all taxable years after 1987, blind and elderly taxpayers receive an additional personal exemption. In 1987, the blind and elderly receive an additional deduction of $200 regardless of whether or not the taxpayer itemizes deductions.[13]

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9. *Id.* § 58.1-321(A).

10. *Id.* § 58.1-322(D)(1)(b). In accordance with the provisions of the Tax Reform Act of 1986 regarding the unearned income of minor children, any person who may be claimed as a dependent on another's tax return may compute his standard deduction only with respect to earned income. *Id.*

11. *Id.* § 58.1-322(D)(2)(a).

12. *Id.*

13. *Id.* § 58.1-322(D)(2)(a)-(b).

The General Assembly repealed the addition to federal adjusted gross income for accelerated depreciation under the federal Accelerated Cost Recovery System effective for taxable years beginning after 1987.[14] Individual taxpayers, however, may recover outstanding amounts in excess cost recovery at the rate of 66.7% in 1988 and 33.3% in 1989.[15]

Effective for taxable years beginning after 1988, persons receiving wages for active or inactive service in the Virginia National Guard may deduct the lesser of $3,000 or the amount of income derived from thirty-nine calendar days of service.[16] This deduction is only available for persons in the ranks of 0-3 and below.[17]

Several amendments have been made to the subtractions and additions to federal adjusted gross income required to compute Virginia taxable income in response to the Tax Reform Act of 1986. First, the Virginia addition requirement of the federal two-earner married couple deduction was repealed.[18] Second, the previously required subtraction for the amount of employer contributions to an employee stock ownership plan was repealed.[19] Third, amounts deducted under the new federal Alternative Depreciation System are not subject to excess cost recovery additions and subtractions.[20] All of these provisions are effective for taxable years beginning after 1987.[21]

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14. 1987 Va. Acts 13, 15.

15. VA. CODE ANN. § 58.1-323.1(A)-(B) (Cum. Supp. 1987). The newly created "Excess Cost Recovery Repeal Fund" provides:

> Beginning with the 1988-89 fiscal year, the amount estimated by the Tax Commissioner which is collected annually in Virginia individual and corporate income tax revenue as a result of accounting changes mandated by the Federal Tax Reform Act of 1986 shall be transferred annually, prior to the end of each fiscal year, to a special nonreverting trust fund which is hereby established on the books of the Comptroller and which shall be called the Excess Cost Recovery Repeal Fund. All interest earned on money in the fund shall remain in the fund. Amounts in the fund shall be used to offset a portion of the cost of repealing the excess cost recovery program as provided in § 58.1-323.1.

Id. § 58.1-323.2.

16. *Id.* § 58.1-322(C)(11).

17. *Id.*

18. 1987 Va. Acts 648, 649.

19. *Id.* at 651.

20. VA. CODE ANN. § 58.1-323(A)(iv).

21. 1987 Va. Acts 648, 655.

2. Corporate Income Tax

Senate Bill 554 broadened the base of S corporation taxable income to conform to federal law by exempting S corporations from tax "to the extent that they are exempt from income tax under the laws of the United States."[22] Those S corporations subject to federal income tax are now subject to Virginia income tax for taxable years beginning in 1987.[23] The General Assembly also restored the special bad debt deduction for savings and loan associations to the percentage of income used before the Tax Reform Act of 1986 which was 40%.[24]

Corporate taxpayers, like individual taxpayers, may recover outstanding amounts in excess cost recovery which had not previously been subtracted at the following rates:[25]

Taxable Years Beginning in	1988	10%
	1989	10%
	1990	30%
	1991	30%
	1992	20%

3. Miscellaneous Income Tax Provisions

Senate Bill 554 amended Code section 58.1-15 regarding the rate of interest on underpayments and overpayments of tax to conform to changes made to the Internal Revenue Code by the Tax Reform Act of 1986.[26] The amended section 58.1-15 applies a differential interest rate depending upon whether an underpayment or overpayment is involved in accordance with the provisions of section 6621(a) of the Internal Revenue Code of 1986.[27]

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22. VA. CODE ANN. § 58.1-401(4) (Cum. Supp. 1987).

23. *Id.*

24. *Id.* § 58.1-403(1) (effective for taxable years beginning after 1986).

25. *Id.* § 58.1-323.1(C).

26. These changes apply not only to income taxes, but to all taxes under title 58.1 of the Code unless otherwise provided. VA. CODE ANN. § 58.1-15 (Cum. Supp. 1987).

27. *Id.* § 58.1-15(A). Section 6621(a) of the Internal Revenue Code provides:

> (1) Overpayment Rate—The overpayment rate established under this section shall be the sum of -
>
> (A) the short-term Federal rate determined under subsection (b), plus
>
> (B) 2 percentage points.
>
> (2) Underpayment Rate—The underpayment rate established under this section shall be the sum of -
>
> (A) the short-term Federal rate determined under subsection (b), plus
>
> (B) 3 percentage points.

I.R.C. § 6621(a) (1986).

In conformity with changes made by the Tax Reform Act of 1986, every trust and every estate with respect to any taxable year ending two or more years after the decedent's death must pay estimated taxes if its Virginia taxable income is reasonably expected to exceed $400.[28] The fiduciary of the estate or trust is responsible for making the estimated tax payments.[29] The declaration of estimated tax must be filed with the commissioner of the revenue for the county or city in which the fiduciary qualified, or if the fiduciary has not qualified, for the city or county in which the fiduciary resides, does business or has an office or where any of the beneficiaries reside.[30] These provisions are effective for taxable years beginning after 1987.[31]

B. *Changes Affecting the Generation-Skipping Transfer Tax*

Senate Bill 554 amended the generation-skipping transfer tax to conform to the new federal generation-skipping transfer tax.[32] These provisions are effective for generation-skipping transfers occurring after October 22, 1986.[33]

C. *Changes Affecting the Sales and Use Tax*

In its 1987 session, the General Assembly passed several bills exempting certain items and sales from the sales and use tax.[34] Effective January 1, 1985, tangible personal property purchased by health maintenance organizations licensed under chapter 43 of title 38.2 are exempt from the retail sales and use tax if the health maintenance organization is exempt from taxation under section 501(c)(3) of the Internal Revenue Code.[35] Effective July 1, 1986, tangible personal property purchased by a nonprofit elementary or secondary school and sales of class rings and school photographs

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28. VA. CODE ANN. 58.1-490(A) (Cum. Supp. 1987).

29. *Id.* § 58.1-490(M). If an overpayment of estimated tax is made, the fiduciary shall receive the refund. No beneficiary of an estate or trust is entitled to a credit against his individual income tax for any overpayment of estimated tax by the estate or trust. *Id.*

30. *Id.* § 58.1-493(B).

31. 1987 Va. Acts 648, 655.

32. VA. CODE ANN. § 58.1-936 (Cum. Supp. 1987).

33. 1987 Va. Acts 648, 655.

34. All of these exemptions are amendments to § 58.1-608 of the Code of Virginia.

35. VA. CODE ANN. § 58.1-608(66) (Cum. Supp. 1987). This provision was inadvertently omitted during the recodification of title 58 in 1985.

are exempt from the retail sales and use tax.[36]

Additional items and sales exempted from the sales and use tax as of July 1, 1987 include: (1) tangible personal property purchased by a section 501(c)(3) organization that is organized "exclusively for the purpose of providing education, training, services and assistance in independent living to foster care children and youth without families";[37] (2) medicines, drugs and prescriptions dispensed or sold by veterinarians;[38] (3) tangible personal property purchased by a community health center exempt from tax under section 501(c)(3) that is established "for the purpose of providing health care services for areas of [Virginia] containing a medically underserved population";[39] (4) tangible personal property purchased by a nonprofit, nonstock Virginia corporation exempt from taxation under section 501(c)(3) and organized "exclusively for the purpose of conducting a clinic furnishing free health care services by licensed physicians and dentists";[40] (5) food, disposable serving items, cleaning supplies, and teaching materials used in operating church camps or conference centers designed to further the church's work;[41] and (6) parts, tires, meters and dispatch radios sold or leased to taxicab operators for use *directly* in their business.[42] Until July 1, 1992 the maximum sales tax that may be levied upon sales of watercraft sold in Virginia or required to be titled in Virginia is $1,000.[43]

D. *Changes Affecting the Real Estate and Recordation Taxes*

Senate Bill 593, House Bill 1157, and House Bill 1545 amended sections 58.1-3211 and 58.1-3215 of the Code regarding the real

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36. *Id.* § 58.1-608(63). The exemption applies even if the school receives a commission or the net proceeds after the payment of the vendors and other direct expenses. *Id.*

37. *Id.* § 58.1-608(67).

38. *Id.* § 58.1-608(21). The veterinarian dispensing or selling the medicines, drugs or prescriptions is deemed the user or consumer of such medicines, drugs or prescriptions and is, therefore, liable for the payment of the sales tax. *Id.*

39. *Id.* § 58.1-608(23a). The term "medically underserved population" is defined in 42 U.S.C. § 254c(b)(3) and means "the population of an urban or rural area designated by the Secretary as an area with a shortage of personal health services or a population group designated by the Secretary as having a shortage of such services."

40. VA. CODE ANN. § 58.1-608(68).

41. *Id.* § 58.1-608(38).

42. *Id.* § 58.1-608(54) (emphasis added). Previously, § 58.1-608(54) exempted only parts and tires. *See id.* § 58.1-608(54) (Repl. Vol. 1984).

43. *Id.* § 58.1-1402 (Cum. Supp. 1987). For the effective date provisions, see 1987 Va. Acts 927, 928.

property tax exemption or deferral for certain elderly and handicapped taxpayers. Under these changes, to qualify for the real property tax exemption, the total combined income received from all sources during the preceding calendar year by owners of the dwelling who use it as their principal residence and owner's relatives who live in the dwelling may not exceed $22,000.[44] In computing this amount, however, $6,500 of the income of each relative other than the owner's spouse may be excluded.[45] In addition, the governing body of the locality may exclude all or any portion of permanent disability compensation received by the owner during the preceding calendar year up to a maximum of $7,500.[46] Furthermore, to qualify for the exemption, the net combined financial worth of the dwelling owners and the spouse of any owner may not exceed $75,000.[47] When an owner qualifying for the exemption from real property tax under Code section 58.1-3211 sells the exempt property to a nonqualifying person, localities are authorized to prorate the exemption or deferral.[48]

The General Assembly enacted a new section 58.1-3226.1 regarding the release of liens upon a portion of real estate when delinquent taxes are paid. Under this section, localities are authorized to adopt ordinances providing for the release of a lien on a *portion* of a tract of real estate upon payment by the purchaser or acquirer of the portion of the delinquent taxes, interest and penalties due.[49]

House Bill 1221 and Senate Bill 378 authorize the Counties of Accomack and James City to assess real estate annually or biennially.[50] Previously, these counties were only authorized to assess real estate annually.[51]

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44. VA. CODE ANN. § 58.1-3211(1) (Cum. Supp. 1987). The combined income had previously been limited to $18,000 unless local governments had qualifying exemptions and deferral programs allowing them to increase the combined income up to $22,000. *Id.* § 58.1-3211(1) (Repl. Vol. 1984).

45. *Id.* § 58.1-3211(1) (Cum. Supp. 1987). The excludable amount was previously $4,000. *Id.* § 58.1-3211(1) (Repl. Vol. 1984).

46. *Id.* § 58.1-3211(1) (Cum. Supp. 1987). The excludable amount was previously limited to $5,000. *Id.* § 58.1-3211(1) (Repl. Vol. 1984).

47. *Id.* § 58.1-3211(2) (Cum. Supp. 1987). This amount was previously $65,000. *Id.* § 58.1-3211(2) (Repl. Vol. 1984).

48. *Id.* § 58.1-3215(B) (Cum. Supp. 1987). Previously, proration was only allowed if the qualifying owner died and the property was transferred to the nonqualifying surviving spouse. *Id.* § 58.1-3215(B) (Repl. Vol. 1984).

49. VA. CODE ANN. § 58.1-3226.1 (Cum. Supp. 1987).

50. *Id.* § 58.1-3274.

51. *Id.* § 58.1-3274 (Repl. Vol. 1984).

E. *Changes Affecting Tangible Personal Property Taxes*

The commissioner of the revenue of a locality may assess automobiles for personal property tax purposes by any method that accurately establishes fair market value if (1) the automobile's value is not listed in a recognized pricing guide and (2) a percentage of the original cost does not accurately reflect the automobile's fair market value.[52] Any motor vehicle owned by a church and used predominantly for church purposes is exempt from tangible personal property tax.[53]

Before July 1, 1987, any locality that prorated tangible personal property taxes had to prorate taxes on motor vehicles, trailers and boats. Such localities are now authorized to exclude boats from the proration.[54]

Currently, daily rental equipment is subject to the tangible personal property tax. Effective July 1, 1988, however, daily rental equipment is defined as merchants' capital under section 58.1-3510 of the Code.[55] "Daily rental equipment" is all tangible personal property, with certain exceptions,[56] "where the possession or use of such tangible personal property is transferred for consideration, without the transfer of ownership, for an hourly, daily, weekly or monthly period."[57] Any tangible personal property rented to a person for a period exceeding ninety days or rerented to the same person or any affiliated person within thirty days after the expiration of the original ninety-day rental period is not daily rental equipment and is subject to the tangible personal property tax.[58]

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52. VA. CODE ANN. § 58.1-3503(A)(3) (Cum. Supp. 1987).

53. *Id.* § 58.1-3617. Previously only vehicles designed to carry more than 10 passengers were exempt from tangible personal property tax. *Id.* § 58.1-3617 (Repl. Vol. 1984).

54. *Id.* § 58.1-3516(A) (Cum. Supp. 1987). The City of Danville was added to the list of localities listed in § 58.1-3516 that may prorate the tangible personal property tax. *Id.*

55. *Id.* § 58.1-3510.

56. "Daily rental equipment" does not include "trailers as defined in § 46.1-1(33) and other tangible personal property required to be titled and registered with the Department of Motor Vehicles, Department of Game and Inland Fisheries, or any other state agency." *Id.* § 58.1-3510.

57. *Id.*

58. *Id.*

F. *Miscellaneous*

1. Local Taxes

The General Assembly made several amendments to section 58.1-3703 of the Code regarding the authority of localities to impose local license taxes. First, the General Assembly clarified that for purposes of the license tax exemption for nonstock corporations, "stock" means membership voting rights.[59] Second, the General Assembly expanded the exemption from local license taxes for newspapers to include any "newsmagazine, newsletter or other news publication."[60] Third, no locality may impose a license tax upon a taxicab driver if the locality has already imposed a license tax upon the taxicab company for which the taxicab driver operates.[61]

In general, penalties and interest for failure to file a local tax return or pay a local tax may not be imposed if the failure was not the taxpayer's fault.[62] Senate Bill 667 delegates the determination of fault to the locality's treasurer in the case of failure to pay a tax and to the locality's commissioner of the revenue in the case of failure to file a return.[63] In addition, any county may set a date for payment of license taxes which coincides with that of an adjacent locality.[64]

A newly created section 58.1-3713.2 requires all coal severance taxes "to be paid to the locality in which the coal is first placed in transit for shipment outside of the jurisdiction imposing the tax."[65] This rule does not apply if an affidavit is submitted to the locality's commissioner of the revenue certifying that the tax has been paid pursuant to sections 58.1-3703, 58.1-3712 or 58.1-3713 of the Code or paid to another state or locality in which the coal was mined pursuant to the other state's coal severance tax, gross receipts tax, business license tax or any other comparable tax.[66]

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59. VA. CODE ANN. § 58.1-3703(B)(10) (Cum. Supp. 1987).
60. *Id.* § 58.1-3703(B)(3) (effective July 1, 1988).
61. *Id.* § 58.1-3703(B)(13).
62. *Id.* § 58.1-3916.
63. *Id.* In jurisdictions without a treasurer or commissioner of the revenue, the local governing body may delegate to local tax officials the determination of fault. In Spotsylvania County the governing body shall make all fault determinations. *Id.*
64. *Id.*
65. *Id.* § 58.1-3713.2.
66. *Id.*

2. Summoning Taxpayers

House Bill 1489 further limits the power of the commissioner of the revenue to summon taxpayers for interrogation. This act amends section 58.1-3110 of the Code to provide that no taxpayer or other person may be summoned regarding the tax liability of the taxpayer that is the subject of litigation.[67]

3. Collection of Taxes

House Bill 1182 added a new section 58.1-3919.1 authorizing the treasurer of a locality to use private collection agents to collect delinquent local taxes, other than real estate taxes.[68] Such use must be approved by the local governing body, and the taxes must have been delinquent for two or more months.[69] In addition, the statute of limitations must not have run on the collection of the tax.[70] The private collection agent must be paid either directly by the local governing body, by means of an expense in the treasurer's budget, or from the funds collected by the agent.[71]

4. Automatic Lien Upon Estates of Nonresident Decedents

House Bill 1442 extends the provisions of section 58.1-908 of the Code, regarding the lien for unpaid taxes of a decedent having a taxable estate, to nonresident decedents as well as resident decedents.[72] Consequently, no automatic lien arises upon the estate of a nonresident decedent unless the Department of Taxation files a memorandum of lien in the clerk's office of the city or county where the decedent's real estate is located for attachment to the decedent's real estate or where the decedent resided for attachment to the decedent's personal estate.[73]

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67. VA. CODE ANN. § 58.1-3110 (Cum. Supp. 1987).

68. VA. CODE ANN. § 58.1-3919.1 (Cum. Supp. 1987).

69. *Id.*

70. *Id.*

71. *Id.*

72. VA. CODE ANN. § 58.1-908 (Cum. Supp. 1987).

73. *Id.*

II. JUDICIAL DECISIONS

A. *Credit for Taxes Paid to Other States*

In *Department of Taxation v. Smith*,[74] the Virginia Supreme Court held that Maryland's local income tax is not an income tax to the state within the meaning of former Virginia Code section 58-151.015(b).[75] Consequently, the taxpayers' payment of the local income tax did not qualify for the credit against Virginia income taxes.[76]

In *Smith*, the taxpayers were residents of Maryland who earned income in Virginia and were taxed on income in both states. Maryland imposed an additional "local income tax" pursuant to a "piggyback" statute. The state collected the tax and remitted it to the localities.[77]

The Virginia Supreme Court, relying on Maryland's interpretation of local income taxes for purposes of its own credit,[78] held that Maryland's local income tax is not an "income tax to the state"

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74. 232 Va. 407, 350 S.E.2d 645 (1986).

75. Formerly the Code provided:

> Whenever a nonresident individual of this State has become liable for income tax to the state where he resides upon his Virginia taxable income for the taxable year, derived from Virginia sources and subject to taxation under this chapter, the amount of income tax payable by him under this chapter shall be credited with such proportion of the tax so payable by him to the state where he resides, upon proof of such payment, as his income subject to taxation under this chapter bears to his entire income upon which the tax so payable to such other state was imposed; provided, that such credit shall be allowed only if the laws of such state: (1) grant a substantially similar credit to residents of this State subject to income tax under such laws or (2) impose a tax upon the income of its residents derived from Virginia sources and exempt from taxation the income of residents of this State. No credit shall be allowed against the amount of the tax on any income under this chapter which is exempt from taxation under the laws of such other state.

VA. CODE ANN. § 58-151.015(b) (Repl. Vol. 1974). Section 58-151.015 was replaced in 1985 by § 58.1-332.

76. *Smith*, 232 Va. at 411, 350 S.E.2d at 647.

77. *Id.* at 408-09, 350 S.E.2d at 645-46.

78. In 1974, the Maryland General Assembly amended its statute granting a credit against Maryland income tax to provide:

> Notwithstanding the aforegoing, with respect to the taxable year 1974 and each taxable year thereafter, the credit provided for by this section operates to reduce only the State income tax payable under this subtitle and does not operate to reduce any local income tax imposed under § 283 of this article.

MD. ANN. CODE art. 81, § 290 (1974).

The Virginia court construed this statute as a "definitive" legislative determination that Maryland has elected to treat its local income tax and its state income tax differently. *Smith*, 232 Va. at 411, 350 S.E.2d at 647.

within the meaning of former Virginia Code section 58-151.015(b). Therefore, the payment of the local income tax does not qualify for the credit against Virginia income taxes.[79]

B. *Local License Taxes of an Electric Cooperative*

Central Virginia Electric Cooperative ("CVEC") distributed power in seventeen counties including Amherst County. It purchased much of its electric power from Virginia Electric Power Company ("VEPCO"), now Virginia Power, at wholesale rates. In 1983, CVEC applied for a business license reporting as its gross receipts the balance remaining after deducting its prorated cost of wholesale power purchased from VEPCO. The Commissioner refused to issue the business license.

The Virginia Supreme Court, in *Amherst County Board of Supervisors v. Central Virginia Electric Cooperative*,[80] held that CVEC was entitled to compute its gross receipts for purposes of the business license tax after deducting the wholesale cost of power it purchased.[81] The authority to impose the tax was derived from former Virginia Code section 58-603(2).[82] Section 58-603(6) specifically allowed such a deduction for any electric cooperative.[83]

Amherst County had relied on language in Virginia Code section 58-603(2) that localities may impose a license tax "under [section] 58-266.1." The court held, however, that section 58-266.1 was a limitation on the localities' power to tax and not a grant of taxing power.[84] Consequently, the court interpreted the language "under section 58-266.1" to mean "subject to the limitations contained in

79. *Smith*, 232 Va. at 411, 350 S.E.2d at 647.
80. 233 Va. 173, 355 S.E.2d 302 (1987).
81. *Id.* at 175, 355 S.E.2d at 303.
82. *Id.*
83. Formerly the Code provided:
> Any city, town or county may impose a license tax under § 58-266.1 upon such corporation for the privilege of doing business therein, which shall not exceed one-half of one percent of the gross receipts of such business accruing to such corporation from such business in such city, town or county.

VA. CODE ANN. § 58-603(2) (Repl. Vol. 1974).
84. Formerly the Code provided:
> There shall be deducted for purposes of this section from the gross receipts of any electric cooperative, as defined in § 56-209, which is engaged in sales to ultimate consumers, and every corporation engaged in the business of furnishing heat, light and power by means of electricity the amount paid in such taxable period by such cooperative or corporation to purchase electricity from a vendor subject to the state franchise tax.

section 58-266.1."[85] "Any other construction would impair the power of the localities to impose the tax."[86]

C. *Real Estate Assessment and Determination of Economic Rent*

In *Nassif v. Board of Supervisors*,[87] the Virginia Supreme Court reviewed for a second time the 1978 tax assessment of certain property owned by Nassif. The property consisted of three adjacent parcels of land on which was located a multi-story office building containing 229,549 square feet of leasable space.[88] The assessed value of the property in 1977 was $5,336,245 determined through use of the capitalization of income method.[89] In 1978, the assessed value increased to $7,113,842 using the same appraisal method but without taking into account the actual contract rent.[90]

The Virginia Supreme Court set forth several propositions in *Nassif* regarding the consideration of contract rent as relevant evidence of economic rent. The court stated that "in determining economic rent, contract rent must be factored into the formula; it cannot be disregarded."[91] In addition, the court held that "the determination of economic rent must be specific to the property under review as opposed to some abstract or theoretical property."[92]

VA. CODE ANN. § 58-603(6) (Repl. Vol. 1974). When title 58 of the Virginia Code was repealed and reenacted as title 58.1, the replacement §§ 58.1-3731 and -3732, made no provisions for deducting the wholesale cost of electricity. *See Amherst*, 233 Va. at 176, 355 S.E.2d at 303.

85. *Amherst*, 233 Va. at 176, 355 S.E.2d at 303. Formerly the Code provided:

> No city, town or county shall levy any license tax in any case in which the levying of a local license tax is prohibited by any general law of the Commonwealth, or on any public service corporation except as permitted by other provisions of law, nor shall this section be construed as repealing or affecting in any way any general law limiting the amount or rate of any local license tax.

VA. CODE ANN. § 58-266.1 (Repl. Vol. 1974).

86. *Amherst*, 233 Va. at 176, 355 S.E.2d 303.

87. 231 Va. 472, 345 S.E.2d 520 (1986).

88. *Id.* at 474, 345 S.E.2d at 521.

89. *Id.* at 475, 345 S.E.2d at 522.

90. *Id.*

91. *Id.* at 484, 345 S.E.2d at 527.

92. *Id.*

D. *Doctrine of Collateral Estoppel*

In *Lake Monticello Service Co. v. Board of Supervisors*,[93] the Virginia Supreme Court examined the doctrine of collateral estoppel as it applied to a constitutional challenge to the validity of real and personal property tax assessments. In a 1981 proceeding before the State Corporation Commission (the "SCC"), the SCC discussed Lake Monticello's contention that a cost-less-depreciation assessment method violated article X, section 2 of the Constitution of Virginia because it produced assessments in excess of fair market value. Lake Monticello later challenged its 1984 assessment on the same grounds.[94]

The Virginia Supreme Court stated the doctrine of collateral estoppel as follows:

> The kindred doctrine of collateral estoppel, however, bars subsequent litigation based upon a collateral and different cause of action. The doctrine precludes parties and their privies to a prior proceeding from relitigating issues in a subsequent proceeding that were previously litigated and essential to a valid and final judgment in the first case.[95]

The court held that "insofar as Lake Monticello's claim in the present case challenges the constitutionality of the cost-less-depreciation method, the Commissioner's decision in the 1981 case is conclusive and the claim is barred by the doctrine of collateral estoppel."[96]

III. REGULATIONS

A. *Individual Income Tax*

The Virginia Department of Taxation issued three final regulations concerning the computation of individual income tax liability. VR 630-2-322 sets forth the manner of computing Virginia taxable income of individuals.[97] It sets forth the additions to federal adjusted gross income,[98] as well as the subtractions from federal

93. 233 Va. 111, 353 S.E.2d 767 (1987).
94. *Id.* at 113-14, 353 S.E.2d at 768-69.
95. *Id.* at 114, 353 S.E.2d at 769.
96. *Id.* at 115, 353 S.E.2d at 770.
97. 3:6 Va. Regs. Reg. 538-45 (Dec. 22, 1986).
98. *Id.* at 539-41. These additions include (1) interest on obligations of other states and

adjusted gross income.[99] The regulation also details the deductions allowed in computing Virginia taxable income.[100]

VR 630-2-325 covers the computations of the taxable income of a nonresident.[101] VR 630-2-332 sets forth the manner of computing the credit for income taxes paid to another state and applies to both Virginia residents and nonresidents.[102]

B. *Corporate Income Tax*

The Virginia Department of Taxation issued final regulation VR 630-3-402 regarding the computation of the Virginia taxable income of corporations.[103] The regulation sets forth the various additions,[104] and subtractions,[105] from federal adjusted gross income.

C. *Sales and Use Tax*

In the area of the sales and use tax, the Virginia Department of Taxation promulgated three final regulations, one proposed regulation, and one emergency regulation. One final regulation, VR 630-10-18.1, sets forth the application of the sales and use tax to catalogs, brochures, letters, reports, and similar printed materials produced for use outside the state.[106] The regulation contains sev-

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certain obligations of the United States, (2) interest eligible for the federal interest exclusion, (3) lump sum distributions, and (4) the two-earner married couple deduction. *Id.*

99. *Id.* at 541-44. These subtractions include (1) interest or dividends on obligations of the United States or Virginia, (2) interest or dividends from pass-through entities, (3) pension and retirement income, (4) disability income, (5) Social Security and Railroad Retirement benefits, (6) income tax refunds, (7) WIN or targeted jobs tax credit, (8) foreign source income, and (9) qualified agricultural contributions. *Id.*

100. *Id.* at 544-45. These deductions include (1) itemized deductions, (2) the standard deduction, and (3) personal exemptions. *Id.*

101. *Id.* at 545-57.

102. *Id.* at 547-50.

103. 3:6 Va. Regs. Reg. 550-55 (Dec. 22, 1986).

104. *Id.* at 552-53. The additions discussed include (1) interest on obligations of other states, (2) interest or dividends from the United States, (3) excess cost recovery, (4) state income taxes, (5) unrelated business taxable income, and (6) ESOP credit carryovers. *Id.*

105. *Id.* at 553-55. The subtractions discussed include (1) interest or dividends on obligations of the United States or Virginia, (2) interest or dividends from pass-through entities, (3) DISC dividends, (4) state tax refunds, (5) foreign dividend gross up, (6) WIN or targeted jobs credit, (7) Subpart F income, (8) foreign source income, (9) excess cost recovery, (10) dividends received, (11) ESOP contributions, and (12) qualified agricultural contributions. *Id.*

106. 3:6 Va. Regs. Reg. 556 (Dec. 22, 1986).

eral definitions and sets forth the catalogs and other items to which the sales and use tax does *not* apply.[107]

The second final regulation, VR 630-10-86, sets forth the application of the sales and use tax to brochures, letters, reports, and similar printed materials produced for use outside the state and the application of the sales and use tax to the production and sale of printing in general.[108] The third final regulation sets forth the application of the sales and use tax to common carriers of property or passengers by railway.[109]

The Virginia Department of Taxation adopted one emergency regulation, effective October 1, 1986 through September 30, 1987, concerning welfare assistance redeemable in goods.[110] The emergency regulation is designed to provide guidance to food dealers in light of the amendment to section 58.1-608.66 of the Code which provides an exemption from the sales and use tax for "tangible personal property purchased with food coupons issued by the United States Department of Agriculture under the Food Stamp Program for drafts issued through the Virginia Special Supplemental Food Program for Women, Infants, and Children."[111]

The Virginia Department of Taxation also issued one proposed regulation representing a revision of an earlier emergency regulation. Regulation 630-10-49.2 sets forth the applicability of the sales and use tax, including the exemptions for industrial manufacturing and research and development activities, to businesses engaged in innovative high technology production or research.[112]

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107. *Id.*

108. *Id.* at 560-63.

109. VR 630-10-24.4, 3:6 Va. Regs. Reg. at 556-60.

110. VR 630-10-112, 2:25 Va. Regs. Reg. 2486-87 (Sept. 15, 1986).

111. *Id.* at 2486 (quoting the amendment to § 58.1-608.66 which became effective October 1, 1986).

112. 2:22 Va. Regs. Reg. 2179-81 (Aug. 4, 1986). The text of the emergency regulation was revised to reflect amendments made by the 1986 General Assembly regarding the sale of custom computer programs and modified prewritten computer programs and the withdrawal of tangible personal property from inventory for donation to certain nonprofit and governmental organizations. *Id.* at 2179; *see* VA. CODE ANN. §§ 58.1-602(24), - (25), -608(59) (Cum. Supp. 1987).