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Annual Survey of Virginia Law: Taxation Law

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TAXATION LAW

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I. INTRODUCTION

This article reviews significant, recent developments in the law affecting Virginia taxation. Each section covers recent judicial decisions and legislative changes over the past two years. The overall purpose of this article is to provide Virginia tax and general practitioners with a concise overview of the recent developments in Virginia taxation most likely to have an impact on Virginia practitioners. This article, however, will not discuss many of the numerous technical legislative changes to the State Taxation Code of Title 58.1.

II. TAXES ADMINISTERED BY THE VIRGINIA DEPARTMENT OF TAXATION

A. *Income Tax*

1. Recent Judicial Decisions

In *Department of Taxation v. Delta Air Lines, Inc.*,[1] the Supreme Court of Virginia held that the inclusion of overflight miles in the calculation of the numerators of an airline's property and

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1. 257 Va. 419, 513 S.E.2d 130 (1999).

sales factors used to determine the airline's apportionment formulas for purposes of Virginia corporate income tax was improper because the apportionment statute unambiguously provided that only property used and sales made in, as opposed to over, Virginia were includable in the factors.[2] Delta Air Lines, Inc. ("Delta") is a Delaware corporation having its principal place of business in Atlanta, Georgia.[3] Delta is qualified to do business in the Commonwealth of Virginia.[4] "Delta's business activities in Virginia include the carriage of persons and property on aircraft that land at and depart from airports situated in the Commonwealth."[5] Delta also flies aircraft over the Commonwealth that do not take off from or land at any airport located within the Commonwealth.[6] These flights are known as "overflights."[7]

During the tax years of 1987, 1988, and 1989, Delta derived income from business activities that it conducted both within and without Virginia,[8] thus requiring Delta to apportion and allocate its Virginia taxable income as required under the Virginia corporate income tax provisions of Virginia Code sections 58.1-407 through 58.1-420.[9] At all times relevant to this decision, Delta was required to use a three-factor method consisting of a property factor, a payroll factor, and a sales factor.[10] Each of these factors was weighted equally.[11]

The issue in this case involved the meaning of the phrase "in the Commonwealth" as used in Virginia's corporate income tax apportionment statutes.[12] The Virginia Department of Taxation ("Department of Taxation") asserted that the phrase "in the

2. *Id.* at 426-27, 513 S.E.2d at 133-34.
3. *Id.* at 422, 513 S.E.2d at 131.
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.* at 423, 513 S.E.2d at 131.
9. *Id.*; *see also* VA. CODE ANN. §§ 58.1-407 to -420 (Repl. Vol. 1997).
10. *Delta Air Lines*, 257 Va. at 423, 513 S.E.2d at 131; *see also* VA. CODE ANN. § 58.1-408 (Repl. Vol. 1997).
11. *Delta Air Lines*, 257 Va. at 423, 513 S.E. 2d at 131; *see also* VA. CODE ANN. § 58.1-408 (Repl. Vol. 1997). Effective January 1, 2000, the sales factor is double weighted so that income is apportioned to Virginia by multiplying income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four. VA. CODE ANN. § 58.1-408 (Cum. Supp. 1999).
12. *Delta Air Lines*, 257 Va. at 426, 513 S.E.2d at 133.

Commonwealth" encompassed overflights.[13] The Supreme Court of Virginia, affirming the decision on this point by the Arlington County Circuit Court, disagreed.[14] The supreme court explained that the Department of Taxation could not require an airline to include overflight miles in the numerator of the sales factor in apportioning airline income.[15] The court noted that the numerator of the sales factor clearly includes sales "in the Commonwealth."[16] Neither the plain language of the statute, nor its legislative history, give any indication that "in" includes activities taking place "over" the Commonwealth, so as to include activities taking place "over" or "above" the Commonwealth would be an improper extension of the statute.[17]

The supreme court also held that the Department of Taxation had no authority to adopt an alternate apportionment formula with respect to the airline because state law specifically limits the Department of Taxation's authority to adopt an alternate formula to circumstances where the taxpayer has requested an alternate formula and that alternate formula results in a lower tax than the formula dictated by the apportionment statutes.[18] The court also reversed the lower court's decision that Delta's application to correct an erroneous tax assessment for the 1987 and 1988 tax years was time-barred.[19] The court held that such tax applications were timely made.[20]

2. Recent Significant Legislative Activity

a. Income Tax Credits

i. Tax Credit for Employers Who Employ Disabled Individuals

In 1999, the General Assembly created a tax credit for an employer who employs an individual with a disability.[21] The credit is

13. *Id.*
14. *Id.* at 426-27, 513 S.E.2d at 133-34.
15. *Id.* at 427, 513 S.E.2d at 134.
16. *Id.* at 426, 513 S.E.2d at 133.
17. *Id.* at 426-27, 513 S.E.2d at 133-34.
18. *Id.* at 428, 513 S.E.2d at 134.
19. *Id.* at 432, 513 S.E.2d at 137.
20. *Id.*
21. VA. CODE ANN. § 58.1-439.11 (Cum. Supp. 1999).

equal to twenty percent of the first $6,000 of annual wages paid to the employee.[22] The credit can be claimed against the individual income tax, corporate income tax, bank franchise tax, insurance gross premiums tax, or regulated utility license tax.[23] This tax credit is non-refundable and non-transferable.[24] The legislation provides that unused credits can be carried over for three succeeding taxable years until used.[25] This change is effective for tax years beginning on and after January 1, 1999, but before December 31, 2002.[26]

ii. Historic Rehabilitation Tax Credit Amended and Expanded

Both the 1999 and 2000 sessions of the General Assembly enacted legislation amending and expanding the Virginia Historic Rehabilitation Tax Credit Program.[27] During the 1999 session, the General Assembly amended the Historic Rehabilitation Tax Credit to allow individuals, trusts, estates, and corporations—who are considered residents of Virginia for income tax purposes—to claim a credit for eligible expenses incurred in a rehabilitation of a historic structure located outside of Virginia, providing the other state has a historic structure rehabilitation tax credit program and a reciprocal agreement with Virginia.[28] Such reciprocal agreement must provide that the residents of the other state would be able to claim a tax credit on their return for the historic rehabilitation of a structure located in Virginia.[29] The 1999 legislature also expanded the tax credit to allow credits granted to partners or shareholders of S corporations to be allocated among the partners and shareholders as they mutually agree.[30]

The 2000 General Assembly enacted a number of bills pertaining to this tax credit. First, the legislature extended the carry-over period for taxpayers to use the historic rehabilitation

22. *Id.* § 58.1-439.11(C) (Cum. Supp. 1999).
23. *Id.*
24. *Id.* § 58.1-439.11(G) (Cum. Supp. 1999).
25. *Id.*
26. *Id.* § 58.1-439.11(C) (Cum. Supp. 1999).
27. *Id.* § 58.1-339.2 (Cum. Supp. 1999 & Repl. Vol. 2000).
28. *Id.* (Cum. Supp. 1999).
29. *Id.*
30. *Id.* § 58.1-339.2(A) (Cum. Supp. 1999).

tax credit from five to ten years.[31] The General Assembly also enacted legislation accelerating, to the 2000 taxable year, the period in which the Department of Historic Resources can enter into reciprocal agreements with other states for the purposes of the historic rehabilitation tax credit.[32] The legislation provides that no credits will be permitted under the reciprocity provisions until taxable years beginning on or after January 1, 2002.[33] Currently no states have reciprocal agreements with Virginia.

The General Assembly also amended the definition of "material rehabilitation" for purposes of the historic rehabilitation tax credit.[34] The current definition requires that qualifying expenditures total at least fifty percent of the assessed value of such buildings.[35] Effective for tax years beginning on and after January 1, 2001, the amended statute will provide that the total rehabilitative expenses for an owner-occupied building must be at least twenty-five percent of the assessed value.[36]

iii. Land Preservation Tax Credit

In 1999, the General Assembly created an income tax credit for individuals, estates, trusts, and corporations donating land for conservation and preservation purposes.[37] The credit is not refundable, but it can be carried forward up to five years.[38] This new credit equals fifty percent of the "fair market value" of the land transferred up to a maximum credit of $50,000 for the 2000 taxable year, $75,000 for the 2001 taxable year, and $100,000 for taxable years thereafter.[39] The legislation contains a provision that would delay implementation of the credit until the level of tangible personal property tax relief required under the Personal Property Tax Relief Act of 1998 reaches 47.5%.[40]

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31. *Id.* (Repl. Vol. 2000).
32. *Id.* § 58.1-339.2(B) (Repl. Vol. 2000).
33. *Id.*
34. *Id.* § 58.1-339.2(D) (Repl. Vol. 2000).
35. *Id.*
36. *Id.*
37. *See id.* §§ 58.1-510 to -513 (Cum. Supp. 1999).
38. *See id.* § 58.1-512(B)(1) (Cum. Supp. 1999).
39. *Id.*
40. *Id.* § 58.1-511 (Cum. Supp. 1999).

iv. Tax Credit for Research and Development Expenses in Tobacco-Dependent Localities

The 2000 General Assembly created a new income tax credit encouraging research and development activity in a tobacco-dependent locality.[41] The legislation creates a tax credit equal to fifty percent of the amount expended by the taxpayer on eligible research and development activity in a tax-dependent locality.[42]

The legislation defines an eligible research and development activity as "qualified research expenses" as defined in Section 41 of the Internal Revenue Code of 1986,[43] as in effect on June 30, 1992, when such expenses are for an activity occurring in a tobacco-dependent locality.[44] The tax credit may be carried over up to ten years[45] and pass through partnerships or S corporations to individual owners.[46] This credit is limited to $500,000 per taxpayer and may only be claimed to the extent that monies are deposited in the Tobacco-Dependent Localities Fund.[47] The legislation also provides that if a taxpayer having this credit has no state tax liability for two consecutive years, the taxpayer may make an application to have the credit redeemed for seventy-five percent of its face value by the Tax Commissioner.[48] If the credit is not redeemed, it may be sold by the taxpayer.[49] The legislation is effective for tax years beginning on and after January 1, 2000, but before January 1, 2010.[50]

v. Tax Credit for Technology Investments into Tobacco-Dependent Localities

The 2000 General Assembly also created a tax credit to assist technology investments in tobacco-dependent localities.[51] The legislation creates a tax credit "equal to fifty percent of a qualified

41. *Id.* § 58.1-439.14 (Repl. Vol. 2000).
42. *Id.* § 58.1-439.14(B) (Repl. Vol. 2000).
43. 26 U.S.C. § 41 (1994).
44. VA. CODE ANN. § 58.1-439.14(A) (Repl. Vol. 2000).
45. *Id.* § 58.1-439.14(C) (Repl. Vol. 2000).
46. *Id.* § 58.1-439.14(F) (Repl. Vol. 2000).
47. *Id.* § 58.1-439.14(C) (Repl. Vol. 2000).
48. *Id.* § 58.1-439.14(E) (Repl. Vol. 2000).
49. *Id.*
50. *Id.* § 58.1-439.14(B) (Repl. Vol. 2000).
51. *Id.* § 58.1-439.13 (Repl. Vol. 2000).

investment in an information technology or biotechnology company located in," or that will be located in, "a tobacco-dependent locality."[52]

The legislation defines a qualified investment as a cash investment in an information technology or biotechnology company or a capital investment for equity or subordinated debt.[53] However, no taxpayer who within a year of the investment received from the company compensation for services provided, or any related person or entity, is eligible for the tax credit.[54] The legislation provides that the credit may be carried over up to ten years[55] and passes through partnerships or S corporations to individual owners.[56] This credit is limited to $500,000 per taxpayer[57] and may only be claimed to the extent that monies are deposited in the Tobacco-Dependent Localities Fund to fund this credit.[58] The legislation is effective "[f]or taxable years beginning on and after January 1, 2000, but before January 1, 2010."[59]

b. Corporate Income Apportionment Factor Test Amended

In 1999, the General Assembly reenacted 1998 legislation that adopted a double-weighted sales factor for corporate income apportionment.[60] Under the revised formula, the sales factor is weighted fifty percent and payroll and property factors are weighted twenty-five percent each in determining the overall corporate income apportionment factor.[61] Prior to this legislation, apportionment for most corporations was based on a formula which averages a property, payroll, and sales factor, with each factor weighted equally.[62] Implementation of the revised apportionment factor rules may be delayed until the level of personal property tax relief required under the Personal Property Tax Relief Act of 1998,[63] is attained.[64]

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52. *Id.* § 58.1-439.13(B) (Repl. Vol. 2000).
53. *Id.* § 58.1-439.13(A) (Repl. Vol. 2000).
54. *Id.*
55. *Id.* § 58.1-439.13(B) (Repl. Vol. 2000).
56. *See id.* § 58.1-439.13(F) (Repl. Vol. 2000).
57. *Id.* § 58.1-439.13(B) (Repl. Vol. 2000).
58. *Id.* § 58.1-439.13(C) (Repl. Vol. 2000).
59. *Id.* § 58.1-439.13(B) (Repl. Vol. 2000).
60. *Id.* § 58.1-408 (Cum. Supp. 1999).
61. *Id.*
62. *Id.* (Repl. Vol. 1997).
63. *Id.* §§ 58.1-3524 to -3536 (Repl. Vol. 2000).

c. Credit for Taxes Paid to Other States Amended

In 1999, the General Assembly expanded the individual income tax credit for taxes paid to other states to allow a Virginia resident to claim this credit for taxes paid on the gain from the sale of any capital asset not used in a trade or business.[65] Prior to this legislation the statute restricted this credit to income tax paid on certain types of income.[66] Virginia residents were only allowed to claim the credit if they paid income tax to another state on earned or business income, or on the gain from the sale of the principal residence.[67] The 1999 legislation expanding this credit is effective for taxable years beginning on or after January 1, 2000.[68]

d. Tax Department Incentive Stock Option Administrative Ruling

In Public Document 99-79,[69] the Department of Taxation held that the gain from the sale of stock acquired under an incentive stock option ("ISO") plan will constitute income from Virginia sources when (1) the ISO constitutes a form of employee compensation and (2) the related employment was performed in Virginia.[70] The amount of compensation attributable to the ISO is determined when the ISO is exercised and the stock is subsequently sold.[71] The Virginia source income or gain is "the lesser of the income or gain recognized for federal income tax purposes or the amount by which the fair market value of the stock exceeded the option price at the date the ISO was exercised."[72] Any appreciation in the fair market value of this stock after the ISO is exercised, but before the stock is sold, constitutes investment income rather than compensation, and therefore, does not constitute Virginia source income when the taxpayer no longer resides in Virginia.[73]

64. *Id.* § 58.1-408 editor's note (Cum. Supp. 1999).
65. *Id.* § 58.1-332(A) (Cum. Supp. 1999).
66. *Id.* § 58.1-332 (Repl. Vol. 1997).
67. *Id.*
68. *Id.* (Cum. Supp. 1999).
69. VIRGINIA DEP'T TAXATION, PUB. DOC. 99-79 (Apr. 20, 1999).
70. *Id.* at 2.
71. *Id.* at 3.
72. *Id.*
73. *Id.*

In this administrative ruling, the taxpayer, while a Virginia resident, received a series of ISOs during the years 1987 through 1993.[74] "On January 15, 1996, the Taxpayer changed his domicile from Virginia to another state but continued to commute to work in Virginia during 1996. On April 30, 1996, the Taxpayer terminated his employment with [his] employer."[75]

On December 18, 1995, and on May 21, 1996, the taxpayer exercised his ISOs.[76] "The Taxpayer subsequently disposed of the shares purchased under the ISO plan over the period beginning June 19, 1996 and ending December 30, 1996."[77] The taxpayer did not report the income gain from these ISOs on his Virginia part-year resident return for 1996.[78] The taxpayer asserted that "Virginia cannot impose income tax on [his] income from the sale of stock because he was a domiciliary resident of another state at the time of the disposition and this income [did] not constitute income from Virginia sources."[79]

The Department of Taxation noted that "ISOs are usually exercisable when granted.... The employee's compensation stems from the employer's willingness to let the employee benefit from market appreciation in the stock that can occur between the time the ISO is granted and the time the ISO is exercised without the employee risking his own capital."[80] However, once the incentive stock option is exercised, the employee's capital is at risk.[81] The court reasoned that

> any appreciation realized from an increase in the fair market value of the stock between the time [the] ISO is exercised and the time the stock is sold is investment income rather than compensation, as the employee has risked his own capital and is subject to gain or loss thought [sic] market fluctuations.[82]

The Department of Taxation specifically revoked its prior position set forth in Public Document 92-58.[83] The prior position of the Department of Taxation as set forth in Public Document 92-

74. *Id.* at 1.
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.* at 2.
80. *Id.* at 3.
81. *Id.*
82. *Id.*
83. *Id.*

58, was that retirement income and stock options granted to Virginia residents who subsequently leave the state would not be subject to withholding of tax from certain retirement benefits paid to non-residents.[84] The ruling also stated that Virginia residents who once worked in Virginia, but who are no longer residents, need not pay Virginia income tax on gains attributable for the stock option awards.[85] The Department of Taxation specifically modified these positions to hold that a taxpayer will have Virginia compensation attributable to the ISO at the time the ISO is exercised and the stock is subsequently sold.[86]

B. *Retail Sales and Use Taxes*

1. Significant Recent Legislative Activity

a. Food Tax Reduction Program

In 1999, the General Assembly adopted legislation that reduces the state sales and use tax rate on food purchased for human consumption by one-half percent each year for four years, beginning January 1, 2000, for a total reduction of state sales and use tax from 3.5% to 1.5% as of April 1, 2003.[87] The local one percent sales and use tax rate will not be affected by this legislation.[88] Furthermore, the gradual rate reduction will not occur in any year when (i) the actual general fund revenues for the second fiscal year preceding a fiscal year in which a rate reduction is planned do not exceed the official general fund revenue estimates for such second fiscal year, as estimated in the most recently enacted and approved general appropriation act, by at least one percent; or (ii) if any of the "circuit breakers" in the Personal Property Tax Relief Act of 1998[89] occur.[90]

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84. VIRGINIA DEP'T TAXATION, PUB. DOC. 92-58 (Apr. 29, 1992).
85. *Id.*
86. VIRGINIA DEP'T TAXATION, PUB. DOC. 99-79 (Apr. 20, 1999).
87. VA. CODE ANN. § 58.1-611.1(A)(1)–(4) (Cum. Supp. 1999).
88. *Id.* § 58.1-611.1(B) (Cum. Supp. 1999).
89. *See id.* §§ 58.1-3524(C), -3536(B) (Repl. Vol. 2000).
90. *Id.* § 58.1-611.1(D)(2) (Cum. Supp. 1999).

b. Information Filing Requirement for Certain Nonprofit Organizations

In 1999, the General Assembly adopted legislation which requires all nonprofit organizations (except churches) to submit, to the Department of Taxation, the same information that is currently required for new exemptions to be obtained from the General Assembly in order for existing organizations to extend their existing sales and use tax exemptions.[91] The legislation requires similar information to be updated every five years after the date of the first update according to the schedule set forth in the revised statute.[92] Failure to file complete and timely information results in grounds to revoke the organization's state sales and use tax exemption.[93]

The 2000 General Assembly simplified the 1999 legislation by deleting the filing requirement for other than nonprofit organizations under Virginia Code sections 58.1-609.4 (education), 58.1-609.7 (medical-related), 58.1-609.8 (civic and community services), 58.1-609.9 (cultural) and 58.1-609.10 (miscellaneous).[94] The 2000 legislation also eliminated the requirement that exemptions for nonprofit organizations are only considered in even-numbered years.[95] The legislation will also permit the General Assembly to consider any tax relief measure, such as a request for sales and use tax exemption, at any time during a regular or special session.[96] Under prior law, any legislative bill that extended or renewed an exemption from retail sales and use tax had to be introduced no later than the first calendar day of any regular session of the General Assembly.[97]

c. Clarification on Taxation of Modular Building Manufacturers and Retailers

The 2000 General Assembly enacted a new Virginia Code sec-

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91. *Id.* § 58.1-608.2(A) (Cum. Supp. 1999).
92. *Id.* § 30-19.05 (Cum. Supp. 1999).
93. *Id.* § 58.1-608.2(A) (Cum. Supp. 1999).
94. *Id.* § 58.1-608.2(B) (Repl. Vol. 2000).
95. *Id.* § 30-19.05(A) (Cum. Supp. 2000).
96. *Id.* § 30-19.05(B) (Cum. Supp. 2000).
97. *Id.* § 30.19-05(A) (Cum. Supp. 1999).

tion 58.1-610.1 that accomplished two goals.[98] First, the taxable base for application of the retail sales and use tax on the retail sale of certain types of modular buildings was reduced from one hundred percent to sixty percent of the retail sales price.[99] Second, the legislation clarified what a builder of modular homes will include in the tax base regarding installation charges.[100] Under the newly enacted legislation, a retail sale of a modular building is a sale without installation to the final customer.[101] A modular housing manufacturer may take a sales or use tax credit on its sales tax return for sales or use tax paid on the cost price of materials incorporated into modular buildings when sold at retail.[102] However, when a modular building is sold with installation by the seller, the transaction is treated as a real property services transaction (i.e., the seller is deemed the taxable user and consumer of the modular building and pays sales tax), while the ultimate purchaser is buying services and does not pay sales tax.[103] In these circumstances, the tax continues to apply to the total cost of the materials incorporated into the product when built, sold, and installed by a modular building manufacturer.[104]

d. Internet Provider Exempt from Sales and Use Tax

The 1999 General Assembly amended the definition of a retail sale as it relates to tangible personal property used in Virginia to provide Internet service to customers.[105] By definition, the retail sales and use tax does not apply to computer hardware and software, servers, hosting equipment, and distribution equipment purchased by an Internet service provider.[106] "Internet service" is defined as "a service that enables users to access proprietary and other content, information, electronic mail, and the Internet as part of a package of services sold to end-user subscribers."[107] This legislation continues the trend of favorable ruling positions taken

98. *Id.* § 58.1-610.1 (Repl. Vol. 2000).
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. *Id.* § 58.1-602 (Cum. Supp. 1999).
106. *Id.*
107. *Id.*

by the Department of Taxation over the past several years on Internet-provided services and materials.[108]

e. Exemption for Harvesting Forest Products Expanded

In 1999, the General Assembly adopted legislation expanding the current sales and use tax exemption available to machinery and tools used directly in the harvesting of forest products.[109] The exemption now applies to machinery used in certain pre-harvesting and post-harvesting activities.[110] Specifically, the exemption applies to machinery and tools used to: "(i) remov[e] timber or other forest products from the harvesting site, (ii) comply[ ] with environmental protection and safety requirements applicable to the harvesting of forest products, (iii) obtain[ ] access to the harvesting site, and (iv) load[ ] cut timber or other forest products onto highway vehicles for transportation to storage or processing facilities."[111] This legislation curtails the ruling position taken by the Department of Taxation which previously held that only the machinery and tools used in the actual harvesting activity qualify for the exemption from sales and use tax.[112]

III. TAXES ADMINISTERED BY LOCALITIES

A. *Classification of Intangible and Tangible Personal Property*

1. Recent Judicial Decision: *Coca-Cola Bottling Co. v. County of Botetourt*

In a decision handed down on March 3, 2000, the Supreme Court of Virginia limited the definition of a manufacturer's capital for Virginia property tax purposes.[113] Virginia Code section 58.1-1101(A)(2) states that "[c]apital, which is personal property,

108. *Id.* § 58.1-609.5(1) (Cum. Supp. 1999); *see also* VIRGINIA DEP'T TAX., PUB. DOC. 97-425 (Oct. 21, 1997); VIRGINIA DEP'T TAX., PUB. DOC. 97-405 (Oct. 2, 1997); VIRGINIA DEP'T TAX., PUB. DOC. 97-239 (May 23, 1997); VIRGINIA DEP'T TAX., PUB. DOC. 97-213 (Apr. 30, 1997); VIRGINIA DEP'T TAX., PUB. DOC. 97-117 (Mar. 6, 1997).

109. VA. CODE ANN. § 58.1-609.2 (Cum. Supp. 1999).

110. *Id.* § 58.1-609.2(6) (Cum. Supp. 1999).

111. *Id.*

112. VIRGINIA DEP'T TAX., PUB. DOC. 96-175 (July 19, 1996).

113. Coca-Cola Bottling Co. v. County of Botetourt, 259 Va. 559 (2000).

tangible in fact, [and] used in manufacturing . . . businesses is non-taxable."[114] As a result of this decision, most of a manufacturer's tangible personal property, except property that is used directly in the manufacturing process, cannot be taxed by Virginia localities. This would include, for example, furniture, fixtures, office equipment and computer equipment used in various administrative activities.[115] Equipment that is used directly in the manufacturing process is generally defined as "machinery and tools" and is taxable by localities.[116]

In *Coca-Cola Bottling*, the taxpayer operated under a license for the production, distribution, and sale of Coca-Cola products.[117] "Most of [Coca-Cola Bottling's] product [was] mixed and bottled in its Roanoke plant, moved into its warehouses located throughout its franchise territory [of southwest Virginia, northeast Tennessee, and southeast West Virginia], and distributed from the warehouses to wholesale purchasers."[118]

> Approximately one-third of [Coca-Cola Bottling's] employees [were] engaged in the manufacture of its product. The remainder [were] engaged in administration, distribution and sales activities.
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> [Coca-Cola Bottling sold] most of its product to retailers such as supermarkets, convenience stores, discount retailers, hotels, motels, restaurants, gasoline filling stations, and other such retail outlets. [Coca-Cola Bottling's] wholesale customers retail[ed] some cooled drinks in cooling and dispensing equipment furnished by [Coca-Cola Bottling].
>
> [Coca-Cola Bottling] retail[ed] a smaller, but substantial, portion of its product in coin operated machines owned or rented by it. The tax status of the vending machines, coolers, and fountain equipment which [Coca-Cola Bottling] owns or rents from others [was] the subject of this opinion.[119]

Coca-Cola Bottling argued that the County had improperly as-

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114. VA. CODE ANN. § 58.1-1101(A)(2) (Repl. Vol. 2000).

115. City of Winchester v. Am. Woodmark Corp., 250 Va. 451, 464 S.E.2d 148 (1995) (holding that furniture, fixtures and computer equipment at manufacturer's corporate headquarters was properly classified as capital and not as machinery and tools).

116. *Id.* at 458, 463 S.E.2d at 152 (citing Commonwealth v. Carter, 198 Va. 141, 146-47, 92 S.E.2d 369, 373 (1956)).

117. *Coca-Cola Bottling*, 259 Va. at 562, 526 S.E.2d at 748.

118. *Id.*

119. *Id.*

sessed its vending equipment as tangible personal property.[120] Coca-Cola Bottling took the position that vending machines and similar property used in making various types of sales should be classified as capital because this property was not used directly in its manufacturing process.[121] Coca-Cola Bottling pointed to its franchise agreement, which controlled its licensing agreement, that clearly stated Coca-Cola Bottling was not permitted to have any sales activity performed independent of its manufacturing activities.[122] Coca-Cola Bottling also argued that its "manufacturing, distribution, and sales activities [were] 'vertically integrated functions'" and that they were not separate businesses for tax purposes.[123] Coca-Cola Bottling maintained that if it was classified as a manufacturer under Virginia Code section 58.1-1101(A)(2), it could not also be classified as a sales business.[124]

On appeal, the Supreme Court of Virginia affirmed the trial court's determination that Coca-Cola Bottling was engaged in two separate businesses: (i) manufacturing and (ii) selling.[125] On this basis, the supreme court held that the vending machines and other equipment used in the "sales business" were not classified as part of the capital of the manufacturing business.[126]

The court's opinion does not address the tax status of personal property utilized in a wholesale sales function.[127] Most manufacturers are not directly involved in the sale of its product at "retail." However, manufacturers will need to be on guard and prepare to defend the exempt status of its furniture, fixtures, computer equipment and other personal property used in its wholesale sales functions. Generally, most Virginia localities have recognized wholesale sales offices as being a component part of the manufacturing business. Localities tend to treat the property in such wholesale sale offices as non-taxable capital. In light of this recent decision in *Coca-Cola Bottling*, manufacturers must remain alert to the possibility that certain localities may seek to classify a manufacturer's wholesale sales office furniture, fixtures

120. *Id.* at 561-62, 526 S.E.2d at 748.
121. *Id.* at 562-63, 526 S.E.2d at 748-49.
122. *Id.* at 563, 526 S.E.2d at 749.
123. *Id.*
124. *Id.*
125. *Id.* at 564-65, 526 S.E.2d at 749-50.
126. *Id.*
127. *See id.* at 565, 526 S.E.2d at 750.

and equipment as a separate line of business and classify those items as tangible personal property taxable by the locality.

2. Recent Significant Legislation on Asset Classification of Personal Property

The 2000 General Assembly enacted a separate classification of property for purposes of local tangible personal property tax for tangible personal property used in the provision of Internet services.[128] This legislation authorizes localities to tax tangible personal property used in the provision of Internet services at lower rates than applied to the general class of tangible personal property within each locality.[129] For purposes of this legislation, "Internet service" is defined as "a service, including an Internet web-hosting service, that enables users to access content, information, electronic mail and the Internet as part of a package of services sold to customers."[130]

B. *Business, Professional and Occupational License and Tax Administration*

1. Recent Judicial Decisions

In *Mutual Broadcasting System, Inc. v. Arlington County*,[131] the Arlington County Circuit Court was asked to interpret the broadcasting exception from the business, professional, and occupational license ("BPOL") tax.[132] Mutual Broadcasting was based in Arlington County and was assessed a BPOL tax for the years 1990 through 1995 of $518,852.[133]

> Mutual produces a variety of live and recorded radio programs at its studios in Arlington, Virginia, and at its off-site mobile facilities. Using an extensive system of sophisticated electronic equipment, this programming is transmitted to an earth station and then to a satellite from which the signal is transmitted to a variety of radio

128. VA. CODE ANN. § 58.1-3506(A)(29) (Repl. Vol. 2000).
129. *Id.* § 58.1-3506(B) (Repl. Vol. 2000).
130. *Id.*
131. 49 Va. Cir. 81 (Cir. Ct. 1999) (Arlington County).
132. VA. CODE ANN. §§ 58.1-3700 to -3735 (Repl. Vol. 2000).
133. *Mut. Broad. Sys.*, 49 Va. Cir. at 81.

> broadcasting stations throughout North America and the world, most of which are contractual affiliates of Mutual .... [T]he signal is also received and rebroadcast by radio stations which are not affiliates of the Mutual Broadcasting System .... None of the stations which are unaffiliated and rebroadcast Mutual's signal and programming pay any fee to Mutual, nor does the public pay a fee to Mutual .... In many ways, Mutual operates in much the same way as other national radio and television broadcasting networks such as CBS, NBC, and ABC in that its correspondents cover certain national and international events and provide news and information about those events to the network's affiliates ....
>
> Mutual assert[ed] that as a matter of fact and law, its activities qualify it as a "radio broadcasting service" under Va. Code § 58.1-3703 thereby rendering it exempt from the BPOL taxes. [Arlington] County [took] the position that since Mutual [did] not broadcast directly to the public, but rather transmit[ed] its signal to its affiliates which thereafter broadcast[ed] to the public, it is not a "radio broadcasting service" as defined by the statute.[134]

An important procedural aspect of the case was whether Virginia Code section 58.1-3703(B)(3) was a limitation of a local government's authority to tax or whether it was an exemption from tax.[135] If the statute is a limitation of a city or county's authority to tax, the rules of statutory construction are strictly construed against the taxing authority.[136] Conversely, if the statute is an exemption, it must be strictly construed against the purported taxpayer.[137] The Arlington County Circuit Court concluded, relying principally on *Chesterfield Cablevision, Inc. v. County of Chesterfield*,[138] that Virginia Code section 58.1-3703(B)(3) should be treated as an exemption from taxation.[139] The circuit court noted that "Virginia adheres to the rule of strict construction of tax exemptions. Taxation is the rule, not the exception. Therefore, tax statutes are strictly construed against the taxpayer."[140] The significance of the court's determination that it was interpreting an exemption, and not a classification, is that Mutual Broadcasting was required to carry the burden of proof that it was entitled to

134. *Id.* at 82.
135. *See id.* at 83.
136. *Id.*
137. *Id.*
138. 241 Va. 252, 401 S.E.2d 678 (1991).
139. *Mut. Broad. Sys.*, 49 Va. Cir. at 83-84.
140. *Id.* at 83 (quoting WTAR Corp. v. Commonwealth, 217 Va. 877, 879, 234 S.E.2d 245, 247 (1977)).

the statutory exemption from the BPOL gross receipts tax.[141] The Arlington County Circuit Court concluded that Mutual Broadcasting met its burden of proof and further held that Mutual Broadcasting was a radio broadcasting service as defined in Virginia Code section 58.1-3703(B)(3).[142] Accordingly, the court concluded that Mutual Broadcasting was exempt from Arlington County's BPOL tax and ordered the County to refund all taxes and interest from the 1990 through 1995 assessments.[143]

In *Board of Tuckahoe Ass'n. v. City of Richmond*,[144] the Supreme Court of Virginia determined that a condominium association that purchased utilities at commercial rates based on master meters and paid the charges out of amounts collected from the individual unit owners was not entitled to be classified as a residential consumer under a City of Richmond ordinance.[145] "[T]he City of Richmond enacted an ordinance imposing a utility tax on telephone, electric, and gas service, which is collected by the seller of each service. The ordinance establishes different tax rates for purchasers of commercial and residential service."[146] The city ordinance did not define the terms "residential" and "commercial."[147] The City of Richmond imposed its commercial tax rate on the Association's purchase of electric and gas services from the utility providers at commercial rates.[148] "The Association alleged that it was a 'residential user' of the utility services and was entitled to a refund of the amount of utility taxes paid 'in excess of the residential [tax] rate [it] should [have been] properly be charged.'"[149] The Association also alleged that the City's classification of the Association for purposes of the utility tax, not having a reasonable basis for a commercial classification, was entirely arbitrary and violated the Equal Protection Clauses of the United States and Virginia Constitutions.[150]

"The City of Richmond responded that its utility tax ordinance

141. *Id.*
142. *Id.* at 86.
143. *Id.*
144. 257 Va. 110, 510 S.E.2d 238 (1999).
145. *Id.* at 119, 510 S.E.2d at 243.
146. *Id.* at 113, 510 S.E.2d at 239-40 (citation omitted).
147. *Id.* at 114, 510 S.E.2d at 240.
148. *Id.*
149. *Id.* (alterations in original).
150. *Id.*

expressly classifie[d] taxpayers based on the type of utility service purchased, rather than on the nature of the ultimate consumer of the service."[151] Upon the parties' motions for summary judgement, the Richmond Circuit Court

> ruled that the residential and commercial classifications contained in the ordinance are "not based on real differences" and thus are arbitrary and unreasonable. The trial court also held that the ordinance unconstitutionally delegates to the utility companies the right to determine, based on their own internal regulations, who qualifies for the more favorable residential service taxation rate.[152]

The supreme court reversed the trial court and held that the Richmond utility ordinance is facially valid.[153] The court stated that "[s]ince the ordinance's classifications are based on the type of utility service purchased, they contain distinctions resting on real and not feigned differences."[154] The court noted that the Association admitted that the utility tax classifications contained in the City ordinance imposed a greater tax rate on volume purchasers who received the benefit of a lower purchase price from the utility provider.[155] Conversely, purchasers of residential services who pay a higher unit cost than commercial purchasers for their utility services are given the benefit of a lower tax rate.[156] The court held "that such distinctions are not unreasonable or so disparate in their treatment as to be arbitrary, and that the trial court erred in concluding otherwise."[157]

The supreme court also disagreed

> with the trial court's ruling that the ordinance's classifications effectively delegate governmental authority, allowing the utility providers to "pick and choose" which purchasers will be deemed eligible for the lower residential tax rate. Under the ordinance, the utility providers' role is limited to collecting the utility tax. The providers do not determine the particular rate of tax each purchaser must pay.[158]

The court also noted that "there is no language in the ordinance

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151. *Id.*
152. *Id.*
153. *Id.* at 117, 510 S.E.2d at 241.
154. *Id.*
155. *Id.* at 117, 510 S.E.2d at 242.
156. *Id.*
157. *Id.*
158. *Id.*

or evidence in the record to show that the utility providers exercise discretionary authority under the ordinance."[159]

The supreme court also disagreed with the trial court's reasoning "that 'each household/end-user at the Tuckahoe building purchases these services on an individual basis through its pro rata share of total condominium consumption.'"[160] The court noted that the record in the case

> showed that the Association, a non-profit corporation, actually contracted and paid for the utility services recorded on its master meters. The fact that the individual unit owners' assessments are the source of funds for payment of the corporation's obligations does not alter the nature of those obligations or make the unit owners purchasers under the ordinance.[161]

The court concluded that the circuit court "erred in ruling that the Association was entitled to be 'classified as residential for purposes of the City's utility tax scheme.'"[162] The court concluded that the trial court also "erred in ruling that the individual unit owners should be treated as purchasers of residential utility services."[163]

2. Significant Legislative Activity

a. Local Tax Assessment Appeals and Rulings

One of the most significant pieces of legislation enacted by the 1999 General Assembly was the creation of a new local tax assessment appeals procedure.[164] The legislation amended Virginia Code section 58.1-3980 by creating a mechanism which allows taxpayers to administratively appeal assessments of any local tax to the Commissioner of the Revenue.[165] Prior to this legislation, only local license, real estate, tangible personal property, machinery and tools and merchants' capital taxes could be appealed to a

159. *Id.* at 118, 510 S.E.2d at 242.
160. *Id.* at 118-19, 510 S.E.2d at 242-43.
161. *Id.* at 119, 510 S.E.2d at 243.
162. *Id.* at 120, 510 S.E.2d at 243.
163. *Id.*
164. *See* VA. CODE ANN. § 58.1-3980 (Cum. Supp. 1999).
165. *Id.*

Commissioner of the Revenue.[166] The amendment provides that any local tax including, but not limited to, the transient occupancy, food and beverage, and admissions taxes may be administratively appealed.[167] The statute of limitations for appealing a local tax assessment to a Commissioner of Revenue is generally three years from the last day of the tax year for which the assessment is being made.[168]

As part of the overhaul of the local tax appeal procedures, the 1999 General Assembly enacted legislation creating an appeal and ruling process through the local assessor and the Virginia Tax Commissioner for local business tax, "the machinery and tools tax, business tangible personal property tax . . . and merchants' capital tax" similar to that currently provided for the local BPOL tax.[169] The legislation establishes that any person assessed with any local business tax may apply within ninety days from the date of such assessment to the Commissioner of the Revenue or other official responsible for assessment for a correction of the assessment.[170] "The application shall be filed in good faith and sufficiently identify the taxpayer, remedy sought, each alleged error in the assessment, the grounds upon which the taxpayer relies, and any other facts relevant to the taxpayer's contention."[171]

"The assessment shall be deemed prima facie correct."[172]

> Provided a timely and complete application is made, collection activity shall be suspended by the treasurer or other official responsible for the collection of such tax until a final determination is issued by the commissioner or other assessing official, unless the treasurer . . . determines that collection would be jeopardized by delay or is advised by the commissioner . . . that the taxpayer has not responded to a request for relevant information after a reasonable time. Interest shall accrue, but no further penalty shall be imposed, while collection action is suspended.[173]

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166. *Id.* (Repl. Vol. 1997).
167. *Id.* § 58.1-3980(A) (Cum. Supp. 1999).
168. *Id.*
169. *Id.* § 58.1-3983.1(A)–(B) (Cum. Supp. 1999). For a discussion of the BPOL Guidelines which establish the appeals and rulings procedures, see Craig D. Bell, *Taxation*, 31 U. RICH. L. REV. 1221, 1244-47 (1997).
170. VA. CODE ANN. § 58.1-3983.1(B) (Cum. Supp. 1999).
171. *Id.*
172. *Id.*
173. *Id.* § 58.1-3983.1(C) (Cum. Supp. 1999).

The new statute provides that any person assessed with a local business tax may apply within ninety days of the determination rendered by the commissioner of the revenue or other assessing official on an application pursuant to Virginia Code section 58.1-3983.1(B) to the Tax Commissioner for a correction of such assessment.[174] "The Tax Commissioner shall issue a determination to the taxpayer within ninety days of receipt of the taxpayer's application, unless the taxpayer and the commissioner of the revenue or other assessing official are notified that a longer period will be required."[175]

The legislation also grants any taxpayer the opportunity to "request a written ruling regarding the application of a local business tax to a specific situation from the commissioner of the revenue or other assessing official."[176] The statute states that

> [e]very person who is assessable with a local business tax shall keep sufficient records to enable the commissioner of the revenue or other assessing official to verify the correctness of the tax paid for the taxable years assessable and to enable the commissioner of the revenue or other assessing official to ascertain what is the correct amount of tax that was assessable for each of those years.[177]

The final piece of this local tax reform legislation amended Virginia Code section 58.1-3984 to provide taxpayers at least one year to appeal the Tax Commissioner's determination to a circuit court.[178] The legislation is effective for assessments made on or after January 1, 2000, except for appeals on questions of fair market value, which becomes effective on January 1, 2001.[179]

b. Related Entity Exclusion from BPOL Tax

The 2000 Session of the General Assembly amended Virginia Code sections 58.1-3700.1 and 58.1-3703 to broaden the types of business entities which are eligible to participate in certain intercompany transfers to be excluded from the local BPOL tax base.[180]

174. *Id.* § 58.1-3983.1(D) (Cum. Supp. 1999).
175. *Id.*
176. *Id.* § 58.1-3983.1(F) (Cum. Supp. 1999).
177. *Id.* § 58.1-3983.1(G) (Cum. Supp. 1999).
178. *Id.* § 58.1-3984(A)(iii) (Cum. Supp. 1999).
179. *Id.* § 58.1-3984 editor's note (Cum. Supp. 1999).
180. *Id.* §§ 58.1-3700.1, -3703 (Repl. Vol. 2000).

The legislation allows limited partnerships, limited liability partnerships and limited liability companies to be members of an "affiliated group" for purposes of the BPOL tax and to exclude gross receipts or purchases from other members of the affiliated group from the taxable measure.[181] Prior to this legislation, only corporations were eligible to be members of an affiliated group and to take advantage of this exclusion.[182]

c. Locality Option to Exclude BPOL and Merchant's Capital Tax on Merchants

The 1999 General Assembly enacted legislation that authorizes any locality to exempt or partially exempt a merchant from the local BPOL tax or the merchants' capital tax, or both.[183] The legislation follows from an amendment to Article X of the Virginia Constitution which was ratified by the voters of Virginia on November 3, 1998, with an effective date of January 1, 1999.[184]

d. Out-of-State Contractors Subject to BPOL

The 1999 General Assembly amended Virginia Code section 58.1-3715 to subject any contractor without a definite place of business in the locality to a locality's BPOL license tax or fee when the amount of the business done there by such contractor exceeds $25,000 for the year.[185] The legislation defines a place of business to be an office or a location at which occurs a regular and continuous course of dealing for thirty or more consecutive days.[186] In some cases, a contractor's work in a locality will not exceed thirty days for the particular year, meaning that such contractor has not established a definite place of business in the locality. Under current law, a Virginia contractor without a definite place of business in a locality is still subject to a locality's BPOL tax or fee if the amount of the business done in that locality exceeds $25,000 for the year.[187] Prior to the passage of this legisla-

181. *Id.* §§ 58.1-3700.1, -3703(C)(10) (Repl. Vol. 2000).
182. *Id.* § 58.1-3703 editor's note (Repl. Vol. 2000).
183. *Id.* §§ 58.1-3509, -3704 (Cum. Supp. 1999).
184. *Id.*; VA. CONST. art. X, § 6.
185. VA. CODE ANN. § 58.1-3715 (Cum. Supp. 1999).
186. *Id.*
187. *Id.*

tion, this exception to the definite place of business requirement was not applicable to out-of-state contractors.[188]

e. Interest on Refunds of Erroneous Assessments

Another significant piece of legislation enacted by the 1999 General Assembly corrects an inequity which existed in a number of localities regarding interest on refunds of erroneous tax assessments. The General Assembly amended Virginia Code sections 58.1-535, 58.1-3916, 58.1-3918, 58.1-3981 and 58.1-3987, and repealed Virginia Code section 58.1-3991.[189] The effect of this legislation is to require a locality to pay interest on refunds of overpayments and erroneously assessed taxes at the same rate which the locality charges interest on delinquent taxes.[190] Prior to this legislation, localities could pay interest on refunds of local taxes.[191] This legislation makes it mandatory for localities to pay interest on refunds of erroneous assessments or overpayments of local taxes if the locality charges interest on underpayments of taxes.[192]

f. Delinquent Tax Responsibility for Limited Liability Companies

The 1999 General Assembly also clarified existing law to specifically provide that a member, manager or employee of a limited liability company is an individual who may be held personally responsible for delinquent local admissions, transient occupancy, food and beverage, or daily rental property taxes in certain circumstances.[193] The effect of this legislation is to treat any member, manager or employee of a limited liability company in the same manner as the pre-existing law treated any officer, partner or employee of a corporation or partnership who, while under a duty to perform on behalf of the entity had actual knowledge of the failure or attempt to not pay such taxes, had actual knowl-

188. *Id.* (Repl. Vol. 1997).
189. *Id.* §§ 58.1-535, -3916, -3918, -3987, -3991 (Cum. Supp. 1999).
190. *Id.* § 58.1-535 (Cum. Supp. 1999); *see also id.* §§ 58.1-15, -3916, -3918 (Cum. Supp. 1999).
191. *See id.* § 58.1-535 (Repl. Vol. 1997).
192. *Id.* § 58.1-3918 (Cum. Supp. 1999).
193. *Id.* § 58.1-3906 (Cum. Supp. 1999).

edge of the failure to pay such taxes, and had the authority to prevent such failure or attempt to pay such taxes.[194]

C. *Real Property Tax*

1. Recent Judicial Decisions

In *Smyth County Community Hospital v. Town of Marion,*[195] the Supreme Court of Virginia held that property owned by a tax-exempt nonprofit hospital and operated as a nursing home (an intermediate care nursing facility) is exempt from property tax.[196] The issue in this case was whether the exemption provided in Virginia Code section 58.1-3606(A)(5) exempts from taxation "[p]roperty belonging to and actually and exclusively occupied and used by . . . hospitals . . . conducted not for profit but exclusively as charities . . . ."[197] At trial, the circuit court determined that the property was not exempt from taxation stating the statute required that the property "'be used as an integral part of the hospital's operations'" to be entitled to the exemption.[198]

The supreme court reversed the judgement of the trial court.[199] The court held that the nursing home qualified for the exemption from Virginia real and personal property taxes property belonging to and exclusively occupied and used by a nonprofit hospital.[200] The court noted that although the nursing home had its own administrator and was licensed and inspected according to separate requirements from those of the hospital, the nursing home was governed by the hospital's board of directors and was staffed by nurses and employees of the hospital who worked at both facilities.[201] Furthermore, the court noted that the financial arrangement between the hospital and nursing home was such that both were presented as a single entity on the hospital's

194. *See id.*
195. 259 Va. 328, 527 S.E.2d 401 (2000).
196. *Id.* at 337, 527 S.E.2d at 405-06.
197. *Id.* at 333, 527 S.E.2d at 403 (citing VA. CODE ANN. § 58.1-3606(A)(5) (Repl. Vol. 1997)) (alteration in original).
198. *Id.* at 331, 527 S.E.2d at 402.
199. *Id.* at 331, 337, 527 S.E.2d at 402, 405-06.
200. *Id.*
201. *Id.* at 332, 527 S.E.2d at 403.

audited consolidated financial statements for the relevant tax years.[202]

Smyth County argued that the nursing home was a separate entity and relied upon the consolidated financial statements which referred to the nursing home as a wholly-owned subsidiary of the hospital and, unlike the other departments of the hospital, the nursing home separated out payments made by the hospital for services provided by the nursing home and reflected a debt owed by the nursing home to the hospital.[203]

The supreme court stated that looking at the entire trial record, Smyth County could not overcome the overall and undisputed evidence that the hospital actually and exclusively occupied and used the nursing home.[204] In reaching this result, the court applied the "Dominant Purpose" test.[205] The dominant purposes of the nursing home was to further the charitable purposes of the hospital.[206] Patients were admitted to both institutions without regard to their ability to pay and collection of unpaid bills was undertaken only when the patient had the means to pay.[207] Any interest in the hospital's officers and the financial health of the nursing home did not mean that the purpose of the nursing home was the production of revenue for the hospital.[208] "Insuring that the [nursing home] did not have a significant adverse financial effect on the ability of the hospital itself to function was a legitimate responsibility of the [hospital's] officers and board members."[209] The court held that "the trial court erred in holding that the property owned by the hospital and operated as the [nursing home] was not entitled to an exemption from taxation under Virginia Code section 58.1-3606(A)(5)."[210]

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202. *Id.* at 331-33, 527 S.E.2d at 402-03.
203. *Id.* at 333, 527 S.E.2d at 403-04.
204. *Id.* at 334-35, 527 S.E.2d at 404-05.
205. *Id.* at 334, 527 S.E.2d at 404.
206. *Id.* at 336, 527 S.E.2d at 405.
207. *Id.*
208. *Id.*
209. *Id.* at 335, 527 S.E.2d at 405.
210. *Id.* at 337, 527 S.E.2d at 405-06.

In the *City of Richmond v. United Methodist Homes, Inc.*,[211] the Supreme Court of Virginia considered the issue of whether "certain properties were exempt from the assessment of local real estate taxes because of [the properties'] status as charitable 'asylums.'"[212] The Virginia United Methodist Homes, Inc. ("Methodist Homes"), a non-stock, nonprofit, Virginia corporation, operated continuing care facilities for adults throughout Virginia.[213] Two of these facilities were located within the City of Richmond.[214] In 1976, a 115-bed nursing home facility was added to one of its continuing care facilities.[215] The effect of this addition was to enable the property to provide three levels of care: independent living, assisted living and health care.[216] "Depending on the needs of an individual resident, these levels of care are available under continuing care contracts for the life of the resident or under monthly and daily leases."[217] When Methodist Homes was originally incorporated in 1945, its Articles of Incorporation

> called for the establishment of "a home or homes for the aged and infirm and needy persons." As a matter of policy, admission was limited initially to persons age 65 and older. Individual contracts of admission were negotiated with each prospective resident based upon the estimated cost of lifetime care and the individual's available income and assets to pay that cost, generally in monthly installments. However, the ability of the resident to pay the full cost of care from personal income and assets was not a requisite factor in determining admission. Once admitted, no resident was expelled because of the inability to continue to pay the agreed upon installments.[218]

During subsequent years, a greater emphasis by the Methodist Homes "was placed on the ability of a prospective resident 'to pay for their cost of care over their actuary life expectancy.'"[219] Methodist Homes amended its Articles of Incorporation in 1961 "to reflect that the purpose of the corporation was to provide 'a home or

211. 257 Va. 146, 509 S.E.2d 504 (1999).
212. *Id.* at 150, 509 S.E.2d at 504.
213. *Id.*
214. *Id.*
215. *Id.* at 150, 509 S.E.2d at 504-05.
216. *Id.* at 150, 509 S.E.2d at 505.
217. *Id.*
218. *Id.* at 150-51, 509 S.E.2d at 505.
219. *Id.* at 151, 509 S.E.2d at 505.

homes for aging persons.'"[220] "As a result of this change and emphasis in the admission policy and corporate purpose, Methodist Homes began requiring that prior to admission there be an identified source of funds from 'the individual, the government, family, church [or] somebody' adequate to pay for the expected cost of lifetime care."[221]

During the 1980s, Methodist Homes established a charitable fund designed to provide "benevolent care" in an attempt to fund the shortfall in future anticipated cost of care of prospective residents who lack sufficient income and assets to pay that cost at the time of admission.[222] "However, funds available for benevolent care are limited and are first applied to the needs of residents already living in the properties."[223] In the unfortunate event that daily or monthly pay residents are unable to meet their lease obligations, and are not entitled to receive assistance from the charitable fund or other direct assistance from Methodist Homes, they are asked to relocate.[224]

Until 1996, the City of Richmond listed the Methodist Homes' properties as tax exempt.[225] "In 1996 and again in 1997, the City assessor determined that the properties were not eligible for tax-exempt status and assessed real estate taxes against them."[226] Methodist Homes then initiated its lawsuit against the City.[227]

At trial, Methodist Homes argued that the properties were originally exempt from local taxation because they were conducted exclusively as charities and constituted "asylums" under the classification exemption provided in Section 183(e) of the 1902 Constitution of Virginia.[228] Methodist Homes maintained that the properties remained tax exempt under Virginia Code section 58.1-3606(A)(5), which provides for the same exemption from local taxation for "asylums" as did Section 183(e) of the 1902

220. *Id.*
221. *Id.* (alteration in original).
222. *Id.*
223. *Id.*
224. *Id.* at 151-52, 509 S.E.2d at 505.
225. *Id.* at 152, 509 S.E.2d at 505.
226. *Id.*
227. *Id.*
228. *Id.* at 502, 509 S.E.2d at 506.

Virginia Constitution.[229] Methodist Homes further asserted that the "grandfather clause" of Article X, Section 6(f) of the 1971 Virginia Constitution and codification of the exemption in Virginia Code section 58.1-3606(B), requires the application of the rule of liberal construction to the exemption for "asylums," as that exemption is provided in Virginia Code section 58.1-3606(A)(5) for entities in existence in 1971, rather than the rule of strict construction as is required under Article X, Section 6(f) for tax exemptions generally.[230]

The City argued that under either rule of construction, the Methodist Homes' properties never operated as asylums.[231] The City further asserted that when Methodist Homes amended its corporate purpose and its admission policies, any attempt to consider itself as an asylum was lost.[232] The Richmond Circuit Court held that Methodist Homes were entitled to the benefit of the liberal construction to the exemption by classification under the prior 1902 Virginia Constitution.[233] The trial court then held that the Methodist Homes' properties were used as asylums for nonprofit purposes exclusively as charities and ordered a refund of the tax assessments for the 1996 and 1997 tax years.[234]

The supreme court held that the Methodist Homes were entitled to use the liberal rule of statutory construction because the

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229. *Id.* at 152-53, 509 S.E.2d at 506. Virginia Code section 58.1-3606(A)(5) exempts from taxation:

> Property belonging to and actually and exclusively occupied and used by the Young Men's Christian Associations and similar religious associations, including religious mission boards and associations, orphan or other asylums, reformatories, hospitals and nunneries, conducted not for profit but exclusively as charities....

VA. CODE ANN. § 58.1-3606(A)(5) (Repl. Vol. 1997).

230. *United Methodist Homes*, 257 Va. at 153, 509 S.E.2d at 506. *Compare* VA. CODE ANN. § 58.1-3606(B) (Repl. Vol. 1997) ("Property, belonging in one of the classes listed in subsection A of this section, which was exempt from taxation on July 1, 1971, shall continue to be exempt from taxation under the rules of statutory construction applicable to exempt property prior to such date.") *with* VA. CONST. art. X, § 6(f) (amended 1971) ("Exemptions of property from taxation as established or authorized hereby shall be strictly construed; provided, however, that all property exempt from taxation on the effective date of this section shall continue to be exempt until otherwise provided by the General Assembly as herein set forth.").

231. *United Methodist Homes*, 257 Va. at 153, 509 S.E.2d at 506.

232. *Id.*

233. *Id.*

234. *Id.*

properties owned by Methodist Homes pre-existed the 1971 Virginia Constitution.[235] However, the court went on to hold that when Methodist Homes amended their Articles of Incorporation in 1961 to delete the reference to "the aged and affirmed and needy persons," and replaced those words with the term "aging persons," such act constituted a significant change in the purpose for which the properties would be used.[236] The court then concluded that the properties no longer qualified for the exemption for asylums even under a liberal construction of the exemption.[237] The court added that "'aging persons' [did] not necessarily include disabled or afflicted persons; nor [was] there any indication in the amended articles of incorporation that assisting those of financial need would continue to be a relevant consideration of the corporate purpose."[238] The supreme court reversed the circuit court and held that the properties do not belong in the class of properties defined in Virginia Code section 58.1-3606(A)(5) and thus, do not qualify for that tax exemption.[239]

2. Recent Significant Legislation

The 2000 General Assembly enacted a number of changes concerning the administration of real estate taxes. First, the legislature enacted Virginia Code section 58.1-3965.1 which authorizes any city to adopt an ordinance making real estate on which taxes are delinquent, eligible for a tax sale on December 31, following the first anniversary of the date the taxes become due.[240] The General Assembly also amended Virginia Code section 58.1-3967 to provide that a person notified of a tax sale of real estate by publication may request a rehearing within ninety days of the entry of the confirmation of sale (the court order that allows the property to be sold).[241] Lastly, the legislation authorized localities to adopt an ordinance allowing the locality to release tax liens in

235. *Id.* at 157, 509 S.E.2d at 508.
236. *Id.* at 158, 509 S.E.2d at 509.
237. *Id.*
238. *Id.*
239. *Id.* at 159, 509 S.E.2d at 509.
240. VA. CODE ANN. § 58.1-3965.1 (Repl. Vol. 2000).
241. *Id.* § 58.1-3967 (Repl. Vol. 2000).

order to facilitate the sale of real estate in certain circumstances.[242] Such liens would remain the personal obligation of the owner of the property at all times the liens were imposed.[243]

242. *Id.*
243. *See id.*

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