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Taxation

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TAXATION

Craig D. Bell *

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 year. 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 practices. This article, will not, however, discuss many of the numerous technical legislative changes to the State Taxation Code of Title 58.1.

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PART ONE: TAXES ADMINISTERED BY THE VIRGINIA DEPARTMENT OF TAXATION

II. INCOME TAX

A. *Recent Significant Legislative Activity*

1. Selective Deconformity with the Internal Revenue Code

Since 1972 Virginia has conformed to federal income tax law. Whenever the Internal Revenue Code has been amended, the changes have automatically affected Virginia income taxes unless otherwise exempted by the General Assembly of Virginia. When Congress recently made changes to the Internal Revenue Code through the enactment of the Job Creation and Worker Assistance Act of 2002¹ and the Victims of Terrorism Tax Relief Act of 2001,² the 2002 General Assembly amended Virginia Code section 58.1-301 to fix Virginia's conformity to the Internal Revenue Code as of December 31, 2001 (commonly referred to as "decoupling").³

The effect of the 2002 General Assembly's decoupling with the Internal Revenue Code was to prevent those taxpayers eligible for the thirty percent bonus depreciation, corporations with net operating loss carry backs and carry forwards, and retirement plans from benefiting from certain technical corrections made by this recent federal tax legislation to existing provisions of the Internal Revenue Code.⁴ The 2002 decoupling legislation, in addition to the pecuniary losses to Virginia taxpayers, created the need for taxpayers to keep two sets of tax records and imposed similar administrative burdens.⁵ The subject was sufficiently complicated that in the space of nineteen days the Department of Taxation

1. Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21.

2. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427.

3. Act of Feb. 27, 2003, ch. 2, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-301 (Cum. Supp. 2003)).

4. *See id.*; *see also* Job Creation and Worker Assistance Act of 2002, Public L. No. 107-147, 116 Stat. 21; Victims of Terrorism Relief Act of 2001, Public L. No. 107-134, 115 Stat. 2427.

5. Act of Feb. 27, 2003, ch. 2, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-301 (Cum. Supp. 2003)).

felt compelled to issue two bulletins to explain the impact of the decoupling legislation.⁶

Perhaps recognizing the administrative difficulties the 2002 general decoupling legislation caused, the 2003 General Assembly passed emergency legislation amending Virginia Code section 58.1-301 to advance Virginia's fixed-date conformity to the federal income tax laws from December 31, 2001 to December 31, 2002, with two exceptions.⁷ Virginia will not conform with the federal tax provisions allowing the special thirty percent bonus depreciation⁸ and the five-year net operating loss carry back.⁹ However, Virginia will conform to all other previously enacted provisions under federal income tax law up to December 31, 2002.¹⁰

2. Virginia Tax Amnesty Program

The 2003 General Assembly enacted legislation creating new Virginia Code section 58.1-1840.1 establishing the Virginia Tax Amnesty Program for a period of not less than sixty days nor more than seventy-five days.¹¹ The program shall be conducted during the Commonwealth's 2004 fiscal year (July 1, 2003 through June 30, 2004) at a time to be established by the Tax Commissioner.¹² The Tax Amnesty Program is intended to improve voluntary compliance with the laws and to increase and accelerate collections of certain taxes owed to Virginia.¹³ The Tax Amnesty Program is designed to apply to any person, individual, corporation, estate, trust, or partnership required to file a return or to pay any tax administered by the Department of Taxation.¹⁴

6. VA. DEPT OF TAX'N, TAX BULLETIN 02-2 (Mar. 20, 2002), available at <http://www.tax.state.va.us/> (last visited Sept. 22, 2003); VA. DEPT OF TAX'N, TAX BULLETIN 02-3 (Apr. 8, 2002), available at <http://www.tax.state.va.us/> (last visited Sept. 22, 2003).

7. Act of Feb. 17, 2003, ch. 2, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-301 (Cum. Supp. 2003)).

8. VA. CODE ANN. § 58.1-301(B)(1) (Cum. Supp. 2003).

9. *Id.* § 58.1-301(B)(2) (Cum. Supp. 2003).

10. *Id.* § 58.1-301(B) (Cum. Supp. 2003); see also VA. DEPT OF TAX'N, TAX BULLETIN 0-31 (Feb. 18, 2003), available at <http://www.tax.state.va.us/> (last visited Sept. 22, 2003); VA. DEPT OF TAX'N, TAX BULLETIN 03-2 (Feb. 18, 2003), available at <http://www.tax.state.va.us/> (last visited Sept. 22, 2003).

11. Act of Mar. 16, 2003, ch. 52, 2003 Va. Acts ___ (codified at VA. CODE ANN. § 58.1-1840.1(D)(1) (Cum. Supp. 2003)).

12. VA. CODE ANN. § 58.1-1840.1(A)-(D)(1) (Cum. Supp. 2003).

13. *Id.* § 58.1-1840.1(A) (Cum. Supp. 2003).

14. *Id.* § 58.1-1840.1(B) (Cum. Supp. 2003).

The Department of Taxation will remove any penalties, civil or criminal, and fifty percent of the interest due from wayward taxpayers who settle their delinquent accounts.¹⁵

Not all taxpayers will be eligible to participate in the Tax Amnesty Program. Any taxpayer currently under investigation for filing a fraudulent return will be excluded,¹⁶ as will individual, fiduciary, and corporate income taxpayers for taxes due for the 2002 taxable year.¹⁷ A twenty percent penalty will be assessed on the unpaid tax of any outstanding balance due after the close of the Tax Amnesty Program—in addition to all other penalties that may apply.¹⁸ The new provisions states that:

Any taxpayer who defaults upon any agreement to pay tax and interest arising out of a grant of [tax] amnesty is subject to reinstatement of the penalty and interest forgiven and the imposition of the penalty . . . as though the taxpayer retained the original outstanding balance at the close of the Virginia Tax Amnesty Program.¹⁹

B. *Foreign Source Income Subtraction Eliminated for Individuals*

The 2003 General Assembly eliminated the foreign source income subtraction from federal adjusted gross income for individuals when calculating their taxable income for tax years beginning after 2002.²⁰ A limited exception exists for any amount of foreign source income received in tax year 2003 attributable to foreign dividends that should have been paid in a prior tax year pursuant to a final court order.²¹ This limited exception permits the subtraction, provided it is claimed for taxable years beginning on or after January 1, 2003, but before January 1, 2004.²² Virginia corporate income taxpayers may continue to deduct foreign source income from federal taxable income.²³

15. *Id.* § 58.1-1840.1(D)(2) (Cum. Supp. 2003).

16. *Id.* § 58.1-1840.1(D)(2)(a) (Cum. Supp. 2003).

17. *Id.* § 58.1-1840.1(D)(2)(c) (Cum. Supp. 2003).

18. *Id.* § 58.1-1840.1(F)(1) (Cum. Supp. 2003).

19. *Id.* § 58.1-1840.1(F)(2) (Cum. Supp. 2003).

20. Act of Apr. 2, 2003, ch. 980, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-322(C) (Cum. Supp. 2003)).

21. VA. CODE ANN. § 58.1-322(F)(2) (Cum. Supp. 2003).

22. *Id.*

23. *See id.* § 58.1-402(C)(8) (Cum. Supp. 2003).

1. Nonprofit Corporation Filing Deadline Changed

Virginia Code section 58.1-441 was amended by the General Assembly to change the date on which nonprofit corporations with unrelated business taxable income or other taxable income must file their returns.²⁴ For tax years beginning on or after January 1, 2003, corporations will be allowed to file their corporate income tax returns on or before the fifteenth day of the sixth month following the close of the nonprofit corporation's tax year.²⁵ This change is designed to permit nonprofit corporations to file Virginia tax returns after they file their federal tax returns, which are due by the fifteenth day of the fifth month after the close of the nonprofit corporation's tax year. Prior to this amendment, nonprofit corporations had to file their Virginia returns by the fifteenth day of the fourth month after the close of the nonprofit corporation's tax year.²⁶ As a practical matter, nonprofit corporations frequently filed extensions for filing their Virginia tax returns until after their federal tax returns were complete and filed. This legislation greatly reduces, if not eliminates, the need for taking this extra step.

2. Filing Bases for Income Tax Returns of Affiliated Corporations

The 2003 General Assembly amended Virginia Code section 58.1-442 to enable certain corporations to file applications with the Virginia Tax Commissioner after June 30, 2003—through affiliated corporations that have filed on the same basis for at least the preceding twenty years—for permission to change the basis of their Virginia corporate income tax returns from consolidated to separate or from separate or combined to consolidated.²⁷ Permission will be granted if: (1) for the taxable year for which the new election would apply, there would have been no decrease in tax liability computed under the proposed election as compared to the group's former filing method;²⁸ and (2) the affiliated group agrees

24. Act of Mar. 16, 2003, ch. 376, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-441 (Cum. Supp. 2003)).

25. VA. CODE ANN. § 58.1-441(B) (Cum. Supp. 2003).

26. *Id.* § 58.1-441 (Repl. Vol. 2000).

27. Act of Mar. 16, 2003, ch. 166, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-442(C) (Cum. Supp. 2003)).

28. VA. CODE ANN. § 58.1-442(C)(1) (Cum. Supp. 2003).

to file returns computing its Virginia income tax liability under both the new filing method and the former filing method and to pay the greater of the two amounts for the tax year in which the election is effective, as well as the immediately succeeding tax year.²⁹

3. Fraudulent Tax Return Penalty Increased

Effective July 1, 2003, the criminal penalty for filing fraudulent income tax returns was increased from a Class 1 misdemeanor to a Class 6 felony.³⁰ The 2003 General Assembly amended Virginia Code sections 58.1-348 and 58.1-452 to increase the penalty for both an individual and an officer of a corporation who make either a fraudulent return or a false statement on a return with the intent to evade the payment of taxes.³¹ The increased criminal penalty also applies to an individual or fiduciary who willfully fails or refuses to file an income tax return.³²

4. Enterprise Zone Business Tax Credit Expanded

The Virginia legislature amended the Virginia Enterprise Zone Business Tax Credit against franchise tax, corporate income tax, personal income tax, and license taxes on insurance companies and utilities.³³ The Virginia Enterprise Zone Business Tax Credit is established in Virginia Code section 59.1-280.³⁴ The 2003 General Assembly amended this statute to include a “[h]igh investment/limited job creation qualified business firm[]” as an eligible business.³⁵ A high investment/limited job creation qualified business firm is defined as a qualified business firm making qualified zone investments of at least fifty million dollars, resulting in the

29. *Id.* § 58.1-442(C)(2) (Cum. Supp. 2003).

30. Act of Mar. 16, 2003, ch. 180, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. §§ 58.1-348, -452 (Cum. Supp. 2003)).

31. *Id.*

32. VA. CODE ANN. §§ 58.1-348, -452 (Cum. Supp. 2003).

33. Act of Mar. 19, 2003, ch. 676, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 59.1-280 (Cum. Supp. 2003)).

34. VA. CODE ANN. § 59.1-280 (Cum. Supp. 2003).

35. Act of Mar. 19, 2003, ch. 676, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 59.1-280(E) (Cum. Supp. 2003)).

creation of fewer than fifty permanent full-time positions.³⁶ The amount of business tax credit is an amount to be determined by agreement between the qualified business firm and the Department of Taxation.³⁷ In no case may the tax credit exceed eighty percent of the tax due to Virginia for the first tax year and sixty percent of the tax due for the second through tenth tax years.³⁸

The tax credit may not exceed the amount of revenues recovered from the Virginia income tax generated by the new full-time positions created within a five-year period.³⁹ Furthermore, credits authorized for a high investment/limited job creation qualified business firm will count against the three million dollar Enterprise Zone General Business Tax Credit and real property investment tax credit pool reserved for large qualified business firms and large qualified zone residents.⁴⁰

III. FIDUCIARY—PROBATE TAX

The 2003 General Assembly amended Virginia Code sections 58.1-1712 and 58.1-1714 to raise the value of an estate that is subject to the probate tax from \$10,000 to \$15,000, and to require the filing of a return with the clerk of the court at the time either the will is offered for probate or the grant of administration is sought.⁴¹

36. VA. CODE ANN. § 59.1-280(A) (Cum. Supp. 2003).

37. *Id.* § 59.1-280(E) (Cum. Supp. 2003).

38. *Id.*

39. *Id.*

40. *Id.* § 59.1-280 (D)–(E) (Cum. Supp. 2003).

41. Act of Mar. 16, 2003, ch. 195, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. §§ 58.1-1712, -1714 (Cum. Supp. 2003)). For more information on the 2003 developments in the area of wills, trusts, and estates, see J. Rodney Johnson, *Annual Survey of Virginia Law: Wills, Trusts, and Estates*, 38 U. RICH. L. REV. 287 (2003).

IV. RETAIL SALES AND USE TAXES

A. *Recent Significant Legislative Activity*

1. Certified Pollution Control Equipment and Facilities Exemption

The 2003 General Assembly amended Virginia Code section 58.1-609.3(9) to require that the sales and use tax exemption for certified pollution control equipment provide that such equipment must be certified to the Virginia Department of Taxation by the appropriate state certifying authority.⁴² This clarifying legislation is designed to ensure that the sales and use tax exemption for certified pollution control equipment and facilities undergoes the same two-step process as the exemption for tangible and real property that qualifies for exclusion from local taxes.⁴³

A taxpayer seeking an exemption from property taxes for pollution control equipment and facilities must first apply to the appropriate state certifying authority (i.e., "the State Water Control Board, for water pollution; the State Air Pollution Control Board, for air pollution; the Department of Mines, Minerals and Energy, for coal, oil, and gas production, including gas, natural gas, and coalbed methane gas; and the Virginia Waste Management Board, for waste disposal facilities").⁴⁴ Upon receiving approval from the appropriate certifying authority having jurisdiction, such certifying authority "certifies" the equipment and/or facilities to the Virginia Department of Taxation "as having been constructed, reconstructed, erected, or acquired in conformity with the state program or requirements for abatement or control of water or atmospheric pollution or contamination."⁴⁵ The Department of Taxation will then issue a letter or certificate to the taxpayer that such equipment or facility meets the tangible and/or real property classification of certified pollution control equipment and facilities. This amendment to the sales and use tax exemption for certified pollution control equipment and facilities

42. Act of Mar. 22, 2003, ch. 859, 2003 Va. Acts ____ (codified as amended at VA. CODE ANN. § 58.1-609.3(9) (Cum. Supp. 2003)).

43. See VA. CODE ANN. § 58.1-3660 (Cum Supp. 2003).

44. *Id.* § 58.1-3660(B) (Cum. Supp. 2003).

45. *Id.*

ensures that the appropriate state certifying authority review and certification process occurs before such equipment and facilities will qualify for the sales and use tax exemption.⁴⁶

2. Process for Obtaining Sales and Use Tax Exemptions by Nonprofit Organizations Altered

The 2003 General Assembly enacted a new statute to establish a process by which a nonprofit organization may seek an exemption from sales and use taxes.⁴⁷ The new statute, Virginia Code section 58.1-609.11, will not go into effect July 1, 2004.⁴⁸ Under the new system, the Department of Taxation is empowered to grant exemptions administratively, according to criteria set forth in the new statute. Generally, to qualify for the exemption, a nonprofit organization will be required to establish either that: (1) the entity is exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code,⁴⁹ or (2) the entity's exempt under section 501(c)(4) of the Internal Revenue Code⁵⁰ and was organized for a charitable purpose.⁵¹

Virginia Code section 58.1-609.11 also sets forth a list of compliance measures the nonprofit organization must meet relating to state solicitation laws,⁵² establishes limits on administrative costs as a percentage of revenues,⁵³ imposes requirements for an independent certified public accountant financial audit for nonprofit entities having an annual gross revenue of \$250,000 or greater in a prior year,⁵⁴ and other similar requirements.⁵⁵

After July 1, 2004 the Department of Taxation will be able to grant exemptions to qualifying nonprofit organizations for a pe-

46. *Id.* § 58.1-609.3(9)(i) (Cum. Supp. 2003).

47. Act of Mar. 20, 2003, ch. 757, 2003 Va. Acts ___ (codified at VA. CODE ANN. § 58.1-609.11 (Cum. Supp. 2003)).

48. VA. CODE ANN. § 58.1-609.11(B) (Cum. Supp. 2003).

49. *Id.* § 58.1-609.11 (Cum. Supp. 2003); *see also* 26 U.S.C. § 501(c)(3) (2000) (defining the requirements nonprofit organizations must meet to be considered exempt from federal income taxation).

50. VA. CODE ANN. § 58.1-609.11 (Cum. Supp. 2003); *see also* 26 U.S.C. § 501(c)(4) (2000) (defining the net earnings requirements for exempt nonprofit organizations).

51. VA. CODE ANN. § 58.1-609.11(C)(1)(a)(i)-(ii) (Cum. Supp. 2003).

52. *Id.* § 58.1-609.11(C)(2) (Cum. Supp. 2003).

53. *Id.* § 18.1-609.11(C)(3) (Cum. Supp. 2003).

54. *Id.* § 58.1-609.11(C)(4) (Cum. Supp. 2003).

55. *See id.* § 58.1-609.11(C) (Cum. Supp. 2003).

riod of at least five years, but not more than seven years.⁵⁶ Failure to maintain compliance by the nonprofit organization will provide grounds for revocation of the sales and use tax exemption by the Department of Taxation.⁵⁷

V. JUDICIAL REVIEW OF STATE TAX ASSESSMENTS

A. *Significant Recent Legislative Activity*

1. Circuit Court "Pay to Play" Rule Repealed

In a surprising and unexpected move, the 2003 General Assembly eliminated the requirement that taxpayers first pay the assessment of state imposed taxes before they may challenge a tax assessment in circuit court.⁵⁸ The legislation amends Virginia Code section 58.1-1825 to eliminate the jurisdictional requirement that a taxpayer must first pay a state tax assessment (i.e., income tax, corporate franchise tax, retail sales and use tax, bank franchise tax, etc.) in order to challenge the assessments in circuit court.⁵⁹ Prior to this legislation, a taxpayer was not allowed to challenge an assessment in circuit court unless the assessment was paid or a bond was posted within ninety days of the assessment.⁶⁰

Virginia Code section 58.1-1825, as amended, does contain a limited exception that would require the taxpayer to pay the assessment before proceeding with a judicial challenge.⁶¹ Specifically, if the Tax Commissioner demonstrates to the circuit court that the Department of Taxation is likely to prevail on the merits of the case because: (1) the taxpayer's application is not well grounded in fact; (2) the taxpayer's case is not warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; (3) the taxpayer's case is interposed for an improper purpose, such as to harass, to cause unnecessary

56. *Id.* § 58.1-609.11(E) (Cum. Supp. 2003).

57. *Id.*

58. Act of Mar. 22, 2003, ch. 908, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-1825 (Cum. Supp. 2003)).

59. *Id.*

60. VA. CODE ANN. § 58.1-1825 (Repl. Vol. 2000).

61. *Id.* § 58.1-1825 (Cum. Supp. 2003).

delay in revenue collection, or to create needless cost to Virginia; or (4) the taxpayer's application is otherwise frivolous, then the taxpayer would be required to pay the tax before continuing with his or her judicial challenge to the tax assessment.⁶²

Should the court require that the taxpayer pay the tax first under this exception, the amended statute affords the taxpayer the opportunity—in lieu of paying the tax—to post a bond or offer an irrevocable letter of credit within sixty days of the court's ruling.⁶³ The letter of credit must be in the amount of the assessment, increased by twice the interest rate for tax underpayments in effect at the time the application is filed.⁶⁴

Virginia Code section 58.1-1825, as amended, is effective for proceedings initiated on or after July 1, 2003.⁶⁵ Nothing in the provision is designed to prevent the Department of Taxation from collecting the assessment if the Tax Commissioner determines that collection is in jeopardy.⁶⁶ A jeopardy assessment is a rather extreme event, to be utilized only in selected cases where conditions merit such drastic collection activities (e.g., a taxpayer seeking to flee the country, the purposeful wasting or hiding of assets, or other high risk cases).

62. *Id.* § 58.1-1825(B)(i)-(iv) (Cum. Supp. 2003).

63. *Id.* § 58.1-1825(C) (Cum. Supp. 2003).

64. *Id.*

65. *Id.* § 58.1-1825 (Cum. Supp. 2003).

66. *Id.* § 58.1-1825(E) (Cum. Supp. 2003).

PART TWO: TAXES ADMINISTERED BY LOCALITIES

VI. PROPERTY TAXATION

A. *Significant Recent Legislative Activity*

1. Certified Pollution Control Equipment and Facilities Classification Expanded

The 2003 General Assembly amended Virginia Code section 58.1-3660, pertaining to the property tax classification for “certified pollution control equipment and facilities,” to include “equipment used to grind, chip, or mulch trees, tree stumps, underbrush, and other vegetative cover for reuse as mulch, compost, or fuel,” whether or not the property has been certified to the Department of Taxation by a state certifying authority.⁶⁷

2. Assessment of Substantially Completed Buildings

Virginia Code section 58.1-3292.1 was amended by the 2003 General Assembly to allow selected localities to assess real property taxes on new buildings when they are substantially completed or fit for occupancy, regardless of the actual date of construction completion or fitness.⁶⁸ The localities covered include the counties of Arlington, Loudoun, and Prince William; as well as the cities of Alexandria, Falls Church, Fairfax, Manassas, and Manassas Park.⁶⁹ Prior to this amendment, only Fairfax County enjoyed this benefit.⁷⁰ The affected jurisdictions pushed for the legislation so they would be on the same “footing” as Fairfax

67. Act of Mar. 22, 2003, ch. 859, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3660(B) (Cum. Supp. 2003)).

68. Act of Feb. 18, 2003, ch. 6, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3292.1 (Cum. Supp. 2003)).

69. The General Assembly expanded Virginia Code section 58.1-3292.1 to apply to “any city with a population between 15,000 and 25,000 that is within such county” and any “county operating under the urban county executive form of government.” VA. CODE ANN. § 58.1-3292.1 (Cum. Supp. 2003). For a complete list of the 2003 United States Census population figures for counties and cities of the Commonwealth, see the Appendix of Title 15.2 of the Virginia Code.

70. VA. CODE ANN. §§ 58.1-3292, -3292.1 (Repl. Vol. 2000).

County and not at a competitive disadvantage as it relates to each locality's revenue base. Under prior law, a county, city, or town could only assess real estate on new buildings that were substantially completed or fit for use and occupancy prior to November 1 of the tax year, with the exception of Fairfax County, Virginia.⁷¹

3. Real Estate Appeals to Boards of Equalization and Circuit Courts

The 2003 General Assembly made a number of revisions to the process of appealing real estate assessments. For purposes of appeals to a board of equalization, the legislation codified existing case law that provides there shall be a presumption that the valuation of real estate as determined by the local assessing officer is correct, and that the taxpayer must produce substantial evidence that the valuation of his or her real estate is both "erroneous and was not arrived at in accordance with generally accepted appraisal practice."⁷² Virginia Code section 58.1-3379(C), as amended, provides that "[m]istakes of fact, including computation, that affect the assessment shall be deemed not to be in accordance with generally accepted appraisal practice."⁷³ Furthermore, the board of equalization will be advised that the taxpayer does not need to show that "the assessment is a result of manifest error or disregard of controlling evidence."⁷⁴

As to applications challenging real estate assessments in circuit court, the new legislation does not change existing law with regard to the burden and standard of proof that a taxpayer must satisfy in circuit court.⁷⁵ The revised section also provides for a three-year statute of limitations to appeal real estate assessments to all circuit courts.⁷⁶ Generally, there already exists a three-year statute of limitations.⁷⁷ However, in some localities

71. *Id.*

72. Act of May 1, 2003, ch. 1036, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3379(C) (Cum. Supp. 2003)).

73. VA. CODE ANN. § 58.1-3379(C) (Cum. Supp. 2003).

74. *Id.* § 58.1-3379(B) (Cum. Supp. 2003).

75. Act of May 1, 2003, ch. 1036, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3379(F) (Cum. Supp. 2003)).

76. VA. CODE ANN. § 15.2-717 (Repl. Vol. 2003).

77. *Id.* § 58.1-3984 (Repl. Vol. 2000).

there is a one-year statute of limitations (e.g., cities of Richmond, Newport News, Hampton, Norfolk, Chesapeake and Virginia Beach and Arlington County).⁷⁸ As to those localities with the one-year statute of limitations, the new three-year limitations period will be phased in over several years.⁷⁹ By the year 2007, all localities will be subject to the three-year statute of limitations.⁸⁰ The effective date for this legislation is January 1, 2004.⁸¹

4. Situs for Assessment of Business Motor Vehicles

Virginia Code section 58.1-3511 was amended by the 2003 General Assembly to change the location or locality in which to apply the personal property tax on business vehicles weighing 10,000 pounds or less.⁸² The new rule is that the locality in which the business owner has a definite place of business and from which the owner directs or controls the vehicle's use is the situs of the vehicles for the assessment of the personal property tax.⁸³ Under prior law, the personal property tax on vehicles was imposed by the jurisdiction where the vehicles were garaged or parked on tax day.⁸⁴

B. *Recent Judicial Decisions*

1. Situs of Property for Assessment of Property Taxes

In *City of Virginia Beach v. International Family Entertainment, Inc.*,⁸⁵ the Supreme Court of Virginia held that the City of Virginia Beach lacks the authority to tax satellite transponders—owned and used by a corporation with offices located in the City

78. *Id.* §§ 58.1-3260, -3261 (Repl. Vol. 2000).

79. *Id.* § 58.1-3984 (Repl. Vol. 2000 & Cum. Supp. 2003).

80. *Id.* § 58.1-3984(A) (Repl. Vol. 2003).

81. *Id.* § 58.1-3511(A) (Cum. Supp. 2003).

82. Act of Mar. 16, 2003, ch. 43, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3511 (Cum. Supp. 2003)).

83. VA. CODE ANN. § 58.1-3511 (Cum. Supp. 2003).

84. *Id.* § 58.1-3511(A) (Repl. Vol. 2000).

85. 263 Va. 501, 561 S.E.2d 696 (2002).

of Virginia Beach—that are attached to satellites that orbit the earth.⁸⁶

International Family Entertainment, Inc. (“International”), a Delaware corporation, operates a cable television network that produces and distributes family-oriented entertainment, including “made-for-television” movies and informational programming.⁸⁷ International’s corporate offices, as well as its corporate books and records, are located in Virginia Beach.⁸⁸ International’s income tax records and its filings with the federal Securities and Exchange Commission identify Virginia Beach as the address of the corporation.⁸⁹

International owns three transponders that are permanently affixed to communications satellites that orbit the earth. The satellites are physically located approximately 22,300 miles above the earth’s equator in an assigned geostationary orbit. A transponder is a device that amplifies and relays transmissions between transmitting and receiving stations. The transponders receive audio and video program signals from an “uplink” and transmit the signals to satellite dishes on the earth. Cable television companies and home satellite dishes receive these signals. The cable television companies transmit these signals to cable subscribers throughout the United States.

The transponders have never had a physical presence in Virginia Beach. They were not constructed or assembled in Virginia Beach or anywhere else in Virginia.⁹⁰

During the tax years 1993 through 1998, International was assessed and paid personal property taxes to the City on the transponders in the amount of \$120,169.12 per year.⁹¹

The court found that “[n]o other jurisdiction taxed or asserted the right to tax the value of the transponders for those tax years.”⁹² International sought a refund of personal property taxes paid for those years with respect to the transponders.⁹³ The City of Virginia Beach denied International’s claim.⁹⁴ The Circuit Court of the City of Virginia Beach ruled in favor of Interna-

86. *Id.* at 507, 561 S.E.2d at 699.

87. *Id.* at 503, 561 S.E.2d at 697.

88. *Id.*

89. *Id.* at 503–04, 561 S.E.2d at 697–98.

90. *Id.* at 504, 561 S.E.2d at 698.

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

tional, holding that the city lacked the authority to tax the transponders, and awarded International a refund of \$480,676.48 in taxes.⁹⁵

The City of Virginia Beach has the power to tax the category of property contained in Virginia Code section 58.1-3511, which deals with the situs of taxation and prescribes limitations upon the city's power to tax.⁹⁶ Virginia Code section 58.1-3511(A) specifically states that "[t]he situs for the assessment and taxation of . . . machinery and tools shall in all cases be the . . . city in which such property may be physically located on the tax day."⁹⁷ The transponders in this case, which are affixed to satellites 22,300 miles above the earth, have never been physically located in Virginia Beach.⁹⁸

The City of Virginia Beach argued before the Supreme Court of Virginia that the transponders were machinery and that this category of property is properly taxed by the city pursuant to Virginia Code section 58.1-3507.⁹⁹ International, on the other hand, argued that Virginia Code section 58.1-3511(A) controls and that the city cannot tax property not located within the city's geographical boundaries.¹⁰⁰ Furthermore, International asserted that Virginia Code section 58.1-3511(A) imposes statutory limits relating to the situs of property for assessment.¹⁰¹

The supreme court agreed with International and ruled that Virginia Code section 58.1-3511(A) prescribes limitations upon the city's power to tax.¹⁰² Specifically, the court noted that the statute provides that the "situs for the assessment and taxation of . . . machinery and tools shall in all cases be the . . . city in which such property may be physically located on the tax day."¹⁰³ The court continued, "[i]t is undisputed that the transponders in

95. *Id.*

96. VA. CODE ANN. § 58.1-3511 (Repl. Vol. 2000 & Cum. Supp. 2003).

97. *Id.* § 58.1-3511(A) (Repl. Vol. 2000 & Cum. Supp. 2003).

98. *Int'l Family Entm't, Inc.*, 263 Va. at 504, 561 S.E.2d at 698.

99. *Id.* at 505, 561 S.E.2d at 698.

100. *Id.* at 505, 561 S.E.2d at 699.

101. *Id.* at 505-06, 561 S.E.2d at 699.

102. *Id.* at 506, 561 S.E.2d at 699.

103. *Id.* at 507, 561 S.E.2d at 699 (quoting VA. CODE ANN. § 58.1-3511(A) (Repl. Vol. 2000)).

this case, which are affixed to satellites 22,300 miles above the earth, have never been physically located in Virginia Beach.”¹⁰⁴

2. Distinction Between Capital, Machinery and Tools

In *Daily Press, Inc. v. City of Newport News*,¹⁰⁵ the Supreme Court of Virginia ruled that equipment and machines used by a newspaper publisher in the information and news-gathering process were manufacturer’s capital subject to property taxation solely by the state, and that such property was not machinery and tools subject to a city’s local property taxation.¹⁰⁶

The Daily Press, Inc. (“Daily Press”) is a newspaper operating in Newport News, Virginia, which claimed a refund of personal property taxes for the tax years 1991 and 1993 through 1996 totaling \$273,928, plus interest from the payment dates.¹⁰⁷ The Daily Press asserted that its equipment and machinery used in news-gathering activities is capital that should be classified as “intangible personal property” under Virginia Code sections 58.1-1100 and 58.1-1101(A)(2), and subject to taxation solely by the Commonwealth of Virginia.¹⁰⁸ The City of Newport News argued this same equipment and machinery was properly classified as “machinery and tools” subject to local taxation by the city pursuant to Virginia Code section 58.1-1101(A)(2).¹⁰⁹

The Circuit Court for the City of Newport News found that the Daily Press’ business operations could be divided into three “components” for purposes of deciding which items of property should be taxable as machinery and tools pursuant to Virginia Code section 58.1-1101(A)(2):¹¹⁰ (1) “[t]he first component consist[ed] of content or information gathering;”¹¹¹ (2) the second component

104. *Id.*

105. 265 Va. 304, 576 S.E.2d 430 (2003).

106. *Id.* at 310, 576 S.E.2d at 433.

107. *Id.* at 306–07, 576 S.E.2d at 431.

108. *Id.* at 306, 576 S.E.2d at 431; *see also* VA. CODE ANN. §§ 58.1-1100, -1101(A)(2) (Repl. Vol. 2000 & Cum. Supp. 2003).

109. *Daily Press*, 265 Va. at 306, 576 S.E.2d at 431; *see also* VA. CODE ANN. § 58.1-1101(A)(2) (Repl. Vol. 2000 & Cum. Supp. 2003).

110. *Daily Press*, 265 Va. at 307, 576 S.E.2d at 431; *see also* VA. CODE ANN. § 58.1-1101(A)(2) (Repl. Vol. 2000 & Cum. Supp. 2003).

111. *Daily Press*, 265 Va. at 307, 576 S.E.2d at 431.

was called the "pre-press process,"¹¹² and (3) the third component involved "the actual operation of the printing presses in the press room."¹¹³ The Daily Press and the city agreed the machinery and equipment in the press room were used directly in the manufacturing process, and were properly taxable by the city as "machinery and tools."¹¹⁴ The city and taxpayer disagreed as to the classification of equipment and machinery in the first two components.¹¹⁵

The Daily Press argued at trial that the equipment and machines used in the first two stages of operations do support the manufacturing process, but are not used directly in the manufacturing of its product, nor used in connection with the operation of any machinery actually and directly used in the manufacturing process.¹¹⁶ The city asserted, and the circuit court agreed, that the Daily Press has an integrated manufacturing process that begins with the gathering of news and ends with the printed newspaper.¹¹⁷ Accordingly, the machinery and equipment used in the first two stages (i.e. components) of the newspaper's operations are just as critical to the manufacturing process as the printing presses.¹¹⁸

On appeal to the Supreme Court of Virginia, the city made the same arguments that succeeded before the circuit court.¹¹⁹ The supreme court, however, disagreed with the circuit court's focus on the Daily Press' integrated manufacturing operations rather than on the actual manufacturing process wherein new materials are transformed into a substantially different product.¹²⁰ The court looked at its earlier decision in *City of Winchester v. American Woodmark Corp.*¹²¹ in which the court adopted a definition of machinery and tools to mean machinery used in the actual process of manufacturing.¹²² This judicial definition coincided with the

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* at 308, 576 S.E.2d at 432.

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* at 310, 576 S.E.2d at 433.

121. 250 Va. 451, 464 S.E.2d 148 (1995).

122. *Daily Press*, 265 Va. at 309-10, 576 S.E.2d at 433 (citing *American Woodmark*, 250 Va. at 456, 464 S.E.2d at 151).

same definition used by both the Virginia Tax Commissioner and Attorney General on a number of occasions over a period of fifty years.¹²³

The supreme court continued its analysis by noting that, once a taxpayer is deemed as engaging in a manufacturing process, a distinction must be drawn between the taxpayer's "machinery and tools" and its "capital."¹²⁴ The court concluded that the equipment and machinery the Daily Press used in the first two stages of its operations were not directly used in operating the printing presses and were thus classified as "capital" rather than "machinery and tools."¹²⁵ The court ordered a refund of taxes paid plus interest.¹²⁶

VII. MISCELLANEOUS LOCAL TAXES AND PROCEDURES

A. *Recent Significant Legislative Activity*

1. Local Business Tax Appeal Procedures

The 2003 General Assembly amended Virginia Code section 58.1-3983.1 to require the Tax Commissioner to determine within thirty days whether the Department of Taxation has jurisdiction to hear an appeal of a local tax dispute.¹²⁷ Under previous law, the Tax Commissioner had ninety days to conclude whether he would entertain the appeal.¹²⁸ The new law mandates that the Tax Commissioner issue a decision in a local business tax administrative appeal within 150 days of receipt of the appeal (ninety days under the statute, plus a sixty-day extension).¹²⁹

123. *Id.* at 309–10, 576 S.E.2d at 433.

124. *Id.* at 311, 576 S.E.2d at 434. For a more thorough discussion of the distinction to be made and ramifications of the classification between a manufacturer's "capital" and its "machinery and tools," see Craig D. Bell, *Annual Survey of Virginia Law: Taxation*, 30 U. RICH. L. REV. 1543, 1582–95 (1996).

125. *Daily Press*, 265 Va. at 312, 576 S.E.2d at 435.

126. *Id.*

127. Act of Mar. 16, 2003, ch. 196, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3983.1(D)(1) (Cum. Supp. 2003)).

128. VA. CODE ANN. § 58.1-3983.1(D)(1) (Repl. Vol. 2000).

129. *Id.* § 58.1-3983.1(D)(1) (Cum. Supp. 2003).

2. Discount for Early Payment of Local Taxes

The 2003 General Assembly enacted new Virginia Code sections 15.2-1104 and 15.2-1201.2 authorizing local tax authorities to establish an ordinance allowing a discount for the early payment of any local tax or assessment imposed.¹³⁰

3. Clarification on Telecommunication Utility Tax

The 2003 General Assembly amended Virginia Code section 58.1-3812 to enable telecommunications companies to ensure their nontaxable services remain nontaxable when rendering bills that "bundle" such services with taxable communications services.¹³¹

Long-distance, cable, broadband, and DSL services are not subject to the local consumer utility tax; however, most of these services are now offered in a bundled package.¹³² This new provision guarantees that telecommunications services, currently tax-free under the local consumer utility tax, will remain tax-free if the provider meticulously identifies the nontaxable services on its books and records kept in the regular course of business.¹³³

Virginia Code section 58.1-3812 also stipulates that if telecommunications services falling under the umbrella of the consumer utility tax are indeed taxed at different rates, such services will not be taxed at the highest rate if the company can establish on its books what services are subject to the lower tax rate.¹³⁴ In other words, to avoid the highest tax on all of its services, a telecommunications provider must carefully differentiate the types of services subject to the various rates and maintain accurate books and records for purposes of audit and compliance to ensure only those services entitled to lower tax rates are actually taxed at such lower rates.¹³⁵

130. Act of Mar. 16, 2003, ch. 216, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. §§ 15.2-1104, -1201.2 (Repl. Vol. 2003)).

131. Act of Mar. 16, 2003, ch. 160, 2003 Va. Acts ___ (codified as amended at VA. CODE ANN. § 58.1-3812(L)(1)–(3) (Cum. Supp. 2003)).

132. VA. CODE ANN. § 58.1-3812(L)(1)–(2) (Cum. Supp. 2003).

133. *Id.*

134. *Id.* § 58.1-3812(L)(3) (Cum. Supp. 2003).

135. *Id.* For additional discussion of telecommunications and public utility law within the Commonwealth in 2003, see B. Paige E. Holloway, *Annual Survey of Virginia Law: Public Utility Law*, 38 U. RICH. L. REV. 195 (2003).