

# University of Richmond Law Review

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Volume 58  
Issue 1 *Annual Survey of Virginia Law*

Article 6

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12-1-2023

## Taxation

Craig D. Bell

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### Recommended Citation

Craig D. Bell, *Taxation*, 58 U. Rich. L. Rev. 79 (2023).

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# TAXATION

*Craig D. Bell \**

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## INTRODUCTION

This Article reviews significant recent developments in the laws affecting Virginia state and local taxation. Its Parts cover legislative activity, judicial decisions, and selected opinions from the past year. Part I of this Article addresses taxes administered by the Virginia Department of Taxation (the “Tax Department” or “Department”). Part II covers local taxes, including real and tangible personal property machinery and tools, license taxes, and other discrete local taxes.

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 that are most likely to impact their clients. However, it does not address many of the numerous minor, locality-specific, or technical legislative changes to Title 58.1 of the Code of Virginia, which covers taxation.

## I. TAXES ADMINISTERED BY THE TAX DEPARTMENT

A. *Significant Legislative Activity*

## 1. Income Taxation

## a. Conformity to the Internal Revenue Code

Consistent with its long-standing practice, the General Assembly amended Code of Virginia section 58.1-301, which mandates conformity with the Internal Revenue Code (“IRC”) as of a certain date, and moved that date from December 31, 2021 to December 31, 2022.<sup>1</sup> Although advancing the date of conformity, Senate Bill 882 and House Bill 1595 did not change the previously adopted exceptions to its conformity legislation that are codified at section 58.1-301(B)(1)–(10).<sup>2</sup>

The General Assembly’s conformity legislation permits Virginia to conform its Code to several tax-related provisions in the

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1. 2023 Va. Acts chs. 1 & 772 (codified as amended at VA. CODE ANN. § 58.1-301 (Cum. Supp. 2023)).

2. S.B. 882, Va. Gen. Assembly (Reg. Sess. 2023) (enacted as 2023 Va. Acts ch. 1); H.B. 1595, Va. Gen. Assembly (Reg. Sess. 2023) (enacted as 2023 Va. Acts ch. 772); VA. CODE ANN. § 58.1-301(B)(1)–(10) (Cum. Supp. 2023).

Inflation Reduction Act of 2022 (“IRA”)<sup>3</sup> and the Secure 2.0 provisions of the Consolidated Appropriations Act of 2023 (“CAA”).<sup>4</sup> The IRA legislation includes three provisions that may impact Virginia income tax returns. These provisions are (1) enhancements to the Energy Efficient Commercial Building Deduction; (2) Cost Recovery for Qualified Property and Energy Storage Technology; and (3) Extension of the Limit on Excess Business Losses.<sup>5</sup> Advancing Virginia’s date of conformity to December 31, 2022 will allow Virginia to conform to the three provisions identified above. As a result, adjustments are generally not required on the Virginia income tax return to address the provisions of this federal legislation.

The Secure 2.0 Act of 2022, which is contained within the provisions of the CAA, contains several provisions amending the rules governing the federal treatment of retirement accounts and addressing charitable conservation easements (hereinafter referred to as the “Secure 2.0 provisions”).<sup>6</sup> Several of the Secure 2.0 provisions related to the federal treatment of retirement accounts will have a substantial impact on Virginia taxpayers. These retirement-related provisions include:

1. Option to treat employer matching or non-elective contributions as Roth contributions;<sup>7</sup>
2. Option for employers to offer pension-linked emergency savings accounts that are generally treated as Roth IRAs that benefit from tax exempt treatment;<sup>8</sup>
3. Exclusion of certain disability-related first responder retirement payments;<sup>9</sup>
4. Treatment of student loan payments as elective deferrals for purposes of matching contributions, which will allow employees with student debt to benefit from employer retirement

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3. Inflation Reduction Act of 2022, Pub. L. No. 117-169, 136 Stat. 1818.

4. Consolidated Appropriations Act of 2023, Pub. L. No. 117-328, 136 Stat. 4459 (2022).

5. Inflation Reduction Act §§ 13303, 136 Stat. at 1947; 13703, 136 Stat. at 1997; 13903, 136 Stat. at 2014.

6. Secure 2.0 Act of 2022, Pub. L. No. 117-328, 136 Stat. 5275.

7. § 604, 136 Stat. at 5392.

8. § 127, 136 Stat. at 5318.

9. § 309, 136 Stat. at 5345.

- contributions, even if they are unable to make contributions themselves;<sup>10</sup>
5. Elective deferrals generally limited to regular contribution limitations;<sup>11</sup> and
  6. One-time election to enhance qualified charitable contribution distributions.<sup>12</sup>

Unlike prior sessions of the Virginia General Assembly, the 2023 General Assembly also enacted a second conformity provision to allow the Code of Virginia to conform with federal tax laws on a rolling basis, meaning that Virginia tax laws will incorporate changes to federal income tax laws reflected in the IRC as soon as Congress enacts them on or after January 1, 2023.<sup>13</sup> However, this legislation also provides for a number of exceptions that cause the Code to not conform with federal tax laws.

For example, Senate Bill 1405 and House Bill 2193 would cause Virginia to not conform with any amendment to federal income tax law, enacted on or after January 1, 2023, that would increase or decrease general fund revenues by \$15 million in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years.<sup>14</sup> This nonconformity provision would not apply to any federal tax changes that the Virginia General Assembly subsequently adopts or to a “federal tax extender.”<sup>15</sup> This new legislation defines a federal tax extender to mean “an amendment to federal tax law that extends the expiration date of a federal tax provision to which Virginia conforms or has previously conformed.”<sup>16</sup> Beginning January 1, 2024, the \$15 million threshold would be adjusted annually by the change in the Chained Consumer Price Index for All Urban Consumers (“C-CPI-U”) for the previous year.<sup>17</sup>

The rolling conformity legislation would also cause Virginia to not conform with any amendments to federal tax law “enacted on

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10. § 110, 136 Stat. at 5290.

11. § 603, 136 Stat. at 5391.

12. § 307, 136 Stat. at 5343.

13. 2023 Va. Acts chs. 763 & 791 (codified as amended at VA. CODE ANN. § 58.1-301 (Cum. Supp. 2023)).

14. S.B. 1405, Va. Gen. Assembly (Reg. Sess. 2023) (enacted as 2023 Va. Acts ch. 763); H.B. 2193, Va. Gen. Assembly (Reg. Sess. 2023) (enacted as 2023 Va. Acts, ch. 791); VA. CODE ANN. § 58.1-301(B)(11)(a)(1) (Cum. Supp. 2023).

15. § 58.1-301(B)(11)(a)(1).

16. § 58.1-301(B)(11)(b).

17. § 58.1-301(B)(11)(a)(3).

or after January 1, 2023, and occurring between adjournment sine die of the previous regular session of the General Assembly and the first day of the subsequent regular session of the General Assembly,” if the cumulative impact of such amendments “would increase or decrease general fund revenues by more than \$75 million in the fiscal year in which the amendments were enacted or any of the succeeding four fiscal years.”<sup>18</sup> This nonconformity provision would not apply to any amendments to federal tax law that the Virginia General Assembly subsequently adopts or that are enacted before the date on which the cumulative projected impact is met.<sup>19</sup> This nonconformity provision would also not apply in the case of any federal tax extender as previously defined.<sup>20</sup>

The Secretary of Finance is required to provide an annual report “on the fiscal impact of amendments to federal income tax law occurring since the adjournment sine die of the preceding regular session of the General Assembly to the Chairman of the Senate Committee on Finance and Appropriations and the House Committees on Appropriations and Finance.”<sup>21</sup>

#### b. Filing Method for Affiliated Corporations Amended

For federal income tax purposes, an affiliated group of corporations electing to file a consolidated return is treated as one entity, combining their financial activities for the purpose of computing their federal income tax liability.<sup>22</sup> For Virginia income tax purposes, each corporation with nexus in Virginia may elect to file a separate Virginia tax return, regardless of its federal tax filing methods.<sup>23</sup> In addition, Virginia allows corporations that are members of an affiliated group of corporations with nexus in Virginia to elect to file using a consolidated method, similar to the federal consolidated tax return, or to file using a Virginia combined method.<sup>24</sup> All returns for subsequent years are required to be filed under the

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18. § 58.1-301(B)(11)(b)(2).

19. *Id.*

20. *Id.*

21. § 58.1-301(B)(11)(d).

22. I.R.C. § 1501.

23. § 58.1-442(A) (Cum. Supp. 2023).

24. *Id.*

same method unless the Tax Department grants permission to change methods.<sup>25</sup>

Under prior law in effect before the 2023 General Assembly convened, the Code of Virginia permitted an affiliated group that had filed using the same method for at least the twelve preceding years to change its filing method from consolidated to separate, or from separate or combined to consolidated under two conditions:

1. The tax liability computed under the affiliated group's requested method must be equal to or greater than the tax liability for the full taxable year immediately preceding the taxable year for which the newly requested method would be applicable (the "prior year test").<sup>26</sup>
2. The affiliated group must agree to compute its tax liability under both the newly requested method and the formerly elected method, and further agree to be liable for the greater of the two resulting amounts for the taxable year in which the requested method becomes effective and for the immediately succeeding taxable year (the "greater of the two rule").<sup>27</sup>

The 2023 General Assembly amended the requirements under section 58.1-442 for an affiliated group to elect to change its corporate income tax filing method by removing the prior year test.<sup>28</sup> Section 58.1-442 retained its other requirements, including the requirement that the affiliated group has filed under the same method for at least the preceding twelve years and the greater of the two rule.<sup>29</sup>

### c. Taxable Income Apportionment by Affiliated Retail Companies

Since July 1, 2015, Code of Virginia section 58.1-422.1 required all corporations primarily engaged in activities that would be classified as in the retail trade sector in accordance with the North American Industry Classification System ("NAICS") to use the "single sales factor" method of apportionment.<sup>30</sup> The 2023 General

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25. *Id.*

26. § 58.1-442(C)(1) (2022).

27. § 58.1-442(C)(2) (2022).

28. 2023 Va. Acts chs. 520 & 521 (codified as amended at VA. CODE ANN. § 58.1-442 (Cum. Supp. 2023)).

29. § 58.1-442(C) (2022).

30. § 58.1-422.1 (Cum. Supp. 2023).



Assembly amended section 58.1-422.1 to add subsection (D), which allows an affiliated group of corporations with eighty percent or more of their sales derived from retail company activities to apportion all of their income using the single sales factor on a Virginia consolidated return.<sup>31</sup> The new subsection incorporates the definition of “affiliated corporations” under section 58.1-302 and only makes the election effective in years during which the aforementioned eighty percent of sales threshold is met.<sup>32</sup> Furthermore, such election cannot be changed without permission of the Tax Department.<sup>33</sup>

#### d. Hybrid Sales Factor Apportionment for Certain Internet Root Infrastructure Providers

The 2023 General Assembly amended Code of Virginia section 58.1-416 and added section 58.1-422.5 to create a hybrid sales factor for an internet root infrastructure provider in their income apportionment calculations when filing Virginia corporate income tax returns.<sup>34</sup> The internet root infrastructure provider must meet certain criteria and enter into a memorandum of understanding (“MOU”) with the Virginia Economic Development Partnership Authority (the “Authority”).<sup>35</sup>

For internet root infrastructure providers, sales of services are in Virginia if they are derived from sales transactions with a customer or client who receives the benefit of the services in Virginia.<sup>36</sup> This new rule shall apply regardless of the location of an internet root infrastructure provider’s operations.<sup>37</sup>

Newly enacted section 58.1-422.5 provides the requirements and steps that an internet provider must meet to be able to avail itself of the hybrid sales factor apportionment rules.<sup>38</sup> The Code defines “[i]nternet root infrastructure provider” as “an entity and its affiliated entities that is designated to operate one or more of the 13

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31. 2023 Va. Acts chs. 38 & 39 (codified as amended at VA. CODE ANN. § 58.1-422.1 (Cum. Supp. 2023)).

32. § 58.1-422.1(D) (Cum. Supp. 2023).

33. *Id.*

34. 2023 Va. Acts chs. 405 & 406 (codified as amended at VA. CODE ANN. § 58.1-416 & codified at VA. CODE ANN. § 58.1-422.5 (Cum. Supp. 2023)).

35. § 58.1-422.5(B) (Cum. Supp. 2023).

36. § 58.1-416(B)(3) (Cum. Supp. 2023).

37. *Id.*

38. § 58.1-422.5(B) (Cum. Supp. 2023).

Internet root servers of the Internet Assigned Names Authority (IANA) root and functions as the authoritative directory for one or more Top-Level Domains.”<sup>39</sup> An internet root infrastructure provider that meets the statutory criteria and enters into an MOU with the Authority is then able to use the hybrid sales factor apportionment scheme.<sup>40</sup> For sales other than sales of tangible personal property, the hybrid sales factor would use a market-based sourcing rule for sales of services, and the standard cost of performance rule would be used for all other non-service sales.<sup>41</sup> The requirements to be able to use the hybrid sales factor include that a taxpayer that has at least 550 full-time employees with an average annual salary of \$175,000 in an eligible planning district.<sup>42</sup>

The Code defines MOU as “a performance agreement or related document entered into by an [i]nternet root infrastructure provider and the Authority” between January 1, 2023, and November 30, 2023.<sup>43</sup> The MOU sets forth the requirements for commitments to Virginia.<sup>44</sup> The legislation also includes a statement of legislative policy that provides that the presence of the internet root infrastructure provider industry is essential to the continued fiscal health of Virginia.<sup>45</sup>

#### e. Elective Pass-Through Entity Tax Amended

In 2022 the General Assembly enacted a qualifying pass-through entity (“PTE”) law which permitted PTEs to make an annual election for taxable years 2021 through 2025 to pay an income tax at a rate of 5.57% at the entity level.<sup>46</sup> The 2022 legislation also provided a corresponding refundable income tax credit for taxable

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39. § 58.1-422.5(A).

40. § 58.1-422.5(B).

41. § 58.1-416(D) (2022); *Market-Based Sourcing Guidelines for Qualifying Property Information and Analytics Firms*, VA. DEP’T OF TAX’N (2020), <https://www.tax.virginia.gov/market-based-sourcing-guidelines-qualifying-property-information-and-analytics-firms> [<https://perma.cc/77AY-GPUF>].

42. § 58.1-422.5(B)(1) (Cum. Supp. 2023).

43. § 58.1-422.5(A).

44. *Id.*

45. *See* § 58.1-422.5(C).

46. 2022 Va. Acts chs. 689 & 690 (codified as amended at VA. CODE ANN. §§ 58.1-332, -390.1, -390.2 & codified at VA. CODE ANN. § 58.1-390.3 (2022)). For further information on the 2022 PTE tax legislation, see Craig D. Bell, *Annual Survey of Virginia Law: Taxation*, 57 U. RICH. L. REV. 96, 97–99 (2022).

years 2021 through 2025 for any amount of income tax paid by a qualifying PTE to its individual owners.<sup>47</sup>

The 2023 General Assembly amended Code of Virginia sections 58.1-390.1 and -390.3, cumulatively making three significant enhancements to the PTE tax (“PTET”):

1. Removes the requirement that a pass-through entity be 100% owned by natural persons or person eligible to be shareholders of an S corporation in order to make the PTET election;<sup>48</sup>
2. Defines “eligible owner” as “a direct owner of a pass-through entity who is a natural person . . . or an estate or trust”;<sup>49</sup> and
3. Provides that “only the pro rata or distributive share of each item of income, gain, loss, or deduction attributable to eligible owners” would be subject to the PTET.<sup>50</sup>

The 2023 legislation makes these changes effective for taxable years beginning on and after January 1, 2021.<sup>51</sup>

#### f. Land Preservation Income Tax Credit Application Filing Deadline Extended

The 2023 General Assembly amended Code of Virginia section 58.1-512(D)(4)(a) to extend the deadline for filing a complete application for the land preservation tax credit conveyance made on or after January 1, 2017.<sup>52</sup> The deadline would be extended for any number of days exceeding ninety during which the application is being reviewed for verification of conservation value by the Virginia Department of Conservation and Recreation, provided that such application is otherwise complete at the time of the original filing deadline.<sup>53</sup>

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47. 2022 Va. Acts chs. 689 & 690.

48. 2023 Va. Acts chs. 686 & 687 (codified as amended at VA. CODE ANN. §§ 58.1-390.1, -390.3 (Cum. Supp. 2023)).

49. *Id.*

50. *Id.*

51. *Id.*

52. 2023 Va. Acts ch. 173 (codified as amended at VA. CODE ANN. § 58.1-512 (Cum. Supp. 2023)).

53. *Id.*

## 2. Retail Sales and Use Taxation

### a. Agricultural Exemption Expanded

The 2023 General Assembly amended Code of Virginia sections 58.1-609.2 and -610 to expand the Retail Sales and Use Tax agricultural exemption to include certain property, regardless of whether affixed to real property, that is used directly in producing agricultural products for market in an indoor, closed, controlled environment agricultural facility.<sup>54</sup> The property is largely classified in three areas, which include the following:

1. Internal components or materials required for:
  - a. Towers for growing plans;
  - b. Conveyance for moving such towers;
  - c. Insulation, partition, and cladding of interior walls;
  - d. Lighting systems;
  - e. Heating, cooling humidification, dehumidification, and air circulation systems; and
  - f. Watering and water treatment systems.<sup>55</sup>
2. External components, machinery, and equipment required for:
  - a. Heating, cooling, humidification, dehumidification, and air circulation systems;
  - b. Utility upgrades and related distribution infrastructure; and
  - c. Creating, supporting, and maintaining the necessary growing environment for plants.<sup>56</sup>
3. Structural components of:
  - a. Insulation, partitions or classing of exterior walls used in indoor vertical farming to create and maintain the necessary growing environment for plants; and

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54. 2023 Va. Acts chs. 516 & 517 (codified as amended at VA. CODE ANN. §§ 58.1-609.2, -610 (Cum. Supp. 2023)).

55. VA. CODE ANN. § 58.1-609.2(8)(a) (Cum. Supp. 2023).

56. § 58.1-609.2(8)(b).

- b. Translucent or transparent windows, walls, and roofs that allow sunlight in greenhouses to create and maintain the necessary growing environment for plants.<sup>57</sup>

For purposes of this legislative expansion of the agricultural sales and use tax exemption, the terms “indoor, closed, controlled-environment commercial agricultural facility” include facilities for indoor vertical farming and greenhouses.<sup>58</sup> The amended exemption defines “agricultural products” to include “horticulture, floricultural, viticulture, or other farm crops.”<sup>59</sup> However, the exemption provided by section 58.1-609.2(8) does not apply to “property used in producing cannabis or any derivative of cannabis.”<sup>60</sup> The Code further extends this expanded agricultural exemption to contractors engaged to construct the covered facilities.<sup>61</sup>

- b. Service Exemption Expanded to Include Diagnostic Work for Automotive Repair and Emergency Road Service

The 2023 General Assembly amended Code of Virginia section 58.1-609.5 to include a tax exemption for “[a]n amount separately charged for labor rendered in connection with diagnostic work [on] automotive repair and emergency roadside service for motor vehicles . . . regardless of whether there is a sale of a repair or replacement part or a shop supply charge.”<sup>62</sup> The definition of a motor vehicle does not include “a bicycle, electric personal assistive mobility device, electric power-assisted bicycle, motorized skateboard or scooter, moped, or personal delivery device.”<sup>63</sup>

### 3. State Administered Procedural Provisions.

- a. Installment Agreements for Payment of Taxes

The 2023 General Assembly made several changes with respect to installment agreements for payment of income tax.

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57. § 58.1-609.2(8)(c).

58. § 58.1-609.2(8).

59. *Id.*

60. *Id.*

61. § 58.1-610(B) (Cum. Supp. 2023).

62. 2023 Va. Acts ch. 35 (codified as amended at VA. CODE ANN. § 58.1-609.5 (Cum. Supp. 2023)).

63. § 46.2-100 (Cum. Supp. 2023).

The changes amend Code of Virginia section 58.1-1817 to require the State Tax Commissioner to offer to enter into an installment agreement with any individual income taxpayer under which the taxpayer may satisfy his or her entire tax liability over a payment term of up to five years.<sup>64</sup> The legislation also removes the State Tax Commissioner's power to alter, modify, or terminate an installment agreement if it is determined that the taxpayer's financial condition has significantly changed or if the taxpayer fails to provide a financial condition update upon request.<sup>65</sup> However, the amended statute retains the Tax Department's authority to modify or terminate an installment agreement if the taxpayer fails to pay any installment when due or file any required tax or informational return during the period in which such agreement is in effect.<sup>66</sup>

#### b. Tax Collection Statute of Limitations Amended

Prior to the 2023 legislative action described below, Code of Virginia section 58.1-1802.1 provided that tax collection actions had to cease after seven years from the date of the assessment.<sup>67</sup> However, the running of the seven-year statute of limitations was suspended while the assets of the taxpayer were subject to the custody or control of any state or federal court, including federal bankruptcy courts, and the taxpayer was located outside of Virginia for more than six months; or during a period in which the taxpayer had entered into an installment agreement.<sup>68</sup>

The 2023 General Assembly amended section 58.1-1802.1 to also suspend the seven-year statute of limitations on state tax collections actions while any administrative or judicial proceedings contesting the assessment are pending.<sup>69</sup> House Bill 1625 repealed a provision suspending the statute of limitations while the taxpayer is outside of Virginia.<sup>70</sup>

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64. 2023 Va. Acts ch. 643 (codified as amended at VA. CODE ANN. § 58.1-1817 (Cum. Supp. 2023)).

65. *Id.*

66. *Id.*

67. § 58.1-1802.1 (2022).

68. *Id.*

69. 2023 Va. Acts ch. 265 (codified as amended at VA. CODE ANN. § 58.1-1802.1(B) (Cum. Supp. 2023)).

70. H.B. 1625, Va. Gen. Assembly (Reg. Sess. 2023) (enacted as 2023 Va. Acts ch. 265); § 58.1-1802.1(B) (Cum. Supp. 2023).

### c. Filing and Payment of Taxes by Mail

The 2023 General Assembly amended Code of Virginia sections 58.1-9 and -3916 to allow a tax return or a tax payment to be deemed to have been timely received if, through no fault of the taxpayer, no postmark is affixed, or if the postmark affixed by the U.S. Postal Service is illegible or bears no date and such tax return or payment is received within five days of the due date.<sup>71</sup> The legislation further provides that no penalty or interest for untimely filing will be imposed if there is “evidence that remittance of a tax return or a tax payment was timely”; such evidence includes “a United States Postal Service Certificate of Mailing, or other proof of mailing showing such return was filed or such payment was made before the close of business on the last day such return may be filed or such tax may be paid without penalty or interest.”<sup>72</sup>

### B. Significant Judicial Decisions

#### 1. Trial Court Holds Utah Corporation Is Not Operating as a Unitary Business with a Separate Business of Which It Held a Minority Ownership Interest

In *FJ Management Inc. v. Virginia Department of Taxation*, the Richmond City Circuit Court, following a trial, ruled that FJ Management and Pilot Travel Centers were not part of the same unitary business for Virginia corporate income tax purposes.<sup>73</sup> The circuit court held the Tax Department improperly denied FJ Management’s amended Virginia corporate income tax returns and awarded FJ Management tax refunds and accrued interest on the refunds for taxable years 2013–2015.<sup>74</sup> While the court’s order does not delve deeply into the facts of the case, the parties filed extensive stipulations of facts and documentary evidence, and presented witness testimony.<sup>75</sup>

The case addresses whether the Tax Department violated the U.S. Constitution when it taxed FJ Management’s distributive

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71. 2023 Va. Acts ch. 163 (codified as amended at VA. CODE ANN. §§ 58.1-9, -3916 (Cum. Supp. 2023)).

72. *Id.*

73. Order at 1, *FJ Mgmt., Inc. v. Commonwealth* (Va. Cir. Ct. 2023) (City of Richmond) (No. CL20-5842).

74. *Id.* at 1–2.

75. Stipulated Facts, *FJ Mgmt.* (No. CL20-5842).

share of income based on apportionment factors related to a non-unitary passive minority interest in Pilot Travel Centers, LLC, a limited liability company treated as a partnership for income tax purposes (“Pilot Travel Centers”).<sup>76</sup> FJ Management argued that the Tax Department “unfairly and unconstitutionally impose[d] Virginia corporate income tax on FJ Management’s activities that are not conducted in Virginia in violation of the Due Process and Commerce Clauses of the U.S. Constitution,” because the Tax Department did not allow FJ Management to allocate the investment income it received from its passive minority interest in Pilot Travel Centers to Utah—its state of commercial domicile—and instead required FJ Management to allocate the investment income to Virginia based on FJ Management’s three apportionment factors.<sup>77</sup>

The facts of the case, which are critical to the court’s findings and holdings, are described below as they appeared in the record of the case and cited to the evidence presented to the Richmond City Circuit Court.

#### a. FJ Management’s History and Bankruptcy

FJ Management is a stock corporation organized under the laws of the State of Utah and qualified to do business in Virginia.<sup>78</sup> The company’s principal place of business has always been located in Salt Lake City, Utah.<sup>79</sup> FJ Management wholly owns and operates Big West Oil, LLC—an oil refinery that produces and processes about 35,000 barrels a day (over one million gallons) in North Salt Lake, Utah.<sup>80</sup>

Prior to 2008, FJ Management owned and operated a diverse portfolio of oil, gas, and transportation-related assets, including travel center assets consisting primarily of over 200 “Flying J” interstate truck travel centers and travel plazas (the “Travel Centers”).<sup>81</sup> These Travel Centers retailed diesel and gasoline fuel and provided other goods (i.e., food) and services (e.g., bathrooms, showers, etc.) for its customers.<sup>82</sup> Due to significant changes in

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76. FJ Management, Inc.’s Pretrial Memorandum at 1, *FJ Mgmt.* (No. CL20-5842).

77. *Id.*

78. Stipulated Facts, ¶ 1, *FJ Mgmt.* (No. CL20-5842).

79. *Id.* at ¶ 2.

80. *Id.* at ¶ 14.

81. *Id.* at ¶ 15.

82. *See id.*



crude oil prices, a decrease in demand for gasoline, and an unprofitable refinery located in California, FJ Management filed for Chapter 11 bankruptcy protection in Delaware on December 22, 2008.<sup>83</sup> In connection with its Chapter 11 bankruptcy proceeding, FJ Management disposed of numerous assets in transactions—which had the effect of sales—in order to generate cash to pay its creditors.<sup>84</sup> As a result, FJ Management shifted its focus away from operating retail long-haul truck diesel and gasoline fuel centers and towards its oil refinery business.<sup>85</sup>

As a result of the reorganization plan established under FJ Management's Chapter 11 bankruptcy proceeding, Pilot Corporation, an independent and unrelated business, acquired FJ Management's Travel Centers, which brought Pilot Corporation's holdings to more than 550 interstate travel centers and plazas.<sup>86</sup> This acquisition was effectuated by a contribution agreement executed in connection with the plan of reorganization, by which FJ Management contributed over 200 Travel Centers to Pilot Travel Centers in exchange for a small minority ownership interest and cash.<sup>87</sup> FJ Management also disposed of all of its truck and gas pipeline assets.<sup>88</sup> After FJ Management exited the Chapter 11 bankruptcy proceeding in 2010, its notable remaining assets were its Big West Oil, LLC oil refinery and a minority stake in Pilot Travel Centers, which is treated as a partnership for federal income tax purposes.<sup>89</sup>

b. Pilot Travel Centers, Pilot Corporation, and Propeller Corp.

Since Pilot Corporation acquired FJ Management's assets, FJ Management's former Travel Centers have been owned and operated by Pilot Travel Centers—a Delaware limited liability company licensed to do business in Virginia.<sup>90</sup> Pilot Travel Centers' membership interests are primarily owned by two entities: Pilot Corporation and Propeller Corp.<sup>91</sup> Both Pilot Corporation and Propeller Corp. are independently owned, operated, and managed

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83. *Id.* at ¶ 16.

84. *Id.* at ¶ 17.

85. *Id.*

86. *Id.* at ¶ 18.

87. *Id.* at ¶ 19.

88. *Id.* at ¶ 20.

89. *Id.* at ¶ 21.

90. *Id.* at ¶ 22.

91. *Id.* at ¶¶ 27–28.

businesses, controlled by the Haslam family.<sup>92</sup> Through their ownership of Pilot Corporation and Propeller Corp., the Haslam family directly owns 100% of the Class A member interest in Pilot Travel Centers and over 77.58% of Pilot Travel Centers.<sup>93</sup>

FJ Management has never had any direct or indirect ownership in either Pilot Corporation or Propeller Corp.<sup>94</sup> At all times during the tax years at issue in this case, FJ Management owned a minority Class B unit membership interest in Pilot Travel Centers that did not exceed 17.5%.<sup>95</sup> Pilot Travel Centers is an independently controlled and managed business.<sup>96</sup> FJ Management has no ability to exercise control over Pilot Travel Centers by virtue of its Class B minority investment in Pilot Travel Centers, LLC.<sup>97</sup> Pilot Travel Centers is controlled by its two majority owners, Pilot Corporation and Propeller Corp., both owned by the Haslam family.<sup>98</sup> “The Haslam [f]amily controls, in all meaningful ways, the management, board of directors, and business operations of Pilot Travel Centers.”<sup>99</sup>

The lack of control by FJ Management is demonstrated by these facts:

1. Management of Pilot Travel Centers is vested in a Board of Managers (“Board”);<sup>100</sup>
2. FJ Management is only entitled to designate two representatives on the ten-member Board;<sup>101</sup>

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92. *Id.* at ¶¶ 29–30.

93. *Id.* at ¶ 31.

94. *Id.* at ¶¶ 25–26.

95. *Id.* at ¶ 28.

96. *Id.* at ¶ 29.

97. *Id.* at ¶¶ 25–26, 28.

98. *Id.* at ¶¶ 29–31.

99. According to Pilot Travel Centers’ Operating Agreement, the Board is responsible for overseeing the operations of Pilot Travel Centers and has the authority to approve the following matters: (1) Chief Executive Officer’s selection of executive officers; (2) company strategies, annual operating budgets, business plans and annual capital budgets; (3) significant external business opportunities, such as acquisitions, mergers, and divestitures; (4) policies, such as business ethics, environmental responsibility, employee safety, community, government, employee and customer relations; (5) external and internal audits; and (6) compensation and benefit policies. F.J. Management Inc.’s Pretrial Memorandum at 4, n.8, FJ Mgmt., Inc. v. Commonwealth (Va. Cir. Ct. 2023) (City of Richmond) (No. CL20-5842).

100. *Id.* at 4.

101. *Id.*

3. FJ Management's ability to appoint representatives is conditioned upon its ownership interest, whereas the majority owners of Pilot Travel Centers are entitled to representation regardless of their stake in Pilot Travel Centers;<sup>102</sup>
4. The Board cannot remove, appoint, or replace the CEO of Pilot Travel Centers without approval of the majority members, Pilot Corporation and Propeller Corp.;<sup>103</sup>
5. FJ Management cannot call special meetings of the Board—such power is held exclusively by the majority owners;<sup>104</sup>
6. While a Board meeting may be held without representation by FJ Management, such a meeting can never be held without representation by the majority owners;<sup>105</sup>
7. Based upon veto power granted to the majority owners, FJ Management has no authority to unilaterally bind Pilot Travel Centers;<sup>106</sup>
8. FJ Management is not involved in the day-to-day operations of Pilot Travel Centers;<sup>107</sup>
9. Only the majority owners have veto rights regarding the appointment of executive officers.<sup>108</sup> As such, the majority owners control the day-to-day operations of Pilot Travel Centers, including the approval and appointment of all executive officers;<sup>109</sup>
10. No employee of FJ Management has ever served as CEO or as an executive officer of Pilot Travel Centers. FJ Management has not shared any management, personnel, or office space with Pilot Travel Centers. FJ Management and Pilot Travel Centers do not share corporate functions such as marketing, purchasing, accounting, or legal. Both FJ Management and Pilot Travel Centers operate independently, each with their own operating policies and procedures.<sup>110</sup>

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102. *Id.*

103. *Id.* at 5.

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

In a nutshell, FJ Management’s argument at trial was that FJ Management and Pilot Travel Centers were not part of a unitary business.<sup>111</sup> FJ Management argued that both it and Pilot Travel Centers are distinct multistate businesses, and FJ Management’s business income should not include its distributive share of Pilot Travel Centers’s business income.<sup>112</sup> Accordingly, FJ Management’s distributive share should not be apportioned to Virginia based on FJ Management’s own apportionment factors—it should be apportioned to Virginia based on Pilot Travel Centers’s own apportionment factors.<sup>113</sup> FJ Management further argued that it would be unconstitutional to require the apportionment of its distributive share of Pilot Travel Centers’s business income based on blended apportionment factors as if FJ Management and Pilot Travel Centers were part of a single unitary business.<sup>114</sup> Thus, FJ Management’s investment income from Pilot Travel Centers cannot be apportioned as part of FJ Management’s apportionable business income from its refinery operation.<sup>115</sup> Based on this argument, FJ Management took the position that the amount of Pilot Travel Centers’s income on which Virginia may tax FJ Management is the distributive share apportioned to Virginia at the partnership level based on Pilot Travel Centers’s own apportionment factors.<sup>116</sup> The amount of this tax could then be allocated to FJ Management’s own business income, as distinct from Pilot Travel Centers’s business income, and apportioned to Virginia based on its own apportionment factors.<sup>117</sup>

Following the trial, the parties submitted proposed findings of fact and conclusions of law to the circuit court. The court then entered its order and made the following findings: (1) FJ Management was over-taxed by the Tax Department in the 2013, 2014 and 2015 tax years (the “Tax Years”);<sup>118</sup> (2) FJ Management was not operating unitarily with Pilot Travel Centers during the Tax Years;<sup>119</sup> (3) the income received by FJ Management from Pilot

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111. *Id.* at 7.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.* at 7–8.

118. Order at 1, *FJ Mgmt., Inc. v. Commonwealth* (Va. Cir. Ct. 2023) (City of Richmond) (No. CL20-5842).

119. *Id.* at 1, ¶ 2.

Travel Centers during the Tax Years is not to be apportioned as part of FJ Management's apportionable business income from its refinery operation;<sup>120</sup> (4) the Tax Department's denial of FJ Management's amended tax returns for the Tax Years was arbitrary and erroneous;<sup>121</sup> and (5) the Tax Department owes a total tax refund is \$443,887, plus accrued interest.<sup>122</sup>

## 2. Manufacturer's Income Apportionment Method Election Can Be First Used on an Amended Tax Return

A taxpayer may elect to use the manufacturer's income apportionment method—contained in Code of Virginia section 58.1-422—for the first time in an amended tax return, pursuant to a decision of first impression by the Court of Appeals of Virginia.<sup>123</sup> The court of appeals stated that based on a plain reading of section 58.1-422, the option to elect the manufacturer's apportionment method is not limited to original tax returns.<sup>124</sup>

Virginia law requires that “multistate businesses . . . apportion their income to determine the amount of their income that is taxable in Virginia.”<sup>125</sup> However, manufacturers must meet certain requirements in order to utilize this alternative method to apportion their income.<sup>126</sup> The aforementioned case originated from the Virginia Department of Taxation's audit of 1887 Holdings' 2014 and 2015 corporate income tax returns.<sup>127</sup> During the audit, 1887 Holdings advised the Department that it wished to elect the manufacturer's apportionment method permitted by section 58.1-422.<sup>128</sup> The Department denied the taxpayer's request<sup>129</sup> and based its denial on the “conclusion that a corporation cannot make such an election in an amended return.”<sup>130</sup>

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120. *Id.*

121. *Id.* at 1, ¶ 3.

122. *Id.* at 2, ¶ 3.

123. *Commonwealth v. 1887 Holdings, Inc.*, 77 Va. App. 653, 656, 887 S.E.2d 176, 177 (2023).

124. *Id.*

125. *Id.*

126. *Id.* at 657, 887 S.E.2d at 177 (citing VA. CODE ANN. § 58.1-422(C), (E) (2022)).

127. *Id.*

128. *Id.*

129. *Id.* at 657, 887 S.E.2d at 177–78.

130. *Id.* at 657, 887 S.E.2d at 178.

1887 Holdings filed an administrative appeal with the Virginia State Tax Commissioner pursuant to section 58.1-1821.<sup>131</sup> The Tax Commissioner denied the appeal.<sup>132</sup> The taxpayer initiated a lawsuit in Richmond City Circuit Court.<sup>133</sup> The parties filed cross-motions for summary judgment and the Richmond City Circuit Court granted 1887 Holdings summary judgment.<sup>134</sup> The Tax Department appealed the circuit court decision.<sup>135</sup>

The court of appeals stated that the straightforward issue presented in the appeal was whether a taxpayer company can elect the manufacturer's apportionment method in an amended return, or whether it can only do so when filing an original return.<sup>136</sup> To that end, the court noted the Code "liberally permits the filing of amended income tax returns after the filing deadline, generally allowing them within certain time periods."<sup>137</sup> Although the Code broadly permits amended returns, it does impose some limitations on what elections can be made. For example, Code of Virginia sections 58.1-322.04(4) and -402(F) "specify that elections to 'recognize[]' income from certain dispositions of real property under the installment method must be 'made on or before the due date prescribed by law (including extensions).'"<sup>138</sup>

The court of appeals noted that the statutory language at issue in this case "does not require that the election of the manufacturer's apportionment method be made on or before the due date or otherwise bar a taxpayer from electing this alternative apportionment method in an amended return."<sup>139</sup> However, the court observed that section 58.1-422 does contain related limitations, such as requiring that "a taxpayer company electing the method to adhere to that choice for a period of three taxable years."<sup>140</sup> The court also noted that section 58.1-422 "accounts for the possibility that a company may elect to use the manufacturer's apportionment

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131. *Id.*; VA. CODE ANN. § 58.1-1821 (2022).

132. *1887 Holdings, Inc.*, 77 Va. App. at 657, 887 S.E.2d at 178.

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.* at 658, 887 S.E.2d at 178.

137. *Id.* at 659–60, 887 S.E.2d at 179 (citing VA. CODE ANN. § 58.1-1823 (2022); 23 VA. ADMIN. CODE § 10-20-180 (Cum. Supp. 2022)).

138. *Id.* at 660, 887 S.E.2d at 179 (citing VA. CODE ANN. §§ 58.1-322.04(4), -402(F) (2022)).

139. *Id.* (citing VA. CODE ANN. § 58.1-422 (2022)).

140. *Id.* (citing VA. CODE ANN. § 58.1-422(B) (2022)).

method but fail to meet the requirements over the mandatory three-year period,” yet the section “does not address the converse circumstance in which a company uses the standard apportionment method in the original return, but later realizes that it meets the threshold for the alternative manufacturer’s apportionment method and wishes to make that election retroactively in an amended tax return.”<sup>141</sup>

Despite the Tax Department’s arguments—urging the court to afford greater weight to its interpretation of the statutory scheme as the agency tasked with its administration—the court did not afford the Department’s arguments any more weight than a “typical litigant,” because the plain language of section 58.1-422 was unambiguous and thus controlled.<sup>142</sup> The court opined that the plain language of section 58.1-422 “simply does not prevent a taxpayer company from electing to use the manufacturer’s apportionment method in a timely amended return.”<sup>143</sup> The court further reasoned that the “omission is not ambiguous in light of the legislatures liberal acceptance of amended returns generally elsewhere in the tax code.”<sup>144</sup>

The court also did not afford any weight to the Department’s guidelines on the manufacturer’s alternative apportionment method.<sup>145</sup> While the guidelines themselves “represent the Department’s interpretation of the relevant laws,” they “do not have the force and effect of . . . [a] regulation.”<sup>146</sup> Accordingly, the court determined that the Department’s guidelines did not control the court’s analysis under their *de novo* review of the statute.<sup>147</sup> Lastly, like the circuit court, the court of appeals noted that the legislative purpose of section 58.1-422(E)—to promote Virginia employment and wage growth—is met regardless of whether the alternative apportionment election is made on a taxpayer’s original return or in

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141. *Id.* (citing VA. CODE ANN. § 58.1-422(C) (2022)).

142. *Id.* at 664, 887 S.E.2d at 181.

143. *Id.* at 665, 887 S.E.2d at 181.

144. *Id.*

145. *Id.* at 665, 887 S.E.2d at 182.

146. *Id.* at 665, 887 S.E.2d at 181 (omission and alteration in original) (quoting VA. DEP’T OF TAX’N., SINGLE SALES FACTOR ELECTION FOR MANUFACTURERS GUIDELINES 1 (2013)).

147. *Id.* at 665, 887 S.E.2d at 182.

an amended return.<sup>148</sup> The Court of Appeals of Virginia thereby affirmed the decision of the Richmond City Circuit Court.<sup>149</sup>

## II. TAXES ADMINISTERED BY LOCALITIES

### A. *Significant Legislative Activity*

#### 1. Real Property Tax Exemption for Disabled Veterans

The 2023 General Assembly amended the real property tax exemption for disabled veterans and their spouses by adopting a procedure for the veteran or surviving spouse to obtain the exemption prior to purchasing the qualifying dwelling by filing the documentation—required by Code of Virginia section 58.1-3219.6(A)—with the local tax official for the jurisdiction where the dwelling is located.<sup>150</sup> Section 58.1-3219.6(B) is new, and it requires the locality to process the application within twenty days of receipt and send the veteran a letter stating whether the application is approved or denied.<sup>151</sup> If the application is approved by the locality, then “the letter must also include the amount of the tax exemption for the qualifying property the veteran intends to purchase.”<sup>152</sup> However, the exemption described in the letter will not become effective until the veteran becomes the owner of the property.<sup>153</sup>

#### 2. Personal Property Tax Exemption Expanded for Certain Farm Machinery and Farm Implements

The 2023 General Assembly also amended Code of Virginia section 58.1-3505 to expand the list of certain farm machinery and farm implements that a locality may exempt from personal property taxes.<sup>154</sup> The broadened list of personal property qualifying for this exemption now includes (1) motor vehicles used primarily for agricultural purposes for which the owner is not required to obtain

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148. *Id.* at 666, 887 S.E.2d at 182.

149. *Id.* at 656, 887 S.E.2d at 177.

150. 2023 Va. Acts ch. 659 (codified as amended at VA. CODE ANN. § 58.1-3219.6 (Cum. Supp. 2023)).

151. VA. CODE ANN. § 58.1-3219.6(B) (Cum. Supp. 2023).

152. *Id.*

153. *Id.*

154. 2023 Va. Acts ch. 344 (codified as amended at VA. CODE ANN. § 58.1-3505 (Cum. Supp. 2023)).



a registration certificate, license plate, and decal or pay a registration fee; (2) privately owned trailers used by farmers in their farming operations for the transportation of farm animals or other farm products; and (3) season-extending vegetable hoop houses used for in-field production of produce.<sup>155</sup>

The new legislation further provides that a locality which exempts such motor vehicles or privately owned trailers shall not collect any unpaid tangible personal property taxes, including any interest, penalties, or other charges that are owed to the locality as of July 1, 2023, and such unpaid taxes shall be deemed uncollectible and stricken from the books of the locality's treasurer.<sup>156</sup>

## B. *Significant Judicial Decisions*

### 1. ITFA Preempts Virginia's BPOL Tax and the Grandfather Clause Does Not Apply

The Supreme Court of Virginia ruled that the Internet Tax Freedom Act ("ITFA") preempts Fairfax County's collection of business and professional occupational license ("BPOL") taxes on Cox Communications services, and ITFA's grandfather clause does not apply.<sup>157</sup> The supreme court reversed and remanded the case back to the Fairfax County Circuit Court to determine the tax refund due to Cox Communications Northern Virginia ("Cox").<sup>158</sup>

In 1998, Congress enacted ITFA.<sup>159</sup> ITFA places a state and local tax moratorium on internet access services.<sup>160</sup> The grandfather clause, now repealed, provided that preexisting taxes on internet access services were exempt from the moratorium if "generally imposed and actually enforced prior to October 1, 1998."<sup>161</sup> ITFA allowed a taxing authority to grandfather an existing tax on internet

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155. § 58.1-3505 (A)(8), (15) (Cum. Supp. 2023).

156. 2023 Va. Acts ch. 344.

157. *Coxcom, LLC v. Fairfax Cnty.*, 301 Va. 201, 204, 875 S.E.2d 75, 77 (2022).

158. *Id.*

159. Internet Tax Freedom Act, Pub. L. No. 105-277, § 1100, 112 Stat 2681, 2681-719 (1998) (codified at 47 U.S.C. § 151 note (Moratorium on Internet Taxes)).

160. *Id.*; see also *Coxcom*, 301 Va. at 204, 875 S.E.2d at 77.

161. Internet Tax Freedom Act, Pub. L. No. 105-227, § 1101(a)(1), 112 Stat. 2681, 2681-719, amended by Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, § 922, 130 Stat. 122, 281 (2016). The amendment set a June 2020 deadline for the grandfather clause, so the provision was still in affect during the tax years at issue in this case. See *Coxcom*, 301 Va. at 204 n.1, 205, 875 S.E.2d at 77-78.

services under two circumstances: (1) by “a rule or other public proclamation by an appropriate agency providing that the agency interprets and applies the tax to internet access services”; or (2) by “a practice of generally collecting the tax.”<sup>162</sup>

In 1994, the Fairfax County Board of Supervisors adopted a BPOL ordinance—Fairfax County Code section 4-7.2-22 (the “ordinance”).<sup>163</sup> The ordinance encompasses online computer services and computer time share services within the business service occupations subject to the BPOL tax.<sup>164</sup> Cox has provided internet access services to customers in Fairfax County since 2000.<sup>165</sup> From 2013 to 2015, Cox paid the BPOL tax on all of its gross receipts, including its revenue from providing internet access services.<sup>166</sup> However, in 2016, Cox filed a BPOL tax refund request with the Fairfax County Department of Tax Administration (“Fairfax Department”) for tax years 2013 to 2015, asserting that ITFA preempted Fairfax County from imposing the BPOL tax on internet access service revenues.<sup>167</sup> Cox argued that the Fairfax County BPOL tax did not qualify for ITFA’s grandfather clause exemption because, prior to October 1, 1998, Fairfax County did not give Cox a reasonable opportunity to know that it was subject to the tax under either of the two circumstances which would enable Fairfax County to impose the BPOL tax on Cox.<sup>168</sup>

The Fairfax Department rejected Cox’s refund claim, determining that ITFA did not apply to the BPOL tax because it was not a tax on internet access, but rather a general tax on a business’ entire gross receipts.<sup>169</sup> The Fairfax Department also asserted that even if ITFA did apply, the BPOL tax was authorized under ITFA’s grandfather clause exemption because the BPOL ordinance was “generally imposed and actually enforced” prior to October 1, 1998—the effective date of ITFA.<sup>170</sup> Cox appealed the Fairfax Department’s determination to the Virginia Tax Commissioner, who concluded that ITFA generally prohibited the imposition of the

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162. *Coxcom*, 301 Va. at 205, 875 S.E.2d at 77.

163. *Id.*

164. FAIRFAX COUNTY, VA. CODE § 4-7.2-22 (Supp. 2023); *see also id.* at 205, 875 S.E.2d at 77–78.

165. *Coxcom*, 301 Va. at 205, 875 S.E.2d at 78.

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.* at 206, 875 S.E.2d at 78.

BPOL tax on internet access services.<sup>171</sup> The State Tax Commissioner declined to address the grandfather clause exception.<sup>172</sup>

Both Cox and Fairfax County appealed the Commissioner's decision to the Fairfax County Circuit Court and filed cross-motions for partial summary judgment.<sup>173</sup> Cox argued that Fairfax County's BPOL tax on internet access was preempted by ITFA and that Fairfax County had the burden of proof to demonstrate ITFA's grandfather clause exemption applied, because the County was seeking the benefit of the grandfather clause exemption.<sup>174</sup> Fairfax County's position was that its BPOL tax was not a tax on internet access services, but rather a general tax on gross receipts, thus ITFA did not apply.<sup>175</sup> The circuit court granted Cox's motion for summary judgment, holding the BPOL tax was a tax on internet access and was preempted by the broad scope of ITFA.<sup>176</sup> The circuit court also held that Fairfax County had the burden to prove whether the BPOL tax qualified for the grandfather clause exemption.<sup>177</sup>

During the trial following the circuit court's disposition of the cross motions for summary judgment, Fairfax County's evidence indicated that the BPOL tax was only imposed on internet service providers that had a definite place of business in the county.<sup>178</sup> The County's auditor—who gave the testimony regarding how the BPOL tax was imposed—did not believe Cox's affiliates had a definite place of business in the county.<sup>179</sup>

The circuit court found that Fairfax County's BPOL tax qualified for the grandfather clause exemption because the County's BPOL ordinance, adopted in 1994, constituted a "rule or public proclamation" under the first qualifying circumstance.<sup>180</sup> In contrast, the court held that the County's BPOL tax did not meet the alternative qualifying circumstance triggering the grandfather clause exemption, because the evidence that the BPOL tax was collected against

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171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.* at 207, 875 S.E.2d at 79.

179. *Id.*

180. *Id.*

AOL was insufficient to show that the BPOL tax was “generally collected.”<sup>181</sup> The court concluded that Fairfax County did not need to meet both circumstances of ITFA grandfather clause exemption, and that the County did meet the notice requirement when it issued its BPOL ordinance.<sup>182</sup>

On appeal, the Supreme Court of Virginia made quick work of the federal preemption argument by the County, and upheld the circuit court’s decision that ITFA applies to Fairfax County’s BPOL tax.<sup>183</sup> However, the supreme court reversed the circuit court on the grandfather clause exemption, holding that the grandfather clause exemption did not apply.<sup>184</sup> The County made the same argument that the circuit court found persuasive: the county’s BPOL ordinance was “a rule or other public proclamation made by the appropriate administrative agency of the State or political subdivision thereof that such agency has interpreted and applied such tax to internet access services.”<sup>185</sup>

However, the supreme court held that neither Fairfax County nor its Board of Supervisors are an “administrative agency” of Fairfax County.<sup>186</sup> The Board of Supervisors is the governing body of Fairfax County.<sup>187</sup> “The Board of Supervisors and the County generally do not administer the County’s taxes.”<sup>188</sup> Rather, an “administrative agency” is “an official body, [especially] within the government, with the authority to implement and administer particular legislation.”<sup>189</sup> Under the Fairfax County Code, an “agency” means “all offices, departments, institutions, boards, commissions and corporations of the County government.”<sup>190</sup> The supreme court noted that “[t]he County’s Department of Tax Administration is the administrative agency tasked with construing and implementing the BPOL tax.”<sup>191</sup>

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181. *Id.*

182. *Id.*

183. *Id.* at 208, 875 S.E.2d at 79.

184. *Id.* at 211, 875 S.E.2d at 80.

185. *Id.* at 204, 875 S.E.2d at 77.

186. *Id.* at 209, 875 S.E.2d at 80.

187. *Id.*

188. *Id.* at 209–10, 875 S.E.2d at 80.

189. *Id.* at 210, 875 S.E.2d at 80 (citing *Agency*, BLACK’S LAW DICTIONARY (11th ed. 2019)).

190. *Id.* (omission in original) (citing FAIRFAX COUNTY, VA. CODE § 1-1-2(a)(i)).

191. *Id.*

The supreme court also clarified that “the publication of the [BPOL] ordinance itself does not satisfy the requirement that the County agency responsible for the interpretation and collection of taxes has interpreted and will apply the BPOL tax to internet access services.”<sup>192</sup> The court noted that “[t]here is a difference between publishing an ordinance and a proclamation clarifying the meaning of the ordinance.”<sup>193</sup>

On the alternative statutory exemption clause argument, the supreme court made two findings. First, the court held that Fairfax County had the burden to prove that the grandfather clause exemption applies.<sup>194</sup> Second, the court found that the County failed to meet its burden because the evidence failed to establish that the County generally imposed and actually enforced its BPOL tax on internet service providers.<sup>195</sup> The evidence showed that only one internet access provider, AOL, was subjected to the tax, and other internet service providers were not paying the BPOL tax because they lacked a definite place of business in the county.<sup>196</sup> Accordingly, the supreme court reversed the circuit court judgment and remanded the case for a determination of the tax refund due to Cox.<sup>197</sup>

## 2. Circuit Court Dismisses Additional BPOL Tax Assessment as Untimely

The Norfolk City Circuit Court held that it is not proper for localities to seek correction of a taxpayer’s local tax filing by directly petitioning the court when other statutory avenues are available for assessing additional taxes.<sup>198</sup>

Cox Communications Hampton Roads, LLC (“Cox”) calculated its BPOL tax liability for 2017 based on its gross receipts from all

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192. *Id.*

193. *Id.*

194. *Id.* at 211, 875 S.E.2d at 81.

195. *Id.*

196. *Id.* at 212, 875 S.E.2d at 81.

197. *Id.* at 213, 875 S.E.2d at 81–82.

198. *In re Scott*, No. CL21-4635, 2023 Va. Cir. LEXIS 9, at \*26–28 (Jan. 27, 2023) (City of Norfolk).

services except selling internet access.<sup>199</sup> Cox omitted this from its return based on its reading of ITFA.<sup>200</sup>

The parties were previously engaged in litigation relating to Cox's BPOL returns for years 2013 to 2016.<sup>201</sup> The issue in that case was the application of ITFA to Cox's activities in the locality, and the Norfolk City Circuit Court issued its decision on April 13, 2021.<sup>202</sup> On April 26, 2021, the Norfolk Commissioner of the Revenue (the "Norfolk Commissioner")—Blythe A. Scott—filed a Petition for Review to correct Cox's 2017 BPOL return in light of the decision, to which Cox filed a demurrer and plea in bar.<sup>203</sup>

The parties agreed that Cox's 2017 BPOL return was a timely self-assessment of tax, deemed filed on December 31, 2017.<sup>204</sup> In the event of an under-assessed tax, Code of Virginia section 58.1-3903 requires the commissioner of the revenue to evaluate a taxpayer's return and issue any additional assessment within three years.<sup>205</sup> Also, the commissioner may petition a circuit court for correction of a taxpayer's assessment within three years under section 58.1-3984(D).<sup>206</sup>

The court determined that the Norfolk Commissioner missed the three-year period to make an additional assessment under section 58.1-3903.<sup>207</sup> However, despite filing the circuit court petition outside of the three-year window on April 26, 2021, the Supreme Court of Virginia's COVID-19 judicial emergency tolling orders tolled the statute of limitations until May 5, 2021.<sup>208</sup> This emergency order resulted in a timely filing to correct Cox's 2017 BPOL tax return under section 58.1-3984(D).<sup>209</sup>

The court proceeded to examine the language of section 58.1-3903, finding "shall" to mean that the Norfolk Commissioner

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199. *Id.* at \*3.

200. *Id.* For a complete discussion of the Internet Tax Freedom Act and its interaction with Virginia's BPOL tax, see Part II.B.2. *See also* Craig D. Bell & Michael H. Brady, *Annual Survey of Virginia Law: Taxation*, 55 U. RICH. L. REV. 151, 168–171 (2020).

201. *Cox Commc'ns Hampton Rds., LLC v. City of Norfolk*, 108 Va. Cir. 28 (2021) (City of Norfolk).

202. *Id.* at 29–30.

203. *Scott*, 2023 Va. Cir. LEXIS 9, at \*3–5.

204. *Id.* at \*13.

205. VA. CODE ANN. § 58.1-3903 (2022); *see also Scott*, 2023 Va. Cir. LEXIS 9, at \*13–14.

206. § 58.1-3984(D) (2022); *Scott*, Va. Cir. LEXIS 9, at \*15.

207. *Scott*, Va. Cir. LEXIS 9, at \*14–15.

208. *Id.* at \*15.

209. *Id.* at \*15–16.

should have issued an additional assessment for any missing tax it determined to exist within three years.<sup>210</sup> Further, the Norfolk Commissioner's failure to make the additional assessment prohibited Cox from participating in the administrative appeal process challenging the 2017 assessment.<sup>211</sup>

In response, the Norfolk Commissioner argued that section 58.1-3984(D) provides an alternative procedure where a taxing authority may petition the court without first going through the administrative appeal process.<sup>212</sup> The court agreed and applied the language of the provision, determining that the Norfolk Commissioner must prove that Cox's 2017 BPOL tax self-assessment was "improper and that the amount should be corrected in order to serve the ends of justice" in order to take advantage of the alternative procedure.<sup>213</sup>

Relying on dictionary definitions and non-tax Virginia jurisprudence, the court stated that the "ends of justice provision" only applies when there is no alternative avenue of relief.<sup>214</sup> Because the Norfolk Commissioner had issued an additional assessment for Cox's 2016 BPOL return that prompted the prior litigation, the court determined that the Norfolk Commissioner understood her ability to issue—and the process for issuing—additional assessments.<sup>215</sup> The Norfolk Commissioner explained that the delay in filing the petition was the result of waiting for the court's decision in the prior litigation, but the court found this explanation insufficient; the court noted that this judicial course of action was only available because of the stay of judicial proceedings caused by the COVID-19 pandemic.<sup>216</sup>

The court held that even if section 58.1-3984(D) provides an alternative remedy for the Norfolk Commissioner to correct Cox's BPOL self-assessment and assess additional BPOL taxes related to internet services by petitioning the court directly, such a correction is not justified to serve the ends of justice.<sup>217</sup> Because the Norfolk Commissioner failed to issue an additional assessment within

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210. *Id.* at \*19–20.

211. *Id.* at \*18.

212. *Id.* at \*17.

213. *Id.* at \*23.

214. *Id.* at \*24–25.

215. *Id.* at \*26.

216. *Id.*

217. *Id.* at \*28.

the appropriate three-year period, any additional assessment made by the court would be untimely. Since the Norfolk Commissioner failed to file the petition within the applicable three-year statute of limitations, the court granted Cox's demurrer and plea in bar.<sup>218</sup>

### 3. Supreme Court of Virginia Finds County's Machinery and Tools Tax Scheme Unconstitutional

In its third time addressing this case over the last nine years, the Supreme Court of Virginia affirmed the Isle of Wight County Circuit Court's decision to award a full refund of machinery and tools ("M&T") tax paid by International Paper Company ("IP") in response to Isle of Wight County's unconstitutional tax scheme for the 2017 tax year.<sup>219</sup>

This case has a long history, taking its genesis from an earlier case where IP sued Isle of Wight County, seeking relief from M&T tax assessments for tax years 2012 to 2014.<sup>220</sup> In this case, the circuit court entered a final order in IP's favor, holding that the County's methodology of taxing IP's machinery and tools at their original total capitalized cost, without allowance for depreciation, was clearly erroneous.<sup>221</sup> Due to the County's erroneous methodology, the resulting M&T tax assessments were held to be far in excess of the machinery and tools' fair market value for the 2012 to 2014 tax years.<sup>222</sup> Accordingly, the circuit court ordered a tax refund for tax years 2012 to 2014, totaling approximately \$2.4 million plus accrued interest at ten percent from the dates IP made their first and second half M&T tax payments for 2012 to 2014.<sup>223</sup>

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218. *Id.* at \*28–29.

219. *Cnty. of Isle of Wight v. Int'l Paper Co.*, 301 Va. 489, 489, 501, 881 S.E.2d 776, 776–77, 784 (2022).

220. *Int'l Paper Co. v. Cnty. of Isle of Wight*, 299 Va. 150, 158, 847 S.E.2d 507, 512 (2020). For a comprehensive discussion of the earlier IP litigation, including the Supreme Court of Virginia decision in 2020, see Craig D. Bell, *Annual Survey of Virginia Law: Taxation*, 56 U. RICH. L. REV. 129, 150–151 (2021).

221. *Int'l Paper Co.*, 299 Va. at 158, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 150.

222. *Int'l Paper Co.*, 299 Va. at 158, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 150.

223. *Int'l Paper Co.*, 299 Va. at 158, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 150–51.



The County then adjusted its valuation methodology of M&T in the county from 100% to 40% of original capitalized cost for 2016.<sup>224</sup> Further, the County adopted an amended M&T tax rate of \$1.75 per \$100 of assessed value for M&T tax year 2016 in order to make the change to the 2016 M&T property valuations revenue neutral.<sup>225</sup> The County issued refunds for the 2013, 2014, and 2015 M&T tax years to correct its overassessment, which totaled \$5.6 million.<sup>226</sup> With their refund checks, M&T taxpayers also received a letter from the County Administrator stating that the amount of the refunds were unexpected and would result in an increased M&T tax rate for tax year 2017.<sup>227</sup>

The County then adopted its increased M&T tax rate for 2017, which was an increase from \$1.75 per \$100 of assessed value to \$4.24 per \$100 of assessed value.<sup>228</sup> To help taxpayers afford the one-year tax rate increase, the County created a tax relief program for M&T taxpayers known as the Economic Development Retention Grant program (“M&T Tax Relief Program”).<sup>229</sup> The County funded the M&T Tax Relief Program with \$32,125 in appropriations and approximately \$1.1 million raised from the increased 2017 M&T tax.<sup>230</sup> Any business negatively impacted by the tax rate increase received an “Economic Development Retention Grant” (“M&T Tax Relief Program payments” or “relief payments”) as an automatic credit on its M&T tax bill, which prevented those negatively impacted from being burdened by the tax increase.<sup>231</sup>

For tax year 2017, IP’s M&T property was assessed at a value of \$139,386,552.<sup>232</sup> Application of the increased 2017 M&T tax rate and the M&T Tax Relief Program formula resulted in IP receiving an M&T tax bill from the County, which stated that IP owed the

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224. *Int'l Paper Co.*, 299 Va. at 158–59, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 151.

225. *Int'l Paper Co.*, 299 Va. at 159, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 151.

226. *Int'l Paper Co.*, 299 Va. at 159, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 151.

227. *Int'l Paper Co.*, 299 Va. at 159–60, 847 S.E.2d at 512. *See also* Bell, *supra* note 220, at 152.

228. *Int'l Paper Co.*, 299 Va. at 160, 847 S.E.2d at 513. *See also* Bell, *supra* note 220, at 152.

229. *Int'l Paper Co.*, 299 Va. at 160, 847 S.E.2d at 513.

230. *Id.* at 161, 847 S.E.2d at 513.

231. *Id.* at 161–62, 847 S.E.2d at 513.

232. *Id.* at 162, 847 S.E.2d at 513–14.

County \$5,485,481.82 in M&T taxes for tax year 2017.<sup>233</sup> IP timely paid this amount to the County and subsequently filed an application to correct its assessment.<sup>234</sup>

At trial, IP presented thousands of pages of documents and hours of testimony to prove what it had pled.<sup>235</sup> Following IP's case in chief, the County moved to strike IP's evidence and claims.<sup>236</sup> After hearing the County's argument in favor of its motion to strike, the circuit court granted the motion from the bench.<sup>237</sup> On IP's appeal, the Supreme Court of Virginia concluded that IP had proven its case, citing both the admitted exhibits and testimony at length.<sup>238</sup> In its opinion, the supreme court determined that IP produced evidence "that the County intended, structured, funded, administered, and calculated the M&T Tax Relief Program payments almost entirely within the closed circuit of the M&T taxation process, and that the M&T tax rate increase and the M&T Tax Relief program were both part of an interwoven 2017 M&T tax strategy."<sup>239</sup> In short, "the M&T Tax Relief Program was part of the 2017 M&T taxation process."<sup>240</sup> Virginia's constitutional requirement of uniform property taxation is categorical and unequivocal. Any act that has the effect of allowing one taxpayer to pay less than another taxpayer similarly situated might be required to pay offends uniformity, no matter how the different treatment is affected. As the Supreme Court of Virginia extensively explained, courts "must consider the effect of the tax plan upon those subject to it, rather than the government's stated label for its actions" in determining whether application of a tax plan resulted in a non-uniform assessment.<sup>241</sup>

Put simply, the unequal distribution of burdens on M&T taxpayers was the direct result of Isle of Wight giving relief payments only to M&T taxpayers who experienced a net tax increase in 2017 that was greater than the amount of the tax refund they had received for tax years 2013 to 2015. By awarding such payments, Isle

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233. *Id.* at 162, 847 S.E.2d at 514.

234. *Id.*

235. *Id.* at 163–67, 847 S.E.2d at 514–16.

236. *Id.* at 167, 847 S.E.2d at 516.

237. *Id.* at 168, 847 S.E.2d at 517.

238. *Id.* at 187, 847 S.E.2d at 527.

239. *Id.* at 189, 847 S.E.2d at 528.

240. *Id.*

241. *Id.* at 186, 847 S.E.2d at 527.

of Wight was effectively exempting that sub-class of M&T taxpayers from the burden of the 2017 M&T tax rate increase.<sup>242</sup>

Ultimately, the supreme court held that the M&T Tax Relief Program payments were integrated into the M&T taxation process, and that the relief payments functioned as a partial tax exemption which was granted non-uniformly.<sup>243</sup> Therefore, IP's 2017 M&T tax assessment was "non-uniform, invalid, and illegal," and the supreme court reversed the circuit court's decision to grant the County's motion to strike and remanded the case to the circuit court.<sup>244</sup>

At the remand proceedings, the County only offered evidence of an admission—which was already established in the record—that IP owned machinery and tools within Isle of Wight that were subject to taxation and rested on its case-in-chief.<sup>245</sup> Following closing arguments, the circuit court held that IP established, by a preponderance of the evidence, that the 2017 M&T Tax Rate and the M&T Tax Relief Program were part of an integrated taxation process, and that the 2017 M&T tax assessments were not uniform since the relief payments were effectively partial tax exemptions granted to different members of the same tax class.<sup>246</sup> The result, the court held, is a nonuniform, invalid, and unconstitutional tax assessment levied on IP.<sup>247</sup> Under the provisions of Code of Virginia section 58.1-3987, the circuit court ordered the County to refund \$5,485,481.81—the full amount of IP's 2017 M&T taxes paid to the County—plus accrued interest at an annual rate of ten percent according to the County's ordinance.<sup>248</sup>

The County appealed to the Supreme Court of Virginia, claiming the circuit court erred in finding its tax scheme unconstitutional and, in the alternative, that it erred in the relief it granted.<sup>249</sup> The court rejected both arguments.<sup>250</sup>

The County first argued that the circuit court failed to consider the presumption of constitutionality that attaches to the County's

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242. *Id.* at 190, 847 S.E.2d at 529.

243. *Id.*

244. *Id.*

245. *Cnty. of Isle of Wight v. Int'l Paper Co.*, 301 Va. 486, 496, 881 S.E.2d 776, 781 (2022).

246. *Id.*

247. *Id.*

248. *Id.*

249. *Id.* at 489, 881 S.E.2d at 777.

250. *Id.*

legislative acts.<sup>251</sup> On this point, the County argued that in recognizing this presumption of constitutionality, the circuit court should have “adopted a different interpretation” of the M&T tax rate increase and the M&T Tax Relief Program that would effectively uphold them as constitutional.<sup>252</sup> However, the court clarified that the presumption means neither that a court is required to disbelieve evidence showing that enactment is unconstitutional, nor that a court must accept the government’s evidence in favor of constitutionality; rather, “[t]he presumption means that a litigant who is challenging the constitutionality of an enactment must shoulder the burden of proving . . . that the enactment is unconstitutional.”<sup>253</sup> The court relied on its prior decision in which it determined that IP established a prima facie case of a non-uniform and unconstitutional tax scheme.<sup>254</sup> Since the County presented no new evidence on remand, the court held that IP overcame the presumption of constitutionality.<sup>255</sup>

On the issue of remedy, the County argued that the circuit court should have severed the M&T tax rate increase and the M&T Tax Relief Program and ultimately invalidated the latter.<sup>256</sup> The supreme court held that, “in light of the overwhelming evidence of the interwoven purpose and operation of the high tax rate and the grants, invalidating the grant program while preserving the high rate would not be an appropriate remedy.”<sup>257</sup>

The supreme court finally rejected the County’s argument that if the M&T tax rate increase of \$4.24 is invalid, then IP should pay the prior year’s rate of \$1.75 because the County failed to raise this argument at trial.<sup>258</sup> Since the County only asked the court to uphold both the \$4.24 tax rate and the M&T Tax Relief Program, or, in the alternative, to strike the M&T Tax Relief Program and uphold the higher tax rate, without making any additional

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251. *Id.* at 497, 881 S.E.2d at 781.

252. *Id.* at 497, 881 S.E.2d at 781–82.

253. *Id.* at 497, 881 S.E.2d at 782.

254. *Id.* at 499, 881 S.E.2d at 783. For the Supreme Court of Virginia’s holding in this prior decision, see *Int’l Paper Co. v. Cnty. of Isle of Wight*, 299 Va. 150, 190, 847 S.E.2d 507, 529 (2020). See also *supra* notes 220–244 & accompanying text (discussing the prior litigation between IP and Isle of Wight).

255. *Cnty. of Isle of Wight*, 301 Va. at 499, 881 S.E.2d at 783.

256. *Id.* at 499–500, 881 S.E.2d at 783.

257. *Id.* at 500, 881 S.E.2d at 783.

258. *Id.* at 501–02, 881 S.E.2d at 784.

alternative arguments, the court held that the County “must now live with the choices it made during this litigation.”<sup>259</sup>

Thus, the Supreme Court of Virginia affirmed the circuit court’s decision, which resulted in a full refund of M&T tax paid by IP and accrued interest in the amount of over \$8.3 million in response to the County’s nonuniform and unconstitutional tax scheme.<sup>260</sup> The effect of the Supreme Court of Virginia’s decision is that IP paid no M&T tax on its M&T for the 2017 tax year.<sup>261</sup>

#### 4. Standard of Review by Circuit Courts Addressing Tax Administrative Appeals

The Chesterfield County Circuit Court had the opportunity to address and rule on the standard of judicial review applicable to real property administrative tax appeals submitted to a circuit court pursuant to Code of Virginia section 58.1-3984, in a case brought by Capital One, N.A. (“Capital One”).<sup>262</sup>

Capital One appealed the County’s assessment of its commercial data center, claiming that incorrect valuation methods resulted in an assessment different than the fair market value of the property.<sup>263</sup> The County’s Board of Equalization upheld the assessment and, after Capital One filed suit, a motion was filed by Chesterfield County to determine whether Capital One could introduce an appraisal report that was not submitted to the Board of Equalization.<sup>264</sup>

The court noted that section 58.1-3984 is silent on the standard of review a circuit court must apply when conducting its hearing, but recognized that the standard of review set forth by the Supreme Court of Virginia clarifies that the circuit court acts in the role of an appellate court.<sup>265</sup> While these decisions preclude a court from hearing issues not raised on the initial appeal, the circuit

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259. *Id.* at 502, 881 S.E.2d at 784.

260. *Id.*; see also Stephen Faleski, *Isle of Wight Repays International Paper \$8.3 Million in Machinery Taxes*, TIDEWATER NEWS (Jan. 31, 2023), <https://www.thetidewaternews.com/2023/01/31/isle-of-wight-repays-international-paper-8-3-million-in-machinery-taxes> [<https://perma.cc/2E3Y-NLXZ>].

261. Author’s comment.

262. *Capital One, N. A. v. Chesterfield Cnty. Bd. of Supervisors*, No. CL21-4163, 2022 Va. Cir. LEXIS 232, at \*1 (Dec. 19, 2022) (Chesterfield).

263. *Id.* at \*1–2.

264. *Id.* at \*1–3.

265. *Id.* at \*5–6.

court found that it was not precluded from hearing relevant evidence on issues properly raised.<sup>266</sup> Since the appraisal report would be introduced to support Capital One's argument raised to the Board of Equalization, the court determined that it could be used to help Capital One meet its statutory burden of establishing the assessment was incorrect.<sup>267</sup>

## CONCLUSION

The 2023 Session of the Virginia General Assembly, in a change from recent years, enacted several significant tax laws that addressed corporate income taxation as opposed to the typical technical changes made each year in the tax laws. First, enacting a conformity provision to create a Virginia conformity to federal laws on a rolling basis—meaning that Virginia tax laws will incorporate the changes to federal income tax laws in the Internal Revenue Code as soon as Congress enacts them—is incredibly important. Business taxpayers will now have more timely knowledge of Virginia's adoption of changes to income tax laws, which should provide more certainty as to the impact of state income tax on their business expense and capital investment decisions. Additionally, several corporate income apportionment and filing options were enacted. The General Assembly also made tax law revisions to encourage investment in the internet root infrastructure provider industry, as Virginia seeks to continue its path to encourage this industry to locate their facilities within the Commonwealth. Lastly, at the state level, much needed improvements to tax collection procedures were made to encourage offers-in-compromise agreements and a more straightforward approach to accurately compute tax collections statutes of limitations.

On the litigation front, several important corporate income tax cases were decided. This has been largely missing in the past few years, as tax litigation was largely in the machinery and tools and real property taxation areas. With the recently expanded jurisdiction of the Virginia Court of Appeals to now be able to decide tax cases, the first tax case was decided by the appellate court this year. The decision in the *Virginia Department of Taxation v. 1887 Holdings, Inc.* provided the appellate court with a fully stipulated

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266. *Id.* at \*8.

267. *Id.* at \*10–11.

set of facts that were not at issue. The court was able to explain which rules of statutory construction apply on a number of procedural and substantive tax issues in a very well-reasoned opinion. The appellate court's decision is helpful to tax lawyers who handle such issues on a regular basis and makes for a great "teaching case" for practitioners going forward.