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Annual Survey of Virginia Law: Taxation

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TAXATION

*Carle E. Davis**

In its 1989 session, Virginia's General Assembly passed many bills amending sections of and adding new sections to title 58.1 of the Code of Virginia (the "Code"). These bills affected a broad range of areas, including the individual and corporate income tax, the sales and use tax, real estate and recordation taxes, and miscellaneous local taxes. The Virginia courts decided several cases concerning miscellaneous taxation issues. In addition, the Virginia Department of Taxation finalized regulations concerning the payment of estimated income taxes by individuals and fiduciaries and promulgated other emergency and proposed regulations. This article covers legislative and regulatory changes and judicial decisions affecting Virginia taxation from July, 1988 to July, 1989. Its purpose is to alert Virginia's tax practitioners, as well as general practitioners, to these changes and decisions.

I. LEGISLATIVE ACTIVITY

A. *Changes Affecting Virginia's Income Tax*

1. Individual Income Tax

To return to taxpayers the gains attributable to conforming Virginia's tax provisions to the recent changes to the federal tax laws, the General Assembly enacted House Bill 1417 providing a credit to taxpayers for five years.¹ The legislation enacted a new Code section,² effective January 1, 1989, which grants a credit of thirty-five dollars for each personal and dependent exemption claimed (other than for age or blindness).³ The credit is reduced for certain

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The author gratefully acknowledges the assistance of his associate, Michele A. Wood.

1. 1989 Va. Acts 590 (codified as amended at VA. CODE ANN. § 58.1-335 (Cum. Supp. 1989)).

2. *Id.*

3. VA. CODE ANN. § 58.1-335(A)-(B)(1) (Cum. Supp. 1989). Taxpayers eligible to be claimed as a dependent on another's tax return are not entitled to the credit. *Id.* § 58.1-

taxpayers with higher income. For single individuals and married individuals filing separately, the credit is reduced two dollars for each \$1,000 (or fraction thereof) of adjusted gross income in excess of \$17,000.⁴ The credit is reduced one dollar for every \$1,000 (or fraction thereof) of adjusted gross income in excess of \$34,000 for married individuals filing jointly.⁵ Single individuals and married individuals filing separately do not receive any credit, however, if their adjusted gross income exceeds \$34,000, or \$68,000 in the case of married individuals filing jointly.⁶

For taxable years 1990 through 1993, the credit is reduced to \$22.50.⁷ For single individuals and married individuals filing separately, the credit is reduced four dollars for each \$1,000 (or fraction thereof) of adjusted gross income in excess of \$10,000 and for married individuals filing jointly, two dollars for each \$1,000 (or fraction thereof) of adjusted gross income in excess of \$24,000.⁸ Single individuals and married individuals filing separately do not receive any credit if their adjusted gross income exceeds \$15,000 or \$35,000 in the case of married individuals filing jointly.⁹

The United States Supreme Court in *Davis v. Michigan Department of Treasury*,¹⁰ recently held it unconstitutional for a state to tax retirement benefits of federal employees while exempting retirement benefits of state employees. In response to this decision, the General Assembly provided a subtraction from Virginia taxable income for retirement income effective for taxable years beginning on or after January 1, 1989.¹¹ Taxpayers with retirement income¹²

335(E).

4. *Id.* § 58.1-335(B)(1).

5. *Id.*

6. *Id.* § 58.1-335(B)(2).

7. *Id.* § 58.1-335(C)(1).

8. The credit, however, may never be less than five dollars. *Id.*

9. *Id.* § 58.1-335(C)(2).

10. 57 U.S.L.W. 4389 (U.S. Mar. 28, 1989) (No. 87-1020).

11. VA. CODE ANN. §§ 58.1-322.15, -330 (Cum. Supp. 1989).

12. "Retirement income is defined as the sum of:

(1) Distributions from or pursuant to an employee pension benefit plan (as defined in section 3(2) of the Employee Retirement Income Security Act of 1974) which satisfies the requirements of § 401 of the Internal Revenue Code;

(2) Distributions from or pursuant to a public retirement system of or created by an act of this Commonwealth or a political subdivision of this Commonwealth or any other state or local government;

(3) Distributions from or pursuant to a federal retirement system created by the federal government for any officer or employee of the United States, including any person retired from service in the United States Civil Service, the United States Armed Forces, or any

of \$16,000 or less may subtract all of the retirement income.¹³ For retirement income in excess of \$16,000 and up to \$40,000, the subtraction is phased out one dollar for every three dollars of retirement income.¹⁴ No subtraction is available to taxpayers having more than \$40,000 in retirement income.¹⁵

The General Assembly also extended the statute of limitations for filing claims for refunds as a result of the holding in *Davis* for years beginning on and after January 1, 1989.¹⁶ Taxpayers now have one year after the entry of "a final judicial order of a court of competent jurisdiction not subject to further appeal resolving the issue of the application to Virginia income tax law of the [*Davis* decision]" to file a return.¹⁷

The General Assembly also amended the Code to exempt retirement income received from another state if that state exempts retirement income received by its residents from Virginia.¹⁸ This reciprocal exemption is effective for taxable years beginning on or after January 1, 1989.¹⁹ Further, individuals, as well as corporations, are also now entitled to a deduction for Virginia income tax purposes for qualified agricultural contributions.²⁰ This deduction

agency or subdivision thereof;

(4) Distributions or withdrawals from or pursuant to an eligible deferred compensation plan which satisfies the requirements of § 457 of the Internal Revenue Code;

(5) Distributions or withdrawals from or pursuant to an individual retirement account, annuity, or trust or simplified employee pension which satisfies the requirements of § 408 of the Internal Revenue Code; and

(6) Distributions or withdrawals from or pursuant to an employee annuity (including custodial accounts treated as annuities) subject to § 403(a) or (b) of the Internal Revenue Code. *Id.* § 58.1-322(C)(14)(c).

13. *Id.* § 58.1-322(C)(14)(a).

14. *Id.* § 58.1-322(C)(14)(a)(1).

15. *Id.* § 58.1-322(C)(14)(a)(2).

16. *Id.* § 58.1-1823(C).

17. *Id.* § 58.1-1823(B).

18. 1989 Va. Acts 749; VA. CODE ANN. § 58.1-322(C)(14).

19. 1989 Va. Acts 749.

20. VA. CODE ANN. §§ 58.1-322(C)(14), 58.1-402(C)(13) (Cum. Supp. 1989). A "qualified agricultural contribution" is defined as any contribution of an agricultural product by an individual who is engaged in the trade or business of growing or raising such agricultural product, to an organization exempt from taxation pursuant to section 501(c)(3) of the Internal Revenue Code, provided (i) such product is fit for human consumption; (ii) the use of such product by the donee is related to the purpose or function constituting the basis for the exemption of the donee under section 501(c)(3) of the Internal Revenue Code; (iii) such contribution is not made in exchange for money, property or service; and (iv) such individual receives from the donee a written statement representing that the donee's use and disposition of such agricultural product will be in accordance with the provisions of this subsection. *Id.* § 58.1-322-2(A).

had expired January 1, 1988 and has now been reinstated for tax years beginning on or after January 1, 1989 and before January 1, 1994.²¹ The amount of the deduction is equal to the "wholesale market value"²² of the contributed agricultural products.²³ The deduction must be reduced by the amount of any other deductions related to the contribution claimed under section 170 of the Internal Revenue Code.²⁴

House Bill 1950 allows the reduction of the amount of individual income tax withheld by employees each payroll period by taking into account itemized deductions of the taxpayer, as well as the standard deduction.²⁵ This provision is effective January 1, 1991.²⁶

2. Local Income Tax

A new article 22 was created in title 58.1 of the Code relating to local income taxes.²⁷ Localities with certain population levels may now enact a local income tax subject to certain conditions.²⁸ Basically, this new article enables the counties of Arlington, Fairfax, Loudoun, and Prince William and the cities of Alexandria, Fairfax, Falls Church, Mannassas, Mannassas Park, and Norfolk to levy a local income tax. Certain limitations apply to any such levy.²⁹

21. *Id.* § 58.1-322.2.

22. "Wholesale market price" means the lowest wholesale market price of any agricultural product in the nearest regional market during the month in which the contribution is made, without consideration of grade or quality of such product, as if the quantity of such product contributed were marketable." *Id.* § 58.1-322.2(B).

23. *Id.* § 58.1-322.2(A).

24. *Id.* § 58.1-322.2(C).

25. 1989 Va. Acts 289 (codified as amended at VA. CODE ANN. § 58.1-461 (Cum. Supp. 1989)).

26. *Id.*

27. VA. CODE ANN. § 58.1-540 (Cum. Supp. 1989).

28. *Id.* § 58.1-540(A).

29. a. The levy of the tax must be approved in a local referendum. VA. CODE ANN. § 58.1-54(A) (Cum. Supp. 1989).

b. The tax rate may not exceed one percent and may be levied in one-quarter increments. *Id.*

c. The levy may not extend for more than five taxable years. *Id.* § 58.1-549.

d. The tax rate applicable to corporations must be identical to that applicable to individuals. *Id.* § 58.1-540(A).

e. All revenue generated as a result of any such tax levy must be used for transportation purposes. *Id.* § 58.1-548(E).

f. The local income tax must be administered by the Department of Taxation. *Id.* § 58.1-545(A).

3. Procedural and Miscellaneous Matters

Senate Bill 732 and House Bill 406 modify certain penalty provisions of the Code.³⁰ The penalties for failure to file individual or corporate tax returns and for underpayment of the amount of tax due are increased to five percent of the amount of taxes assessed plus an additional five percent for each month of delinquency up to a maximum of twenty-five percent.³¹ The minimum penalty for a corporation that does not file a return is \$100.³² The penalty for an underpayment of tax due to an understatement that is false with the intent to evade tax is 100 percent.³³ These new penalty provisions are effective for taxable years beginning on or after January 1, 1990.³⁴

These bills, effective January 1, 1990, also allow the Tax Commissioner to place padlocks on the doors of any business enterprise that is delinquent in filing or paying any tax owed after filing a memorandum of lien and determining that such action is in the best interests of the Commonwealth.³⁵ Any person who enters the padlocked premises without approval of the Tax Commissioner shall be guilty of a class one misdemeanor.³⁶ A Tax Amnesty Program³⁷ was also established to "improve voluntary compliance with the tax laws and to increase and to accelerate collections of certain taxes owed to the Commonwealth."³⁸

Code section 58.1-313 was amended to provide that the Department of Taxation may only file a memorandum of lien for collection of income taxes within six years after an assessment.³⁹ This provision is effective October 1, 1989.⁴⁰

30. 1989 Va. Acts 642, 629.

31. VA. CODE ANN. §§ 58.1-347, -351, -450, -455(A) (Cum. Supp. 1989).

32. *Id.* § 58.1-450.

33. *Id.* § 58.1-455(B).

34. 1989 Va. Acts 642, 629.

35. VA. CODE ANN. § 58.1-1805(C) (Cum. Supp. 1989).

36. *Id.* § 58.1-1805.

37. *Id.* § 58.1-1840. The tax amnesty program is to be conducted from January 15 through March 31, 1990 and is to last not more than 62 days. *Id.* § 58.1-1840(D)(1).

38. *Id.* § 58.1-1840(A).

39. *Id.* § 58.1-313(B).

40. *Id.* § 58.1-313.

B. *Changes Affecting Real Estate and Recordation Taxes*

As in 1988, the General Assembly again made several changes affecting the real property tax exemption for elderly and handicapped individuals. To take into account the higher cost of living in Northern Virginia, certain localities (meeting certain population requirements) are authorized to increase the total combined income limitation from \$22,000 to \$40,000 and the net combined financial worth limitations from \$75,000 to \$150,000.⁴¹

Under prior law, if a taxpayer became disqualified for the property tax relief program for the elderly and handicapped at any time during the taxable year, the individual was disqualified for the entire year.⁴² The Code was amended to allow proration of the tax exemption in the event of a change in the taxpayer's circumstances during the taxable year.⁴³

Localities also now have greater flexibility in establishing the total combined income limitations for purposes of qualifying for the tax exemption for the elderly and the handicapped. The income limit may be applied as the greater of \$22,000 or the income limits published annually by the United States Department of Housing and Urban Development for qualifying for federal assistance.⁴⁴ Localities may not require a certain residency period for qualification for any tax exemption or deferral program.⁴⁵ In addition, localities must include a notice in real estate bills that a tax relief program is available for the elderly and the handicapped.⁴⁶

As of July 1, 1989, localities may grant a partial property tax exemption for rehabilitated commercial or residential real estate if the structure is at least twenty-five years old.⁴⁷ The amount of the partial exemption may be either the increase in the assessed value of the property as a result of the rehabilitation or renovation or up to fifty percent of the cost of the rehabilitation.⁴⁸

Real estate devoted to agricultural, horticultural, or forest uses

41. *Id.* § 58.1-3211(3).

42. *Id.* § 58.1-3215(A) (Cum. Supp. 1988).

43. *Id.* § 58.1-3215(A) (Cum. Supp. 1989).

44. *Id.* § 58.1-3211(A).

45. *Id.* § 58.1-3212.

46. *Id.* § 58.1-3213.1.

47. *Id.* §§ 58.1-3220(A), -3221(A).

48. *Id.* §§ 58.1-3220(B), -3221(B).

generally qualifies for the special land use assessment program.⁴⁹ The Code was amended to provide that real estate on which recreational activities are conducted for profit or otherwise shall be considered real estate devoted to agricultural, horticultural, or forest use if the recreational activities do not change the character of the real estate so that it does not meet the uniform standards issued by the Commissioner of Agriculture and Consumer Services or State Forester.⁵⁰

Senate Bill 641 requires boards of equalization to hear taxpayer complaints regarding (i) errors in the amount of acreage assessed and (ii) lack of uniformity in assessment.⁵¹ House Bill 1595 allows localities to have three *or five* members on the board of equalization and requires such members to be appointed for staggered terms.⁵²

Provisions for tax increment financing, designed to generate revenue to finance the costs of redevelopment in blighted areas, were added to title 58.1 in 1988.⁵³ In 1989, the General Assembly expanded the definition of "blighted area" to include any area adjacent to or in the immediate vicinity of a blighted area "which may be improved or enhanced in value by the placement of a proposed highway construction project."⁵⁴

A new Code section was added which requires distribution of forty million dollars of recordation taxes received by the state treasury to cities and counties.⁵⁵ All funds distributed must be used for transportation or public education purposes.⁵⁶ These provisions become effective July 1, 1990 and expire on June 30, 1995.⁵⁷

49. *Id.* § 58.1-3230.

50. *Id.*

51. 1989 Va. Acts 300 (codified as amended at VA. CODE ANN. § 50.1-3378 (Cum. Supp. 1989)).

52. 1989 Va. Acts 390 (codified as amended at VA. CODE ANN. § 58.1-3373 (Cum. Supp. 1989)).

53. 1988 Va. Acts 1226 (codified as amended at VA. CODE ANN. §§ 58.1-3245 to -3245.5 (Cum. Supp. 1988)).

54. VA. CODE ANN. § 50.1-3245 (Cum. Supp. 1989).

55. *Id.* § 58.1-815.

56. *Id.* § 58.1-816(A), (C).

57. *Id.* § 58.1-816, editor's note.

C. *Changes Affecting Tangible Personal Property Taxes*

In 1988, the General Assembly reclassified daily rental equipment as merchant's capital, rather than tangible personal property, effective July 1, 1989.⁵⁸ The General Assembly redefined daily rental property in its 1989 session as all tangible personal property held for rental and owned by a person engaged in the "short-term rental business."⁵⁹ A "short-term rental business" is one not less than eighty percent of the gross rental receipts of which are from transactions involving rental periods of ninety-two consecutive days or less.⁶⁰ Cities and counties may levy a daily rental property tax not to exceed one percent of the gross proceeds to be collected from the lessee at the time of the rental.⁶¹ Property exempt from the retail sales and use tax is exempt from the daily rental property tax.⁶²

The counties of Bedford and Rockbridge and the cities of Charlottesville and Colonial Heights are authorized to prorate the tangible personal property tax on motor vehicles, trailers, and boats.⁶³ House Bill 1463 classified motor vehicles owned by members of a volunteer rescue squad or fire department as a separate class of property for purposes of the tangible personal property tax.⁶⁴ Reclassification of any such vehicle is permitted if: (i) the vehicle is regularly used to respond to volunteer rescue squad or fire department calls, and (ii) the member submits a certificate on January 1 of each year to the commissioner of the revenue that he is a member of a volunteer fire department or rescue squad and regularly uses the motor vehicle to respond to calls and perform other duties for the organization.⁶⁵ Motor vehicles specially equipped to provide transportation for physically handicapped individuals are also specially classified for purposes of the tangible personal property tax.⁶⁶

58. *Id.* § 58.1-3511 (Cum. Supp. 1988).

59. *Id.* § 58.1-3510(B) (Cum. Supp. 1989).

60. *Id.* § 58.1-3510(C).

61. *Id.* § 58.1-3510.1.

62. *Id.* § 58.1-3510.3.

63. *Id.* § 58.1-3516(A), editor's note.

64. 1989 Va. Acts 691 (codified as amended at VA. CODE ANN. § 58.1-3506(A) (13) (Cum. Supp. 1989)).

65. VA. CODE ANN. § 58.1-3506(A)(13) (Cum. Supp. 1989).

66. *Id.* § 58.1-3506(A)(12).

D. *Changes Affecting Sales and Use Taxes*

The General Assembly completely revised the structure of the sales and use tax provisions of title 58.1.⁶⁷ Upon receiving an application for a retail sales and use tax exemption, the General Assembly will examine eight criteria.⁶⁸ Any bill for consideration by the General Assembly must be introduced no later than the first calendar day of any session of the General Assembly unless requested by the Governor.⁶⁹ Also, the existing exemptions were reorganized into ten categories.⁷⁰

A new Code section was added to prevent misuse of exemptions.⁷¹ Under this section, the Department of Taxation is authorized to issue exemption certificates and to require their use in making purchases. Upon any misuse of an exemption certificate, the exemption may be suspended or the person may be subject to a \$1,000 penalty.⁷²

Senate Bill 670, retroactive to January 1, 1985, clarifies the definition of "transient" for purposes of the retail sales and use tax.⁷³ For purposes of taxing the furnishing of rooms and lodgings for transients, a transient does not include a purchaser of camping memberships, timeshares, condominiums, or other similar con-

67. 1989 Va. Acts 739.

68. The criteria include:

1. Estimate of state and local revenues which will be foregone as a direct result of the exemption;
2. Beneficiaries of the exemption;
3. Direct or indirect local, state, or federal government assistance received by the person seeking exemption;
4. The extent to which the person, property, service, or industry is exempt from the retail sales and use tax in other states;
5. Any external statutory, constitutional, or judicial mandates in favor of the exemption;
6. Other state taxes to which the person, property, service, or industry is subject;
7. Similar taxpayers who are not entitled to a retail sales and use tax exemption; and
8. Other criteria, facts, or circumstances which may be relevant to the request for exemption. VA. CODE ANN. § 30-19.05(A) (Cum. Supp. 1989).

69. *Id.* § 30-19.1:2.

70. The ten categories are: (1) governmental and commodities, (2) agricultural, (3) commercial and industrial, (4) educational, (5) service, (6) media-related, (7) medical-related, (8) nonprofit civic and community service, (9) nonprofit cultural organization, and (10) miscellaneous. *Id.* § 8.1-608.

71. *Id.* § 58.1-623.1.

72. *Id.*

73. 1989 VA. ACTS 581 (codified as amended at VA. CODE ANN. § 58.1-623.1(E) (Cum. Supp. 1989)).

tracts or interests.⁷⁴ A purchaser of a right to use the facilities of a specific real estate project on an ongoing basis throughout its term shall not be deemed a transient, provided the term is seven years or more.⁷⁵

Senate Bill 741 revises the discount amount that is paid to dealers collecting the retail sales and use tax from three percent to a range between two and four percent as follows:⁷⁶

<u>Monthly Taxable Sales</u>	<u>Percentage</u>
0 to \$62,500	4%
\$62,501 to \$208,000	3%
\$208,001 and above	2%

House Bill 1745 imposes a fifty cents tax on each new tire sold by a retailer.⁷⁷ The revenues generated by these taxes are to be used to establish a Waste Tire Trust Fund and develop and implement a plan for the management and transportation of all waste tires.⁷⁸ The provision is effective January 1, 1990 and expires December 31, 1994.⁷⁹

E. Changes Affecting Procedural Matters Regarding Local Taxes

Several bills passed by the 1989 General Assembly affect miscellaneous procedural matters involving the administration of local taxes. Localities may now impose interest on delinquent taxes at a rate equal to the greater of ten percent or the interest rate established under section 6621 of the Internal Revenue Code for the second and any subsequent years of the delinquency.⁸⁰ Localities may also establish programs permitting prepayment of designated local taxes at any time before assessment.⁸¹ The locality may pay interest on any such prepayments directly to the taxpayer or credit such interest towards the prepayment of future tax obligations.⁸²

74. VA. CODE ANN. § 58.1-602 (Cum. Supp. 1989).

75. *Id.*

76. 1989 Va. Acts 469 (codified as amended at VA. CODE ANN. § 58.1-622 (Cum. Supp. 1989)).

77. 1989 Va. Acts 630 (codified as amended at VA. CODE ANN. § 58.1-641 (Cum. Supp. 1989)).

78. VA. CODE ANN. §§ 10.1-1422.1, 58.1-643 (Cum. Supp. 1989).

79. *Id.* § 58.1-642, editor's note.

80. *Id.* § 58.1-3916.

81. *Id.* § 58.1-3920.1.

82. *Id.*

Also, the statute of limitations for filing for relief to the Commissioner of the Revenue or circuit court for correction of an erroneous assessment was extended from three to five years.⁸³ Previously, localities were required to omit delinquent tax bills of less than five dollars from the tax books.⁸⁴ Localities may now either collect such taxes or omit them from the books.⁸⁵

F. *Miscellaneous*

1. Probate Tax

The Code was amended to provide that if an estate has been undervalued for probate tax purposes or if the probate tax was overpaid, the additional tax due shall only be collected when the amount due is twenty-five dollars or more.⁸⁶ Further, the Code was amended to provide that no tax shall be imposed if the decedent's estate is valued at less than \$5,000.⁸⁷ Also, if the decedent's estate is valued at less than \$5,000, rather than \$1,000 as under prior law, no probate tax return need be filed.⁸⁸

2. Bank Franchise Tax

The bank franchise tax may be prorated for a new bank or a bank that operated for less than a calendar year.⁸⁹ No bank is eligible for the proration if it was created as part of a reorganization under section 368(a) of the Internal Revenue Code.⁹⁰

3. Setoff Debt Collection Act

A delinquent debt for which a judgment has been obtained is now subject to the Setoff Debt Collection Act. To accomplish this change, the definition of debtor was amended to exclude the requirement of a lack of adjudication of the individual's debt.⁹¹

83. *Id.* §§ 58.1-3980, -3984.

84. *Id.* §§ 58.1-3001, -3005 (Cum. Supp. 1988).

85. *Id.* §§ 58.1-3001, -3005 (Cum. Supp. 1989).

86. VA. CODE ANN. § 58.1-1717 (Cum. Supp. 1989).

87. *Id.* § 58.1-1712.

88. *Id.* § 58.1-1714.

89. *Id.* § 58.1-1204.1.

90. *Id.*

91. *Id.* § 58.1-520.

4. Food and Beverage Taxes

Cities, counties, and towns may not levy a meal tax on food and beverages sold through vending machines.⁹² This provision is effective July 1, 1989.⁹³

5. Motor Vehicle Fuels Sales Tax

In a provision that primarily affects Loudoun County, the Code was amended to provide that motor vehicle sales tax revenues may be distributed directly to any jurisdiction that joins the Northern Virginia Transportation District after July 1, 1989.⁹⁴ Otherwise, these revenues would be paid to the transportation district commissioner.⁹⁵ Any funds so distributed must be used for transportation purposes in that jurisdiction.⁹⁶

A new Code section was added which authorizes the Tax Commissioner of the Virginia Department of Taxation to disclose "such information as may be necessary for the performance of official duties" to the finance officer of any city or county administering the motor vehicle fuel sales tax.⁹⁷ Any information so disclosed is subject to the tax secrecy prohibitions and penalties under Code section 58.1-3.⁹⁸

6. Secrecy of Tax Information

Code section 58.1-3, regarding the secrecy of tax information,⁹⁹ was amended to allow the Tax Commissioner of the Virginia Department of Taxation to provide tax information to the Alcohol Beverage Control Board, upon entering a written agreement "as may be necessary to facilitate the collection of state and local taxes and the administration of the alcoholic beverage control laws."¹⁰⁰ In addition, the Tax Commissioner may provide tax information to the Director of the State Lottery Department "as may be necessary to identify those lottery ticket retailers who owe delinquent taxes."¹⁰¹

92. *Id.* §§ 58.1-3833, -3840.

93. 1989 Va. Acts 391.

94. VA. CODE ANN. § 58.1-1724 (Cum. Supp. 1989).

95. *Id.*

96. *Id.*

97. *Id.* § 58.1-1724.1.

98. *Id.*

99. *Id.* § 58.1-3.

100. *Id.* § 58.1-3(C).

101. *Id.*

7. Operation of Business Enterprises by Blind Persons

Amendments to the Code exempt businesses operated by blind persons that are under the jurisdiction of the Department for the Visually Handicapped from certain local taxes.¹⁰² No city, county, or town may levy a license tax “[o]n any blind person operating a vending stand or other business enterprise under the jurisdiction of the Department for the Visually Handicapped, or a nominee of the Department”¹⁰³ In addition, no such person shall be required to collect and remit meal taxes if the business is operated on United States property acquired or used for any military or naval purpose.¹⁰⁴

8. Virginia Coal Employment and Production Incentive Tax Credit

Amendments to Code section 58.1-2626.1 allow corporations to claim an income tax credit of one dollar for each ton of coal contracted for purchase after July 1, 1986.¹⁰⁵ This amendment is effective for taxable years beginning in 1990 and thereafter, for coal purchased on and after January 1, 1989 thereby enabling purchasers of coal pursuant to long-term contracts to retroactively qualify for the credit.¹⁰⁶ For taxable years beginning in 1991 and thereafter, every corporation in the business of furnishing water, heat, light, or power, whether by means of electricity, gas, or steam, may claim an additional credit of one dollar per ton of coal purchased.¹⁰⁷ To qualify for the credit, the purchased coal must have been mined in Virginia, as certified by the seller.¹⁰⁸ Both of these credits expire for tax years beginning on or after January 1, 2001.¹⁰⁹

102. *Id.* §§ 58.1-3703(B)(14), -3840.

103. *Id.* § 58.1-3703(B)(14).

104. *Id.* § 58.1-3840.

105. *Id.* § 58.1-2626.1(A).

106. *Id.* § 58.1-2626.1, editor's note.

107. *Id.* § 58.1-2626.1(C).

108. *Id.*

109. *Id.* § 58.1-2626.1, editor's note.

II. JUDICIAL DECISIONS

A. *Income Taxation of Foreign Corporate Affiliates*

In *Commonwealth v. General Electric Co.*,¹¹⁰ the Supreme Court of Virginia examined the propriety of the Department of Taxation's combination of the income of a parent corporation with its wholly owned subsidiary. Defendant-taxpayer, General Electric Company ("GE"), a New York corporation doing business in Virginia and subject to Virginia income tax, did not file consolidated Virginia returns with its subsidiaries.¹¹¹ GE's wholly owned subsidiary, General Electric International Sales Company (GE DISC), a Delaware corporation, did not engage in business in Virginia and was not subject to income taxation in Virginia.¹¹² GE DISC is a domestic international sales corporation under sections 991-997 of the Internal Revenue Code.¹¹³

GE DISC was exempt from federal income taxation, however, one-half of its income was treated as a deemed dividend to GE for federal income tax purposes. Taxation of the remaining income was deferred.¹¹⁴ Under former Code section 58-151.083, the Department of Taxation, in connection with an audit, required GE to include in its Virginia taxable income the tax-deferred income of GE DISC.¹¹⁵

The relevant provision of Code section 58-151.083 provided, "In case it shall appear to the Department of Taxation that any arrangements exist in such a manner or improperly to reflect the business done or the Virginia taxable income earned from business done in this State, the Department of Taxation may, in such manner as it may determine, equitably adjust the tax."¹¹⁶

In assessing additional Virginia taxes, the Department took the position that, were it not for the provisions of the statute in question,

110. 236 Va. 54, 372 S.E.2d 599 (1988).

111. *Id.* at 58, 372 S.E.2d at 602.

112. *Id.*

113. *Id.* "The purpose of the federal DISC legislation, enacted in 1971, was to stimulate this country's export activity by providing corporations with the opportunity to defer a portion of export income." *Id.*

114. *Id.* at 59, 372 S.E.2d at 603.

115. *Id.* at 61-62, 372 S.E.2d at 604.

116. VA. CODE ANN. § 58-151.083 (Repl. Vol. 1974). In 1971, the General Assembly adopted income tax conformity designed to conform Virginia's income, estate, and gift tax laws with federal income, estate, and gift tax laws. 1971 Va. Acts 203.

General Electric would be able to minimize its Virginia taxable income subject to apportionment. This could be accomplished by shifting as much of its income from export sales of goods manufactured in Virginia and the United States into the "paper corporation GE DISC" as it is legally permitted to do under the federal DISC laws through an arrangement between the parent-taxpayer and its wholly owned subsidiary.¹¹⁷

Looking at the legislative intent behind the enactment of the statute in question, the Supreme Court of Virginia held that the Department of Taxation "acted with the express statutory authority of Code § 58-151.083 in requiring consolidated tax reporting and in adjusting the taxes in question."¹¹⁸ Noting the addition of the relevant sentence of Code section 58-151.083 at the time of the adoption of conforming language in 1971, the Supreme Court of Virginia stated:

We construe this action to be an affirmative decision by the General Assembly, made at the time it embraced conformity, to provide specifically for a deviation from conformity when, as here, intercorporate relationships exist in such a manner as improperly to reflect the business done or the Virginia taxable income earned from business done in the Commonwealth.¹¹⁹

B. *Assessment of Rolling Stock Tax*

The State Corporation Commission (the "SCC") assessed rolling stock tax against all of the railcars of Winchester and Western Railroad Company (the "Railroad"), an intrastate railroad, in 1982 and 1983. The rolling stock tax was assessed against all railcars owned by the Railroad, including those located and used outside of Virginia.¹²⁰

In *Winchester & West Railroad Co. v. SCC*, the Supreme Court of Virginia upheld the SCC's determination that the Railroad did not satisfy its burden of proving that the railcars not used in Virginia had established a tax situs in other jurisdictions.¹²¹ Noting the United States Supreme Court's position regarding the taxation

117. 236 Va. at 61, 372 S.E.2d at 603.

118. *Id.* at 64, 372 S.E.2d at 605.

119. *Id.* at 65, 372 S.E.2d at 606.

120. *Winchester & W.R.R. v. SCC*, 236 Va. 473, 374 S.E.2d 66 (1988).

121. *Id.* at 481, 374 S.E.2d at 71.

of property used in interstate commerce, the Virginia court stated:

Thus, the Supreme Court is concerned both with over-taxation and under-taxation. The aim is correct taxation, such that property used in interstate commerce is taxed to 100 percent—and no more—of its value by all the taxing jurisdictions which can legitimately assert a right to tax. Because the taxpayer who owns or controls movable property should know where the property is and how it is being utilized, the burden is on the taxpayer to prove the appropriate non-domiciliary tax situs. If the taxpayer fails in this proof, then the domiciliary state can tax the property to 100 percent of its value.¹²²

The Virginia court then noted the manners in which the Railroad could meet its burden of proof as set forth by the United States Supreme Court in *Central Railroad Co. v. Pennsylvania*.¹²³ In *Central R.R. Co.*, the Court determined that there were two ways a railroad could prove that its railcars had established a tax situs in another state: “(1) by proving that the railcars travelled through particular states on fixed and regular routes or (2) by proving that a substantial number of railcars were used on irregular routes in particular states.”¹²⁴ The Virginia court upheld the SCC’s assessment because the Railroad failed to prove either of these facts.

C. *State Corporation Commission Assessment Against Water and Utility Sewer Company*

In *Lake Monticello Service Co. v. Board of Supervisors*,¹²⁵ the Supreme Court of Virginia examined the correctness of the SCC’s tax assessment against certain property owned by Lake Monticello Service Company (“Lake Monticello”). The SCC valued the property, using a cost-less depreciation method, at \$6,900,000. Lake Monticello produced evidence of market value showing that most of its property had no value.¹²⁶

The court held that “if there is evidence of competent market data, the Commission must use that evidence to determine fair market value, rather than evidence of the property’s cost less depreciation.”¹²⁷ Lake Monticello’s market value estimates based on

122. *Id.* at 477, 374 S.E.2d at 69.

123. 370 U.S. 607 (1962).

124. 236 Va. at 478, 374 S.E.2d at 69.

125. 5 V.L.R. 1998 (1989).

126. *Id.*

127. *Id.* at 2002.

comparable sales were rejected by the SCC because the estimates were "based on evidence which showed that the sellers of those allegedly comparable properties were under 'considerable compulsion to get rid of the properties at any price' and that the buyers were not 'willing to buy.'"¹²⁸

The court, reversing the SCC, stated:

The fact that a property is a burden to a seller who is anxious to be rid of it, and that the buyer is relatively disinterested because of the property's lack of profitability is perhaps one of the strongest and most compelling influences on the fair market value of the property.¹²⁹

The court held that the SCC's valuation method was unreasonable because the evidence was sufficient to sustain Lake Monticello's position that the assets in question had no value.

D. Lessee as Proper Party for Personal Property Tax Assessment

Reynolds Metals Co. ("Reynolds") leased equipment used in its business located in Henrico County, Virginia. Reynolds, as lessee, filed the personal property tax returns and paid the taxes on behalf of the lessor. Reynolds and the lessor filed an application for correction of erroneous assessment.¹³⁰ Pursuant to a demurrer filed by Henrico County, Reynolds was dismissed as a party to that action. In *Reynolds Metal Co. v. County of Henrico*,¹³¹ the Supreme Court of Virginia held that Reynolds was a proper party, regardless of the fact that it was not the owner of the property, because Reynolds paid the taxes and was the entity aggrieved by any overpayment. "Reynolds' interest in the property tax assessment clearly makes it a party aggrieved by the assessment and, therefore, entitled to bring an action under section 58.1-3984."¹³²

128. *Id.* at 2003.

129. *Id.*

130. *Reynolds Metal Co. v. County of Henrico*, 5 V.L.R. 2389 (1989).

131. *Id.*

132. *Id.* at 2391.

III. REGULATIONS

The Virginia Department of Taxation issued several final regulations this year and one emergency regulation. All of these regulations applied to income taxes.

A. *Estimated Income Taxes of Individuals and Fiduciaries*

Final Regulations V.R. 630-2-490.1, -490.2, and -492 pertain to the declaration of estimated income tax by individuals and the failure by an individual to pay estimated tax.¹³³ These regulations reflect the new requirement that ninety percent of the taxpayer's tax liability be paid to avoid penalties, rather than eighty percent as under prior law.¹³⁴ Final Regulations 630-5-490, -491, and -492, regarding the estimated tax provisions applicable to fiduciaries, establish procedures regarding the new requirement (effective January 1, 1988) that estates and trusts make estimated tax payments.¹³⁵ These rules generally parallel the federal rules regarding the payment of estimated taxes by estates and trusts.

B. *Excess Cost Recovery*

The Virginia Department of Taxation issued final regulations regarding excess cost recovery that apply to individuals and corporations. Regulations 630-2-323.1 and 630-3-323.1 set forth the rules and procedures for claiming, as subtractions outstanding, balances of excess cost recovery for ACRS additions previously included in income.¹³⁶

C. *Foreign Sales Corporations*

Final Regulation 630-3-446.1 establishes procedures regarding the income tax treatment of corporations that own and transact business with affiliated corporations that qualify as foreign sales corporations, small foreign sales corporations, and domestic international sales corporations under the Internal Revenue Code.¹³⁷ The Regulation is effective for taxable years beginning on or after January 1, 1985.¹³⁸

133. 5 Va. Regs. Reg. 984-990 (Jan. 2, 1989).

134. *Id.*

135. *Id.* at 990-996.

136. 5 Va. Regs. Reg. 2550-2567 (June 5, 1989).

137. 5 Va. Regs. Reg. 594-595 (Nov. 21, 1988).

138. *Id.* at 594.

D. *Withholding Lottery Winnings*

The Department of Taxation promulgated one emergency regulation, Regulation 630-6-4006, which sets forth procedures for the State Lottery Department to follow regarding the withholding of income taxes from lottery winnings.¹³⁹ This regulation took effect September 27, 1988.¹⁴⁰

139. 5 Va. Regs. Reg. 214-15 (Oct. 24, 1988).

140. *Id.* at 214.

