

TAXATION

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INTRODUCTION

This article reviews significant recent developments in the laws affecting Virginia state and local taxation. Each section covers legislative activity, judicial decisions, and selected opinions or pronouncements from the Virginia Department of Taxation (the “Tax Department”) and the Virginia Attorney General over the past year.

Part I of this article addresses state taxes. Part II of this article covers local taxes, including real and tangible personal property, natural gas consumption tax, recordation tax, and administrative local tax procedures.

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 will most likely impact them. However, this article does not discuss many of the numerous technical legislative changes to Title 58.1 of the Virginia Code covering taxation.

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I. TAXES ADMINISTERED BY THE VIRGINIA DEPARTMENT OF TAXATION

A. *Significant Legislative Activity*

1. Fixed Date of Conformity

The 2016 Virginia General Assembly amended Virginia Code section 58.1-301, which mandates conformity with the terms of the Internal Revenue Code (“IRC”), to advance Virginia’s fixed date of conformity from December 31, 2014 to December 31, 2015.¹ This advancement allows Virginia to conform to the federal Protecting Americans from Tax Hikes Act of 2015 (“PATH Act”),² as well as other federal tax legislation enacted during 2015. Specifically, Virginia will conform to the extended deadlines and changes for a number of federal provisions, the more significant include the following:

(1) Under IRC section 179, the PATH Act permanently extends both the \$500,000 deduction limitation and the \$2 million threshold, and indexes both items for inflation, as well as other changes relating to qualified real property, off-the-shelf computer software, and air conditioning and heating units all qualifying for expensing under section 179;³

(2) modifies the above-the-line deduction for certain expenses of elementary and secondary school teachers by indexing the \$250 deduction limitation for inflation, and broadening the scope of the deduction to include professional development expenses;⁴

(3) expands the charitable deduction for contributions of food inventory by increasing the limitation on deductible contributions

1. Act of Feb. 24, 2016, ch. 19, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-301(B) (Cum. Supp. 2016)); Act of Feb. 5, 2016, ch. 2, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-301(B) (Cum. Supp. 2016)); see VA. DEPT OF TAXATION, PUB. DOC. 16-6 (Feb. 5, 2016), <http://tax.virginia.gov/laws-rules-decisions/tax-bulletins/16-1>.

2. Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, 129 Stat. 3040; see VA. DEPT OF TAXATION, PUB. DOC. 16-6 (Feb. 5, 2016), <http://tax.virginia.gov/laws-rules-decisions/tax-bulletins/16-1>.

3. Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, § 124, 129 Stat. 3040, 3053.

4. *Id.* § 104.

of food inventory from 10 percent to 15 percent of the taxpayer's adjusted gross income;⁵ and

(4) removes, as a tax planning strategy, the elimination of tax for corporations that spinoff assets into newly formed subsidiaries, including real estate investment trusts ("REITs").⁶

Prior to the enactment of the PATH Act, when a REIT received real estate assets in a tax-free spinoff and then sold such assets for a gain and distributed the proceeds to its shareholders as dividends, it paid no tax on such transaction because it was permitted to deduct the amount of dividends paid to its shareholders.⁷ The result of the PATH Act legislation is to prohibit such spinoffs involving REITs from qualifying as tax-free spinoffs.

The new Virginia conformity legislation continues to disallow the special bonus depreciation allowance for certain property provided for under IRC sections 168(k), 168(l), 168(m), 1400L, and 1400N,⁸ as well as the five-year carry back period for certain net operating losses under IRC section 172(b)(1)(H).⁹ Virginia tax law also continues to disallow the income tax deductions related to applicable high yield discount obligations under IRC section 163(e)(5)(F) and the deferral of income from the debt cancellation under IRC § 108(i),

unless the taxpayer elects to include such income . . . ratably over a three-taxable-year period beginning with taxable year 2009 for transactions completed in taxable year 2009, or over a three-taxable-year period beginning with taxable year 2010 for transactions completed in taxable year 2010 on or before April 21, 2010.¹⁰

Virginia conforms to the now permanent enhanced federal earned income tax credit and deduction for state and local taxes for those taxpayers that file an itemized deductions with their federal income tax returns.¹¹

5. *Id.* § 113.

6. *Id.* § 311.

7. See STAFF OF JOINT COMM. ON TAX'N, 114TH CONG., TECHNICAL EXPLANATION OF THE PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015, HOUSE AMENDMENT #2 TO THE SENATE AMENDMENT TO H.R. 2029 168–70 (Comm. Print 2015).

8. VA. CODE ANN. § 58.1-301(B)(1) (Repl. Vol. 2013 & Cum. Supp. 2016).

9. *Id.* § 58.1-301(B)(2) (Repl. Vol. 2013 & Cum. Supp. 2016).

10. *Id.* § 58.1-301(B)(3) (Repl. Vol. 2013 & Cum. Supp. 2016).

11. Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, §§ 103, 106, 129 Stat. 3040, 3044–46; VA. CODE ANN. § 58.1-322(D)(1) (Repl. Vol. 2013 & Cum. Supp. 2016).

2. Addback for Captive REIT Dividends Amended

For federal income tax purposes, REITs are effectively exempt from taxation to the extent that such companies distribute their taxable income to their investors.¹² The tax is generally imposed on the dividend received by the REIT investor. Where the investor of a REIT is a corporation, it may receive a dividends received deduction for dividends paid to it by another corporation. This created a tax minimization strategy for corporations that were able to transfer assets into a REIT affiliate so they could use the dividends received deduction in connection with the tax benefits provided by REITs. At the federal level, this tax avoidance strategy has largely been eliminated.¹³

However, for state income tax purposes, many states that allow corporations to file separate tax returns, including Virginia, have a separate dividends received subtraction or deduction that includes no exception for dividends received from a REIT.¹⁴ During the past few years it became a popular state tax minimization strategy for corporations to create a REIT affiliate that is owned or controlled by such corporation, commonly referred to as a “captive REIT.”¹⁵

The tax strategy typically is set up as follows.¹⁶ The parent corporation transfers real estate assets to the captive REIT. The captive REIT then leases such real estate assets back to the parent corporation in exchange for rent. The result is that the parent corporation utilizes the rent payments to shift income to the captive REIT. The captive REIT will claim a deduction from taxable income, which consists of rental income received from the parent

12. This paragraph explains the REIT tax avoidance strategy. See Carolyn Puzella & Jane Steinmetz, *Real Estate Investment Trusts: Under the State Looking Glass*, PRICEWATERHOUSECOOPERS, <http://www.pwc.com/us/en/alternative-investment/assets/mcny-08-0712-alt-puzella-fin.pdf> (last visited Oct. 3, 2016).

13. See Laura Davison, *IRS to Prevent Tax Avoidance in REIT Spinoffs*, BNA BLOOMBERG (June 8, 2016), <http://www.bna.com/irs-seeks-prevent-n57982073817/>.

14. See VA. CODE ANN. § 58.1-402(B)(10) (Repl. Vol. 2013 & Cum. Supp. 2016); Puzella & Steinmetz, *supra* note 12.

15. Sana Siwolop, *Investing IT; Captive REIT's: A Tax Shelter Makes a Comeback*, N.Y. TIMES (May 3, 1998), <http://www.nytimes.com/1998/05/03/business/investing-it-captive-reit-s-a-tax-shelter-makes-a-comeback.html>.

16. The following details the state tax strategy involving REITs. See John A. Biek, *States Push Back Against State Tax Planning With Captive REITs*, J. PASSTHROUGH ENTITIES 17, 17–18 (2007), <http://www.ngelaw.com/files/Publication/fbfd6ddd-3d61-4dc8-a2eb-bf589f5379b5/Presentation/PublicationAttachment/60c0dd4a-5e84-4fcb-a29d-50947a0effba/JPTE.8888.2007Biek.pdf>.

corporation to the extent that it distributes dividends to the parent corporation. The parent corporation may then claim the state dividends received deduction for the dividends it received from the captive REIT. The parent corporation may also deduct the rent it pays to the captive REIT as a business expense. The end result is that the parent corporation, many times, is able to significantly reduce its state income tax liability. Virginia closed down this state tax minimization technique in 2009 when it enacted Virginia Code section 58.1-402(B)(10).¹⁷

The Virginia legislature revisited the captive REIT statute to determine whether a REIT is a captive REIT subject to the Virginia income tax addition when it amended Virginia Code section 58.1-402(B)(10), adding subsection (e) to address the situation where REIT beneficial interests or shares are owned or held in a segregated asset account of a life insurance corporation.¹⁸ Starting January 1, 2016, the General Assembly amended the captive REIT tax statute to exclude those situations where “any voting power or value of the beneficial interests or shares in a REIT that is held in a segregated asset account of a life insurance corporation” from the test that determines whether a REIT is a captive REIT.¹⁹

3. Food Crop Donation Tax Credit Created

The Virginia legislature enacted new Virginia Code section 58.1-439.12:12 to create a nonrefundable tax credit, for corporate and personal income tax purposes, for food crops that are grown by a person engaged in the business of farming and donated by such person to a nonprofit food bank.²⁰ The credit is available “in an amount equal to 30 percent of the fair market value of such food crops donated by the [taxpayer] during the taxable year.”²¹

17. Act of Mar. 27, 2009, ch. 426, 2009 Va. Acts 679, 681–82 (codified as amended at VA. CODE ANN. § 58.1-402(B)(10) (Repl. Vol. 2013 & Cum. Supp. 2016)). For additional information on the Virginia addback statute for captive REITs, see Craig D. Bell, *Annual Survey of Virginia Law: Taxation*, 44 U. RICH. L. REV. 599, 601–03 (2009).

18. Act of Mar. 11, 2016, ch. 342, 2016 Va. Acts __, __ (codified as amended at VA CODE ANN. § 58.1-402(B)(10)(e) (Cum. Supp. 2016)).

19. VA. CODE ANN. § 58.1-402(B)(10)(e) (Cum. Supp. 2016).

20. Act of Mar. 11, 2016, ch. 391, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. §§ 58.1-322(B)(11), -402(B)(11), -439.12:12 (Cum. Supp. 2016)); Act of Mar. 7, 2016, ch. 304, 2016 Va. Acts __, __ (codified as amended at VA CODE ANN. §§ 58.1-322(B)(11), -402(B)(11), -439.12:12 (Cum. Supp. 2016)).

21. VA. CODE ANN. § 58.1-439.12:12(B) (Cum. Supp. 2016).

The food crop donation tax credit will only be permitted if,

(i) the use of the donated food crops by the donee nonprofit food bank is related to providing food to the needy, (ii) the donated food crops are not transferred for use outside [Virginia] or used by the donee nonprofit food bank as consideration for services performed or personal property purchased, and (iii) the donated food crops, if sold by the donee nonprofit food bank, are sold to the needy, other nonprofit food banks, or organizations that intend to use the food crops to provide food to the needy.²²

Under the new tax credit legislation, the Virginia Tax Commissioner is prohibited from issuing more than \$250,000 in tax credits in any fiscal year, and taxpayers are required to submit an application to the Virginia Department of Taxation “in accordance with the forms, instructions, dates, and procedures prescribed by the [Tax] Department.”²³ “Any [tax] credit not usable for the taxable year for which the credit was first allowed may be carried [forward for] . . . the next five succeeding taxable years or until the total amount of the tax credit has been taken, whichever is sooner.”²⁴ Additionally, to the extent the tax credit is allowed, the legislation requires an addition to the taxpayer’s federal adjusted gross income for any amount claimed by the taxpayer as a federal income tax deduction for such donation.²⁵ The latter addition prevents the taxpayer from receiving a double tax benefit for the same donation.

4. Research and Development Expenses Tax Credit Amended and Major Research and Development Expense Tax Credit Created

The Virginia legislature made a number of changes to the research and development expenses tax credit and created a new nonrefundable tax credit available for major research and development expenses that exceed \$5 million during a taxable year.²⁶

The General Assembly amended Virginia Code section 58.1-439.12:08 to increase the annual research and development tax credit cap to \$7 million from \$6 million and extended the credit’s

22. *Id.* § 58.1-439.12:12(C) (Cum. Supp. 2016).

23. *Id.* § 58.1-439.12:12(D) (Cum. Supp. 2016).

24. *Id.* § 58.1-439.12:12(E) (Cum. Supp. 2016).

25. *Id.* §§ 58.1-322(B)(11), -402(B)(11) (Cum. Supp. 2016).

26. Act of Mar. 7, 2016, ch. 300, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.12:11(B) (Cum. Supp. 2016)).

expiration date from January 1, 2019 to January 1, 2022.²⁷ The legislation also increased the amount of credits a taxpayer can claim. Prior to this new legislation, businesses were offered a tax credit of 15 percent of the first \$234,000 in research and development expenses they incurred in Virginia or up to 20 percent of that amount if the qualifying research was conducted with a Virginia college or university.²⁸ The recent changes increase the threshold base of expenditures to \$300,000,²⁹ which results in an increase in the tax credit of \$45,000 and \$60,000 respectively for a taxpayer.³⁰ The legislation provides for several other technical revisions on computing the credit where “research and development expenses [were] incurred . . . for the three taxable years immediately preceding the taxable year for which the credit is being determined.”³¹ Lastly, the legislation prohibits a taxpayer with Virginia qualified research and development expenses in excess of \$5 million from claiming the credit.³²

The General Assembly also created a new nonrefundable credit available against corporate and personal income tax for taxpayers with Virginia qualified research and development expenses in excess of \$5 million for a tax year, effective for tax years beginning on or after January 1, 2016 (the “major research and development expenses tax credit”).³³ The major research and development expenses tax credit is available,

in an amount equal to 10 percent of the difference between (i) the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year and (ii) 50 percent of the average Virginia qualified research and development expenses paid or incurred by the taxpayer for the three taxable years immediately preceding the taxable year for which the [tax] credit is being determined.³⁴

If the taxpayer did not pay or incur Virginia qualified research and development expenses in any one of the three taxable years immediately preceding the taxable year for which the credit is being de-

27. Act of Apr. 1, 2016, ch. 661, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.12:08 (Cum. Supp. 2016)); Act of Mar. 7, 2016, ch. 300, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.12:08(B) (Cum. Supp. 2016)).

28. VA. CODE ANN. § 58.1-439.12:08(B) (Cum. Supp. 2015).

29. *Id.* § 58.1-439.12:08(B) (Cum. Supp. 2016).

30. *Id.* § 58.1-439.12:08(E)(1)–(2) (Cum. Supp. 2016).

31. *Id.* § 58.1-439.12:08(C) (Cum. Supp. 2016).

32. *Id.* § 58.1-439.12:08(H) (Cum. Supp. 2016).

33. Act of Mar. 7, 2016, ch. 300, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.12:11(B) (Cum. Supp. 2016)).

34. VA. CODE ANN. § 58.1-439.12:11(B) (Cum. Supp. 2016).

terminated, the [new] credit shall equal five percent of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the . . . year.³⁵

The amount of the major research and development expenses tax credit the taxpayer claimed for each year is limited to 75 percent of the taxpayer's Virginia income tax liability for the year.³⁶ Any unused credit for the year may be carried forward and applied against the taxpayer's income taxes in the next ten succeeding taxable years.³⁷ The General Assembly adopted an aggregate cap for this new tax credit at \$20 million per fiscal year.³⁸ If applications for the tax credit exceed \$20 million for any taxable year, the Tax Department must apportion the credits by dividing \$20 million by the total amount of tax credits approved to determine the percentage of allowed tax credits each taxpayer will receive.³⁹ The legislation also prevents a taxpayer who receives the major research and development expenses tax credit from using the same expenses "as the basis for claiming any other [tax] credit provided under the Code of Virginia."⁴⁰

Lastly, the legislature eliminated the requirement that the Virginia Economic Development Partnership include information regarding the number of applicants and tax credits approved for the research and development expenses tax credit in its annual report on business incentives.⁴¹ This reporting requirement was transferred to the Tax Department, which is now required to include this information in its annual report to the governor on revenue collections by tax source.⁴²

5. Limitations Period Reduced on Collecting Taxes by Tax Department

In 2012, the General Assembly amended Virginia Code section 58.1-1802.1 to reduce the period of limitations for the Tax Department to initiate a collection action by levy, proceeding in

35. *Id.*

36. *Id.* § 58.1-439.12:11(E) (Cum. Supp. 2016).

37. *Id.*

38. *Id.* § 58.1-439.12:11(C) (Cum. Supp. 2016).

39. *Id.* § 58.1-439.12:11(D) (Cum. Supp. 2016).

40. *Id.* §§ 58.1-439.12:08(G), -439.12:11(F) (Cum. Supp. 2016).

41. Act of Mar. 11, 2016, ch. 433, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.12:08(K) (Cum. Supp. 2016)).

42. *Id.*

court, or any other means available to the State Tax Commissioner from ten to seven years from the date of the tax assessment.⁴³ The Tax Department liberally interpreted this statute to mean that as long as it initiated some form of collection action before the seven year limitations period expired, the Tax Department could treat the assessment as timely for continued collection activity until the tax assessment is satisfied.⁴⁴ The legislature overruled this interpretation by adding new language to Virginia Code section 58.1-1802.1, effective for Virginia tax assessments made on and after July 1, 2016, that provides all tax collection efforts must cease seven years after the assessment of the tax, even if the collection efforts were initiated during the seven-year period allowed for the tax collection effort.⁴⁵ The General Assembly inserted an exception, however, providing that the period of limitations on collection shall be suspended while an installment agreement entered into by the taxpayer pursuant to Virginia Code section 58.1-1817 is in effect.⁴⁶ This exception joins two preexisting exceptions that toll the collections limitation period for when the taxpayer's assets are in the control or custody of any state or federal court, and during any period of time the taxpayer is outside of Virginia for a continuous period of at least six months.⁴⁷

6. Exemption from Sales and Use Tax Enacted for Certain Beer-Making Equipment and Materials

The General Assembly enacted Virginia Code section 58.1-609.3(19) to create an exemption from Virginia retail sales and use tax for certain equipment and materials used by qualified licensed brewers if the preponderance of their use is in the manufacturing of beer.⁴⁸ The exemption applies to:

- (i) machinery, tools, and equipment, or repair parts therefor or replacements thereof, fuel, power, energy, or supplies; (ii) materials for

43. Act of May 18, 2012, ch. 840, 2012 Va. Acts 2248 (codified as amended at VA. CODE ANN. § 58.1-1802.1(A) (Repl. Vol. 2013)).

44. VA. DEP'T OF TAXATION, PUB. DOC. 14-177 (Oct. 17, 2014), <http://tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/14-177>.

45. Act of Apr. 1, 2016, ch. 634, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-1802.1(A) (Cum. Supp. 2016)).

46. Act of Apr. 1, 2016, ch. 634, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-1802.1(B) (Cum. Supp. 2016)).

47. VA. CODE ANN. § 58.1-1802.1(B) (Cum. Supp. 2015).

48. Act of Apr. 6, 2016, ch. 709, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-609.3(19) (Cum. Supp. 2016)).

future processing, manufacturing, or conversion into beer where such materials either enter into the production of or become a component part of the beer; and (iii) materials, including containers, labels, sacks, cans, bottles, kegs, boxes, drums, or bags for future use, for packaging the beer for shipment or sale.⁴⁹

The new exemption applies only if the eligible tangible personal property is used in the manufacture of beer by brewers holding brewery licenses or limited brewery licenses issued by the Virginia Alcoholic Beverage Control Board under Virginia Code section 4.1-208(1) and (2).⁵⁰

7. Interest on Sales and Use Tax Refund Claims Disallowed in Certain Situations

The legislature enacted Virginia Code section 58.1-623(E) to prohibit any purchaser from receiving interest on a Virginia retail sales and use tax refund claim for any period before the purchaser submits a complete refund claim to the Tax Department where the purchaser held an exemption certificate previously issued by the Tax Department at the time of purchase, but failed to present it to the merchant.⁵¹ The new legislation does “not apply to transactions exempted under self-executing certificates of exemption not issued to a specific taxpayer by the [Tax] Department.”⁵²

B. *Recent Judicial Decision: Kohl’s Department Stores, Inc. v. Virginia Department of Taxation*

The Circuit Court of the City of Richmond recently held that because royalty payments to a company’s affiliate were not actually taxed in other states, the addback safe harbor exception contained in Virginia Code section 58.1-402(B)(8)(a)(1) did not apply.⁵³ In *Kohl’s Department Stores, Inc. v. Virginia Department of Taxation*, Kohl’s filed for a refund of corporate income taxes based on the amount of royalty expenses it paid to its affiliate, Kohl’s Illinois, claiming it qualified for a safe harbor exception to the

49. VA. CODE ANN. § 58.1-609.3(19) (Cum. Supp. 2016).

50. *Id.*

51. Act of Mar. 25, 2016, ch. 484, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-623(E) (Cum. Supp. 2016)); Act of Mar. 7, 2016, ch. 303, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-623(E) (Cum. Supp. 2016)).

52. VA. CODE ANN. § 58.1-623(E) (Cum. Supp. 2016).

53. *Kohl’s Dep’t Stores, Inc. v. Va. Dep’t of Taxation*, 91 Va. Cir. 499, 505–06 (2016) (City of Richmond).

addback statute because the royalty payments were included as taxable income by Kohl's Illinois on its other out-of-state income tax returns.⁵⁴ According to Kohl's, "under the plain meaning of [Virginia Code section] 58.1-402(B)(8)(a), if income is included in the computation of a corporation's taxable income in another state, then that income is subject to tax."⁵⁵ Kohl's further claims that "because Kohl's Illinois included the royalty payments it received from Kohl's . . . it is 'subject to a tax . . . in another state' and falls within the safe harbor exception," and thereby should not be required to addback the royalties paid to Kohl's Illinois on its Virginia tax return.⁵⁶ In essence, Kohl's argument is that no portion of the royalties paid to Kohl's Illinois should be added to Kohl's Department Stores, Inc.'s taxable income, even if the amounts listed by Kohl's Illinois in other states is not actually taxed in those states.

On cross motions for summary judgment, the circuit court granted summary judgment for the Virginia Tax Department denying Kohl's Department Stores, Inc.'s motion for summary judgment.⁵⁷ The court determined that the plain language of the Virginia addback statute supports the Tax Department's argument.⁵⁸ Specifically, the court noted that "to fall within the safe harbor exception, the [royalty expenses] paid to [an affiliate] must not only be subject to a tax in another state, but that tax must actually be imposed."⁵⁹ On May 3, 2016, Kohl's Department Stores, Inc. filed its notice of appeal.⁶⁰

C. Tax Department Releases Revised Pass-Through Entity Withholding Guidelines

In 2007, the General Assembly enacted Virginia Code section 58.1-486.2 which imposes a withholding tax on any pass-through entity doing business in Virginia and having taxable income de-

54. *Id.* at 504.

55. *Id.* at 505.

56. *Id.* (quoting VA. CODE ANN. § 58.1-402(B)(8)(a)(1) (Repl. Vol. 2013 & Cum. Supp. 2016)).

57. *Id.* at 506.

58. *Id.*

59. *Id.* at 505.

60. Notice of Appeal, Kohl's Dep't Stores, Inc. v. Va. Dep't of Taxation, No. 160681 (Va. filed May 3, 2016).

rived from Virginia sources.⁶¹ Later that year, the Tax Department published guidelines regarding the pass-through entity withholding tax.⁶² On December 22, 2015, the Tax Department published new pass-through entity withholdings guidelines that superseded the 2007 pass-through entity withholding guidelines.⁶³ The new guidelines provide the Tax Department's interpretation of the relevant laws and cover such topics as (1) pass-through entity electronic filing mandate; and (2) pass-through entity withholding tax requirements and exemptions from the withholding requirements based on the non-Virginia owner's nonresident status.⁶⁴ The new guidelines provide a number of examples designed to address situations involving individuals and entities exempt from taxation, individuals and corporations with no Virginia income tax liability, tiered pass-through entities, and individuals who are included in composite returns.⁶⁵ They also provide guidance on how to claim an exemption for both nonresident owners and exemptions based on the pass-through entity's status.⁶⁶ The guidelines provide information on how the pass-through entity withholding tax is computed and composed, its filing requirements, and a discussion on penalties and interest for non-compliance.⁶⁷ Lastly, it provides information and examples to assist with the application of corporate allocation and apportionment relating to "its proportionate share of property, payroll, and sales for purposes of determining its Virginia apportionment factor."⁶⁸

61. Act of Mar. 23, 2007, ch. 796, 2007 Va. Acts 1216, 1216 (codified at VA. CODE ANN. § 58.1-486.2 (Repl. Vol. 2013)).

62. VA. DEP'T OF TAXATION, PUB. DOC. 07-150 (Sept. 21, 2007), <http://tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/07-150>.

63. VA. DEP'T OF TAXATION, PUB. DOC. 15-240 (Dec. 22, 2015), <http://tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/15-240>.

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

II. TAXES ADMINISTERED BY LOCALITIES

A. Recordation Taxes

1. Exemption for Documents Recorded Pursuant to a Divorce Decree

The legislature enacted Virginia Code sections 58.1-811(A)(15) and 58.1-811(A)(16) to provide an exemption from the recordation tax for “deed[s] of partition, or any combination of deeds simultaneously executed and having the effect of a deed of partition, among joint tenants, tenants in common, or coparceners” and “deed[s] transferring property pursuant to a decree of divorce or of separate maintenance or pursuant to a written instrument incident to . . . [a] divorce or separation.”⁶⁹ Prior to this legislation, deeds of partition among joint tenants, tenants in common, or coparceners, and deeds transferring property pursuant to a divorce or a separate maintenance or pursuant to a written instrument incident to divorce or separation, were subject to the recordation tax at the rate of 50 cents on every \$100 of consideration or actual value of the property conveyed.⁷⁰

2. Recordation Tax Exemption for Certain Deeds on Below Median Household Income Owners and Judicial Sales of Tax-Delinquent Property

The General Assembly amended Virginia Code sections 58.1-802 and 58.1-811 to provide an exemption for deeds of trusts or mortgages “[s]ecuring a loan made by . . . an agency of such a locality, to a borrower whose household income does not exceed 80 percent of the area median household income established by the U.S. Department of Housing and Urban Development, for the purpose of erecting or rehabilitating a home for [the] borrower [and] purchas[ing the] land for such home.”⁷¹ Additionally, the legislation provides for an exemption from the grantor’s tax for a

69. Act of Feb. 26, 2016, ch. 37, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-811(A)(15)–(16) (Cum. Supp. 2016)).

70. See VA. CODE ANN. § 58.1-811 (Cum. Supp. 2015).

71. Act of Apr. 1, 2016, ch. 662, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. §§ 58.1-802(A), -811(B)(6) (Cum. Supp. 2016)).

grantor that is a locality at a judicial sale of tax-delinquent property.⁷²

B. Real and Tangible Personal Property: Effective Date for Pollution Control Property Exemption

The legislature enacted a new statute, Virginia Code section 58.1-3667, to provide that once “real or personal property, machinery, equipment, facilities, devices, or real estate improvements required to be certified by a state or local certifying authority for [the purposes of certain local property] tax exemption[, such property is] deemed exempt as of the date the property is placed in service.”⁷³ The new statute applies to the local property tax exemptions for: (1) certified pollution control equipment and facilities; (2) certified storm water management developments and property; (3) certified solar energy equipment, facilities, and devices; and (4) certified recycling equipment, facilities, and devices.⁷⁴

C. Local Tax Administration

1. Access to Confidential Tax Information in Local Property Tax Litigation

The General Assembly amended Virginia Code section 58.1-3984(A) to require that prior to the release of any confidential tax information as protected in Virginia Code section 58.1-3 in an appeal of a local tax assessment, pursuant to discovery or otherwise, the circuit court must order the parties not to disclose, exhibit, or discuss the confidential information, except as provided in a scheduling court order, unless otherwise ordered by the court.⁷⁵ Confidential tax information may only be revealed to or discussed with: (1) the taxpayer or the local government; (2) counsel for the taxpayer or for the local government; (3) outside experts retained

72. *Id.*

73. Act of Feb. 26, 2016, ch. 35, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3667 (Cum. Supp. 2016)).

74. See VA. CODE ANN. §§ 58.1-3660, -3660.1, -3661 (Repl. Vol. 2013 & Cum. Supp. 2016).

75. Act of Apr. 1, 2016, ch. 635, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3984(A) (Cum. Supp. 2016)); Act of Mar. 23, 2016, ch. 460, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3984(A) (Cum. Supp. 2016)).

by or assisting counsel for the parties in preparation for trial; (4) the court or an administrative board and persons employed by them to transcribe or record the testimony or argument at a hearing, trial, or deposition regarding the tax assessment; and (5) any person who is called as a witness in a hearing, trial, or discovery that a party's counsel believes in good faith to be necessary for preparing or presenting the case.⁷⁶ Prior to receiving the confidential information, outside experts and witnesses must sign an acknowledgement of the order and agree to be bound by the terms of such and subject to the jurisdiction of the court for enforcement of the order.⁷⁷ Violations of the confidentiality provision will subject the person to the penalty provided in Virginia Code section 58.1-3(F), which calls for a Class 1 misdemeanor.⁷⁸

2. Electronic Dissemination of Tax Documents

The legislature amended Virginia Code section 58.1-3912 to expand the authority of treasurers, commissioners of the revenue, and other local tax officials to transmit, with written consent of the taxpayer, certain tax documents (i.e., tax bill) by electronic means, such as facsimile transmission or electronic mail, in lieu of sending the bill through first class mail.⁷⁹ Consent of the taxpayer “may be obtained from the taxpayer electronically, subject to reasonable verification of the taxpayer’s identity.”⁸⁰

D. Significant Judicial Decisions

1. *City of Richmond v. Virginia Electric and Power Company*

The issue presented in this consumer utility tax case is whether Virginia Code section 58.1-3814(H) “permits a locality to impose a tax on natural gas consumed for the sole purpose of generating electricity.”⁸¹ Virginia Electric and Power Company (“VEPCO”) is an operator of a gas-fired electric generation station

76. VA. CODE ANN. § 58.1-3984(A) (Cum. Supp. 2016).

77. *Id.*

78. *Id.*; *id.* § 58.1-3(F) (Cum. Supp. 2016).

79. Act. of Apr. 20, 2016, ch. 768, 2016 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3912(F) (Cum. Supp. 2016)).

80. VA. CODE ANN. § 58.1-3912(F)(3) (Cum. Supp. 2016).

81. *City of Richmond v. Va. Elec. & Power Co.*, 290 Va. 70, 72, 787 S.E.2d 161, 162 (2016).

in Richmond.⁸² The City of Richmond sent VEPCO two tax assessments for natural gas consumed at the electric generation station for tax years 2001 through 2008.⁸³ VEPCO availed itself to the administrative appeal procedures to challenge the tax assessments.⁸⁴ Both the City of Richmond and the State Tax Commissioner denied VEPCO's appeal and upheld the tax assessments.⁸⁵ Following the conclusion of the administrative appeal process, the City sent a new assessment to VEPCO, which included the prior assessments for tax years 2001 through 2008, and added in tax years 2009 through 2013.⁸⁶ The new assessment was in the amount of \$7,292,957.26.⁸⁷

VEPCO initiated the trial by challenging the tax assessment and asserting it was not subject to the tax. Specifically, VEPCO argued "that it consumes natural gas at the station to generate electricity, not to furnish heat or light," thereby making its natural gas consumption fall outside the consumer utility tax of Virginia Code section 58.1-3814(H).⁸⁸ The circuit court held that VEPCO was not subject to the consumer utility tax under Virginia Code section 58.1-3814(H) and set the tax assessments aside.⁸⁹ In reaching its decision, the circuit court stated that "to meet the definition of a pipeline distribution company [that is subject to the consumer utility tax], a company must transmit gas through a pipeline for purposes of furnishing heat or light."⁹⁰ It further noted that the Virginia legislature's use of the phrase "for purposes of furnishing heat or light" clarified the purpose for consuming the gas was the focus of Virginia Code section 58.1-3814(H).⁹¹ The circuit court reasoned further from the use of the phrase "heat, light and power" in Virginia Code section 58.1-2600(A), and specifically "the use of the word 'power' alongside the words 'heat' and 'light' in one provision of [section] 58.1-2600(A), juxtaposed with the omission of the word 'power' from the phrase 'furnishing heat or light' in the same section, reflected

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* at 72-73, 787 S.E.2d at 162.

87. *Id.*

88. *Id.* at 73, 787 S.E.2d at 162.

89. *Id.* at 73, 787 S.E.2d at 163.

90. *Id.* at 73, 787 S.E.2d at 162.

91. *Id.*

legislative intent that the term ‘pipeline distribution companies’ exclude companies transmitting gas consumed solely to produce electricity.”⁹² Accordingly, VEPCO’s tax assessments from the City were set aside.⁹³ The City’s appeal to the Supreme Court of Virginia was granted.⁹⁴

On appeal, the City of Richmond argued that VEPCO’s use of its pipeline to deliver gas to its electricity-generating facility falls within the plain reading of Virginia Code section 58.1-3814(H) because “the evidence established that VEPCO combusts natural gas, thereby creating heat, to power electricity-generating turbines.”⁹⁵ Continuing with its argument, the City said the trial court “should not have construed the term ‘heat or light’ by referring to other parts of [Virginia Code section] 58.1-2600(A) not expressly incorporated into [section] 58.1-3814(H).”⁹⁶ The Supreme Court of Virginia disagreed.

The supreme court stated that courts have a “duty to interpret the several parts of a statute as a consistent and harmonious whole so as to effectuate the legislative goal.”⁹⁷ The Supreme Court of Virginia noted that the word “power” can have many meanings, but in the context of the tax statute at issue it means “a source or means of supplying energy . . . especially electricity.”⁹⁸ Accordingly, the court held that “the omission of the word ‘power’ from the definition of ‘pipeline distribution companies’ reflects that the legislature did not intend [section] 58.1-3814(H) to permit localities to impose a tax on natural gas consumed solely for the purpose of generating electricity.”⁹⁹ Finding no error in the circuit court’s interpretation of the statute, the supreme court affirmed the decision.¹⁰⁰

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.* at 73–74, 787 S.E.2d at 163.

96. *Id.* at 74, 787 S.E.2d at 163.

97. *Id.*

98. *Id.* at 75, 787 S.E.2d at 164 (citing *Power*, WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY (1993)).

99. *Id.* at 75–76, 787 S.E.2d at 164.

100. *Id.* at 76, 787 S.E.2d at 164.

2. *Saddlebrook Estate Community Association, Inc. v. City of Suffolk*

The Supreme Court of Virginia held that the definition of “open or common space” in Virginia Code section 58.1-3284(A) includes real property used for a commercial enterprise, but leaves the common area owned by a community association to be excluded from real property assessments where the value of the common area apportioned to each owner’s respective lot in the development as a percentage of the whole subdivision for tax assessment and collection purposes.¹⁰¹

Kings Fork, LLC (“Kings Fork”) owned a parcel of real estate located in the City of Suffolk.¹⁰² Kings Fork set aside part of the land as the Equestrian Center Parcel (“ECP”).¹⁰³ It leased the ECP to David Christiansen and Indian Point Farms, LLC (“Indian Point”) for use as a riding school and stable.¹⁰⁴ The lease also provided that Christiansen and Indian Point would pay all City of Suffolk real estate taxes on the ECP during the term of the lease.¹⁰⁵ The lease anticipated and permitted that Kings Fork’s ownership interest in the ECP would be conveyed later to a future property owner’s association for the surrounding residential subdivision.¹⁰⁶ Once the Saddlebrook Estates Community Association, Inc. (the “Association”) was organized, Kings Fork conveyed to them the ECP and the other common areas by deed of dedication.¹⁰⁷

The Association’s declaration included the ECP within its property, and included that it was leased to Christiansen and Indian Point.¹⁰⁸ Its declaration included an easement of enjoyment in the Association’s property, including the ECP.¹⁰⁹ For tax years

101. *Saddlebrook Estate Cmty. Ass’n, Inc. v. City of Suffolk*, 292 Va. 35, 41–43, 786 S.E.2d 160, 164–65 (2016).

102. *Id.* at 38, 786 S.E.2d at 162.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

2012 through 2015, the City of Suffolk assessed taxes for the Association's ECP and sent the assessments to the Association, in care of Christiansen.¹¹⁰ The assessments were not paid.¹¹¹

At the conclusion of the Association's case in chief, the City moved to strike the evidence.¹¹² The trial court granted the City's motion on the grounds that "the Stable was a commercial enterprise and that the General Assembly did not intend 'open or common space, as used in [Virginia Code section] 58.1-3284.1(A), to include real estate used for the operation of commercial enterprises open to non-members of a property owners' association" and dismissed the complaint with prejudice.¹¹³

On appeal before the Supreme Court of Virginia, the Association argued that the trial court erred in its interpretation of Virginia Code section 58.1-3284.1(A).¹¹⁴ The Association asserted that "the definition of 'open or common space' in the statute does not exclude real property used for commercial enterprises."¹¹⁵ It also argued that "at common law, the value of an easement is assessed against the owner of the dominant estate and the value of the servient estate is reduced accordingly."¹¹⁶

The Supreme Court of Virginia stated that the language used in section 58.1-3284.1(A) is not ambiguous and should receive the effect of its plain meaning.¹¹⁷ Specifically, section 58.1-3284.1(A) states:

[r]esidential or commercial property, which is part of a planned development which contains open or common space, which includes the right by easement, covenant, deed or other interest in real estate, to the use of the open or common space, shall be assessed at a value which includes the proportional share of the value of such open or common space.

All real property used for open or common space pursuant to this section shall be construed as having no value in itself for assessment purposes. Its only value lies in the value that is attached to the residential or commercial property which has a right by easement, covenant, deed or other interest.¹¹⁸

110. *Id.* at 39, 786 S.E.2d at 162.

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* at 39, 786 S.E.2d at 163.

115. *Id.* at 39–40, 786 S.E.2d at 163.

116. *Id.* at 40, 786 S.E.2d at 163.

117. *Id.*

118. VA. CODE ANN. § 58.1-3284.1(A) (Repl. Vol. 2013).

The supreme court noted that under the second paragraph of Virginia Code section 58.1-3284.1(A), the entire value of the fee of the common area is wholly consumed by the easement conveyed for the benefit of the Association's members. Thus, the court held, "the value of the common area to the servient estate, which the Association owns, is reduced to nothing by operation of the statute."¹¹⁹ However, the court stated, "the common area is not exempt from taxation. Rather, the second paragraph [of 58.1-3284.1(A)] sets the value for assessment purposes as the value of the common area provides to the dominant estate (i.e., the lots in the subdivision, which benefit from the easement)."¹²⁰ Therefore, only the lot owners were held liable for the tax assessed on that value in proportion to each owner's respective lot as a percentage of the whole subdivision.¹²¹

The Supreme Court of Virginia, following earlier precedent in *Lake Monticello Owners' Association v. Ritter*,¹²² did not find the fact that the ECP was leased out for use as a stable to disqualify the Association from the benefits of Virginia Code section 58.1-3284.1(A).¹²³ The supreme court found no constitutional problems with the arrangement, reversed the trial court's decision, and entered final judgment for the Association.¹²⁴

E. *Significant Attorney General Opinion*

The Commissioner of the Revenue for the City of Newport News inquired whether the real property tax exemption provided for in Article X, section 6-A(b) of the Virginia Constitution and Virginia Code section 58.1-3219.9 applies to the surviving spouses of members of the armed forces killed in action prior to January 1, 2015.¹²⁵ The issue arose because in November 2014, Virginia approved a constitutional amendment authorizing the General Assembly to provide a real property tax exemption for surviving spouses of armed forces members killed in action.¹²⁶ The constitutional amendment appears in Article X, section 6-A(b) of the Vir-

119. *Saddlebrook Estates Cmty. Ass'n, Inc.*, 292 Va. at 41, 786 S.E.2d at 163.

120. *Id.*

121. *Id.*

122. 229 Va. 205, 327 S.E.2d 117 (1985).

123. *Saddlebrook Estates Cmty. Ass'n, Inc.*, 292 Va. at 41, 786 S.E.2d at 164.

124. *Id.* at 43, 786 S.E.2d at 165.

125. 2015 Op. Va. Att'y Gen. 167, 167.

126. *Id.*

ginia Constitution. The legislature amended Virginia Code section 58.1-3219.9 to implement the exemption.¹²⁷

The attorney general opined that the real property tax exemption “is applicable to the surviving spouses of members of the armed forces who are killed in action at any time prior to, on, or after January 1, 2015, provided all other requirements for the exemption have been met.”¹²⁸ The exemption applies for tax years beginning on or after January 1, 2015.¹²⁹

127. Act of Mar. 23, 2015, ch. 577, 2015 Va. Acts 1251, 1251-52 (codified as amended at VA. CODE ANN. § 58.1-3219.9 (Cum. Supp. 2015)).

128. 2015 Op. Va. Att’y Gen. 167, 169.

129. *Id.*