TAXATION

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INTRODUCTION

This article reviews significant recent developments in the laws affecting Virginia state and local taxation. Its sections cover legislative activity, judicial decisions, and selected opinions or pronouncements from the Virginia Department of Taxation and the Attorney General of Virginia over the past year.

Part I of this article addresses state taxes. Part II covers local taxes, including real and tangible personal property taxes, license taxes, 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, it does not address many of the numerous technical leg-

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islative changes to title 58.1 of the Virginia Code, which covers taxation.

I. TAXES ADMINISTERED BY THE VIRGINIA TAX DEPARTMENT

A. *Significant Legislative Activity*

1. Fixed Date of Conformity with Internal Revenue Code

As in years past, the Virginia General Assembly amended Virginia Code section 58.1-301, the provision mandating conformity with the Internal Revenue Code ("IRC") as of a certain date, to February 9, 2018 from December 31, 2016.[1] This advancement allows Virginia to fully conform to the Disaster Tax Relief and Airport and Airway Extension Act of 2017 ("Disaster Relief Act"),[2] certain limited portions of the Tax Cuts and Jobs Act of 2017 ("2017 Tax Act")[3] and provisions of the Bipartisan Budget Act of 2018[4] other than those that affect only the 2017 taxable year.[5]

The most significant effect of Virginia's conformity with the Disaster Relief Act is the suspension of limitations imposed on charitable contribution deductions for 2017 hurricane relief efforts.[6] Although there were other provisions of the 2017 Tax Act that Virginia elected to conform to,[7] the most effectual change to Virginia tax law was a reduction of the threshold over which medical expenses may be deducted from 10% of adjusted gross income to 7.5%.[8]

1. Act of Feb. 23, 2018, ch. 15, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-301 (Cum. Supp. 2018)).

2. Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, 131 Stat. 1168 (2017).

3. Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

4. Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64 (2018).

5. *See* VA. CODE ANN. § 58.1-301(B)(7) (Cum. Supp. 2018).

6. Section 504 of the Disaster Relief Act temporarily exempted charitable contributions "made for relief efforts in the Hurricane Harvey disaster area, the Hurricane Irma disaster area, or the Hurricane Maria disaster area" from the limitations on charitable deductions imposed by 26 U.S.C. §§ 68 and 170. *See* Disaster Tax Relief and Airport and Airway Extension Act § 504(2)(4)(A)(i)(II), 131 Stat. at 1182.

7. *See* VA. CODE ANN. § 58.1-301(B)(6)(a)–(b) (Cum. Supp. 2018).

8. *See id.* § 58.1-301(B)(6)(c) (Cum. Supp. 2018) (exempting from non-conformity with the 2017 Tax Act "the temporary reduction in the medical expense deduction floor pursuant to § 11027 of the Act"). Section 11027 of the 2017 Tax Act temporarily amended 26 U.S.C. § 213(f) to decrease the threshold for this itemized deduction. Tax Cuts and Jobs Act § 11027, 131 Stat. at 2077.

As has been the case for many years, Virginia still does not conform to a number of federal tax provisions, including the "special depreciation allowance for certain property provided for under [IRC sections] 168(k), 168(l), 168(m), 1400L, and 1400N,"[9] the five-year carry-back period for "certain net operating losses under" IRC section 172(b)(1)(H),[10] and the income tax deductions related to "applicable high yield discount obligations" under IRC section 163(e)(5)(F).[11] Virginia tax law also continues to disallow the income tax deductions related to the deferral of certain income from the debt cancellation under IRC section 108(i),

> unless the taxpayer elects to include such income in the taxpayer's Virginia taxable 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.[12]

2. Income Taxation: Apportionment Formula Changes for Certain Businesses

a. Apportionment Formula Modifications for New Businesses Creating Jobs

The theme of changing corporate taxation in order to stimulate job creation and investment found expression in the Virginia General Assembly. In 2018, the legislature adopted a law[13] that authorizes certain "eligible compan[ies]"—out-of-state companies with no prior property or payroll in the Commonwealth[14] who invest capital and/or create jobs in certain less populous counties ("qualified localit[ies]")[15] over the next six years—to elect a modified apportionment of the companies' Virginia taxable income.[16]

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9. VA. CODE ANN. § 58.1-301(B)(1) (Cum. Supp. 2018).

10. *Id*. § 58.1-301(B)(2) (Cum. Supp. 2018).

11. *Id*. § 58.1-301(B)(3) (Cum. Supp. 2018).

12. *Id*. § 58.1-301(B)(4) (Cum. Supp. 2018).

13. Act of Apr. 9, 2018, ch. 801, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 2.2-115 (Cum. Supp. 2018); *id*. §§ 58.1-405, -408, -417 to -20, -422.1, -422.2 (Cum. Supp. 2018); codified at *id*. § 15.2-958.2:01 (Cum. Supp. 2018); *id*. § 58.1-405.1 (Cum. Supp. 2018)).

14. *See* VA. CODE ANN. § 58.1-405.1(A) (Cum. Supp. 2018) (defining "[t]raded-sector company").

15. *Id*. (listing the localities which qualify under this section).

16. *Id*. § 58.1-405 (Cum. Supp. 2018).

To become an eligible company, the qualified investment must be a new acquisition of real property or improvements to real property worth at least $5 million and in a qualified locality.[17] The qualifying jobs are new jobs of a permanent, full-time nature that pay time and a half the minimum wage.[18] Having made a qualified investment, a company can become eligible if it also creates ten qualifying jobs; without a qualifying investment, the company must create fifty or more qualifying jobs to become eligible.[19] Eligibility must be certified.[20] Corporate restructuring in order to claim this benefit will not be honored.[21]

For an eligible company that elects multifactor apportionment, the company may subtract from the numerator in that formula that part of the company's property connected to the qualifying investment, its payroll in qualified localities, and all of its sales in Virginia during that taxable year.[22] Eligible companies that elect single-factor apportionment of their Virginia taxable income are authorized to subtract some portion of the numerator connected to their taxable activity or property that occurs or is located in the qualified locality, depending on the industry.[23] There are specific provisions for those eligible companies that are motor carriers,[24]

17. *Id.* § 58.1-405.1(A) (Cum. Supp. 2018) (defining "[n]ew capital investment").

18. *See id.* (defining "[n]ew job").

19. *Id.* (defining "eligible compan[ies]" as those corporations or pass-through entities that do "not have any existing property or payroll in Virginia as of January 1, 2018, and on or after January 1, 2018, but before January 1, 2025, (i) either (a) spends at least $5 million on new capital investment in a qualified locality or qualified localities and creates at least 10 new jobs in a qualified locality or qualified localities or (b) creates at least 50 new jobs in a qualified locality or qualified localities; (ii) is a traded-sector company; and (iii) is certified by the Authority as generating a positive fiscal impact pursuant to subsection B" of that section).

20. *Id.* § 58.1-405.1(A)–(B) (Cum. Supp. 2018). The Virginia Economic Development Partnership Authority has been directed to issue guidelines regarding the certification process. *See* Act of Apr. 9, 2018, ch. 801, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 2.2-115(F)(1) (Cum. Supp. 2018)).

21. VA. CODE ANN. § 58.1-405.1(B)(2) (Cum. Supp. 2018).

22. *Id.* § 58.1-408(B) (Cum. Supp. 2018).

23. *Id.*

24. *Id.* § 58.1-417(C) (Cum. Supp. 2018).

financial corporations,[25] construction corporations,[26] railway companies,[27] manufacturing companies,[28] retail companies,[29] or taxpayers with enterprise data center operations.[30] The Department of Taxation has been directed to promulgate guidelines regarding these modifications to the apportionment formulae.[31] Modifications to Virginia taxable income resulting from reliance upon these provisions must be included and detailed with the taxpayer's return.[32]

b. Single Sales Factor Apportionment of Corporate Income for Debt Buyers

Besides amending apportionment formulas for eligible companies that create new jobs and invest in Virginia, the General Assembly also adopted several amendments to existing Virginia Code sections, and added a new Virginia Code section, addressing apportionment of Virginia taxable income for "debt buyers."[33] A "debt buyer" is defined as "an entity and its affiliated entities that purchase nonperforming loans from unaffiliated commercial entities that (i) are in default for at least 120 days or (ii) are in bankruptcy proceedings"; this does not include third-party debt collectors.[34] Under this new legislation, debt buyers are excluded from the general statutory method of multifactor apportionment applicable to corporate income for taxable year 2019 forward.

Instead, debt buyers' Virginia taxable income, excluding income allocable under Virginia Code section 58.1-407, is multiplied only by the sales factor.[35] Significantly, the ordinary rule for whether a

25. *Id*. § 58.1-418(D) (Cum. Supp. 2018).
26. *Id*. § 58.1-419(C) (Cum. Supp. 2018).
27. *Id*. § 58.1-420(B) (Cum. Supp. 2018).
28. *Id*. § 58.1-422(F) (Cum. Supp. 2018).
29. *Id*. § 58.1-422.1(C) (Cum. Supp. 2018).
30. *Id*. § 58.1-422.2(E) (Cum. Supp. 2018).
31. *See* Act of Apr. 9, 2018, ch. 801, 2018 Va. Acts __, __.
32. *See id*. ch. 801, 2018 Va. Acts at __.
33. *See* Act of Apr. 9, 2018, ch. 807, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. §§ 58.1-408, -416 (Cum. Supp. 2018); codified at *id.* § 58.1-422.3 (Cum. Supp. 2018)).
34. VA. CODE ANN. § 58.1-422.3(A) (Cum. Supp. 2018).
35. *Id*. § 58.1-422.3(B) (Cum. Supp. 2018). The sales factor "is a fraction, the numerator of which is the total sales of the corporation in the Commonwealth during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year, to the extent that such sales are used to produce Virginia taxable income and are effectively connected with the conduct of a trade or business within the United States

sale of other than tangible personal property is included in the numerator of the sales factor—whether the "income-producing activity is performed in the Commonwealth" or whether the greater cost of performing the income-producing activity is performed in the Commonwealth[36]—has been superseded for debt buyers. For debt buyers, sales are deemed to be in the Commonwealth only if the sales "consist of money recovered on debt that a debt buyer collected from a person who is a resident of the Commonwealth or an entity that has its commercial domicile in the Commonwealth," regardless of where the debt buyer is located and the income producing activity is performed.[37]

Under this legislation, a multistate debt buyer based in Virginia with significant collections from debtors across the United States would have a relatively smaller sales factor and, presumably, a smaller total apportionment factor. In comparison, similar debt buyers based outside the Commonwealth may have a relatively larger sales factor and total apportionment formula.

The Tax Commissioner and Department of Taxation are directed to vigorously enforce this apportionment formula for debt buyers and "assert the taxpayer's nexus with the Commonwealth to the maximum extent permitted under the Constitutions of Virginia and the United States and federal law."[38] The Department of Taxation is directed to "develop and make publicly available guidelines implementing the provisions of this act," and to "cooperate with and seek the counsel of interested groups," including via "a public hearing" prior to promulgating any guidelines.[39] Preliminary guidelines are required by the end of 2018, final guidelines by the end of 2019, and updated guidelines by the end of 2021.[40]

and income therefrom is includable in federal taxable income." *Id.* § 58.1-414 (Repl. Vol. 2017).

36. *See id.* § 58.1-416(A) (Cum. Supp. 2018).

37. *Id.* § 58.1-416(B) (Cum. Supp. 2018). The debt buyer taxpayer may use a reasonable estimate, reached in good faith and not for the principal purpose of avoiding taxes, of the dollar value and portion of its sales in the Commonwealth where necessary information is not available. *Id.* § 58.1-416(D) (Cum. Supp. 2018). The Department of Taxation must ultimately conclude that the estimate satisfies these criteria. *Id.*

38. *Id.* § 58.1-416(C) (Cum. Supp. 2018).

39. Act of Apr. 9, 2018, ch. 807, 2018 Va. Acts __, __.

40. *See id.* ch. 807, 2018 Va. Acts at __.

c. Credits and Deductions Against Income Taxation: Tax Credit for Coal and Coalbed Methane Mined Revived and Revised

Besides changes to the amount of taxable income to be reported, the General Assembly in 2018 also revived a preexisting tax credit program applicable to some coal and coalbed methane extraction, the Coalfield Employment Enhancement Tax Credit.[41] For taxable years 2018 through 2022, persons with "an economic interest[42] in coal mined in the Commonwealth shall be allowed a credit against" state taxes, including corporate income tax, of certain amounts for tons of metallurgical coal mined[43] and for millions of British Thermal Units ("BTUs") of coalbed methane produced in the Commonwealth.[44] The limitation on metallurgical coal revises the pre-existing tax credit program.[45]

As before, the amount of the credit varies by method of extraction: more per ton of coal mined by underground methods,[46] and still more for coal mined underground from seams of thirty-six inches or less,[47] but less per ton of coal mined using surface mining methods.[48] As under the earlier tax credit program, the thickness of the coal seam must be certified by a professional engineer and copies of such certification must be maintained by the taxpayer claiming the credit.[49]

Similarly, this revived tax credit cannot be claimed until "the third taxable year following the taxable year in which the credit was earned and allowed."[50] As a result, no credits can be claimed

41. Act of May 18, 2018, ch. 855, 2018 Va. Acts __, __.

42. This economic interest "is the same as the economic ownership interest required by § 611 of the Internal Revenue Code which was in effect on December 31, 1977"; one "who only receives an arm's length royalty" lacks an economic interest in coal. VA. CODE ANN. § 58.1-439.2(C) (Repl. Vol. 2017).

43. *Id.* § 58.1-439.2(A) (Cum. Supp. 2018). Subsection (H) provides the definition of "metallurgical coal." *Id.* § 58.1-439.2(H) (Cum. Supp. 2018).

44. *Id.* § 58.1-439.2(B) (Cum. Supp. 2018) (allowing "a credit in the amount of one cent ($0.01) per million BTUs of coalbed methane produced in the Commonwealth").

45. *See, e.g.*, *id.* § 58.1-439.2(A) (Cum. Supp. 2016) (making no distinction between types of coal "mined by underground methods").

46. *Id.* § 58.1-439.2(A)(1) (Cum. Supp. 2018) (allowing a $1.00 credit per ton of metallurgical coal mined from seams thicker than thirty-six inches).

47. *Id.* (allowing a $2.00 credit per ton of metallurgical coal mined from seams less than thirty-six inches thick).

48. *Id.* § 58.1-439.2(A)(2) (Cum. Supp. 2018) (allowing "a credit in the amount of 40 cents ($0.40) per ton for coal sold in 1996, and each year thereafter").

49. *Id.* § 58.1-439.2(A)(1) (Repl. Vol. 2016 & Cum. Supp. 2018).

50. *Id.* § 58.1-439.2(G) (Cum. Supp. 2018).

until taxable year 2021. The Department of Taxation is directed to "develop and make publicly available guidelines implementing the provisions of this act."[51]

d. Corporate Agricultural Best Management Practices Tax Credit Made Refundable

Since 1998, corporations "engaged in agricultural production for market[s] who ha[ve] in place a soil conservation plan approved by the local Soil and Water Conservation District" could claim credits against their Virginia corporate tax liability in "an amount equaling twenty-five percent of the first $70,000 expended for agricultural best management practices by the corporation."[52] In effect antipollution measures, these agricultural best management practices are those "practice[s] approved by the Virginia Soil and Water Conservation Board (VSWCB) which will provide a significant improvement to water quality in the state's streams and rivers and the Chesapeake Bay and [are] consistent with other state and federal programs that address agricultural, nonpoint-source-pollution management." [53]

Under prior law, the tax credits could be "carried over for credit against income taxes in the next five taxable years until the total amount of the tax credit has been taken."[54] By an act of the General Assembly in 2018,[55] if a corporation has excess credits from expenditures on an agricultural best management practice, "the excess shall be refunded by the Tax Commissioner . . . . on behalf of the Commonwealth for 100 percent of face value . . . . [and] within 90 days after the filing date of the income tax return on which the taxpayer applies for the refund."[56] Accordingly, corporations can now claim a refund on equal terms as a noncorporation.[57]

51. Act of May 18, 2018, ch. 855, 2018 Va. Acts __, __.

52. Act of Apr. 5, 1996, ch. 629, 1996 Va. Acts 1096, 1097 (codified at VA. CODE ANN. §§ 58.1-339.2, -439.4(A) (Cum. Supp. 1996)).

53. VA. CODE ANN. § 58.1-439.5(A) (Repl. Vol. 2017).

54. *Id*. § 58.1-439.5(C) (Repl. Vol. 2017).

55. Act of Mar. 30, 2018, ch. 556, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.5 (Cum. Supp. 2018)).

56. VA. CODE ANN. § 58.1-439.5(C)(2) (Cum. Supp. 2018).

57. *See id*. § 58.1-339.3(C)(2) (Repl. Vol. 2017).

e. Land Preservation Tax Credit Transferrable on Death

Virginia law affords substantial, nonrefundable tax credits against Virginia income tax liability, presently in an amount equal to "40 percent of the fair market value of the land or interest in land" "located in Virginia" that

> is conveyed for the purpose of agricultural and forestal use, open space, natural resource, and/or biodiversity conservation, or land, agricultural, watershed and/or historic preservation, as an unconditional donation by the landowner/taxpayer to a public or private conservation agency eligible to hold such land and interests therein for conservation or preservation purposes.[58]

Only so many of the credits may be taken in any one year, in no case more than $100,000, and then never more than "the amount of individual, fiduciary or corporate income tax otherwise due."[59]

Unused credits may be carried over for ten years "following the taxable year in which the credit originated until fully expended" or as many as thirteen years for credits that originated in taxable years 2009, 2010, 2011, 2015, and thereafter.[60] Besides carrying over such credits, the taxpayer can also "transfer unused but otherwise allowable credit for use by another taxpayer on Virginia income tax returns," subject to a transfer fee.[61]

Under the 2018 amendment to Virginia Code section 58.1-513,[62] an individual taxpayer can also "provide through a will, bequest, or other instrument of transfer that, upon his death, his unused credit shall be transferred to a designated beneficiary."[63] And, in the absence of a will, such unused credits will pass as part of the estate under the rules of intestate succession.[64] This provision applies to all such transfers of credits on or after July 1, 2018, "regardless of when such unused credits were earned."[65] However, note that the timeline for usage of the credits is not extended or

58. *Id.* § 58.1-512(A) (Repl. Vol. 2017).
59. *Id.* § 58.1-512(C)(1) (Repl. Vol. 2017).
60. *Id.*
61. *Id.* § 58.1-513(C)(1)–(2) (Repl. Vol. 2017).
62. Act of Mar. 30, 2018, ch. 560, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-513 (Cum. Supp. 2018)).
63. VA. CODE ANN. § 58.1-513(C)(3) (Cum. Supp. 2018).
64. *Id.*
65. Ch. 560, 2018 Va. Acts at __ (codified as amended at VA. CODE ANN. § 58.1-513 (Cum. Supp. 2018)).

otherwise affected by transfer of the credits as a bequest or via intestacy.[66]

f. Worker Retraining Tax Credit Expansion for Manufacturers

Virginia Code section 58.1-439.6(B) provides that an employer can claim "30 percent of all expenditures paid or incurred by the employer during the taxable year for eligible worker retraining."[67] Only expenditures paid or incurred to retrain employees "in a full-time position requiring a minimum of 1,680 hours in the entire normal year of the employer's operations if the standard fringe benefits are paid by the employer for the employee" can generate any credits.[68]

Under amended and reenacted Virginia Code section 58.1-439.6(B),[69] the General Assembly expanded the scope of the Worker Retraining Tax Credit for certain businesses, offering up to $2000 in tax credits against individual or corporate income tax liability for expenditures on courses provided to junior high and high school students.[70] The credit, however, is not limited to assembly-line-style manufacturing, but extends to all businesses who are primarily engaged in "processing, manufacturing, refining, mining, or converting products for sale or resale."[71]

The tax credit is earned for "direct costs incurred . . . in conducting orientation, instruction, and training in the Commonwealth relating to the manufacturing activities undertaken by the business," and at a rate of 35% for every dollar.[72] Instead of limiting the credit

66. VA. CODE ANN. § 58.1-513(C)(3) (Cum. Supp. 2018).

67. *Id.* § 58.1-439.6(B) (Repl. Vol. 2017). "Eligible worker retraining" is defined as "retraining of a qualified employee that promotes economic development in the form of (i) non-credit courses at any of the Commonwealth's comprehensive community colleges or a private school or (ii) worker retraining programs undertaken through an apprenticeship agreement approved by the Commissioner of Labor and Industry." *Id.* § 58.1-439.6(A) (Repl. Vol. 2017).

68. *Id.* § 58.1-439.6(A) (Repl. Vol. 2017) (defining "qualified employee").

69. Act of Mar. 29, 2018, ch. 500, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.6 (Cum. Supp. 2018)).

70. VA. CODE ANN. § 58.1-439.6(B)(2) (Cum. Supp. 2018).

71. *Id.* (authorizing a credit to a "business primarily engaged in manufacturing"); *id.* § 58.1-439.6(A) (Cum. Supp. 2018) (defining "manufacturing" to mean "processing, manufacturing, refining, mining, or converting products for sale or resale").

72. *Id.* § 58.1-439.6(B)(2) (Cum. Supp. 2018). "Direct costs" are limited to

> the following expenditures: (a) salaries or wages paid to instructors and trainers, prorated for the period of instruction or training; (b) costs for orientation, instruction, and training materials; (c) amounts paid for machinery and equipment used primarily for such instruction and training; and (d) the cost of leased

to retraining of current full-time employees, as under prior law, new subsection (B)(2) authorizes credits to be awarded

> for programs that (i) provide orientation, instruction, and training solely to students in grades six through 12; (ii) are coordinated with the local school division; and (iii) are conducted either at a plant or facility owned, leased, rented, or otherwise used by the business or at a public middle or high school in Virginia.[73]

The "orientation, instruction, and training program" must be "approved by the local school division and certified as eligible by the Virginia Economic Development Partnership Authority" in order to generate any credits.[74] And it remains the case that "any program operated, administered, or paid for by the Commonwealth" cannot be the basis for claiming any credit under either subsection (B)(1) or new subsection (B)(2).[75] Only $1 million in total tax credits, whether for worker retraining under subsection (B)(1) or student training by manufacturers under subsection (B)(2), may be issued by the Department of Taxation in any taxable year,[76] a reduction of $1.5 million from prior law.[77]

g. Green Job Creation Tax Credit Extended

The General Assembly, in 2010, created a tax credit against individual or corporate income tax liability "for each new green job created within the Commonwealth by the taxpayer," in the amount of $500 per job, provided the annual salary for such job was $50,000 or more.[78] The credit was slated to sunset at the end of 2014.[79] Back

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or rented space used primarily for conducting the program.

Id.

73. *Compare id.* § 58.1-439.6(B)(2) (Cum. Supp. 2018), *with id.* § 58.1-439.6(A) (Repl. Vol. 2017).

74. *Id.* § 58.1-439.6(D)(2) (Cum. Supp. 2018).

75. *Compare id.* § 58.1-439.6(F) (Cum. Supp. 2018), *with id.* § 58.1-439.6(F) (Repl. Vol. 2017).

76. *Id.* § 58.1-439.6(B)(3) (Cum. Supp. 2018).

77. *See id.* § 58.1-439.6(B) (Repl. Vol. 2017). The Department of Taxation's Fiscal Impact Statement to House Bill 129 noted, however, that under prior law, no more than $235,000 in credits had been issued in any fiscal year from 2012 through 2017. VA. DEP'T OF TAXATION, 2018 FISCAL IMPACT STATEMENT: H.B. 129 (Jan. 16, 2018), https://lis.virginia.gov/cgi-bin/legp604.exe?181+oth+HB129F161+PDF.

78. Act of Apr. 13, 2010, chs. 722, 727, 2010 Va. Acts 1306, 1314 (codified at VA. CODE ANN. § 58.1-439.12:05 (Cum. Supp. 2010)). For more on the statutory program enacted, *see* Craig D. Bell, *Annual Survey of Virginia Law: Taxation*, 45 U. RICH. L. REV. 377, 380–81 (2010).

79. VA. CODE ANN. § 58.1-439.12:05(A) (Cum. Supp. 2011).

in 2015, the green-jobs tax credit was extended through 2017.[80] This year, the General Assembly extended it further, through 2020.[81]

h. Deduction for Investment Income from Virginia REITs

In 2018, the General Assembly adopted other provisions designed to incentivize investment in Virginia, including allowing otherwise-taxable income, whether individual or corporate, to be deducted if resulting from certain investments in Virginia's less-affluent localities.[82] Amended and reenacted Virginia Code sections 58.1-322.02 and 58.1-402 provide that income attributable to an investment made during the period of 2019 through 2024 in certain real estate investment trusts ("REITs")[83] may be deducted from Virginia taxable income for purposes of individual[84] or corporate taxation.[85]

For the deduction from income to be allowed, the Department of Taxation must certify the REIT as a Virginia REIT.[86] To be so certified, the REIT must register with the Department of Taxation prior to the end of 2024, indicate its intent "to invest at least 90 percent of trust funds in Virginia and at least 40 percent of trust funds in real estate in localities that are distressed or double distressed," and be found to have carried out that intent by the Department of Taxation.[87] Localities that are "distressed" or "double distressed" are defined by certain criteria in Virginia Code sections 2.2-115(E)(2) and (E)(3), respectively, provisions that are part

80. Act of Mar. 23, 2015, ch. 486, 2015 Va. Acts 888, 888–89 (codified as amended at VA. CODE ANN. § 58.1-439.12:05(A) (Cum. Supp. 2015)); Act of Mar. 17, 2015, ch. 249, 2015 Va. Acts 461, 461 (codified as amended at VA. CODE ANN. § 58.1-439.12:05 (Cum. Supp. 2015)).

81. Act of Mar. 19, 2018, ch. 347, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-439.12:05 (Cum. Supp. 2018)).

82. Act of Apr. 18, 2018, ch. 821, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. §§ 58.1-322.02, -402 (Cum. Supp. 2018)).

83. A real estate investment trust is defined by reference to federal law, particularly I.R.C. § 856 (2012 & Supp. IV 2018). *See* VA. CODE ANN. §§ 58.1-322.02(28)(b), -402(26)(b) (Cum. Supp. 2018).

84. *Id.* § 58.1-322.02(28)(a) (Cum. Supp. 2018).

85. *Id.* § 58.1-402(26)(a) (Cum. Supp. 2018).

86. *Id.* §§ 58.1-322.02(28)(b), -402(26)(b) (Cum. Supp. 2018).

87. *Id.*

of the statutes governing the Commonwealth's Development Opportunity Fund.[88]

The Department of Taxation is directed to develop guidelines "establishing procedures implementing the provisions of this act relating to the registration and certification of a real estate investment trust as a Virginia real estate investment trust" by the end of 2018.[89]

i. Reporting Obligations of Income Tax Return Preparers

In 2017, the Virginia General Assembly adopted an antifraud provision requiring employers and payroll-service providers to notify the Virginia Attorney General of breaches of taxpayer information that may lead to identity theft or other fraud, and the Virginia Attorney General to notify the Department of Taxation.[90] In 2018, the General Assembly adopted Virginia Code section 58.1-341.2, extending this reporting obligation to income tax return preparers and requiring direct notification of the Department of Taxation in the event of breach.[91]

In certain circumstances, an "income tax return preparer"[92] who has "primary responsibility for the overall substantive accuracy of the preparation of a return or claim for refund"—a "signing income tax return preparer"—must notify the Department of Taxation "without unreasonable delay after the discovery or notification of unauthorized access and acquisition of unencrypted and unredacted return information."[93] "Return information" involves nonpublic information showing a taxpayer's identity, i.e.,

88. *Id.* § 58.1-115(E)(2)–(3) (Repl. Vol. 2017); *id.* §§ 58.1-322.02(28)(b), -402(26)(b) (Cum. Supp. 2018).

89. Act of Apr. 18, 2018, ch. 821, 2018 Va. Acts __, __.

90. Act of Mar. 13, 2017, ch. 427, 2017 Va. Acts 677, 678 (codified as amended at VA. CODE ANN. § 18.2-186.6 (Cum. Supp. 2017)).

91. Act of Mar. 19, 2018, ch. 360, 2018 Va. Acts __, __ (codified at VA. CODE ANN. § 58.1-341.2 (Cum. Supp. 2018)).

92. This statute incorporates the definition of "[i]ncome tax return preparer" found in Virginia Code section 58.1-302, which defines it as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this chapter or any claim for refund of tax." VA. CODE ANN. § 58.1-302 (Repl. Vol. 2017).

93. *Id.* § 58.1-341.2(A)–(B)(1) (Cum. Supp. 2018).

> the name of a person with respect to whom a return is to be filed and his taxpayer identification number as defined in 26 U.S.C. § 6109,[94] . . . and the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, assessments, or tax payments.[95]

The duty to notify the Department of Taxation is triggered if the access and acquisition of the return information: (1) "compromises the confidentiality of such information maintained by such signing income tax return preparer"; (2) "creates a reasonable belief that an unencrypted and unredacted version of such information was accessed and acquired by an unauthorized person"; and (3) "causes, or such preparer reasonably believes has caused or will cause, identity theft or other fraud."[96]

If the duty to notify arises, the signing income tax return preparer must "provide the Department with the name and taxpayer identification number of any taxpayer that may be affected" by the breach "as well as the name of the signing income tax return preparer, his preparer tax identification number, and such other information as the Department may prescribe."[97] Companies that provide income tax return preparation must "complete the notice required by this section on behalf of any of its employees who are signing income tax preparers and who would otherwise be required to notify the Department [of Taxation]."[98]

3. Sales and Use Taxation: Agricultural Exemption Increased

Virginia law has long exempted a number of agricultural activities from state and local sales and use taxation under Virginia Code chapter 6 of title 58.1.[99] In 2011, the sale of "[a]gricultural produce, as defined in § 3.2-4738" (i.e., fruits and vegetables), "and eggs, as described in § 3.2-5305, raised and sold by an individual at local farmers markets and roadside stands" was added to the list of exemptions, but only "when such individual's annual income from such sales does not exceed $1,000."[100] This year the General

94. *Id.* § 58.1-341.2(A) (Cum. Supp. 2018) (defining "[t]axpayer identity").
95. *Id.* (defining "[r]eturn information").
96. *Id.* § 58.1-341.2(B)(1) (Cum. Supp. 2018).
97. *Id.* § 58.1-341.2(B)(2) (Cum. Supp. 2018).
98. *Id.* § 58.1-341.2(C) (Cum. Supp. 2018).
99. *See generally id.* § 58.1-609.2 (Repl. Vol. 2017).
100. Act of Mar. 24, 2011, ch. 466, 2011 Va. Acts 740, 741 (codified as amended at VA.

Assembly amended Virginia Code section 58.1-609.2 to increase the amount of the exemption to $2500.[101]

B. *Significant Judicial Decisions*

1. Corporate Income Tax

a. *Kohl's Department Stores, Inc. v. Virginia Department of Taxation*

In this case, the Supreme Court of Virginia considered the subject-to-tax exception of Virginia's related party intangible expense add back statute.[102] The majority held that the subject-to-tax exception contained in Virginia Code section 58.1-402(B)(8)(a)(1) "applies only to the extent that the royalty payments were actually taxed by another state" (i.e., on a post-apportionment basis).[103] The court stated that the subject-to-tax exception applies as long as royalties are actually taxed, regardless of which entity paid the tax (i.e., even if paid by an affiliate, as part of a combined filing or statutory add back).[104] The Supreme Court of Virginia reversed the Richmond City Circuit Court decision and remanded the case for further proceedings.[105]

Kohl's Department Stores, Inc. ("Kohl's") "operates retail stores throughout the United States, including Virginia"; "Kohl's Illinois, Inc. . . . , a corporation organized under the laws of Nevada, is an affiliate of Kohl's."[106] Kohl's Illinois, Inc. ("Kohl's Illinois"), does not operate any retail stores in Virginia.[107] Kohl's Illinois "owns, manages, and licenses certain intellectual property," which it licensed to Kohl's; pursuant to the license agreement between Kohl's and Kohl's Illinois, Kohl's paid almost $442 million in royalties to Kohl's Illinois during tax year 2009 and almost $482 million during tax year 2010.[108] When Kohl's calculated its federal taxable income

CODE ANN. § 58.1-609.2 (Cum. Supp. 2011)).

101. Act of Mar. 19, 2018, ch. 362, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-609.2 (Cum. Supp. 2018)).

102. Kohl's Dep't Stores, Inc. v. Va. Dep't of Taxation, 295 Va. 177, 810 S.E.2d 891 (2018).

103. *Id.* at 184, 190, 810 S.E.2d at 896, 899.

104. *See id.* at 191, 810 S.E.2d at 900.

105. *Id.* at 191, 810 S.E.2d at 900.

106. *Id.* at 180, 810 S.E.2d at 894.

107. *Id.* at 180, 810 S.E.2d at 894.

108. *Id.* at 180, 810 S.E.2d at 894.

for 2009 and 2010, "Kohl's deducted these royalty payments from its income as an ordinary and necessary business expense under" section 162(a) of the Internal Revenue Code.[109] In contrast, "Kohl's Illinois included the royalties as income in its taxable income calculations."[110]

Kohl's Illinois wound up not paying state income taxes "on a substantial portion of the royalties."[111] "Each state in which Kohl's Illinois filed a [tax] return only taxed an apportionable share of its taxable income."[112] Necessarily, this left much of the income generated from royalties untaxed.[113]

Virginia is a separate return reporting state. This means that Kohl's files a Virginia tax return in Virginia reporting only income from its Virginia operations.[114] As a separate reporting state, corporate taxpayers calculate their Virginia taxable income by starting with their federal taxable income and then make certain adjustments.[115] One of these adjustments is the requirement to add back "the amount of any intangible expenses and costs . . . paid" to their related members "to the extent such expenses were . . . deducted in computing federal taxable income."[116] The royalty payments paid by Kohl's to Kohl's Illinois were "intangible expenses and costs" paid to a related member, and Kohl's argued that they fell "within the 'subject-to-tax' exception to the add back statute."[117] "This exception provides that the 'addition shall not be required for any portion of the intangible expenses and costs if . . . [t]he corresponding item of income received by the related member is subject to a tax based on or measured by net income or capital imposed by . . . another state.'"[118]

On cross-motions for summary judgment on a fully stipulated case, the Richmond City Circuit Court held that, because Kohl's royalty payments to Kohl's Illinois were not actually taxed in other

109. *Id*. at 180, 810 S.E.2d at 894.
110. *Id*. at 180, 810 S.E.2d at 894.
111. *Id*. at 180, 810 S.E.2d at 894.
112. *Id*. at 180–81, 810 S.E.2d at 894.
113. *See id*. at 181, 810 S.E.2d at 894.
114. *See* VA. CODE ANN. § 58.1-400 (Repl. Vol. 2017).
115. *Id*. § 58.1-402(A) (Repl. Vol. 2017).
116. *Id*. § 58.1-402(B)(8)(a) (Repl. Vol. 2017).
117. *Kohl's*, 295 Va. 182, 810 S.E.2d at 895.
118. *Id*. at 182, 810 S.E.2d at 895 (citing VA. CODE ANN. § 58.1-402(B)(8)(a) (Repl. Vol. 2017)).

states, the add back exception contained in Virginia Code section 58.1-402(B)(8)(a)(1) did not apply.[119] The court granted the Tax Department's motion for summary judgment and denied Kohl's motion.[120]

The arguments made by the parties before the Supreme Court of Virginia were largely the same as those argued at the trial court. Kohl's argued the subject-to-tax exception provides that royalties paid to a related member that were subject to a tax in another state are not added back if that state imposes a tax that is "based on or measured by net income" or capital.[121] Under Kohl's argument, all of the royalties fell within the subject-to-tax exception because they were all included in the taxable income of Kohl's Illinois. In Kohl's view, if the royalty fee "income is included in the computation of a corporation's taxable income in another state, then it is 'subject to a tax based on or measured by net income.'"[122]

The Department of Taxation countered by arguing that "while all of the royalties were included in the taxable income of Kohl's Illinois, a substantial portion of these royalties was not attributable to any state in which Kohl's Illinois filed its returns and, as a result, not subject to a tax imposed by another state."[123] In other words, the Supreme Court of Virginia noted, "Kohl's argue[d] that the subject-to-tax exception applie[d] on a 'pre-apportionment' basis, while the Department [of Taxation] argue[d] that the subject-to-tax exception applie[d] on a 'post-apportionment' basis."[124]

The Supreme Court of Virginia began its review by examining the plain language of Virginia Code section 58.1-402(B)(8). The court found the statute's language ambiguous, holding that "looking only at the plain language of the statute, it is doubtful and uncertain whether the General Assembly intended the subject-to-tax exception to apply on a pre or postapportionment basis."[125] The

119. Kohl's Dep't Stores, Inc. v. Va. Dep't of Taxation, 91 Va. Cir. 499, 504–06 (2016) (Richmond City); *see* Craig D. Bell, *Annual Survey of Virginia Law: Taxation*, 51 U. RICH. L. REV. 103, 112–13 (2016) (discussing the trial court's decision).

120. *Kohl's*, 91 Va. Cir. at 506.

121. *Kohl's*, 295 Va. at 185, 810 S.E.2d at 896.

122. *Id.* at 185, 810 S.E.2d at 896 (quoting VA. CODE ANN. § 58.1-402(B)(8)(a)(1) (Repl. Vol. 2017)).

123. *Id.* at 185, 810 S.E.2d at 896.

124. *Id.* at 185, 810 S.E.2d at 896.

125. *Id.* at 187, 810 S.E.2d at 897.

term "subject-to-tax" is not defined by the Virginia Tax Code.[126] The Supreme Court of Virginia then examined the legislative history of Virginia Code section 58.1-402(B)(8) in an attempt to determine the legislature's intent in enacting the statute. The court found that by enacting the add back statute, Virginia had "joined numerous states with legislation 'designed primarily to prevent the deduction of royalties and interest paid to related intangible holding companies.'"[127] Based on this history, the court found that "[u]nder a pre-apportionment interpretation," as advocated by Kohl's, "[a] corporation[] could avoid application of the add back statute by paying royalties to a related member in a state in which its apportionment factor is insignificant."[128] Such a result, the court concluded, would "resurrect the loophole" that the add back statute was designed to close.[129] Therefore, the court held that the subject-to-tax exception "applie[d] on a post-apportionment, rather than a pre-apportionment, basis"; "the subject-to-tax exception applies only to the extent that the royalty payments were actually taxed by another state."[130]

The Supreme Court of Virginia also addressed an alternative argument put forward by Kohl's, which the circuit court did not address in its decision. The Tax Department had allowed Kohl's "a partial exception to the add back statute to the extent that the royalty payments were apportioned and taxed in many of the Separate Return States."[131] However, the royalty payments had also been included in combined filing states' taxable income calculations, where the Kohl's affiliate to which the royalties were paid was included in the combined group.[132] The Department of Taxation required Kohl's to add the royalties back to its taxable income for these other states with add back statutes (Connecticut, Maryland, Massachusetts, Georgia, and New Jersey).[133] Kohl's argued that, even if the subject-to-tax exception applied on a post-apportionment basis, the Department of Taxation had erred in calculating

126. *Id.* at 186, 810 S.E.2d at 896.
127. *Id.* at 189–90, 810 S.E.2d at 899.
128. *Id.* at 190, 810 S.E.2d at 899.
129. *Id.* at 190, 810 S.E.2d at 899.
130. *Id.* at 190, 810 S.E.2d at 899.
131. *Id.* at 190, 810 S.E.2d at 899.
132. *See id.* at 190, 810 S.E.2d at 899.
133. *See id.* at 190, 810 S.E.2d at 899.

the amount of the royalties that would fall within the exception. Kohl's contended that "to the extent the royalties were apportioned to and taxed by all of the [add back] states, they fall within the subject-to-tax exception."[134]

The Department of Taxation countered that the court can only look to the tax returns of Kohl's affiliate when determining whether the royalty payments were subject to a tax in another state.[135] In other words, "for the royalty payments to fall within the subject-to-tax exception, the tax must have been paid by the related member."[136] The Department of Taxation based this argument on the reasoning that "the add back statute only applies to any intangible expenses paid to a 'related member,' and that the subject-to-tax exception only applies to '[t]he corresponding item of income received by the related member.'"[137]

The Supreme Court of Virginia disagreed with the Department of Taxation and held that the statute only requires that the item of income received by the related member, in this case, the royalties, be taxed by another state; it does not require that the related member be the entity that pays the tax on the item of income.[138] In short, the court held that "[t]o the extent that the royalties were actually taxed by the Separate Return States, Combined Return States, or Addback States, they fall within the subject-to-tax exception regardless of which entity paid the tax."[139] The Supreme Court of Virginia remanded the case back to the circuit court "for a determination of what portion of the royalty payments [were] actually taxed by another state and, therefore, excepted from the add back statute."[140]

134. *Id.* at 191, 810 S.E.2d at 899.

135. *Id.* at 191, 810 S.E.2d at 900.

136. *Id.* at 191, 810 S.E.2d at 900.

137. *Id.* at 191, 810 S.E.2d at 900 (quoting VA. CODE ANN. § 58.1-402(B)(8)(1) (Cum. Supp. 2017)).

138. *Id.* at 191, 810 S.E.2d at 900 (citing VA. CODE ANN. § 58.1-402 (Cum. Supp. 2018)).

139. *Id.* at 191, 810 S.E.2d at 900.

140. *Id.* at 191, 810 at S.E.2d at 900. Kohl's filed a petition for rehearing with the Supreme Court of Virginia, asserting that the court incorrectly relied on the Department of Taxation's interpretation in its original opinion. Petition for Rehearing at 1, Kohl's Dep't Stores, Inc. v. Va. Dep't of Taxation, 294 Va. 57, 803 S.E.2d 336 (2017) (No. 160681). The Supreme Court of Virginia agreed and granted the petition for rehearing and issued a revised opinion (discussed above) in which the Supreme Court of Virginia affirmed that the subject-to-tax exception applies on a post-apportionment basis and only to the extent that the royalty payments are actually taxed in another state. *Kohl's*, 295 Va. 177, 810 S.E.2d 891. A comparison of the two majority opinions reflects that the court removed its previous

A strong and well-reasoned dissenting opinion joined by three justices refuted the court's holding that Virginia Code section 58.1-402(B)(8)(a)(1) applies on a post-apportionment, rather than a pre-apportionment basis.[141] The dissenting justices asserted that the court "inserted an apportionment calculation into this provision that is not supported by the provision's plain language."[142] In so holding, the dissenting Justices agreed that Kohl's was entitled to a full refund and would have reversed the circuit court's judgment.[143]

However, perhaps more important to Virginia practitioners, the dissenting justices accused the court of "revers[ing] more than a century of Virginia law" by "abandon[ing] Virginia's well-settled strict-construction canon resolving ambiguities in tax statutes in favor of the taxpayer to divine the true legislative intent of the statute."[144] Even if the dissenting Justices agreed with the majority that Virginia Code section 58.1-402(B)(8)(a)(1) is ambiguous, they "would nevertheless resolve any ambiguity in favor of Kohl's."[145]

b. *Corporate Executive Board v. Virginia Department of Taxation*

The Arlington County Circuit Court held that Virginia's cost-of-performance statutory method to apportion income generated from the sales of a company's subscription-based services is not unconstitutional, and that companies are not entitled to use an alternative apportionment method.[146] The taxpayer, Corporate Executive Board ("CEB") is a multinational corporation headquartered in Arlington, Virginia.[147] Over 1400 CEB employees are based in Arlington, comprising the bulk of its employees company-wide.[148] CEB's web-based primary subscription product service is known as its

discussion on the weight it originally assigned to the Department of Taxation's interpretations. *Id.* at 177, 810 S.E.2d at 891; *see also Kohl's*, 294 Va. 57, 803 S.E.2d 336.

141. *Kohl's*, 295 Va. at 192–93, 810 S.E.2d at 900–01 (McClanahan, J., dissenting).

142. *Id.* at 193, 810 S.E.2d at 901.

143. *Id.* at 201, 810 S.E.2d at 905.

144. *Id.* at 193, 810 S.E.2d at 901.

145. *Id.* at 196, 810 S.E.2d at 903.

146. Corp. Exec. Bd. v. Va. Dep't of Taxation, 96 Va. Cir. 287, 300–01 (2017) (Arlington County).

147. *Id.* at 290.

148. *Id.*

Core Product.[149] The Core Product is an annual fixed-fee subscription service that includes online access to information and data services content.[150] CEB's bundled product includes "best practices research, executive education, and networking events, in addition to tools used by executives to analyze business functions and processes."[151]

According to CEB, "nearly all of its costs of performance are incurred at its Rosslyn[ ] Arlington County headquarters rather than where its customers are located."[152] At its headquarters, "CEB received, analyzed, and disseminated business practices for its global client network, and, at that location, created, developed, and improved the data and information it sold."[153] "Customers, whether local, national, or international, could access CEB's servers that were managed and controlled by CEB's Information Technology function, also located at CEB's headquarters."[154] Even if a CEB "customer does not use the product, CEB still realized a sale."[155]

This case called into question Virginia's corporate income apportionment system for companies that have multistate operations, requiring their income to be apportioned among multiple states. Virginia's statutory apportionment of corporate income for tax liability is governed by Virginia Code section 58.1-408.[156] This statute determines Virginia "tax liability on income generated by a corporation [to be] apportioned by use of a formula involving [(1)] the value of the corporation's property, real and tangible personal property, located in Virginia in relation to all such property, [(2)] paid or accrued payroll in Virginia in relation to all such payroll, and [(3)] sales (which is double-weighted)."[157]

"The dispute in this case concerns CEB's sales that were allocated to Virginia when calculating what is termed the sales factor of income apportionment to a corporate taxpayer who conducts multi-state business."[158] Virginia calculates the sales factor using

149. *Id.* at 290–91.
150. *See id.* at 290.
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.* at 287 (discussing VA. CODE ANN. § 58.1-408 (Repl. Vol. 2017)).
157. *Id.*
158. *Id.*

a division function, "the numerator of which is the total sales of the corporation in [Virginia] during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year."[159] When a business generates income as a result of actions performed in Virginia and other states, "gross receipts are allocated to Virginia if a greater portion of the income-producing activity is performed in Virginia than in any other state, based on costs of performance."[160]

CEB sought an adjustment to how the sales factor was computed as to its sales because fewer than 6% of its customers were billed at a Virginia address.[161] CEB proposed an alternative method of allocation to evaluate its income-producing activities, that of "destination-based sourcing"; the Department of Taxation denied this request and the present litigation ensued.[162]

CEB argued that its gross receipts or sales should be sourced based on its customers' billing addresses (i.e., customers' zip codes) because the statutory apportionment method, as applied, resulted in a tax on income generated outside Virginia's borders, thereby violating the United States Constitution.[163] The trial court disagreed, finding that CEB failed to prove that its income attributed to Virginia under the statutory method was all out of proportion with its Virginia activities, or that the statutory apportionment method led to a grossly distorted result.[164] The court held that use of the zip codes as the sales apportionment factor "would lead to an arbitrary result."[165] The court stated that "[t]here is no direct evidence or reasonable inference that using a customer's zip code negates the type or extent of business CEB conducted within Virginia in relation to its income or to generate its income."[166]

The circuit court further dismissed CEB's arguments that Virginia's four-factor apportionment method was unconstitutional, telling CEB that a "taxpayer who attacks a state's apportionment as unconstitutional must prove by clear and cogent evidence that it results in extraterritorial values being taxed" and that CEB

159. *Id.* at 287–88 (citing VA. CODE ANN. § 58.1-414 (Repl. Vol. 2017)).
160. *Id.* at 288 (citing VA. CODE ANN. § 58.1-416 (Repl. Vol. 2017)).
161. *Id.* at 291.
162. *Id.* at 289.
163. *See id.* at 291, 293.
164. *See id.* at 297.
165. *Id.*
166. *Id.*

failed to meet its burden of proof to show that using Virginia's apportionment formula leads to a "grossly distorted result."[167] The circuit court noted that Virginia did not tax benefits created or generated in other states:

> The record demonstrates that CEB realized income from customers who paid CEB's subscription fee for data and information, but who would not necessarily have to access that data and information, which is relevant to the finding that the income-producing activity is more directly determined by the location at which the data and information were created, developed, and improved, or even stored, to wit Virginia, and not where the customer is located.[168]

The court also dismissed CEB's argument that the State Tax Commissioner "acted in an arbitrary, capricious, or unreasonable manner" when denying CEB's request to use a different sales apportionment method.[169]

CEB filed a petition for appeal with the Supreme Court of Virginia on December 8, 2017.[170] The supreme court granted CEB an appeal on May 9, 2018.[171]

2. Land Preservation Tax Credits for Individuals and Corporations: *Woolford v. Virginia Department of Taxation*

In an opinion that may have far-reaching implications for how tax appraisals and audits of land preservation tax credits are performed in Virginia, the Supreme Court of Virginia unanimously reversed an entry of summary judgment in favor of the Virginia Department of Taxation.[172] The dispute involved the granting of Virginia Land Preservation Tax Credits based on the placement of a conservation easement.[173] At issue were $4.9 million in income tax credits that were purchased and later transferred to 168 transferees.[174] The Department of Taxation asserted that the appraiser who valued the land at issue was not qualified and that the tax

167. *Id.* at 294–95, 297.
168. *Id.* at 299.
169. *Id.*
170. Corp. Exec. Bd. v. Va. Dep't of Taxation, 97 Va. Cir. 287 (Arlington County), *appeal docketed*, No. 171627 (Va. Dec. 2017).
171. *Id.*
172. Woolford v. Va. Dep't of Taxation, 294 Va. 377, 391, 806 S.E.2d 398, 400 (2017).
173. *Id.* at 382, 806 S.E.2d at 400.
174. *Id.* at 382, 806 S.E.2d at 400–01.

credits were invalid.[175] The trial court agreed and entered summary judgment in favor of the Department of Taxation.[176]

The Woolfords owned a 450-acre farm in King William County ("Property") that had been in the family for over 160 years.[177] The Property had valuable sand and gravel deposits beneath the surface.[178] The Woolfords engaged Michael Simerlein, a licensed General Real Estate Appraiser, licensed by the Virginia Real Estate Appraiser Board, to value the Property before deciding whether to pursue a conservation easement.[179] Simerlein valued the Property "at $13.5 million without a land preservation easement, and at $1,070,000 with a conservation easement, a reduction in value of $12,430,000."[180] This amount constituted the value of the donation when the easement was conveyed to the Virginia Outdoors Foundation ("VOF"), an agency of Virginia that is eligible to hold conservation easements under the Virginia Land Conservation Incentives Act of 1999 (the "Act").[181] Under the Act, taxpayers can obtain tax credits equal to 40% of the fair market value of any "qualified donation" to an eligible conservation agency, including the Commonwealth or an instrumentality thereof.[182] The VOF, as a public conservation agency, qualifies as an eligible instrumentality of the Commonwealth.[183]

The Woolfords donated the conservation easement to the VOF on November 11, 2011.[184] "The easement, which encumber[ed] the entire [P]roperty, prohibit[ed] the Woolfords from mining the sand and gravel on the [P]roperty."[185] Simerlein had earlier informed the Woolfords that the "value of the land overwhelmingly rested in as yet unmined sand and gravel deposits."[186] At the time the Woolfords put the easement on the Property, they "obtained a special use permit from [King William] County and an active state permit

175. *Id.* at 382–83, 806, S.E.2d at 401.
176. *Id.* at 384, 806 S.E.2d at 402.
177. *Id.* at 381, 806 S.E.2d at 400.
178. *Id.* at 381, 806 S.E.2d at 400.
179. *Id.* at 381, 806 S.E.2d at 400.
180. *Id.* at 381, 806 S.E.2d at 400.
181. VA. CODE ANN. §§ 58.1-510 to -513 (Repl. Vol. 2017).
182. *Id.* § 58.1-512(B) (Repl. Vol. 2017).
183. *Woolford*, 294 Va. at 382, 806 S.E.2d at 400.
184. *See id.* at 382, 806 S.E.2d at 400.
185. *Id.* at 382, 806 S.E.2d at 400.
186. *Id.* at 381, 806 S.E.2d at 400.

through the Virginia Department of Mines, Minerals and Energy."[187] The permit, however, was limited to five acres which was not being actively mined.[188] The Woolfords then applied for land preservation tax credits, and on January 10, 2012, the Department of Taxation awarded a tax credit for $4,972,000 based on Simerlein's appraisal.[189] The Woolfords then transferred the credits to 168 transferees.[190]

About one year later, the Department of Taxation informed the Woolfords that there were material deficiencies that rendered the Simerlein appraisal unreliable.[191] The Woolfords met with the Department of Taxation and also provided a second appraisal in an attempt to resolve the dispute, but no resolution was reached and this litigation ensued.[192]

The primary scope of the trial concerned Mr. Simerlein's qualifications as an appraiser. "In addition to being licensed by Virginia as a real estate appraiser, [he also held] a master's degree in real estate appraisal and investment analysis, . . . [having] appraised commercial and residential properties since 1992, . . . [including] approximately 100 conservation easement donations."[193] Simerlein also appraised four properties involving sand and gravel mines, either by himself or in conjunction with other appraisers.[194] Simerlein acknowledged in his trial testimony that he had taken no "coursework on the subject of mineral appraisals."[195] At trial, the court discounted Simerlein's experience and lack of formal training in mining appraisals, and granted summary judgment to the Department of Taxation.[196]

In its review of Virginia Code sections 58.1-512(B) and 58.1-512.1, the Supreme Court of Virginia noted that the legislature had incorporated the federal law and regulations explaining what constitutes a "qualified appraiser."[197] The court noted that there are

187. *Id.* at 381, 806 S.E.2d at 400.
188. *See id.* at 381, 806 S.E.2d at 400.
189. *See id.* at 381, 806 S.E.2d at 400.
190. *Id.* at 382, 806 S.E.2d at 401.
191. *See id.* at 382, 806 S.E.2d at 401.
192. *Id.* at 382–83, 806 S.E.2d at 401.
193. *Id.* at 383, 806 S.E.2d at 401.
194. *Id.* at 383, 806 S.E.2d at 401.
195. *Id.* at 383, 806 S.E.2d at 401.
196. *Id.* at 384, 806 S.E.2d at 402.
197. *Id.* at 385–86, 806 S.E.2d at 401 (citing I.R.C. § 170(f)(11)(E)(ii)–(iii) (2012)).

several requirements an appraiser must meet to be qualified. First, an appraiser must have "earned an appraisal designation from a recognized professional appraiser organization."[198] An appraiser must also "demonstrate[] verifiable education and experience in valuing the type of property subject to the appraisal."[199] The court noted that Simerlein had experience in prior appraisals valuing properties containing sand and gravel deposits, which provided relevant experience and learning.[200] Additionally, Simerlein had consulted colleagues and other professionals in the industry, demonstrating "considerable effort in learning about sand and gravel mines in general and about the local and regional market for those products."[201] The court concluded Simerlein was a qualified appraiser within the meaning of Virginia Code section 58.1-512(B).[202]

The Supreme Court of Virginia also addressed the Woolfords' argument that the Department of Taxation could not challenge the Simerlein appraisal after it had earlier accepted it and awarded the tax credits accordingly.[203] In support of their argument, the Woolfords pointed to Virginia Code section 58.1-512(D)(4)(a), which specifies that:

> If within 30 days after an application for credits has been filed the Tax Commissioner provides written notice to the donor that he has determined that the preparation of a second qualified appraisal is warranted, the application shall not be deemed complete until the fair market value of the donation has been finally determined by the Tax Commissioner.[204]

The Woolfords argued that the Department of Taxation made no such determination within thirty days of its receipt of the Woolford's tax credit application, so the Department of Taxation was "forever barred from challenging the appraisal."[205] The Supreme Court of Virginia disagreed, noting that Virginia Code section 58.1-512(D)(4)(a) "deals with the [Tax] Commissioner's *initial acceptance* of an application for tax credits, not the Commissioner's

198. *Id.* at 386, 806 S.E.2d at 401 (quoting I.R.C. § 170(f)(11)(E)(iii) (2012)).
199. *Id.* at 386–87, 806 S.E.2d at 403 (quoting I.R.C. § 170(f)(11)(E)(ii) (2012)).
200. *Id.* at 387–88, 806 S.E.2d at 403.
201. *Id.* at 388, 806 S.E.2d at 403–04.
202. *Id.* at 388, 806 S.E.2d at 404.
203. *Id.* at 388, 806 S.E.2d at 404.
204. *Id.* at 388, 806 S.E.2d at 404 (quoting VA. CODE ANN. § 58.1-512(D)(4)(a) (Repl. Vol. 2017)).
205. *Id.* at 388, 806 S.E.2d at 404.

authority to later audit the value of the tax credits."[206] The court reasoned, "[t]his provision of the statute does not by its plain terms or by implication foreclose a subsequent audit by the Commissioner of the appraisal or of the claimed value of the tax credit."[207]

The court also addressed what it called the Department of Taxation's "striking position," namely, that the Woolfords were entitled to nothing for their donation; "unless the Department [of Taxation] concludes in good faith based on the evidence that the value of the easement is zero, it must award the Woolfords tax credits for the fair market value of the donation."[208] The court remanded the case back for further proceedings consistent with the supreme court's opinion.[209]

II. TAXES ADMINISTERED BY LOCALITIES

A. *Significant Legislative Activity*

1. Real Estate Taxation

In 2018, the Virginia General Assembly adopted a number of provisions affecting the taxation of real estate. Some involved valuation, while others impacted exemptions and deferred taxes.

a. Valuation of Community Land Trust Property

The General Assembly adopted a provision regarding valuation, requiring assessors to consider certain unique factors and use a single methodology in determining the fair market value "of structural improvements conveyed by a community land trust," subject to certain restrictions, including long-term ground leases with options to repurchase at set prices.[210] The stated purpose of these changes was to ensure that the properties remain affordable to less affluent families in the area.[211]

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206. *Id*. at 388–89, 806 S.E.2d at 404.
207. *Id.* at 389, 806 S.E.2d at 404.
208. *Id.* at 391, 806 S.E.2d at 405.
209. *Id.* at 391, 806 S.E.2d at 405.
210. Act of Mar. 23, 2018, ch. 436, 2018 Va. Acts __, __ (codified at VA. CODE ANN. § 58.1-3295.2 (Cum. Supp. 2018)).
211. *See id*. ch. 436, 2018 Va. Acts at __.

The factors that must be considered (notwithstanding any other provision of law) are: (1) duly recorded ground leases or memoranda imposing restrictions on the price at which the improvements may be sold; and (2) a deed of trust or leasehold deed of trust on the improvements or underlying real property that shows (a) the amount of debt incurred by the improvement's owner, (b) that the deed of trust does not earn interest, and (c) that the deed of trust need not be repaid prior to satisfaction of any interest-earning promissory note or a subsequent transfer of the property.[212]

The methodology that must be used is "the income approach," applied in light of "the property's current use, the contract rent, the income restrictions, and provisions of any arms-length contract, including restrictions on the transfer of title or other restraints on the alienation of the real property."[213]

The provisions regarding valuation of land under new Virginia Code section 58.1-3295.2 are similar to those applicable to real property operated as "affordable rental housing."[214]

b. Classifying Real Estate as Devoted to Agricultural or Horticultural Use

Although apparently a classification statute, the amendments to Virginia Code sections 58.1-3230, 58.1-3231, and 58.1-3234[215] expand the number of properties that may be subjected to use value assessment and taxation by local ordinance.[216] Under current law, when application is duly made by the land owner[217] and the special use validated,[218] the locality "shall consider only those indicia of value which such real estate has for agricultural, horticultural, forest or open space use" when assessing and taxing the real estate.[219]

In 2018, the General Assembly expanded the potential application of use valuation by revising two definitions. The first, "[r]eal

212. VA. CODE ANN. § 58.1-3295.2(A)(1)–(2) (Cum. Supp. 2018).
213. *Id.* § 58.1-3295.2(B) (Cum. Supp. 2018).
214. *Compare id.* § 58.1-3295(A) (Cum. Supp. 2018), *with id.* § 15.2-2305 (Repl. Vol. 2018).
215. Act of Mar. 29, 2018, ch. 504, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. §§ 58.1-3230 to -3231, -3234 (Cum. Supp. 2018)).
216. VA. CODE ANN. § 58.1-3231 (Repl. Vol. 2017).
217. *Id.* § 58.1-3234 (Repl. Vol. 2017).
218. *Id.* § 58.1-3233 (Repl. Vol. 2017).
219. *Id.* § 58.1-3236 (Repl. Vol. 2017).

estate devoted to agricultural use," has been revised to include not only "real estate devoted to the bona fide production for sale of plants and animals," but also devoted to the production of "products made from such plants and animals on the real estate, that are useful to man or devoted to and meeting the requirements and qualifications for payments or other compensation pursuant to soil and water conservation programs under an agreement with an agency of the state or federal government."[220] Second, "[r]eal estate devoted to horticultural use" has been revised to include not only "real estate devoted to the bona fide production for sale of fruits of all kinds, including grapes, nuts, and berries; vegetables; nursery and floral products," but also land devoted to the bona fide production of:

> plants or products directly produced from fruits, vegetables, nursery and floral products, or plants on such real estate, [and] devoted to and meeting the requirements and qualifications for payments or other compensation pursuant to a soil and water conservation program under an agreement with an agency of the state or federal government under uniform standards . . . .[221]

Besides expanding these definitions, the Virginia General Assembly also made several statutory changes to allow land owners to meet the uniform standards for classification under the four qualifying uses sooner, and to hold on to the classification longer. One change provided that any requirement under the uniform standards that the real estate has "been used for a particular purpose for a minimum length of time before qualifying as real estate devoted to agricultural use or horticultural use" must count the time in which there was "use of other similar property by a lessee of the owner."[222] Another change required the uniform standards to allow for a shorter minimum length of time for qualification of real estate if "the owner submits a written document of the owner's intent regarding use of the real estate containing elements set out in the uniform standards."[223] The last change permitted localities to allow validation of the qualifying land use to be shown every six years, rather than annually.[224]

220. *Id*. § 58.1-3230 (Cum. Supp. 2018).
221. *Id*.
222. *Id*. § 58.1-3231 (Cum. Supp. 2018).
223. *Id*.
224. *Id*. § 58.1-3234 (Cum. Supp. 2018).

c. Nonqualified Transfer Triggers Payment of Deferred Real Estate Taxes

Localities have been authorized to provide for the exemption from tax and/or a deferral of payment of real estate tax on the sole dwelling of persons aged sixty-five or older or those "found to be permanently and totally disabled."[225] The law, prior to recent amendment, was that in the case of deferrals, "the accumulated amount of taxes deferred shall be paid to" the locality, either "upon the sale of the dwelling, or from the estate of the decedent within one year after the death of the last owner thereof who qualifies for tax deferral."[226] The amount of deferred taxes, along with any interest provided by ordinance, up to 8% per annum, "shall constitute a lien upon" the property for which taxes were deferred, but may be paid without penalty.[227]

In 2018, the Virginia General Assembly clarified that not only sale of the real estate, or death of the "qualified owner,"[228] but also "a nonqualified transfer of the real estate" would trigger payment of deferred taxes.[229] Now, the property may be transferred without triggering the payment of deferred taxes (1) to a spouse; (2) to a revocable inter vivos trust over which the qualified owner, or the qualified owner and his spouse, hold the power of revocation; (3) or to an irrevocable trust under which a qualified owner alone or in conjunction with his spouse possesses a life estate or an estate for joint lives, or enjoys a continuing right of use or support.[230]

2. Personal Property Tax

a. New Valuation Class of Tangible Personal Property: Computer Equipment and Peripherals Used in a Data Center

In 2013, the Virginia General Assembly amended Virginia Code section 58.1-3506 to make "[c]omputer equipment and peripherals

225. *Id*. § 58.1-3210 (Repl. Vol. 2017).
226. *Id*. § 58.1-3216 (Repl. Vol. 2017).
227. *Id*.
228. *See id*. § 58.1-3216(A) (Cum. Supp. 2018) (defining "[q]ualified owner" as "the owner of the real property who qualifies for a tax deferral by county, city, or town ordinance").
229. Act of Mar. 9, 2018, ch. 291, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3216 (Cum. Supp. 2018)).
230. VA. CODE ANN. § 58.1-3216(A) (Cum. Supp. 2018).

used in a data center" a separate class of tangible personal property, for rate purposes, that is subject to local taxation.[231] However, it was not made a separate class "for valuation purposes" under Virginia Code section 58.1-3503(A).[232] In 2018, the General Assembly amended Virginia Code section 58.1-3503 to add subsection (A)(17), covering "[c]omputer equipment and peripherals used in a data center, as defined in" Virginia Code section 58.1-3506 (A)(43).[233] This new class of property "shall be valued by means of a percentage or percentages of original cost, or by such other method as may reasonably be expected to determine the actual fair market value."[234]

b. Reducing Tax Exemptions of Large Solar Energy Generators

In 2018, the General Assembly amended the provision separately classifying and providing for partial or total exemption from state and local taxation of "[c]ertified pollution control equipment and facilities," removing the exemption for certain larger "solar photovoltaic (electric energy) systems," i.e., solar panel farms.[235]

Since 2014, "certified pollution control equipment" has been expressly defined to include "solar energy equipment, facilities, or devices owned or operated by a business that collect[s], generate[s], transfer[s], or store[s] thermal or electric energy," as well as "solar photovoltaic (electric energy) systems."[236] At that time, the exemption for solar panels "applie[d] only to projects equaling 20 megawatts or less, as measured in alternating current (AC) generation capacity."[237] In 2016, subsection (B) of Virginia Code section 58.1-3660 exemption for solar panel farms was modified to include additional conditions related to when a given farm joined the electric grid and the size of the facility.[238] Among the additional conditions

231. Act of Mar. 14, 2013, ch. 393, 2013 Va. Acts 646, 649 (codified as amended at VA. CODE ANN. § 58.1-3506 (Cum. Supp. 2013)).

232. *See* VA. CODE ANN. § 58.1-3503(A) (Repl. Vol. 2017).

233. Act of Mar. 9, 2018, ch. 292, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. §§ 58.1-3503, -3506 (Cum. Supp. 2018)).

234. VA. CODE ANN. § 58.1-3503(A)(17) (Cum. Supp. 2018).

235. Act of Apr. 18, 2018, ch. 849, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3660 (Cum. Supp. 2018)).

236. Act of Apr. 6, 2014, ch. 737, 2014 Va. Acts 1308, 1308–09 (codified as amended at VA. CODE ANN. §§ 58.1-3660 to -3661 (Cum. Supp. 2014)).

237. *Id.* ch. 737, 2014 Va. Acts at 1308–09.

238. Act of Mar. 11, 2016, ch. 346, 2016 Va. Acts 634, 636–37 (codified as amended at VA. CODE ANN. §§ 58.1-609.3, -3660 to -3661 (Cum. Supp. 2016)).

was the adoption of an 80% exemption of the assessed value of projects greater than twenty megawatts "for which an initial interconnection request form has been filed with an electric utility or a regional transmission organization after January 1, 2015 . . . for projects first in service on or after January 1, 2017."[239] A similar 80% exemption of "the assessed value of all other projects equaling more than 5 megawatts, as measured in alternating current (AC) generation capacity for which an initial interconnection request form has been filed with an electric utility or a regional transmission organization on or after January 1, 2019," was also adopted.[240]

The 2018 amendment to subsection (B) of Virginia Code section 58.1-3660[241] retained the exemption for 80% of the assessed value of projects greater than twenty megawatts "for which an initial interconnection request form has been filed with an electric utility or a regional transmission organization [] between January 1, 2015 and June 30, 2018."[242] That amendment, however, eliminated the exemption for projects of 150 megawatts or more that filed an initial interconnection request form "on or after July 1, 2018" and were "first in service on or after January 1, 2017."[243] And the amendment also limited the 80% exemption for "all other projects" of 150 megawatts or more that "[filed] an initial interconnection request form . . . on or after January 1, 2019."[244]

c. Exemption of Leaseholds Owned by Land Bank Entities

In adopting the Land Bank Entities Act in 2016,[245] the Virginia General Assembly adopted Virginia Code section 15.2-7510, which exempted land bank entities from having "to pay any taxes upon any property acquired or used by the land bank entity under the provisions of the Act."[246] The exempt status flows from the public

239. *Id*. ch. 346, 2016 Va. Acts at 636–37.
240. *Id*. ch. 346, 2016 Va. Acts at 636–37.
241. Act of Apr. 18, 2018, ch. 849, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3660 (Cum. Supp. 2018)).
242. VA. CODE ANN. § 58.1-3660(B) (Cum. Supp. 2018).
243. *Id*.
244. *Id*.
245. Act of Mar. 11, 2016, ch. 383, 2016 Va. Acts 669, 669–72 (codified at VA. CODE ANN. §§ 15.2-7500, -7512, -3970.2 (Cum. Supp. 2016)); Act of Mar. 1, 2016, ch. 159, 2016 Va. Acts 282, 282–86 (codified as amended at VA. CODE ANN. §§ 15.2-7500 to -7512, -3970.2 (Cum. Supp. 2016)).
246. VA. CODE ANN. § 15.2-7510 (Repl. Vol. 2017).

purpose and function of such entities, which are created by localities "for the purpose of assisting the locality to address vacant, abandoned, and tax delinquent properties."[247]

In 2018, the General Assembly amended Virginia Code section 58.1-3203, a section concerning the taxation of leasehold interests, adding subsection (C) that provides "[w]hen any real property is exempt from taxation under § 15.2-7510, the leasehold interest in the property shall also be exempt from taxation."[248]

d. Property of LLC with Nonprofit Single Member May Be Exempted

By statute, localities are authorized to adopt, by ordinance of the governing body, various designations or classifications of property that are "exempt from real or personal property taxes, or both . . . [and the real or personal] property, or both, owned by a nonprofit organization" and used for certain identified purposes.[249] In 2018, the General Assembly adopted a clarifying amendment,[250] providing expressly that such "nonprofit organization[s] includ[e] a single member limited liability company whose sole member is a nonprofit organization."[251] This amendment addresses a common situation, generated by liability or other corporate structuring concerns, in which nonprofits hold property through various LLCs, which are not themselves recognized nonprofits and so may be challenged when they claim exemption.

e. Exempt Agricultural Products Defined

Virginia Code section 58.1-3505 exempts "agricultural products" from taxation "while in the hands of a producer."[252] In 2018, the General Assembly clarified subsection (A)'s exemption by defining "agricultural product" as "any livestock, aquaculture, poultry, horticultural, floricultural, viticulture, silvicultural, or other farm crops," a definition borrowed from Virginia Code section 3.2-

247. *Id.* § 15.2-7501(A) (Repl. Vol. 2017).
248. Act of Mar. 23, 2018, ch. 437, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3203 (Cum. Supp. 2018)).
249. VA. CODE ANN. § 58.1-3651(A) (Repl. Vol. 2017).
250. Act of Feb. 26, 2018, ch. 29, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3651(A) (Cum. Supp. 2018)).
251. VA. CODE ANN. § 58.1-3651(A) (Cum. Supp. 2018).
252. *Id.* § 58.1-3505(C) (Repl. Vol. 2017).

6400.[253] The General Assembly further clarified that the exemption was only from the taxes imposed under chapter 35 of title 58.1, which involves the tangible personal property tax and merchants' capital tax, among others.[254]

3. Merchants' Capital Tax: *New Class of Merchants' Capital for Warehoused Inventory*

Localities may impose a tax upon the separate class of property known as merchants' capital.[255] Merchants' capital is separately defined to embrace inventory and tangible personal property offered for sale.[256] Prior to 2018, some statutory exceptions to the generally applicable definition have been made,[257] as well as a separate classification for the inventory of pharmaceutical wholesalers.[258]

In 2018, the General Assembly added another separate classification, this time embracing "[m]erchants' capital of any wholesaler reported as inventory that is located, and is normally located, in a structure that contains at least 100,000 square feet, with at least 100,000 square feet used solely to store such inventory."[259] As with pharmaceutical wholesalers, localities are authorized by new Virginia Code section 58.1-3510.02 to "levy a tax on such inventory at different rates from the tax levied on other merchants' capital" although "[t]he rates of tax and the rates of assessment shall not exceed that applicable generally to merchants' capital."[260]

253. Act of Mar. 30, 2018, ch. 618, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3505 (Cum. Supp. 2018)) (quoting VA. CODE ANN. § 3.2-6400 (Repl. Vol. 2017)).

254. VA. CODE ANN. § 58.1-3505(C) (Cum. Supp. 2018).

255. *Id*. § 58.1-3509 (Repl. Vol. 2017).

256. *Id*. § 58.1-3510(A) (Repl. Vol. 2017) (defining "merchants' capital" as "[i]nventory of stock on hand; daily rental vehicles as defined in § 58.1-1735; and all other taxable personal property of any kind whatsoever, except money on hand and on deposit and except tangible personal property not offered for sale as merchandise").

257. *See id*. § 58.1-3510(B)–(C) (Repl. Vol. 2017).

258. In 1997, pharmaceutical wholesalers' inventory were separately classed from other merchants' capital, and the rates of tax and the rates of assessment were capped at the amount "applicable generally to merchants' capital" in the locality. Act of Mar. 2, 1997, ch. 71, 1997 Va. Acts 99, 99 (codified at VA. CODE ANN. § 58.1-3510.01 (Cum. Supp. 1997)).

259. Act of Feb. 26, 2018, ch. 23, 2018 Va. Acts __, __ (codified at VA. CODE ANN. § 58.1-3510.02 (Cum. Supp. 2018)).

260. VA. CODE ANN. § 58.1-3510.02 (Cum. Supp. 2018).

4. Disclosure of Confidential Taxpayer Information to Localities' Third-Party Contractors

Virginia Code section 58.1-3 generally prohibits disclosure or dissemination by the Tax Commissioner, local taxing authorities, or their agents of any information acquired in the performance of their duties that relate "to the transactions, property, including personal property, income or business of any person, firm or corporation."[261] Violation of this provision is a Class 1 misdemeanor,[262] which carries a penalty of "confinement in jail for not more than twelve months and a fine of not more than $2,500, either or both."[263] There are a number of limited exceptions to this prohibition contained in Virginia Code section 58.1-3,[264] and some exceptions in other sections of the Code, such as the provision for disclosure in discovery for challenges to local assessments.[265] Among the exceptions to the rule of nondisclosure in Virginia Code section 58.1-3 is one allowing the Department of Taxation to disclose "information to nongovernmental entities with which the Department has entered into a contract to provide services that assist it in the administration of refund processing or other services related to its administration of taxes."[266]

In 2018, the General Assembly similarly authorized "the commissioner of the revenue, treasurer, director of finance, or other similar local official who collects or administers taxes for a county, city, or town" to disclose "information to nongovernmental entities with which the locality has entered into a contract to provide services that assist it in the administration of refund processing or other non-audit services related to its administration of taxes."[267] It bears noting that the exception does not apply in favor of disclosure to a nongovernmental entity providing "non-audit services related to the administration of taxes," a limitation not contained in the exception for the Tax Commissioner. Also, unlike the exception for the Tax Commissioner, these local tax collecting and adminis-

261. *Id.* § 58.1-3(A) (Cum. Supp. 2018).
262. *Id.*
263. *Id.* § 18.2-11(a) (Repl. Vol. 2014).
264. *See id.* § 58.1-3(A)–(B) (Cum. Supp. 2018).
265. *See, e.g.*, *id.* § 58.1-3984(A) (Repl. Vol. 2017).
266. *Id.* § 58.1-3(B)(3) (Cum. Supp. 2018).
267. Act of Feb. 26, 2018, ch. 40, 2018 Va. Acts __, __ (codified as amended at VA. CODE ANN. § 58.1-3 (Cum. Supp. 2018)).

tering officials are statutorily prohibited from "disclos[ing] information to such entity unless he has obtained a written acknowledgement by such entity that the confidentiality and nondisclosure obligations of and penalties set forth in subsection A apply to such entity and that such entity agrees to abide by such obligations."[268]

B. *Significant Judicial Decisions*

1. Business Professional Occupation and License Tax: *Dulles Duty Free, LLC v. County of Loudoun*

The Supreme Court of Virginia found the imposition of the Loudoun County Business Professional Occupation and License ("BPOL") gross receipts tax on the sale of duty-free items sold at Dulles International Airport to be unconstitutional.[269] In reversing the Loudoun County Circuit Court, the Supreme Court of Virginia held in a unanimous decision, that Loudoun County's BPOL tax on Dulles Duty Free, LLC's sales of duty-free goods to international travelers violated the United States Constitution's Import-Export Clause, which prohibits states from imposing duties on exported goods without express permission from Congress.[270]

Dulles Duty Free, LLC ("Duty Free") "is a duty-free retailer."[271] During the relevant tax years at issue in this case, Duty Free operated multiple shops at Dulles International Airport in Loudoun County, all of which were within security.[272] Duty Free sells alcohol, tobacco, luxury gifts, fragrances, and other goods.[273] Federal law authorizes Duty Free's shops, and the entire duty-free process is highly regulated with significant federal oversight, primarily through United States Customs and Border Protection.[274] By federal law, the term duty-free merchandise "means merchandise sold by a duty-free sales enterprise on which neither Federal duty nor

268. VA. CODE ANN. § 58.1-3(B)(5) (Cum. Supp. 2018).

269. Dulles Duty Free, LLC v. County of Loudoun, 294 Va. 9, 11, 803 S.E.2d 54, 55 (2017), *cert. denied*, 138 S. Ct. 1440 (2018).

270. *Id.* at 23–24, 803 S.E.2d at 62. For a discussion of the Loudoun County Circuit Court decision in this case, see Craig D. Bell & Emily J.S. Winbigler, *Annual Survey of Virginia Law: Taxation*, 52 U. RICH. L. REV. 79, 104–08 (2017).

271. Bell & Winbigler, *supra* note 270, at 104.

272. *Id.* at 104–05.

273. *Dulles Duty Free,* 294 Va. at 11, 803 S.E.2d at 55.

274. *Id.* at 11, 803 S.E. 2d at 55 (citing 19 U.S.C. § 1555 (2012)). This federal statute authorizes bonded duty free sales of merchandise for export. *See* § 1555.

Federal tax has been assessed pending exportation from the customs territory."[275] Duty Free must comply with 19 U.S.C. § 1555 and its implementing regulations in order to preserve its duty-free status.[276]

Duty Free's goods, both imported and domestic, gather "in bonded warehouses in Florida and Texas."[277] Bonded carriers then bring the goods to Duty Free's secured warehouse located at Dulles Airport "which, in turn, distributes the merchandise to [Duty Free's] retail stores inside the airport."[278]

> The merchandise is sold in a restricted area of the airport. Only passengers with boarding passes may enter and these passengers must first go through security. Duty Free can sell items to both domestic and international passengers. For domestic travelers, Duty Free charges a Virginia sales tax and the purchaser takes immediate possession of the item. When the sale involves a bonded imported item, the domestic passenger pays an import duty. Duty Free does not challenge the imposition of the BPOL tax to such domestic sales.[279]

International sales are handled differently. International travelers must show their passports and boarding passes to Duty Free's cashier, who rings up the sale without charging a sales tax, bags the items, and accepts payment.[280] The cashier then places the bagged goods in a cart for delivery to the jetway serving the purchaser's flight, the traveler obtains a receipt, and a bonded duty-free cartman meets the traveler at the jetway just prior to boarding the plane.[281] The receipt-for-goods exchange thus occurs just prior to the international passenger boarding the plane.[282] Under this system, travelers receive their goods after the airline clears the plane to have passengers board.[283] If, for any reason, the traveler does not board the plane, she cannot collect the goods, and the cartman returns the unclaimed goods to Duty Free, which voids the

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275. § 1555(b)(8)(E).
276. *Id.* § 1555.
277. *Dulles Duty Free*, 249 Va. at 11, 803 S.E.2d at 55.
278. *Id.* at 11, 803 S.E. 2d at 55.
279. *Id.* at 11, 803 S.E. 2d at 55.
280. *See id.* at 12, 803 S.E. 2d at 55.
281. *Id.* at 12, 803 S.E. 2d at 55.
282. *Id.* at 12, 803 S.E.2d at 55.
283. *Id.* at 12, 803 S.E. 2d at 55 (citing 19 U.S.C. § 1555(b)(3)(F)(i)(II) (2012)). This provision requires duty free merchandise to be delivered to the international traveler-purchasers at the exit point of a specific departing flight. *See* 1555(b)(3)(F)(i)(II).

sale.[284] In this manner Duty Free ensures that the items sold for export are in fact for export.

Duty Free tracks which sales are domestic and which sales are international, and for the tax years at issue in the case, international sales for export amounted to between 92% and 99.8% of Duty Free's total sales.[285]

Loudoun County requires every person engaged in business in the county to obtain a business license; Duty Free obtained a license for each of its stores located in Dulles Airport.[286] Loudoun County's BPOL tax was imposed on all of Duty Free's gross receipts, domestic and international, for 2009 to 2013 (the tax years at issue) at a rate of seventeen cents for every $100 in retail sales.[287] Duty Free paid the BPOL taxes and sought a refund of the BPOL taxes it paid on sales made for export to international travelers.[288] The circuit court issued a detailed letter opinion that "canvassed the cases from the United States Supreme Court and concluded that 'the BPOL tax of Loudoun County [did] not violate the Import Export Clause of the U.S. Constitution.'"[289] As a result of its decision, the trial court denied Duty Free's application for a refund.[290]

The Supreme Court of Virginia noted that Duty Free sought "an 'as applied' challenge rather than a challenge to the facial constitutionality of the BPOL tax."[291] The Import-Export Clause provides that "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws."[292] This clause, "along with the Commerce Clause and the Export Clause, was designed to suppress fratricidal trade policies and thus 'provide for the harmony and proper intercourse among the States.'"[293]

284. *Dulles Duty Free*, 294 Va. at 12, 803 S.E.2d at 55.

285. *Id.* at 12, 803 S.E.2d at 55; *see* Transcript of Record at 10, 255–58, 271–87, 457, Dulles Duty Free, LLC v. County of Loudoun, Civil No. 90613, letter op. at 2 (Va. Cir. Ct. Apr. 26, 2016) (Loudoun County) (unpublished decision) (on file with authors).

286. *Dulles Duty Free*, 294 Va. at 12, 803 S.E.2d at 56.

287. *Id.* at 13, 803 S.E.2d at 56.

288. *Id.* at 13, 803 S.E.2d at 56.

289. *Id.* at 13, 803 S.E.2d at 56.

290. *Id.* at 13, 803 S.E.2d at 56.

291. *Id.* at 13, 803 S.E.2d at 56.

292. U.S. CONST. art. 1, § 10, cl. 2.

293. *Dulles Duty Free*, 294 Va. at 14, 803 S.E.2d at 57. Justice McCullough went back to

The Supreme Court of Virginia noted that "[r]esolution of the constitutional propriety of the BPOL tax to Duty Free's in-transit export sales hinges on the applicability, and ongoing validity, of the [United States Supreme Court] decision in *Richfield Oil Corp. v. State Bd. of Equalization*."[294] Duty Free argued that the holding in *Richfield Oil* controlled.[295] Loudoun County "asserted that the case [was] distinguishable or superseded by later decisions" of the United States Supreme Court.[296]

Richfield Oil had a contract with the government of New Zealand for the sale of oil, all of which was for export.[297] "California assessed a retail sales tax against Richfield Oil that was 'measured by the gross receipts from the transaction.' Richfield Oil argued that the tax violated the Import-Export Clause and the [United States] Supreme Court agreed."[298] The California sales tax was an excise tax for the privilege of conducting a retail business measured by the gross receipts from sales.[299] The United States Supreme Court, however, stated that "'whether the tax deprives the taxpayer of a federal right,' . . . turns not on the characterization of the tax under state law but, rather, on 'its operation and effect.'"[300] The Court in *Richfield Oil* also quoted Chief Justice John Marshall, who said that "a tax measured by the gross receipts of sales is effectively a tax on the article itself."[301]

The United States Supreme Court in *Richfield Oil* also provided that "[a] tax that effectively 'add[s] to the price of the article, and [is] paid by the consumer, or by the importer himself,' such as a tax 'on the occupation of an importer' is in practical effect no different from 'a direct duty on the article itself.'"[302]

the debates and papers from the 1787 Constitutional Convention, and in particular the Papers of James Madison on the debates in order to divine the genesis of the Import-Export Clause. *See* THE FEDERALIST NO. 42, at 263 (James Madison) (Clinton Rossiter ed., 2003).

294. *Dulles Duty Free*, 294 Va. at 14, 803 S.E.2d at 57 (citing Richfield Oil Corp. v. State Bd. of Equalization, 329 U.S. 69 (1946)).

295. *Dulles Duty Free*, 294 Va. at 14–15, 803 S.E.2d at 57.

296. *Id.* at 15, 803 S.E.2d at 57.

297. *Id.* at 15, 803 S.E.2d at 57.

298. *Id.* at 15, 803 S.E.2d at 57 (quoting *Richfield Oil*, 329 U.S. at 71–72).

299. *Id.* at 15, 803 S.E.2d at 57.

300. *Id.* at 16, 803 S.E.2d at 57–58 (citing *Richfield Oil*, 329 U.S. at 84).

301. *Id.* at 16, 803 S.E.2d at 58 (citing *Richfield Oil*, 329 U.S. at 84 (quoting Brown v. Maryland, 25 U.S. (12 Wheat.) 419, 444 (1827))).

302. *Id.* at 16, 803 S.E.2d at 58 (quoting *Richfield Oil*, 329 U.S. at 85).

The Supreme Court of Virginia next examined developments since the 1946 decision in *Richfield Oil*. The 1976 United States Supreme Court decision in *Michelin Tire Corp. v. Wages* adopted a policy-based test when evaluating a Georgia *ad valorem* inventory tax on goods held in storage in a warehouse after completing their international travels from France and Nova Scotia into Georgia and while awaiting subsequent domestic transportation.[303] The goods in *Michelin Tire* were no longer in-transit, and the United States Supreme Court held the *ad valorem* tax was not an "impost" or "duty," and the Georgia *ad valorem* tax was nondiscriminatory and "did not single out imports for taxation."[304] The Supreme Court of Virginia acknowledged that many "courts have struggled to determine which test to apply when it comes to assessing the constitutionality of taxes that fall on export goods in transit."[305] In this case, "[t]he bright line *Richfield Oil* test, rather than the policy-based *Michelin* test, supplies the rule of decision."[306]

The Supreme Court of Virginia noted that

> the [United States] Supreme Court has not overruled *Richfield Oil* and, while it has significantly revised its Import-Export Clause jurisprudence, the Court has carefully carved out for future disposition the issue [of] whether the *Michelin* test would apply to a non-discriminatory tax that falls on export goods in transit.[307]

The United States Supreme Court also "has not retreated from its method of assessing the constitutionality of a state tax based on its operation and effect[;] [a] state's characterization of the tax does not control."[308]

The Supreme Court of Virginia stated that the Loudoun County BPOL tax "is indistinguishable from the prohibited gross receipts tax in *Richfield Oil*."[309] Under that precedent, "a tax that falls directly on export goods in transit violates the [Import-Export] Clause."[310] Both California's tax in *Richfield Oil* and the BPOL tax

303. *Dulles Duty Free*, 294 Va. at 16, 803 S.E.2d at 58; *see* 423 U.S. 276, 278 (1976).
304. *Dulles Duty Free*, 294 Va. at 16, 803 S.E.2d at 58–59.
305. *Id.* at 21, 803 S.E.2d at 60.
306. *Id.* at 21, 803 S.E.2d at 60.
307. *Id.* at 22, 803 S.E.2d at 61.
308. *Id.* at 23, 803 S.E.2d at 61.
309. *Id.* at 23–24, 803 S.E.2d at 62.
310. *Id.* at 23, 803 S.E.2d at 62.

are imposed on a percentage of gross sales, and are, in their operation and effect, direct taxes on exported goods in transit.[311] The Supreme Court of Virginia ruled that "the BPOL tax as applied to Duty Free's export goods in transit constitutes an impermissible impost upon an export in violation of the Import-Export Clause," and it reversed and remanded the case "for a determination of the refund due to Duty Free."[312]

Loudoun County filed a petition for a writ of certiorari with the United States Supreme Court on December 19, 2017.[313] Perhaps the county sought to capitalize on Justice McCullough's comment in his opinion that perhaps "the United States Supreme Court will provide additional guidance concerning the applicability of the Import-Export Clause to nondiscriminatory taxes like the BPOL tax that would be imposed upon export goods in transit."[314] Duty Free filed its Respondent's Brief on February 26, 2018, and the county filed its Petitioner's Reply on March 8, 2018.[315] The United States Supreme Court denied Loudoun County's petition on April 2, 2018.[316]

2. Personal Property and Real Property Taxation of a Marine Freight Container Terminal

In *Virginia International Gateway, Inc. v. City of Portsmouth*, the Portsmouth City Circuit Court had to rule on both the taxpayer's challenges of its real estate and personal property tax assessments, and a counterclaim by the City of Portsmouth seeking an increase of the tax assessments.[317] The trial court ruled that neither party presented credible expert testimony on real property value, and rejected the owner's calculation of fair market value for high-tech terminal cranes for which no market currently exists.[318]

311. *Id.* at 23–24, 803 S.E.2d at 62.

312. *Id.* at 24, 803 S.E.2d at 62.

313. Petition for a Writ of Certiorari, County of Loudoun v. Dulles Duty Free, LLC, 138 S. Ct. 1440 (2018) (No. 17-904).

314. *Dulles Duty Free*, 294 Va. at 24, 803 S.E.2d at 62.

315. Brief in Opposition, *County of Loudoun*, 138 S. Ct. 1440 (No. 17-904); Petitioner's Reply to Brief in Opposition, *County of Loudoun*, 138 S. Ct. 1440 (No. 17-904).

316. *Dulles Duty Free, LLC*, 294 Va. 9, *cert. denied*, 138 S. Ct. 1440.

317. Va. Int'l Gateway v. City of Portsmouth, Nos. CL15-2813, CL16-1427, 2018 Va. Cir. LEXIS 69, at *1 (Mar. 22, 2018) (Portsmouth City).

318. *Id.* at *14–16.

Virginia International Gateway, Inc. ("Gateway") owned a large tract of land in the City of Portsmouth, used as a "marine container terminal and [at the time of the case] under long-term lease to the Virginia Port Authority."[319] Gateway challenged its real property assessments for tax year 2016 and its personal property assessments for tax years 2015 and 2016.[320] Gateway engaged Glen Fandl to appraise the real estate and serve as their expert witness; Fandl had his real property license from New York, but he obtained temporary Virginia appraisal licensure on two separate occasions.[321] Contemporaneously with the case, Fandl performed tax consulting work on valuing the real property for a meeting with the Portsmouth Commissioner of the Revenue, and again when he prepared his written appraisal report.[322] Subsequently, when Fandl testified at trial as a real property appraisal expert, his temporary Virginia appraisal license had lapsed.[323]

The trial court noted that Fandl's training and experience as a state and local tax consultant was impressive; however, as a real estate appraiser, his experience was less impressive "[and] seemingly an adjunct to his primary work of consulting."[324] The court did find Fandl's experience and training sufficient to be qualified as an expert to opine on valuations of real property over the City of Portsmouth's objections.[325] However, Portsmouth also objected to Fandl as an appraiser on the grounds that "he violated Virginia law by engaging in appraisal work . . . [and] presenting himself in Court to testify as an expert witness after his temporary Virginia license had expired."[326] The requirement of a Virginia license in real estate or real property appraisals is clear under Virginia Code section 54.1-2011(A), which makes it unlawful to "engage in the appraisal of real estate or real property for compensation or valuable consideration in this Commonwealth without first obtaining a real estate appraiser license."[327]

319. *Id*. at *1.
320. *Id*.
321. *Id*. at *2–3.
322. *Id*.
323. *Id*. at *3–4.
324. *Id*. at *2–3.
325. *Id*. at *3.
326. *Id*. at *3–4.
327. *Id*. at n.1 (quoting VA. CODE ANN. § 54.1-2011(A) (Repl. Vol. 2013)).

The circuit court stated that trial judges must be "advers[e] to exercising a power which will serve to promote illegal conduct."[328] Accordingly, the trial judge decided that he should not have recognized Fandl as an expert in real estate values without a Virginia license, and struck the entirety of Fandl's testimony.[329]

The circuit court then turned to Portsmouth's counterclaim asserting a higher fair market value than the real property tax assessment. The court noted that the city's appraiser, John Soscia, had no prior experience in appraising a marine container terminal and had relied heavily on other "experts" who did not appear as trial witnesses.[330] Additionally, Soscia was not able to explain specialized reference resources relating to marine container terminals, made an $8,000,000 math error on several crane fixtures, did not appraise specific individualized improvements, and valued the complete terminal, consisting of 457 acres of developable land at $375,000 per acre, even though only twenty-one of the acres abutted the river.[331] Soscia's appraisal approach also failed to "take into account the actual uses, to which the land [was] being employed . . . ."[332] The court concluded Soscia's valuation failed to establish the fair market value of the real property, so the city did not meet its burden of proof on its counterclaim.[333]

On the personal property case, the court noted no appraiser license was required.[334] The court took note of Virginia Code section 58.1-3503(B), which permits the Portsmouth Commissioner of the Revenue to assess the value of personal property by using a percentage of original cost.[335] When a percentage of the original cost renders a value the taxpayer believes is greater than fair market value, the Commissioner may reduce the value if presented with credible and independent evidence (i.e., an appraisal).[336] Experts for both parties testified "that there [was] no market in the world for [used automated stacking cranes]" because they were new technology for which infrastructure was still rare.[337] The court held

328. *Id.* at *4–5.
329. *See id.* at *5.
330. *See id.* at *5–6.
331. *See id.* at *8–10.
332. *Id.* at *10.
333. *Id.* at *10–12.
334. *Id.* at *12.
335. *Id.*; VA. CODE ANN. § 58.1-3503(B) (Repl. Vol. 2017).
336. *Va. Int'l Gateway*, 2018 Va. Cir. at *12–13.
337. *Id.* at *14.

Gateway was unable to meet its burden of proof that the personal property assessment was erroneous, and the court "decline[d] to make any adjustment to the subject assessment."[338]

CONCLUSION

The 2018 session of the Virginia General Assembly continued its recent trend of addressing mostly targeted and technical changes in the tax laws. However, Virginia's judiciary has been active in addressing a number of important issues on both state administered taxes as well as those administrated by localities. The resolution of *Kohl's Department Stores* brings certainty to the battling theories on how to interpret the subject-to-tax exception contained in Virginia Code section 58.1-402(B)(8)(a)(1) to apply only to the extent royalty taxes are actually taxes by another state. The Virginia Supreme Court in *Woolford* also provides needed guidance that addresses the qualifications required to be a "qualified appraiser" within the meaning of Virginia Code sections 58.1-512(B) and 58.1-512.1 when valuing property or conservation easement transfers for purposes of obtaining tax credits under Virginia's Land Conservation Incentives Act of 1999.

As to Virginia local taxes, the Virginia Supreme Court in *Dulles Duty Free* unanimously reversed a trial court decision to hold that a locality's imposition of its gross receipts BPOL tax on the sale of duty-free items sold at Dulles International Airport to be unconstitutional, as a violation of the United States Constitution's Import-Export Clause, which prohibits states from imposing duties on exported goods without permission from Congress. The Court set out the standards of Federal Constitutional law when analyzing a state tax statute on an as applied challenge to the constitutionality of Virginia's BPOL tax. The message of this article on recent developments in Virginia taxation is that an increasing number of court cases are being decided, interpreting and resolving state and local tax statutes while including informative guidance. Perhaps next year we may be able to receive a similar level of guidance on legislative changes to Virginia's Tax Code as opposed to those of a more technical variety.

338. *Id.* at *16.