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Annual Survey of Virginia Law: Taxation

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TAXATION

*Carle E. Davis**

In its 1990 session, Virginia's General Assembly passed many bills amending sections of and adding new sections to title 58.1 of the Code of Virginia (the "Code"). These bills affected a broad range of areas, including the individual and corporate income tax, the sales and use tax, real estate and recordation taxes, and miscellaneous local taxes. The Supreme Court of Virginia also decided several cases concerning miscellaneous taxation issues. In addition, the Virginia Department of Taxation finalized several regulations and promulgated proposed regulations. This article covers legislative and regulatory changes, and recent judicial decisions affecting Virginia taxation from July 1989 to July 1990. Its purpose is to alert Virginia's tax practitioners, as well as general practitioners, to these changes and decisions.

I. LEGISLATIVE ACTIVITY

A. *Changes Affecting Virginia's Income Tax*

1. Individual Income Tax

In its 1989 session, the General Assembly provided a subtraction from Virginia taxable income for retirement income effective for taxable years beginning on or after January 1, 1989.¹ The subtraction was phased out as the taxpayer's retirement income increased.² In its 1990 session, the General Assembly repealed this retirement income subtraction program and enacted a new provision which allows all taxpayers who are sixty-five or older to subtract the first \$12,000 of income reduced by social security or certain railroad retirement income.³ Taxpayers who are age 62, 63, or

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

2. *Id.* § 58.1-322(C)(14)(a).

3. *Id.* § 58.1-322(C)(15)(a) (Cum. Supp. 1990).

64 may subtract the first \$6,000 of income reduced by the amount of any social security or certain railroad retirement income.⁴ These amounts will be indexed annually by an amount "equivalent to the most recent percentage increase in the social security wage base" beginning in 1992.⁵ The General Assembly also repealed section 58.1-330 which allowed a retirement income tax credit for taxpayers age sixty-two or older.⁶ The 1990 amendments are effective for taxable years beginning on or after January 1, 1990.⁷

In a complimentary bill,⁸ the General Assembly deferred the subtraction for one-half of a self-employed person's social security tax in 1990 and 1991 for purposes of computing Virginia taxable income, thereby requiring taxpayers to add back the federal deduction for purposes of computing Virginia tax.⁹ The deferred amount may be recovered after two years.¹⁰ These provisions are effective for taxable years beginning on or after January 1, 1990.¹¹

The 1990 General Assembly also modified certain legislation enacted in 1989 that allowed employees to adjust their withholding allowances to reflect the difference between the standard deduction and itemized deductions.¹² Previously, the effective date of this legislation was to be January 1, 1991. Under Senate Bill 39 the effective date of this legislation was delayed until January 1,

4. *Id.* § 58.1-322(C)(15)(b).

5. *Id.* § 58.1-322(C)(15)(c).

6. 1990 Va. Acts 771 (repealing VA. CODE ANN. § 58.1-330 (Repl. Vol. 1984)). Former Code § 58.1-330 provided:

Any individual taxpayer aged sixty-two or over shall be allowed a credit against the tax imposed by § 58.1-320 of an amount equal to five percent of the maximum amount allowable as a benefit under Title II of the Social Security Act to a single beneficiary of his age (as determined by the Commissioner) such maximum amount reduced by:

(i) The total amount of benefits actually received under the Social Security Act or the Railroad Retirement Act; and

(ii) Twice the amount by which such taxpayer's federal adjusted gross income exceeds \$12,000. In no event shall the credit allowed hereunder exceed the total amount of tax liability of such taxpayer. No taxpayer who claims the credit under this section shall be permitted to subtract any amount under the provisions of subsection C(3) or C(4a) of § 58.1-322.

VA. CODE ANN. § 58.1-330 (Repl. Vol. 1984).

7. 1990 Va. Acts 771, 774.

8. 1990 Va. Acts 1101 (codified as amended at VA. CODE ANN. §§ 58.1-322(B)(8), (C)(16) (Cum. Supp. 1990)).

9. VA. CODE ANN. § 58.1-322(C)(16)(Cum. Supp. 1990). This change makes Virginia law nonconforming to federal law until taxable years beginning after 1991.

10. *Id.*

11. 1990 Va. Acts 1104.

12. 1989 Va. Acts 380.

1993.¹³ In addition, House Bill 433 provides that in the case of an underpayment of estimated tax by an individual, trust, or estate, there will be no penalty imposed if the underpayment is \$150 or less.¹⁴ This provision is effective for taxable years beginning on or after January 1, 1990.¹⁵

2. Corporate Income Tax

Several bills passed by the General Assembly affect the income tax of corporations. House Bill 159 amends Code section 58.1-442 to allow a corporation that files a consolidated federal income tax return to file a consolidated Virginia income tax return regardless of the type of return that the corporation currently files in Virginia.¹⁶ Under prior Virginia law, once a corporation had elected a filing status, the Tax Commissioner would generally deny a corporation's request to change the type of return the corporation filed, whether or not the type of business the corporation engaged in or the corporate structure had changed.¹⁷ This provision is effective for taxable years beginning on or after January 1, 1990.¹⁸

The General Assembly also amended Code section 58.1-302 to exclude the gross receipts from the sale of securities in apportioning corporate income tax under Virginia's corporate income tax.¹⁹ This exclusion has the effect of reducing the corporate income tax liability for multistate corporations headquartered in Virginia that are actively engaged in securities trading. On the other hand, multistate corporations headquartered outside Virginia may experience an increase in tax liability under this change. This provision

13. 1990 Va. Acts 1606.

14. 1990 Va. Acts 456 (codified as amended VA. CODE ANN. § 58.1-492(D)(3)(Cum. Supp. 1990)).

15. VA. CODE ANN. § 58.1-492 editor's note (Cum. Supp. 1990).

16. 1990 Va. Acts 913 (codified as amended at VA. CODE ANN. § 58.1-442(B)(1) (Cum. Supp. 1990)).

17. VA. CODE ANN. § 58.1-442(B)(1) (Repl. Vol. 1984). The Department of Taxation is granted the authority to promulgate regulations specifying how consolidated groups compute and apportion Virginia taxable income. *Id.* § 58.1-442(A). "The regulations are expected to allow groups currently filing separate or combined returns to switch to a consolidated Virginia return if, and only if, the group includes corporations subject to Virginia income tax and required to use different factors." Va. Dept. of Tax'n, *1990 Legislative Summary* 6 (May 1990).

18. 1990 Va. Acts 913.

19. VA. CODE ANN. § 58.1-302 (Cum. Supp. 1990). This change requires a multistate corporation to use the net gains instead of the gross receipts from the sale or disposition of intangible personal property when computing the Virginia sales factor for purposes of apportioning taxable income.

is effective for taxable years beginning on or after January 1, 1990.²⁰

3. Depreciation

Senate Bill 199 amended Code section 58.1-323.1 to extend Virginia's conformance to federal depreciation write-offs for two years to 1994.²¹ The recovery percentages for taxable years 1990 and 1991 are decreased and full recovery of previously deferred depreciation amounts is allowed over a seven-year, rather than five-year, period.²² The provisions of this section are effective for taxable years beginning on or after January 1, 1990.²³

4. Rental Income

Two of the more relevant sections enacted included Code section 58.1-316,²⁴ which requires information reporting on rental payments to nonresident payees, and Code section 58.1-317,²⁵ which requires registration of nonresident sellers of Virginia real estate. Under these sections, nonresidents who rent or sell real property in Virginia must register with the Department of Taxation. The taxpayers subject to registration include not only nonresident individuals but also nonresident estates and trusts, partnerships and S corporations which have any nonresident partners or shareholders, and corporations which are not formed or organized under Virginia

20. 1990 Va. Acts 403.

21. 1990 Va. Acts 1243 (codified as amended at VA. CODE ANN. § 58.1-323.1(C) (Cum. Supp. 1990)).

22. VA. CODE ANN. § 58.1-323.1(C) (Cum. Supp. 1990). The table set forth below illustrates the differences in the recovery provisions under prior law and current law.

<u>Taxable Year</u>	<u>% of Outstanding ACRS Additions Prior Law</u>	<u>Recovered Current</u>
1988	10%	10%
1989	10%	10%
1990	10%	10%
1991	30%	20%
1992	20%	20%
1993	0	20%
1994	0	20%

Va. Dept. of Tax'n, *1990 Legislative Summary* 6 (May 1990).

23. 1990 Va. Acts 1243.

24. VA. CODE ANN. § 58.1-316(A) (Cum. Supp. 1990).

25. *Id.* § 58.1-317(A).

law.²⁶ "Brokers," as defined in Internal Revenue Code section 6045(c), must obtain a registration form from each nonresident owner of Virginia rental property to whom the broker pays rental income.²⁷ The nonresident may, in lieu of a registration form, provide the broker with satisfactory evidence of prior registration with either another broker or the Department of Taxation.²⁸ Also, a "real estate reporting person," as defined in Internal Revenue Code section 6045(e), must obtain a registration form from each nonresident seller of Virginia real estate.²⁹ Registration, however, will not be required in transactions that are not subject to federal or state income tax.³⁰ If the seller does not complete the registration form at closing, the real estate reporting person must complete the form on the client's behalf.³¹ The registration form must be submitted by the real estate reporting person by the fifteenth day of the month following the month in which the closing occurred.³² Brokers must file on behalf of renters who do not furnish

26. *Id.* §§ 58.1-316(A), -317(A).

27. *See id.* § 58.1-316(B). Internal Revenue Code § 6045(c) provides:

DEFINITIONS.—For purposes of this section—

(1) **BROKER.** The term "broker" includes—

(A) a dealer,

(B) a barter exchange, and

(C) any other person who (for a consideration) regularly acts as a middleman with respect to property or services.

A person shall not be treated as a broker with respect to activities consisting of managing a farm on behalf of another person.

(2) **CUSTOMER.** The term "customer" means any person for whom the broker has transacted any business.

(3) **BARTER EXCHANGE.** The term "barter exchange" means any organization of members providing property or services who jointly contract to trade or barter such property or services.

(4) **PERSON.** The term "person" includes any governmental unit and any agency or instrumentality thereof.

I.R.C. § 6045(c) (West Supp. 1990).

28. VA. CODE ANN. § 58.1-316(B) (Cum. Supp. 1990).

29. *Id.* § 58.1-317(B). Internal Revenue Code § 6045(e)(2) provides:

For purposes of this subsection, the term "real estate reporting person" means any of the following persons involved in a real estate transaction in the following order:

(A) the person (including any attorney or title company) responsible for closing the transaction,

(B) the mortgage lender,

(C) the seller's broker,

(D) the buyer's broker, or

(E) such other person designated in regulations prescribed by the Secretary.

I.R.C. § 6045(e)(2). Closing attorneys are also included as real estate reporting persons.

30. *See* VA. CODE ANN. § 58.1-317(B) (Cum. Supp. 1990).

31. *Id.* § 58.1-317(C).

32. *Id.* § 58.1-317(B).

the requested registration forms to the Department of Taxation within sixty days of the broker's request.³³ Brokers must transmit the registration forms by the fifteenth day of the month following the month in which the form was received from the nonresident property owner.³⁴ If any of these requirements are not complied with, the Department of Taxation will assess a penalty of \$50.00 per month for a period of up to six months per form.³⁵

5. Miscellaneous Income Tax Credits

In its 1990 session, the Virginia General Assembly also enacted several provisions affecting miscellaneous income tax credits.³⁶ For taxable years beginning on or after January 1, 1991 and before January 1, 1994, newly enacted Code section 58.1-339 provides a tax credit for landlords providing rent reductions for elderly and disabled tenants.³⁷ Landlords who provide a reduced rent of at least fifteen percent to tenants who are either over sixty-two or totally and permanently disabled are entitled to a credit of fifty percent of the total rent reductions allowed during the taxable year to such tenants.³⁸ The total credit allowed in any one year for each individual or corporation shall not exceed \$10,000 or the total income tax liability of such individual or corporation.³⁹ Section 58.1-339 sets forth a procedure for the Virginia Housing Development Authority ("VHDA") to certify to the Department of Taxation that the individual or corporation claiming the credit is providing rent reductions as authorized. The individual or corporation must obtain certification to take the credit, and the VHDA may not approve credits in excess of \$1 million in any fiscal year.⁴⁰ The VHDA is authorized to divide the Commonwealth of Virginia into low-income housing tax credit allocation areas to permit the division or allocation of the \$1 million in tax credits on a statewide regional basis to assure that such credits are fairly allocated across the various regions of the Commonwealth. Applicants for the tax credits must be landlords doing business in the allocation area and

33. *Id.* § 58.1-316(C).

34. *Id.* § 58.1-316(B).

35. *Id.* §§ 58.1-316(C), -317(C).

36. VA. CODE ANN. § 58.1-377 (Cum. Supp. 1990). The credit is nonrefundable but may be carried over for up to five years until fully exhausted. *Id.*

37. *Id.* § 58.1-339.

38. *See id.*

39. *Id.*

40. *Id.*

the statute sets forth a procedure for allocating credits according to credit allocation area.⁴¹

In legislation enacted in its 1989 session, the General Assembly granted a tax credit of \$22.50 for tax years 1990 through 1993.⁴² This credit was designed to return to taxpayers some of the gains attributable to conforming Virginia's tax provisions to recent changes in the federal tax laws. The 1990 General Assembly repealed this credit.⁴³

House Bill 684 postpones the effective date of the low-income housing credit from January 1, 1990 to January 1, 1992.⁴⁴ The Virginia credit is only available if the taxpayer is entitled to the equivalent federal credit. The federal credit had been scheduled to expire but was temporarily extended through 1990. A taxpayer will not be entitled to any Virginia credit unless the federal credit is further extended.⁴⁵

Newly enacted Code sections 58.1-337 and 58.1-436 provide for an income tax credit of twenty-five percent of the cost of purchasing improved equipment for a more precise pesticide and fertilizer application.⁴⁶ To qualify for the credit, the individual taxpayer or corporation must be engaged in agricultural production for market and have in place a nutrient management plan approved by the local Soil and Water Conservation District.⁴⁷ The credit is limited to the lesser of \$3,750 or the total amount of income tax due and is available in the year of purchase.⁴⁸ Excess credit amounts may be carried over for up to five years.⁴⁹ The credit is available for taxable years beginning on or after January 1, 1990.⁵⁰

House Bill 279 also amends Code sections 58.1-334 and 58.1-432 to clarify that the existing tax credit for the purchase of conservation tillage equipment available to a partnership or S corporation is to be allocated to the individual partners or shareholders in proportion to their ownership interest in the partnership or S corpora-

41. *Id.*

42. *Id.* § 58.1-335(C)(1).

43. *Id.* § 58.1-335.

44. 1990 Va. Acts 1352 (codified as amended at VA. CODE ANN. §§ 36-55.63, -336, -435 (Cum. Supp. 1990)).

45. Va. Dept. of Tax'n, *1990 Legislative Summary* 4 (May, 1990).

46. VA. CODE ANN. § 58.1-337(A), -436(A) (Cum. Supp. 1990).

47. *Id.*

48. *Id.* §§ 58.1-337(B), -436(B).

49. *Id.*

50. 1990 Va. Acts 599.

tion.⁵¹ This amendment is effective for taxable years beginning on or after January 1, 1990.⁵²

Finally, newly enacted Code sections 58.1-338 and 58.1-445.1 authorize an individual and corporate income tax credit of ten percent of the purchase price paid during the taxable year for machinery and equipment used in manufacturing facilities located in Virginia to produce recycled items of tangible personal property for sale.⁵³ The total credit claimed in any one year cannot exceed forty percent of the taxpayer's Virginia income tax liability in the taxable year of purchase before claiming the credit.⁵⁴ A five-year carry forward is available for any unused credit.⁵⁵ To qualify for the credit, the Department of Waste Management must certify that the machinery and equipment are integral to the recycling process before the credit may be claimed.⁵⁶ These provisions are effective for taxable years beginning on or after January 1, 1991 and before January 1, 1993.⁵⁷

B. *Changes Affecting Real Estate and Recordation Taxes*

As in 1988 and 1989, the General Assembly made several changes affecting the real property tax exemption for elderly and handicapped individuals. The maximum income ceiling for local real property tax exemption or deferral for permanently disabled taxpayers or taxpayers age sixty-five or older was increased from \$22,000 to \$30,000 effective July 1, 1990.⁵⁸ Effective March 19, 1990, doctors who are military officers on active duty with the United States Armed Forces may certify a person under sixty-five as permanently or totally disabled for local property tax relief.⁵⁹ Also, a taxpayer otherwise qualifying for local real estate tax exemption or deferral whose health later deteriorates may have a relative reside in the home without having to include such relative's

51. 1990 Va. Acts 601 (codified as amended at VA. CODE ANN. §§ 58.1-334(C), -432(C) (Cum. Supp. 1990)).

52. VA. CODE ANN. § 58.1-334 editor's note, -432 editors note (Cum. Supp. 1990).

53. *Id.* §§ 58.1-338(A), -445.1(A).

54. *Id.*

55. *Id.* §§ 58.1-338(B), -445.1(B).

56. *Id.* §§ 58.1-338(A), -445.1(A).

57. *Id.* § 58.1-338 editor's note, -445.1 editor's note. Unused credits which have been carried forward do not expire under these effective date provisions. *Id.*

58. VA. CODE ANN. § 58.1-3211(1)(a) (Cum. Supp. 1990).

59. *Id.* § 58.1-3213(D). The General Assembly declared that an emergency existed and that this bill was effective from the date of its passage. *See* 1990 Va. Acts 225, 226.

income to determine whether the taxpayer meets the income limitations for purposes of qualifying for the exemption or deferral.⁶⁰ The General Assembly also expanded the increased income limitations enacted in 1989, for areas where the cost of living is higher, to include the cities of Manassas, Manassas Park, Chesapeake, and Suffolk, the county of Chesterfield, and the town of Leesburg.⁶¹

Newly enacted Code sections 58.1-3219 to 58.1-3219.3, effective July 1, 1990, set up a procedure for local deferral of real estate tax.⁶² Under this procedure, local governments are authorized to adopt a program that allows a taxpayer to defer a portion of real property tax increases when the real estate assessment in a single taxable year increases more than 105% above the tax assessment for the preceding year.⁶³ The local government may establish the terms and conditions for qualifying for the deferral program, and determine whether residential or commercial real estate qualifies for the deferral.⁶⁴ Taxes deferred under any such program must accrue interest and the taxes and interest will be payable upon sale or transfer of the property or within one year of the taxpayer's death and constitute a lien against the property.⁶⁵ Real estate which cannot qualify for the deferral program includes (1) real estate subject to the real estate tax relief program for the elderly and handicapped, (2) real estate on which taxes are delinquent, and (3) real estate in the use value assessment program.⁶⁶

The General Assembly also modified the procedures that the local government must follow when proposing a real estate tax increase. The advertisements that the local government must publish when the proposed increase exceeds one percent must also state the proposed increase in the locality's total budget under the proposed tax rate.⁶⁷ In addition, any public hearing on the proposed tax increase must be separate from the local budget hearing.⁶⁸

60. VA. CODE ANN. § 58.1-3211(1)(b). To qualify for this exception the taxpayers must have no other alternative except to permanently reside in a hospital, nursing home, convalescent home or other facility for physical or mental care. *Id.*

61. *Id.* § 58.1-3211(3).

62. *Id.* §§ 58.1-3219.1 to -3219.3.

63. *Id.* § 58.1-3219.1.

64. *Id.* § 58.1-3219.

65. *Id.* § 58.1-3219.1. If the real estate is owned jointly, the death of one of the joint owners will not disqualify the surviving owner from qualifying for the deferral. *Id.*

66. *Id.* § 58.1-3219.3.

67. *Id.* §§ 58.1-3321(A), -3321(B).

68. *Id.* § 58.1-3221(B).

To aid assessors in obtaining information from owners of income-producing property, Code section 58.1-3294 now provides that any owner of certain income-producing property who will not provide the real estate assessor with income and expense data for the property may not use this information in any judicial action involving an appeal of the assessment.⁶⁹

Two acts passed by the General Assembly affect the state recordation tax.⁷⁰ Effective July 1, 1990, a release of a contractual right is exempt from the recordation tax if the release is contained within a single deed that performs more than one function and one of these other functions is subject to the recordation tax.⁷¹ Also, the transfer of the state's recordation taxes to localities, in increments of \$10 million, was delayed until October 1, 1990.⁷² The expiration date of this provision was extended from June 30 to September 30, 1995.⁷³

Two additional acts amend the provisions regarding land use taxation.⁷⁴ Code section 58.1-3237 now provides that property rezoned to a more intensive use before July 1, 1988 at the request of the owner or the owner's agent will be subject to the roll-back tax at the time the use is changed rather than at the time the zoning is changed.⁷⁵ A fifty percent penalty is imposed upon the imposition of roll-back taxes.⁷⁶ Section 58.1-3233 was amended to allow a locality to prescribe by ordinance a minimum acreage greater than five acres for purposes of qualifying for land use taxation on the basis of open space use.⁷⁷ All recorded subdivision lots recorded after July 1, 1983 are excluded from the determination of minimum acreage requirements that must be met to qualify for land use taxation.⁷⁸ This provision is effective for tax years beginning on or after December 31, 1989.⁷⁹

69. *Id.* § 58.1-3294.

70. 1990 Va. Acts 395, 1314 (codified at VA. CODE ANN. § 58.1-811(H), -816(B) (Cum. Supp. 1990)).

71. VA. CODE ANN. § 58.1-811(H) (Cum. Supp. 1990).

72. *Id.* § 58.1-816(B).

73. *Id.* § 58.1-816 editors note.

74. 1990 Va. Acts 1046, 1441 (codified as amended at VA. CODE ANN. §§ 58.1-3233, -3237 (Cum. Supp. 1990)).

75. VA. CODE ANN. § 58.1-3237(D) (Cum. Supp. 1990).

76. *Id.*

77. *Id.* § 58.1-3233(2).

78. *Id.*

79. 1990 Va. Acts 1046.

C. *Changes Affecting Tangible Personal Property Taxes*

Senate Bill 313 classifies privately owned camping trailers and certain motor homes used for recreational purposes only as a separate class of property for purposes of the tangible property tax. This change permits this property class to be taxed at a rate lower than that imposed on other classes of tangible personal property.⁸⁰ Similarly, motor vehicles owned by a nonprofit organization which are "used to deliver meals to homebound persons or provide transportation to senior or handicapped citizens in the community to carry out the purposes of the nonprofit organization" may also be a separate class of tangible personal property to determine this tax.⁸¹

"[C]ertified recycling equipment, facilities or devices" are also classified as a separate class of property for purposes of the tangible personal property tax. Local governments are authorized to exempt or partially exempt such property from the tangible personal property tax.⁸²

"Certified recycling equipment, facilities, or devices" means machinery and equipment which is certified by the Department of Waste Management as integral to the recycling process and for use primarily for the purpose of abating or preventing pollution of the atmosphere or waters of the Commonwealth, and used in manufacturing facilities or plant units which manufacture, process, compound, or produce for sale recyclable items of tangible personal property at fixed locations in the Commonwealth.⁸³

D. *Changes Affecting Sales and Use Taxes*

Several amendments to Code section 58.1-608 create new exemptions to the sales and use tax. Effective July 1, 1992, "nonprescription drugs and proprietary medicines purchased for the 'cure, mitigation, treatment, or prevention of disease in human beings'" are exempt from the sales and use tax.⁸⁴ The following items are ex-

80. 1990 Va. Acts 1036 (codified as amended at VA. CODE ANN. § 58.1-3506(A)(15), (B) (Cum. Supp. 1990)).

81. VA. CODE ANN. § 58.1-3506(A)(14), (B) (Cum. Supp. 1990).

82. *Id.* § 58.1-3661(A).

83. *Id.* § 58.1-3661(B).

84. VA. CODE ANN. § 58.1-608(7)(O) (Cum. Supp. 1990). "The terms 'nonprescription drugs' and 'proprietary medicines' shall be defined pursuant to regulations promulgated by the Department of Taxation." *Id.*

empt from the sales and use tax as of July 1, 1990:

1. Tangible personal property or services purchased for use by an organization which is organized and operated primarily for the purpose of encouraging participation in the free enterprise system through secondary school and college information programs, college scholarship programs, and recognition of achievement in the American free enterprise system.⁸⁵

2. Purchases made by a nonprofit, nonstock corporation exempt from federal income tax under Internal Revenue Code section 501(c)(3) and from local property taxation if the organization is operated to provide certain social services to the needy. These services may include traveler's aid, family life education, counseling persons in financial distress, counseling for the mentally ill and mentally retarded and their significant others, assistance to persons interested in adoption or foster care, and related social services.⁸⁶

3. Purchases made by a nonprofit organization exempt from taxation under Internal Revenue Code section 501(c)(13) and organized for the purpose of operating an arts center offering a year-round schedule of art education classes for adults or children, a continuous series of exhibits focusing on twentieth century art, and sponsoring a wide range of seminars for the public at no or nominal charge.⁸⁷

4. Purchases of tangible personal property for use or consumption by a nonprofit organization operating a Head-Start program, extended day care program, and shelter for runaways pursuant to contract with a municipality.⁸⁸

5. Purchases made by day-care centers or preschools whose teachers are certified public school teachers or who are college graduates holding a degree from an accredited four-year institution and certified by an organization recognized by the U.S. Department of Education or some other nationally recognized organization.⁸⁹

6. Purchases of tangible personal property for use or consump-

85. *Id.* § 58.1-608(4)(l).

86. *Id.* § 58.1-608(8)(p). This exemption is only available until June 30, 1991. *Id.*

87. *Id.* § 58.1-608(4)(m). This exemption is only available until June 30, 1993. *Id.*

88. *Id.* § 58.1-608(8)(o). This exemption is only available until June 30, 1993. *Id.*

89. *Id.* § 58.1-608(4)(i).

tion by a nonstock, nonprofit charitable corporation exempt from taxation under Internal Revenue Code section 501(c)(3) and "organized and operated to offer social services, including, but not limited to, transitional housing for homeless individuals, employment counseling, placement and referral services to persons in financial need, health-related assistance, child care for children whose parents are either employed or enrolled in job training programs, emergency assistance (including the provision of food) to persons in financial need who may face eviction or termination of utility services, and related social welfare activities."⁹⁰

Effective July 1, 1991 until June 30, 1993, tangible personal property purchased for use or consumption by a community action agency is exempt from the sales and use tax.⁹¹

Two acts amended the provisions of the Code regarding the motor vehicle sales and use tax.⁹² Code section 58.1-2424 precludes a credit against motor vehicle sales and use taxes paid to another state if that state exempts from its motor vehicle sales and use tax vehicles sold to residents of a state that does not give credit for tax.⁹³ Code section 58.1-2403 now includes an exemption from the motor vehicle sales and use tax for motor vehicles used by hospitals or other nonprofit corporations to provide mobile diagnostic or therapeutic medical services to the public.⁹⁴ This exemption is effective retroactively to July 1, 1989.⁹⁵

Senate Bill 114 increases the maximum watercraft titling tax from \$1,000 to \$2,000 and repeals the July 1, 1992 sunset clause included in the 1987 legislation that enacted the maximum tax.⁹⁶

90. *Id.* § 58.1-608(8)(q). This exemption is only available until June 30, 1993. *Id.*

91. *Id.* § 58.1-608(8)(s). Code § 2.1-588 defines a community action agency as follows:

"Community action agency" means a local subdivision of the Commonwealth, a combination of political subdivisions, a separate public agency or a private nonprofit agency which has the authority under its applicable charter or laws to receive funds to support community action activities and other appropriate measures designed to identify and deal with the causes of poverty in the Commonwealth, and which is designated as a community action agency by federal law, federal regulations or the Governor.

Id. § 2.1-588 (Repl. Vol. 1987).

92. 1990 Va. Acts 93, 229 (codified as amended at VA. CODE ANN. §§ 58.1-2403, -2424 (Cum. Supp. 1990)).

93. VA. CODE ANN. § 58.1-2424(A) (Cum. Supp. 1990).

94. *Id.* § 58.1-2403(20).

95. *Id.* § 58.1-2403 editor's note.

96. 1990 Va. Acts 997 (codified as amended at VA. CODE ANN. § 58.1-1402 (Cum. Supp. 1990)).

E. *Changes Affecting Procedural Matters*

Several bills passed by the General Assembly concern procedural matters affecting both state and local taxes, including statutes of limitation, information returns, and time of payment. Newly enacted Code section 58.1-1802.1 imposes a twenty-year statute of limitations commencing on the date of assessment on the collection of delinquent taxes by the Department of Taxation effective July 1, 1990.⁹⁷ The period of limitations is suspended during any period that the taxpayer's assets are in the control of any state or federal court, including the United States Bankruptcy Court, or for any continuous period of at least six months during which the taxpayer is outside Virginia.⁹⁸ In addition, the Department of Taxation may not continue to assess additional interest and penalties if it has had no contact with the taxpayer for a period of seven years and no memorandum of lien has been appropriately filed in a jurisdiction in which the taxpayer owns real estate.⁹⁹ Attorneys and collection agencies hired to collect delinquent taxes may no longer receive any compensation for such services if the delinquent taxes are subsequently collected under the Setoff Debt Collection Act.¹⁰⁰

Commissioners of the Revenue may disclose sales tax information to the chief executive officer of any county or city upon a written request that includes a reason for such request.¹⁰¹ Such officer will be subject to the provisions of Code section 58.1-3 regarding the secrecy of information so disclosed.¹⁰²

The General Assembly also passed two bills that enhance the ability of Commissioners of the Revenue to obtain information for purposes of real estate taxes. House Bill 468 increases the penalty for failure to furnish certain information from a Class 4 to a Class 3 misdemeanor.¹⁰³ Furthermore, *owners* of apartment houses, trailer parks, or marinas, as well as operators, and owners and operators of any office building or shopping center must furnish a list

97. VA. CODE ANN. § 58.1801.1(A) (Cum. Supp. 1990).

98. *Id.* § 58.1-1802 (B).

99. *Id.* § 58.1-1802.1(C).

100. *Id.* § 58.1-3957(B). This limitation does not apply to contracts or agreements entered into before July 1, 1990. *Id.*

101. *Id.* § 58.1-3(D). Previously, this information could only be disclosed to local tax officials administering taxes. *Id.* § 58.1-3(A) (Repl. Vol. 1984 & Cum. Supp. 1990).

102. *Id.* § 58.1-3(D) (Cum. Supp. 1990).

103. 1990 Va. Acts 228, 229 (codified as amended at VA. CODE ANN. § 58.1-3111 (Cum. Supp. 1990)).

of tenants upon request of the Commissioner of the Revenue.¹⁰⁴

For personal property tax purposes, taxpayers owning machinery or tools or business personal property must furnish the Commissioner of the Revenue, upon request, information regarding the original cost by year of purchase.¹⁰⁵ The cost provided should be "the original capitalized cost or the cost that would have been capitalized if the expense deduction in lieu of depreciation was elected under section 179 of the Internal Revenue Code."¹⁰⁶ Also, any city that is contiguous to a county which has established a date for payment of license or personal property taxes may establish the same date for payment of such taxes in the city.¹⁰⁷ Any county may establish payment dates for personal property taxes coinciding with the payment dates in any adjacent county.¹⁰⁸

In proceedings involving the sale of real estate for delinquent taxes, service of process upon any party who is not otherwise served may be made by publication under Code section 8.01-316.¹⁰⁹ Parties receiving such service may petition for a rehearing upon a showing of good cause within one year after entry of a final decree.¹¹⁰

Local governing bodies are also authorized to provide for a ninety-day extension for filing returns for and payment of business, professional, and occupational license taxes and for payment of real estate taxes.¹¹¹

F. *Miscellaneous*

1. Estate Tax

In an effort to conform the Virginia estate tax to the federal estate tax, Senate Bill 351 amended Code section 58.1-905 to allow an extension of time to pay Virginia estate taxes when the Internal Revenue Service has granted an extension of time to pay federal

104. VA. CODE ANN. § 58.1-3901 (Cum. Supp. 1990) (emphasis added).

105. *Id.* § 58.1-3518.

106. *Id.*

107. *Id.* § 58.1-3916.

108. *Id.*

109. *Id.* § 58.1-3967.

110. *Id.* Previously, parties could petition for a rehearing for up to two years thereby making it difficult to convey clear title in the case of such sales. *See id.* § 58.1-3967 (Repl. Vol. 1984).

111. *Id.* § 58.1-3916 (Cum. Supp. 1990).

estate taxes.¹¹² The Virginia extension will apply for the same period and portion of tax as the federal extension.¹¹³ The personal representative must furnish a copy of the federal extension to the Department of Taxation.¹¹⁴ This provision will eliminate many late payment penalties and the necessity of filing requests for waivers of penalties.

2. Daily Rental Property Tax

In a technical correction, House Bill 636 amends Code sections 58.1-3510.1 and 58.1-3510.3 to clarify that the daily rental property tax is to be collected in the same manner as the local retail sales and use tax.¹¹⁵ The Commissioner of the Revenue will assess the tax and the treasurer or director of finance will collect the tax rather than the Department of Taxation.¹¹⁶ This correction is effective retroactively for daily rental property taxes collected beginning on or after July 1, 1989.¹¹⁷

3. Merchant's Capital Tax

Effective July 1, 1990, Code section 58.1-3510 was amended to clarify that lottery tickets are to be valued based only upon the compensation payable to the agent and not upon the cost of the tickets to the merchant in localities that levy a merchant's capital tax.¹¹⁸

4. Food and Beverage Taxes

Specific legislation enacted by the General Assembly in 1990, applicable only to counties, clarifies several matters concerning the authority of counties to levy the meals tax.¹¹⁹ This legislation amended Code section 58.1-3833 and (1) removes the limitation that food be consumed on the premises to be subject to taxation,

112. 1990 Va. Acts 1050 (codified as amended at VA. CODE ANN. § 58.1-905(B) (Cum. Supp. 1990)).

113. VA. CODE ANN. § 58.1-905(B) (Cum. Supp. 1990).

114. *Id.*

115. 1990 Va. Acts 229 (codified as amended at VA. CODE ANN. §§ 58.1-3510.1, -3510.3 (Cum. Supp. 1990)).

116. VA. CODE ANN. § 58.1-3510.3. (Cum. Supp. 1990).

117. *Id.*

118. VA. CODE ANN. § 58.1-3510(E).

119. 1990 Va. Acts 1454, 1495 (codified as amended at VA. CODE ANN. § 58.1-3833 (Cum. Supp. 1990)).

(2) sets the maximum tax rate at eight and one-half percent when combined with the state retail sales and use tax, (3) excepts from the tax meals sold by public school cafeterias, nursing homes, and hospitals, and (4) subjects to tax prepared sandwiches and single meal platters sold at delicatessen counters of grocery and convenience stores.¹²⁰

Newly enacted Code section 58.1-3841 provides that the situs for taxation of food and beverage sales is the locality where the vendor maintains his business rather than the place where the food or beverage is delivered to the customer.¹²¹ If the vendor is subject to tax in more than one locality, the tax is to be prorated if both localities impose a tax.¹²²

5. Transient Occupancy Tax

Two bills affected the transient occupancy tax as it is applied in certain jurisdictions. House Bill 1024 authorizes Franklin County to impose a transient occupancy tax, not in excess of two percent, on condominiums, apartments, and townhouses in which rooms are rented for periods of less than thirty days at a time.¹²³ Senate Bill 63 permits any county with a county manager, including Arlington County, to levy an additional one-quarter percent transient occupancy tax beginning July 1, 1991 until December 31, 1993. Any additional revenue from this tax must be used to promote tourism and the tourist industry within the county.¹²⁴

6. Tax Increment Financing

House Bill 992 expanded the authorized uses of tax increments financing by local governments to include not only the elimination of blighted areas, but also the development of roads, water, sewers, and parks.¹²⁵

120. VA. CODE ANN. § 58.1-3833(A) (Cum. Supp. 1990).

121. *Id.* § 58.1-3841(A).

122. *Id.* § 58.1-3841(B).

123. 1990 Va. Acts 639 (codified at VA. CODE ANN. § 58.1-3821 (Cum. Supp. 1990)).

124. 1990 Va. Acts 1614 (codified at VA. CODE ANN. § 58.1-3822 (Cum. Supp. 1990)).

125. 1990 Va. Acts 404 (codified at VA. CODE ANN. § 58.1-3245.1 (Cum. Supp. 1990)).

7. License Taxes

Code section 58.1-3730.1 was amended to provide that the license tax on agricultural associations, as well as industrial loan associations, cannot exceed \$500.¹²⁶

8. Motor Vehicle Dealer License Tax

In sales of motor vehicles involving trade-ins, the dealer's gross receipts for license tax purposes must be reduced by the amount of any trade-in.¹²⁷ Also, a locality cannot assess omitted taxes against a dealer who calculated gross receipts for periods before January 1, 1991 unless the locality enforced the requirement that the deals include the amount of a trade-in in gross receipts for periods before January 1, 1990.¹²⁸

9. Gas Severance Tax

Newly enacted Code section 58.1-3713.4 authorizes localities to levy an additional local gas severance tax not to exceed one percent of gross receipts.¹²⁹ Any revenue received from such tax must be paid into the general fund of the city or county where the gas is severed.¹³⁰ The counties of Buchanan, Dickenson, Lee, Russell, Scott, Tazewell, and Wise and the City of Norton must submit one-half of such revenues to the Virginia Coalfield Economic Development Fund.¹³¹

10. Road Tax on Motor Fuel

In another change, the computation of the road tax on motor fuel must now be calculated based on miles traveled quarterly rather than annually.¹³² The State Corporation Commission can also grant a credit to motor carriers for road taxes paid on fuel purchased by their lessees.¹³³

126. VA. CODE ANN. § 58.1-3730.1 (Cum. Supp. 1990).

127. VA. CODE ANN. § 58.1-3734.1(B) (Cum. Supp. 1990).

128. *Id.* § 58.1-3734.1(A).

129. VA. CODE ANN. § 58.1-3713.4 (Cum. Supp. 1990).

130. *Id.*

131. *Id.*

132. VA. CODE ANN. § 58.1-2704 (Cum. Supp. 1990).

133. *Id.* § 58.1-2706(F).

II. JUDICIAL CHANGES

A. *Property Tax Exemption by Classification*

In *Westminster-Canterbury v. City of Virginia Beach*,¹³⁴ the Supreme Court of Virginia examined the propriety of an assessment of real estate taxes by the City of Virginia Beach against Westminster-Canterbury of Hampton Roads, Inc. ("Westminster-Canterbury"). Westminster-Canterbury is a nonstock, nonprofit corporation organized at the direction of two religious organizations that owns and operates a housing and health-care facility for the elderly in Virginia Beach. For many years, Westminster-Canterbury had been exempt from real property taxes. The City of Virginia Beach then assessed approximately \$400,000 of real estate taxes against it in 1984 for 1982, 1983, and 1984.¹³⁵ The facility in Virginia Beach is identical to four other facilities located in Virginia, all of which enjoy exemption from real estate taxes by special designation of the General Assembly.¹³⁶

Westminster-Canterbury argued that it qualified for tax-exempt status under the classification (as opposed to designation) statutes because it is a nonprofit religious association whose property is used exclusively for charitable purposes. Furthermore, the General Assembly had designated other similar facilities located in Virginia as "charitable," "benevolent," and "religious." Therefore, Westminster-Canterbury claimed it must be the same type of organization entitled to the same classification and tax treatment because its facilities are identical to the exempted facilities.¹³⁷

The court ruled that tax exemptions under the Virginia Constitution must be strictly construed. "This means that Westminster's entitlement to exemption must appear clearly from the statutory provisions upon which it relies."¹³⁸ Examining Code sections 58.1-3606(A)(5) and 58.1-3617, the court concluded that Westminster-Canterbury was not clearly organized solely for charitable purposes and accordingly was not entitled to exemption under those sections. The court rejected Westminster-Canterbury's claim for exemption under the classification statutes and stated that there was a clear dichotomy between the classification statutes and the desig-

134. 238 Va. 493, 385 S.E.2d 561 (1989).

135. *Id.* at 495-96, 385 S.E.2d at 562.

136. *Id.* at 497, 385 S.E.2d at 563.

137. *Id.* at 499-500, 385 S.E.2d at 565.

138. *Id.* at 501, 385 S.E.2d at 565.

nation statutes under which its affiliates had received an exemption.¹³⁹

Westminster-Canterbury then argued that the City of Virginia Beach was estopped from assessing such taxes retroactively and *prospectively* because of prior assurances it had received from the City of Virginia Beach regarding its tax-exempt status upon which Westminster-Canterbury had relied.¹⁴⁰ The court rejected this argument stating, "We have repeatedly held that estoppel does not apply to the state or local governments when acting in a governmental capacity."¹⁴¹ This same doctrine applies in the case of taxation, as well as in other areas. "Even where a municipality has contracted formally to exempt property from taxation, it is not estopped from making a later assessment if the property is not 'within any exempted class.'"¹⁴² Accordingly, the court held that Westminster-Canterbury was liable not only for taxes in 1984 and prospective years, but also for 1982 and 1983.¹⁴³

B. *Income Tax Credit for Net Income Taxes Paid to District of Columbia*

In *King v. Forst*,¹⁴⁴ the Supreme Court of Virginia held that the District of Columbia's tax on the net income of unincorporated businesses is an income tax. As a result, a Virginia resident who conducts business in the District of Columbia is entitled to a credit against his Virginia income taxes for the amount of tax paid on net income to the District of Columbia.

In *King*, the taxpayer, a Virginia resident, operated an unincorporated printing business in the District of Columbia. In 1983, the taxpayer paid \$19,211 in taxes to the District of Columbia on the net income of the business. He claimed a credit for these taxes on his Virginia individual income tax return. The Tax Commissioner denied the credit stating that the net income tax was a franchise tax rather than an income tax and did not qualify for the credit.¹⁴⁵

The court based its decision on District of Columbia precedent

139. *Id.* at 502, 385 S.E.2d at 566.

140. *Id.*

141. *Id.* at 503, 385 S.E.2d at 566.

142. *Id.* at 503, 385 S.E.2d at 567.

143. *Id.*

144. 239 Va. 557, 391 S.E.2d 60 (1990).

145. *Id.* at 558-59, 391 S.E.2d at 61.

which holds that the tax on the net income of unincorporated businesses was an income tax rather than a franchise tax. The court found that the taxpayer was entitled to a credit against his Virginia income taxes for such taxes paid to the District of Columbia.¹⁴⁶

C. *Tax on Manufacturing Machinery and Equipment*

In *County of Chesterfield v. BBC Brown Boveri, Inc.*,¹⁴⁷ a case of first impression, the Supreme Court of Virginia determined whether property used in business should be taxed at a rate applicable to manufacturing property or at the higher rate applicable to tangible personal property. The taxpayer was engaged in both manufacturing and nonmanufacturing activities. The trial court had determined that the taxpayer was a manufacturer and that the personal property and business license tax assessments against the taxpayer were erroneous. The County of Chesterfield appealed.¹⁴⁸

The supreme court applied a substantiality test for determining whether the taxpayer was engaged in manufacturing. In formulating the test, the court announced that “[w]hen a party is engaged in both manufacturing and non-manufacturing activities, it will nonetheless be classified as a manufacturer for tax purposes if the manufacturing portion of its business is substantial.”¹⁴⁹ The court also explained that:

The test of substantiality of manufacturing activities for determining whether a multi-purpose business qualifies as a manufacturer for tax purposes does not lend itself to a rigid definition. Rather, the business must be considered as a whole in determining whether it qualifies as a manufacturer. To be considered substantial, the manufacturing component of a business must not be *de minimis*, merely trivial, or only incidental to its principal business.¹⁵⁰

The court set forth several factors that must be examined to make this determination which include “the manufacturing component’s financial receipts, its proportion of the total corporate income, the percentage it comprises of the total capital investment, the number

146. *Id.* at 561, 391 S.E.2d at 62-63.

147. 238 Va. 64, 380 S.E.2d 890 (1989).

148. *Id.* at 66, 380 S.E.2d at 891.

149. *Id.* at 70, 380 S.E.2d at 893 (citation omitted).

150. *Id.* at 71, 380 S.E.2d at 893-94 (citation omitted).

of employees working in the manufacturing component as compared with the total number of employees, or the ratio of manufacturing activities to the entire business."¹⁵¹

The court held that the trial court, upon the examination of all of these factors, did not err in concluding that the taxpayer was a manufacturer and its machinery and tools were subject to the lower tax rate applicable to manufacturers.¹⁵² In addition, the court held that the taxpayer was also exempt from the payment of business license taxes as its nonmanufacturing activities were "ancillary" to its primary business of manufacturing.¹⁵³

D. *Taxation of Leased Computer Equipment*

In *City of Martinsville v. Tultex Corp.*,¹⁵⁴ the Supreme Court of Virginia held that the use of property by a lessee (rather than the lessor) determines its classification for tangible personal property tax purposes. The taxpayer leased certain computer and computer-related equipment from Bameri-Lease, Inc. The City of Martinsville assessed tangible personal property taxes against the equipment. The taxpayer argued that the property was capital and was not subject to tangible personal property tax. The trial court sided with the taxpayer.¹⁵⁵

The court stated that the proper test is not how the *owner* used the property but rather whether "the property is in fact 'used or employed in a manufacturing . . . business.'"¹⁵⁶ Because the equipment was used in a manufacturing business, it was classified as intangible capital and subject only to state and not local taxation.¹⁵⁷

III. REGULATIONS

In the past year, the Virginia Department of Taxation issued three final regulations and one proposed regulation. These regulations pertained to income taxes, the tire tax, and certain administrative procedures to be followed by the Department of Taxation

151. *Id.* at 71, 380 S.E.2d at 894.

152. *Id.* at 72, 380 S.E.2d at 894.

153. *Id.* at 72-73, 380 S.E.2d at 894.

154. 238 Va. 59, 381 S.E.2d 6 (1989).

155. *Id.* at 60, 381 S.E.2d at 6.

156. *Id.* at 63, 381 S.E.2d at 8.

157. *Id.*

when padlocking premises.

A. *Telecommunication Companies*

Final regulation 630-3-400.1 concerns the taxation of telecommunication companies. This regulation was promulgated as a result of legislation enacted in 1988 that subjects telecommunication companies to the Virginia corporate income tax (rather than the license tax on gross receipts) beginning in 1989.¹⁵⁸ These regulations are effective January 3, 1990.¹⁵⁹

B. *Virginia Tax Reform Credit*

The Department of Taxation promulgated proposed regulations setting forth the procedure for low-income individuals to claim the credits as enacted by the General Assembly in its 1989 Session.¹⁶⁰ The 1990 General Assembly repealed a portion of these credits.¹⁶¹

C. *Virginia Tire Tax*

Effective February 14, 1990, final regulations 630-27-640 to 644 explain the application of the Virginia Tire Tax to the retail sale of new tires.¹⁶²

D. *Padlocking Premises*

Final regulation 630-1805.1 sets forth the administrative procedures that the Department of Taxation must follow in suspending the business operations of delinquent taxpayers by padlocking the doors of the business.¹⁶³ This regulation is effective April 1, 1990.¹⁶⁴

158. 6 Va. Regs. Reg. 731 (Dec. 4, 1989).

159. *Id.*

160. 6 Va. Regs. Reg. 884 (Dec. 4, 1989).

161. See *supra* notes 42-43 and accompanying text.

162. 6 Va. Regs. Reg. 1175 (Jan. 15, 1990).

163. 6 Va. Regs. Reg. 1641 (Feb. 26, 1990).

164. *Id.*

