



## Southeast State & Local Tax: Important Developments - January 2014

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The Williams Mullen Southeast [State and Local Tax](#) (SESALT) team is pleased to provide you with a comprehensive recap of recent legislation around the U.S.

### VIRGINIA

#### INDIVIDUAL INCOME TAX

- **Virginia Income Tax Treatment of Same-Sex Couples.** Outgoing Virginia Attorney General Ken Cuccinelli issued an advisory opinion on his last day in office stating that the Virginia Constitution prohibits Virginia's governor from directing or requiring state agencies to allow same sex couples to receive joint marital status for Virginia income tax returns. [Va. Atty. Gen. Op. 13-114](#) (2014); see also [Va. P.D. 13-209](#) (Department of Taxation rules that same-sex couples cannot file a Virginia joint income tax return). Virginia's new attorney general, Mark Herring, has announced that he intends to reverse Virginia's position on same-sex marriage and will not defend the Commonwealth in suits challenging its ban on same-sex marriages.

#### CORPORATE INCOME TAX

- **Subsidiary Included in Consolidated Return.** The Department of Taxation held that a Virginia corporation ("Corporation A") acquired by the taxpayer must include the taxpayer's Virginia subsidiary ("Subsidiary A") in its consolidated Virginia income tax return. Prior to the acquisition, Subsidiary A filed a Virginia income tax return, but the taxpayer itself was not subject to Virginia income tax. Va. Code § 58.1-442 allows corporations to elect to file returns as separate, combined or consolidated entities, regardless of how they file their federal income tax returns. The Department concluded that, because the taxpayer was not subject to Virginia income taxes before or after the acquisition, no new affiliated group was created. Accordingly, Subsidiary A would be required to join in the election with Corporation A and its affiliates. [Va. P.D. 13-241](#).
- **Net Add-Back of Royalties.** The Department of Taxation held that a corporate taxpayer did not qualify for an exception to Virginia's add-back requirements under Va. Code § 58.1-402(B)(8) on royalties paid by its affiliates. The taxpayer claimed that all of the royalty payments qualified for the

add-back exception under Va. Code § 58.1-402(B)(8) because they were subject to tax in another state. The Department ruled that Va. Code § 58.1-402(B)(8) is limited to the portion of a taxpayer's royalty payments to its affiliate that correspond to the portion of the affiliate's income taxable in another state using the apportionment percentages on the other state's returns. Va. Code § 58.1-402(B)(8) does not apply to the gross amount of payments that a taxpayer makes to an affiliate merely because the gross amount is shown on another state's tax return. [Va. P.D. 13-226](#); See also [Va. P.D. 13-238](#).

## SALES AND USE TAX

- **Gaming-Related Items Not Subject to Sales and Use Tax.** The Department of Taxation held that the taxpayer's sales of gaming-related items are not subject to the retail and communications sales and use taxes. The taxpayer sells video game console point cards, video game online memberships and online point cards at retail locations and on its website. Customers purchase the point cards and memberships to gain access to amenities. Consequently, the Department held that the items are not tangible personal property under Va. Code §§ 58.1-602 and 58.1-603, and thus, not subject to retail sales and use tax. Also, as the items are not communications services under Va. Code §58.1-647, the Department ruled that the items are not subject to the communications sales and use tax. [Va. P.D. 13-236](#).
- **Medical Device Sales Exempt from Sales and Use Tax.** The Department of Taxation ruled that a taxpayer's sales of medical devices to for-profit hospitals are exempt from sales and use tax under Va. Code § 58.1-609.10(10) if they are purchased on behalf of an individual for use by such individual. The exemption does not apply if the items are purchased in bulk and then dispensed to individual patients. In addition, the Department ruled that, under Va. Code § 58.1-609.11, sales of medical devices are exempt from sales and use tax if they are sold to a non-profit hospital, clinic or retirement home, regardless of whether such devices are purchased on behalf of an individual. [Va. P.D. 13-234](#).

## PROPERTY TAX

- **Local Property Tax Exemptions.** The Virginia Attorney General issued an advisory opinion stating that the exemption or deferral of real property taxes for a person sixty-five (65) or older or disabled under Art. X, § 6(b) of the Constitution of Virginia does not extend to a person who has placed title to the real property in any form of trust. However, according to the opinion, the exemption under Art. X, § 6(b) does extend to a person who holds a life estate in real property and otherwise qualifies for the exemption. Also, the Virginia Attorney General opined that the property tax exemption provided under Art. X, § 6-A for totally disabled veterans extends to qualifying veterans who hold a life estate in the real property. [Va. Atty Gen. Op. 13-070](#).

## BUSINESS, PROFESSIONAL AND OCCUPATIONAL TAX

- **BPOL Tax Does Not Apply to Non-Profit Organization.** The Department of Taxation ruled that the BPOL tax did not apply to a non-profit organization exempt from federal income taxation under § 501(c)(3) of the Internal Revenue Code, provided that the organization did not generate any

unrelated business taxable income (“UBTI”). The Department noted that, if it engages in activities in the future that result in UBTI, the organization would be required to obtain a license and pay BPOL tax in the appropriate locality. [Va. P.D. 13-218](#).

- **Registration Fees Donated to Non-Profit Organization May be Subject to BPOL Tax** The Department of Taxation ruled that registration fees collected by the organizer of a 5k race for a non-profit organization would be subject to the BPOL tax unless the organizer acts as the agent of the non-profit. In order for there to be an agency relationship, (i) there must be a contractual relationship between the organizer and the non-profit, (ii) the organizer cannot commingle the registration fees with other funds and (iii) the organizer must not report the pass-through costs on its federal income tax return. BPOL tax may apply to funds ultimately donated to non-profit organizations unless they follow strict requirements. [Va. P.D. 13-216](#).
- **Manufacturing Exemption to BPOL Tax** The Department of Taxation ruled that a producer of custom electronic devices qualified for the manufacturing exemption to the BPOL tax under Va. Code § 58.1-3703(c)(4). The taxpayer purchased component parts from unrelated companies, which it assembled and sold to the federal government. The County’s position was that the assembly of component parts does not qualify as manufacturing. The term “manufacturing” is not defined by the Code of Virginia for purposes of the exemption under Va. Code § 58.1-3703(c)(4). However, pursuant to decisions of the Supreme Court of Virginia and guidance provided by 23 Va. Admin Code § 10-500-520(C), the Department concluded that the taxpayer was a manufacturer because it assembled integrated parts into a substantially different product. [Va. P.D. 13-224](#).

## CREDITS AND INCENTIVES

- **Land Preservation Tax Credits** The Department of Taxation held that the taxpayer’s income from the deemed sale of Land Preservation Tax Credits for federal income tax purposes would not result in any change to the taxpayer’s Virginia taxable income, but that the taxpayer still must file an amended Virginia income tax return. The taxpayer and the IRS entered into an agreement re-characterizing capital contributions to the partnership as sales of Virginia Land Preservation Tax Credits by the partners to the investors. As a result, the taxpayer’s federal adjusted gross income and deductions were adjusted. The taxpayer claimed that the federal adjustments from the re-characterization should be disregarded for Virginia income tax purposes. The Department agreed, noting that, under Va. Code § 58.1-513(E), the transfer of Land Preservation Tax Credits does not create gain or loss for the transferor or transferee. The Department also noted that, pursuant to Va. Code § 58.1-339.2(F), gain or loss from the allocation of Historic Rehabilitation Tax Credits does not create taxable gain or income for Virginia income tax purposes. The taxpayer still must file an amended Virginia income tax return to report the adjustment. [Va. P.D. 13-225](#).

## RECORDATION TAXES

- **Federal Credit Unions Exempt from Recordation Tax** The Virginia Attorney General issued an advisory opinion on January 3, 2014 stating that federal credit unions are exempt from Virginia’s recordation tax. The opinion notes that pursuant to federal law, 12 U.S.C. § 1278, federal credit unions are exempt from “all taxation,” except any federal, state and local taxation on its real and

tangible personal property. Pursuant to guidance from the Virginia Administrative Code and decisions by the Supreme Court of Virginia, the recordation tax is a tax on a civil privilege, not a tax on property. Thus, the Attorney General opined that federal credit unions are exempt from the recordation tax. [Va. Atty Gen. Op. 13-105](#).

## **NORTH CAROLINA**

- **Bond Market Discount Income.** The North Carolina Department of Revenue held that income from the disposition of U.S. bonds by the taxpayer (Fidelity Bank) was not deductible for North Carolina corporate income tax purposes. In order for market discount income to be deductible from North Carolina taxable income, N.C. Gen. Stat. § 105-130.5(b)(1) requires that: (1) the income must be interest upon the obligations of the United States; and (2) interest on North Carolina bonds must be exempt from federal income taxes. The Department ruled that, since market discount income on North Carolina bonds was included in federal taxable income, market discount income on U.S. bonds also must be taxable for North Carolina corporate tax purposes. The Department remanded the issue of whether accrued interest on the bonds should be reduced or waived to an administrative law judge. [N.C. Dept. of Rev. Final Agency Decision, No. 08 Rev. 2665](#).
- **Collection of Sales and Use Tax on Service Contracts.** The North Carolina Department of Revenue released an important notice on the collection of service contracts for retailers of service contracts. North Carolina imposes a 4.75% general state sales and use tax (plus applicable local tax) to the sales price of a service contract sold at retail by a retailer on or after January 1, 2014 and sourced to North Carolina. The notice provides that, in order to accommodate a number of business practices, any sales and use taxes collected and remitted by a salesperson, agent or other person will be treated as properly collected and paid on behalf of the retailer. The notice adds that any salesperson, agent or other person that enters into or executes a “service contract” on behalf of a retailer should give notice to the retailer of its intent to collect the applicable sales and use taxes on such transactions. [N.C. Dept. of Rev, Important Notice: Collection of Tax on Service Contracts \(2014\)](#); see also [N.C. Directive No. 08-13-5 \(2013\)](#).
- **Protective Refund Claim.** The Department of Revenue announced that the protective refund claim policy is repealed, effective January 1, 2014, because **N.C. Gen. Stat. § 105-241.6(b)(5) now provides an exception to the general statute of limitations for obtaining a refund of an overpayment due to a contingent event.** There is no special form for filing a protective claim. The Department will accept any written submission that is (i) filed prior to the expiration of the statutory refund claim period; (ii) identifies and describes the contingencies affecting the claim; (iii) is sufficiently clear and definite to put the Department on notice as to the essential nature of the claim; and (iv) identifies the tax schedule and the specific year for which the protective claim is filed. Upon conclusion of the contingency, a taxpayer may perfect the claim for refund by filing an amended return. [N.C. Dept. of Rev., Protective Refund Claim \(2014\)](#).

## **MARYLAND / SOUTH CAROLINA**

**Fourth Circuit Rules that Fannie Mae and Freddie Mac are Exempt from County Transfer and Recordation Taxes in Maryland and South Carolina.** Fannie Mae and Freddie Mac acquired real property in Maryland and South Carolina through foreclosures on mortgages that they owned or

guaranteed. Pursuant to 12 USC § 1723a(c)(2) and 12 USC § 1452(e), Fannie Mae and Freddie Mac are exempt from state and local taxes except real property taxes. When selling the properties to third parties, they claimed the federal exemptions and did not pay county transfer taxes or recording fees. Maryland and South Carolina argued that the exemptions did not apply as “real property” includes the deeds to real property and, therefore, that Fannie Mae and Freddie Mac should be subject to transfer and recordation taxes. The U.S. Court of Appeals for the Fourth Circuit held otherwise, finding that there is a difference between a “tax on property” and a “tax on the transfer of property.” The court noted that Maryland’s and South Carolina’s statutes even confirmed this distinction. The court also concluded that the exemptions did not violate Congress’ constitutional powers under the Commerce Clause. Therefore, the court held that Fannie Mae and Freddie Mac are exempt from paying county transfer and recordation taxes in Maryland and South Carolina. [Montgomery County, Maryland v. Federal National Mortgage Association, U.S. Ct. App. \(4th Cir.\), Dkt. Nos. 13-1691; 13-1752 \(Jan. 27, 2014\).](#)

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