



## Southeast State & Local Tax: Important Developments - April Update

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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

#### CORPORATE INCOME TAX

- **IC-DISCS.** An interest-charged domestic international sales corporation (“IC-DISC”) is a tax exempt entity that an export company may form as part of a planning technique to lower its federal rate of taxation on export income. Effective for taxable years beginning on or after January 1, 2014, IC-DISCS also are exempt from Virginia corporate income tax, the minimum tax on telecommunications companies, and the tax imposed on electric suppliers, pipeline distribution companies, gas utilities, and gas suppliers. [S.B. 515, H.B. 480 Leg. 2014 \(Va. 2014\)](#); see [Impact Statement](#).

#### PASS-THROUGH ENTITIES

- **Filing Requirements.** The Department of Taxation held that a State A LLC that provided engineering services to customers in Virginia was not required to file a Virginia income tax return because its activities in Virginia were not sufficient to create a positive apportionment factor for Virginia income tax purposes. Although its employees occasionally made visits to Virginia, the majority of the LLC’s work was performed in State A. The LLC did not have any Virginia source income because it did not have any property or payroll in Virginia. In addition, it did not have any sales attributable to Virginia, as more than 50% of the cost for providing services to Virginia customers was incurred in State A. [Va. P.D. 14-48](#).

#### FIDUCIARY INCOME TAX

- **Resident Trusts.** The Department of Taxation held that three generation-skipping trusts (“GSTs”) were not required to file a Virginia fiduciary income tax return because they did not satisfy any of the criteria to be treated as “resident trusts” under Va. Code § 58.1-381. The GSTs were established outside of Virginia by grantors who never resided in Virginia, and none of the GSTs

owned property in Virginia. The GSTs were administered by two co-trustees. Co-Trustee 1, a State A corporation, administered the day-to-day operations of each GST. Co-Trustee 2, a Virginia resident, could not make decisions individually and was limited to participating in committee meetings in State A to set annual distributions by each GST. Citing Va. P.D. 02-101, the Department concluded that the GSTs were not administered in Virginia. [Va. P.D. 14-49](#).

## SALES AND USE TAX

- **Accelerated Sales Tax Payment.** The Department of Taxation issued guidelines regarding the additional payment made by dealers required to make an accelerated sales tax payment. Effective for calendar year 2014, any dealer having taxable sales and/or purchases of \$48.5 million or greater during the 12-month period beginning July 1 and ending June 30 of the immediately preceding calendar year must make a payment equal to 90% of the retail sales and use tax liability for the previous June on or before each June 30 if paying by electronic funds transfer. If payment is made by another method, the payment must be made on or before June 25. The guidelines include information on the accelerated sales tax payment requirement, affected dealers, exceptions, accelerated sales tax payment and reconciliation, penalties and interest, hardship exceptions, requests for reconsideration and disposition of revenues. [Va. P.D. 14-58](#).
- **Contractor vs. Retailer.** The Department of Taxation held that a taxpayer, a commercial interior business located in Tennessee, is a contractor with respect to real property for Virginia sales and use tax purposes. As such, the Department held that the taxpayer is subject to Virginia use tax on tangible personal property purchased for use and consumption when it supplies and installs window treatments and cubicle curtains in the performance of real property jobs in Virginia. In instances where the taxpayer is required to pay Tennessee sales or use tax on property consumed in Virginia jobs, and if an audit is performed, the taxpayer may be allowed credit for any Tennessee use tax on such property. [Va. P.D. 14-43](#).

## BUSINESS PROFESSIONAL AND OCCUPATIONAL LICENSE TAX

- **Deductions.** The Department of Taxation held that a taxpayer was permitted a deduction for gross receipts attributable to business conducted in other states. The County had disallowed the deduction, claiming that there was no statutory basis for allowing the out-of-state deduction when a taxpayer uses payroll apportionment to situs gross receipts. The Department cited the Supreme Court of Virginia's decision in *Ford Motor Credit Co. v. Chesterfield County*, 281 Va. 321, 707 S.E.2d 311 (2011), to support its position. The Department also clarified the three-step process for computing the deduction where gross receipts have been situated by payroll apportionment. [Va. P.D. 14-29](#); see also [Va. P.D. 14-30](#) and [Va. P.D. 14-31](#).

## MACHINERY AND TOOLS TAX

- **Manufacturing Process.** In an advisory opinion, the Department of Taxation indicated that post-production and packaging equipment used by a paper manufacturer may not be subject to the machinery and tools tax ("MTT"). The MTT applies to equipment (i) actually and directly used in the manufacturing process where new materials are transformed into a substantially different product or (ii) connected with the operation of machinery actually and directly used in the manufacturing process. The Department noted that various machinery used by the taxpayer to roll,

cut and package the paper after it has been made does not appear to transform the paper into a substantially different product. The Department declined to make a final determination without examining the taxpayer's operations. [Va. P.D. 14-22](#).

## BUSINESS TANGIBLE PERSONAL PROPERTY TAX

- **Fixtures to Real Property.** The Department of Taxation ruled that gas pumps replaced by a service station to comply with federal requirements regarding debit card transactions were fixtures to real property and, thus, subject to local real property taxes and not local business tangible personal property taxes. Citing the Supreme Court of Virginia's decision in *Danville Holding Corp. v. Clement*, 178 Va. 223 (1941), the Department concluded that the gas pumps satisfied the three general rules to be treated as a fixture that is part of the real estate (annexation, adaption, intent). [Va. P.D. 14-53](#).

## OTHER

- **Taxpayer Bill of Rights.** The Department of Taxation ruled that Virginia's Taxpayer Bill of Rights only applies to local taxes administered by the Department (e.g., audit and collection procedures for the local portion of the retail sales and use tax). The Taxpayer Bill of Rights does not extend to taxes administered by the locality, such as real estate taxes, tangible personal property taxes, and the Business, Professional and Occupational License Tax. [Va. P.D. 14-17](#).

## NORTH CAROLINA

- **Exception to General Statute of Limitations for Refund.** The Department of Revenue has released guidance concerning legislation effective January 1, 2014 that provides an exception to the general statute of limitations for obtaining a refund of an overpayment due to a contingent event or an event or condition other than a contingent event. A "contingent event" is litigation or a state tax audit initiated prior to the expiration of the statute of limitations period that prevents a taxpayer from possessing the information necessary to file an accurate and definite request for refund of an overpayment. An "event or condition other than a contingent event" is an event or condition other than litigation or a state tax audit that has occurred and prevents the taxpayer from filing an accurate and definite request for refund of an overpayment within the statute of limitations period. The guidance provides procedures for claiming the refund. [N.C. Dept. of Rev., Exception to the General Statute of Limitations for Certain Events \(April 29, 2014\)](#).
- **Sales Tax – Rentals of Certain Accommodations.** The Department of Revenue has published guidance on its website about a previously published Important Notice regarding sales tax due on rentals of certain accommodations, including private residences and cottages. Until an amendment to the Notice on June 14, 2012, the Department's position had been that accommodations listed with a real estate agent or broker for rental to transients generally were available for rental to transients and that the "less than 15 days exclusion" was not applicable to such rental receipts. In the June 14, 2012 amendment to the Important Notice, the Department altered its interpretation to provide that the gross receipts derived from the rental of accommodations for fewer than 15 days in a calendar year were not subject to sales tax, whether or not such accommodations were listed with a real estate agent or broker. Upon further review, the Department has concluded that the June 14, 2012 amendment did not reflect the intent of the law. The Department has asked the

General Assembly to provide clarifying legislation upholding the longstanding interpretation prior to change, which the General Assembly will consider in the 2014 short session. [N.C. Dept. of Rev., Sales Tax on Rentals of Private Residences, Cottages, and Other Accommodations \(April 17, 2014\)](#)

- **Adjustments for Code Section 179 Expenses.** For tax years 2010 through 2013, North Carolina did not fully conform to federal law regarding expenses under Section 179 of the Internal Revenue Code (the “Code”). For 2013, North Carolina law provided that the North Carolina dollar limitation was \$25,000 and that the North Carolina investment limitation was \$125,000. The Department has been advised by the staff of the General Assembly that there was a drafting error in the law regarding the investment limitation for 2013. According to staff, the General Assembly intended the North Carolina investment limitation for taxable year 2013 to be \$200,000. The Revenue Laws Study Committee has voted to recommend that the General Assembly change the North Carolina investment limitation for the taxable year 2013 to \$200,000 during the 2014 legislative session. [N.C. Dept. of Rev., Important Notice: Income Tax Adjustments for Code Section 179 Expenses \(April 16, 2014\)](#).

## MARYLAND

- **Nexus Created by Lack of Economic Substance with Parent** Maryland’s highest court affirmed a Maryland Court of Appeals decision holding that two-out-of-state subsidiaries with no in-state physical presence were subject to Maryland corporate income tax. According to the court, nexus was established because the subsidiaries did not have economic substance separate from their parent, an entity with operations in Maryland. Among other factors, the court noted that (i) the subsidiaries depended on the parent for their income, (ii) there was a circular flow of money between the subsidiaries and their parent, (iii) the subsidiaries relied on their parent for core functions and services and (iv) there was a general absence of any substantive activity by the subsidiaries that would separate them from the parent. [Gore Enterprise Holdings, Inc. v. Comptroller of the Treasury, Md. Ct. App. No. 36 Sept. Term 2013 \(2014\)](#).
- **Research and Development Tax Credit** The Comptroller of the Treasury adopted amendments to the regulations regarding Maryland’s research and development tax credit. Under the amendments, a “small business” is defined as a for-profit corporation, limited liability company, partnership, or sole proprietorship with net book assets of less than \$5 million. The maximum annual credits are increased from \$3 million to \$4 million, and if the credit allowed in any taxable year exceeds the state income tax for that taxable year, a small business may claim a refund for the excess amount. [Md. Regs. Code §§ 03.04.10.01, -.04, -.08 \(Effective March 31, 2014\)](#).

## DISTRICT OF COLUMBIA

- **Tax Reform – Recommendations.** On September 14, 2011, the District of Columbia created the Tax Revision Commission (the “Commission”) with the purpose of “preparing comprehensive recommendations” to address the fairness of apportionment of taxes, broaden the tax base, make the District’s tax policy competitive with the surrounding jurisdictions, encourage business growth and “modernize, simplify, and increase transparency in the District’s tax code.” After many meetings and input from a varied list of taxpayers and taxpayer groups, the Commission issued its

Final report in May 2014. The Commission focused on the burden on individuals within the District and how the District compared to Maryland and Virginia. Of import to businesses, the Commission looked at two areas – business tax and sales/use tax. See [Williams Mullen Alert](#).

## SOUTH CAROLINA

- **Combined Reporting.** The Department of Revenue announced that it will cease work on the proposed draft ruling on combined unitary reporting, [S.C. Dept. of Rev., Rev. Rul-14-STAFF Draft \(Feb. 28, 2014\)](#), and will form a committee to study alternative allocation and apportionment methods. The committee will include personnel from the Department, various industry groups and tax practitioners, who will study alternative apportionment methods, including combined unitary reporting, in an attempt to reach an equitable, balanced approach that provides taxpayers and the Department with objective and reasoned standards. While the committee studies the available options regarding this issue, the Department has stated that it will not assert on audit combined unitary reporting as an alternative apportionment method, and will work to resolve audit issues on other bases. [S.C. Dept. of Rev., Information Concerning the Department's Review of Alternative Allocation and Apportionment Methods \(May 1, 2014\)](#).

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