Rulings of the Tax Commissioner

Document Number:	**14-29**
Tax Type:	**BPOL Tax**
Brief Description:	**Taxpayer is permitted a deduction for gross receipts attributable to business conducted in other states**
Topics:	**Accounting Periods and Methods; Computation of Tax; Out of State Tax Credits; Subtractions and Exclusions; Taxpayers' Remedies**
Date Issued:	**03/05/2014**

March 5, 2014

Re: Appeal of Final Local Determination
Locality Assessing Tax: *****
Taxpayer: *****
Business, Professional and Occupational License Tax

Dear *****:

This final state determination is issued upon the application for correction filed by ***** (the "Taxpayer") with the Department of Taxation. The Taxpayer appeals a denial of a refund request and assessments of Business, Professional and Occupational License (BPOL) tax issued to the Taxpayer by the ***** (the "County") for the 2008 through 2012 tax years.

The BPOL tax is imposed and administered by local officials. *Virginia Code* § 58.1-3703.1 authorizes the Department to issue determinations on taxpayer appeals of BPOL tax assessments. On appeal, a BPOL tax assessment is deemed *prima facie* correct, *i.e.*, the local assessment will stand unless the taxpayer proves that it is incorrect.

The following determination is based on the facts presented to the Department summarized below. The *Code of Virginia* sections and public documents cited are available on-line at www.tax.virginia.gov in the Laws, Rules and Decisions section of the Department's web site.

FACTS

The Taxpayer, a business service provider, had a definite place of business in the County, as well as offices located in other Virginia localities and other states. For BPOL tax purposes, the Taxpayer sitused gross receipts using payroll apportionment for all the taxable years at issue.

In 2011, the Taxpayer calculated the out-state-deduction for the 2008 through 2010 tax years and requested a refund of BPOL tax. In addition, the Taxpayer filed its 2011 and 2012 BPOL tax returns claiming an out-of-state deduction. The County disallowed the deductions claimed by the Taxpayer, denied refunds for the 2008 through 2010 tax years, and issued assessments for the 2011 and 2012 tax years.

The Taxpayer appealed the County's adjustments. In its final determination, the County determined the Department over-reached its statutory authority and its determinations in Public Document (P.D.) 10-228 (9/29/2010) and P.D. 12-89 (5/31/2012) are inconsistent with applicable statutory requirements. The Taxpayer appeals the County's final determination, contending it qualified for the out-of-state deduction and it properly followed the Department's rulings in calculating the deduction.

ANALYSIS

<u>Out of State Deduction</u>

Virginia Code § 58.1-3732 B 2 provides a deduction from gross receipts otherwise taxable for any receipts "attributable to business conducted in another state or foreign country in which the taxpayer . . . is liable for an income or other tax based upon income." Because revenues are sitused by directly assigning receipts to a taxpayer's definite place of business, it would be entitled to claim the deduction for those gross receipts that are attributable to business conducted in another state or foreign country in which it was liable for an income or income like tax based on income.

In P.D. 10-228, the Department ruled that when gross receipts are apportioned by using the general payroll apportionment formula, the amount of the out-of-state deduction would be determined by multiplying the total out-of-state gross receipts by the same payroll factor used to determine the situs of gross receipts. The Department further clarified how the out-of-state deduction should be computed when payroll apportionment is used to situs gross receipts in P.D. 12-89 and P.D. 12-146 (8/31/2012).

The County argues that there is no statutory basis for allowing the out-of-state deduction when using payroll apportionment to situs gross receipts. *Virginia Code* § 58.1-3732 B 2 allows the deduction for gross receipts attributable to business conducted out-of-state. The Department has consistently held that using payroll apportionment to situs gross receipts does not prohibit a taxpayer from taking the out-of-state deduction. See P.D. 99-87 (4/23/1999), P.D. 04-80 (8/25/2004), P.D. 05-118 (7/19/2005), P.D. 09-146 (10/8/2009), P.D. 10-228 and P.D. 12-89. In addition, the Virginia Supreme Court, in *Ford Motor Credit Co. v. Chesterfield County*, 281 Va. 321, 707 S.E.2d 311 (2011), held that the out-of-state deduction is permitted even when payroll apportionment is used to situs gross receipts.

The County also contends that the Department's methodology for determining the deduction does not result in the appropriate deduction. It argues that the multiplication of gross receipts eligible for the deduction by the payroll factor is not supported by the statute.

Payroll apportionment is a concept based on income tax principles. The legislature granted the use of this method for situsing, gross receipts when the normal statutory methods were untenable. The United States Supreme Court has recognized that allocation and apportionment of income is an arbitrary process designed to approximate income from business transactions within a state. As long as each state's method of allocation and apportionment is rationally related to the business transacted within a state, then each state's tax is constitutionally valid even though there may be some overlap. See *Moorman Mfg. Co. v. Bair*, 437 U.S. 279, 98 S.Ct. 2340 (1978). As such, the apportionment of gross receipts by using a taxpayer's payroll is a process designed to reasonably approximate gross receipts from business transactions within a locality.

In P.D. 10-228 and 10-229 (9/29/2010), the Department reasoned that, because the situs of gross receipts using payroll apportionment is an approximation, any deduction for out-of-state gross receipts would be, at best, an estimate. In P.D. 12-88 (5/31/2012), P.D. 12-89 and P.D. 12-146, the Department set forth a methodology to compute the out-of-state deduction when a taxpayer must situs gross receipts using payroll apportionment. In promulgating its method, the Department considers whether the method met the statutory requirements of *Va. Code* § 58.1-3732 B 2 in granting a deduction, whether it could reasonably be administered, and whether it could be applied uniformly.

Finally the County asserts that the Department's requirement that Virginia based employees only need minimal contacts with out-of-state customers to be eligible for the deduction is too broad. The deduction requires a business to be liable for income tax in another state.

Public Law (P.L.) 86-272, codified at 15 U.S.C. §§ 381-384, prohibits a state from imposing a net income tax where the only contacts with a state are a narrowly defined set of activities constituting solicitation of orders for sales of tangible personal property. The Department has a long established policy of narrowly interpreting the provisions of P.L. 86-272. The Department limits the scope of P.L. 86-272 to only those activities that constitute solicitation, are ancillary to solicitation or are de minimis in nature. See *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 112 S.Ct. 2447 (1992).

Because nexus for income tax purposes only requires minimal contacts with a state in order to allow that state to impose an income tax, the Department found it reasonable to only require minimal contacts with customers in other states in order to meet the requirement for a deduction. As such, it is not necessary for a business to demonstrate that income earned by the Virginia definite place of business or any of its transactions are included in the taxable income shown on the return filed with any other state, or caused the corporation to be subject to tax in any other state. See P.D. 10-228.

<u>Out of State Deduction Computation</u>

After further reviewing the example in P.D. 12-89, the Department finds it necessary to clarify the three-step process for computing the deductions. The clarified process assumes gross receipts have already been sitused by payroll apportionment. The three steps to computing the out-of-state deduction when payroll apportionment is used to situs gross receipts are as follows:

1. Determine if employees from the definite place of business earn, or participate in earning receipts attributable to customers in other states where a taxpayer filed an income tax return;

2. Determine the receipts that are eligible for deduction; and

3. Multiply the receipts eligible for the deduction by the same payroll factor used to determine the situs of gross receipts.

An example of the out-of-state deduction computation when there is payroll apportionment follows:

T has definite places of business in a Maryland, North Carolina, Pennsylvania and a Virginia locality. Its employees from the Virginia locality participate in earning receipts attributable to each state where it has a definite place of business. T is required to file income tax returns in Virginia, Maryland, and North Carolina. The Taxpayer has total gross receipts of $1,000,000. Payroll is attributable as follows:

40% to Virginia
30% to Maryland
10% to North Carolina
20% to Pennsylvania

Using the three step process as described above, the out-of-state deduction would be determined as follows:

1. Employees from T's definite place of business participate in earning gross receipts from customers located in Maryland, North Carolina and Pennsylvania.

2. The gross receipts eligible for the deduction would be computed by multiplying gross receipts ($1,000,000) by the combined payroll percentages of Maryland and North Carolina (40%). Gross receipts derived from customers in Pennsylvania are not eligible for the deduction because no income tax return is filed in Pennsylvania. Based on this computation, gross receipts eligible for the deduction would be $400,000 ($1,000,000 x 40%).

3. The out-of-state deduction would be the gross receipts eligible for the deduction ($400,000) multiplied by the Virginia payroll factor (40%). In this example, the out-of-state deduction would be $160,000 ($400,000 x 40%).

This deduction would be subtracted from gross receipts sitused to Virginia in determining gross receipts subject to the BPOL tax. In this example, gross receipts sitused to Virginia would be equal to total gross receipts ($1,000,000) multiplied by the Virginia payroll factor (40%) or $400,000. Subtracting the $160,000 out-of-state deduction from the $400,000 gross receipts sitused to the definite place of business results in $240,000 gross receipts on which BPOL tax could be assessed.

DETERMINATION

In accordance with this determination, the Taxpayer is permitted a deduction for gross receipts attributable to business conducted in other states. The County has not allowed a deduction pursuant to *Va. Code* § 58.1-3732 B 2. As such, I am remanding this case to the County in order to adjust the Taxpayer's BPOL tax liability for the 2008 through 2012 tax years to allow for the out-of-state deduction using the methodology set forth in the example above.

If you have any questions regarding this determination, you may contact ***** in the Department's Office of Tax Policy, Appeals and Rulings, at *****.

Sincerely,

Craig M. Burns
Tax Commissioner

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