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**HOUSE BILL NO. 170**

Offered January 9, 2008

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*A BILL to amend and reenact §§ 58.1-402 and 58.1-609.3 of the Code of Virginia, relating to the promotion of spaceflight in Virginia.*

\_\_\_\_\_  
Patron—Kilgore

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Referred to Committee on Finance

**Be it enacted by the General Assembly of Virginia:****1. That §§ 58.1-402 and 58.1-609.3 of the Code of Virginia are amended and reenacted as follows:**

§ 58.1-402. Virginia taxable income.

A. For purposes of this article, Virginia taxable income for a taxable year means the federal taxable income and any other income taxable to the corporation under federal law for such year of a corporation adjusted as provided in subsections B, C, D, and E.

For a regulated investment company and a real estate investment trust, such term means the "investment company taxable income" and "real estate investment trust taxable income," respectively, to which shall be added in each case any amount of capital gains and any other income taxable to the corporation under federal law which shall be further adjusted as provided in subsections B, C, D, and E.

B. There shall be added to the extent excluded from federal taxable income:

1. Interest, less related expenses to the extent not deducted in determining federal taxable income, on obligations of any state other than Virginia, or of a political subdivision of any such other state unless created by compact or agreement to which the Commonwealth is a party;

2. Interest or dividends, less related expenses to the extent not deducted in determining federal taxable income, on obligations or securities of any authority, commission or instrumentality of the United States, which the laws of the United States exempt from federal income tax but not from state income taxes;

3. [Repealed.]

4. The amount of any net income taxes and other taxes, including franchise and excise taxes, which are based on, measured by, or computed with reference to net income, imposed by the Commonwealth or any other taxing jurisdiction, to the extent deducted in determining federal taxable income;

5. Unrelated business taxable income as defined by § 512 of the Internal Revenue Code;

6. The amount of employee stock ownership credit carry-over deducted by the corporation in computing federal taxable income under § 404 (i) of the Internal Revenue Code;

7. The amount required to be included in income for the purpose of computing the partial tax on an accumulation distribution pursuant to § 667 of the Internal Revenue Code;

8. a. For taxable years beginning on and after January 1, 2004, the amount of any intangible expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with one or more related members to the extent such expenses and costs were deductible or deducted in computing federal taxable income for Virginia purposes. This addition shall not be required for any portion of the intangible expenses and costs if one of the following applies:

(1) The 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 Virginia, another state, or a foreign government that has entered into a comprehensive tax treaty with the United States government;

(2) The related member derives at least one-third of its gross revenues from the licensing of intangible property to parties who are not related members, and the transaction giving rise to the expenses and costs between the corporation and the related member was made at rates and terms comparable to the rates and terms of agreements that the related member has entered into with parties who are not related members for the licensing of intangible property; or

(3) The corporation can establish to the satisfaction of the Tax Commissioner that the intangible expenses and costs meet both of the following: (i) the related member during the same taxable year directly or indirectly paid, accrued or incurred such portion to a person who is not a related member, and (ii) the transaction giving rise to the intangible expenses and costs between the corporation and the related member did not have as a principal purpose the avoidance of any portion of the tax due under this chapter.

b. A corporation required to add to its federal taxable income intangible expenses and costs pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return for the

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59 taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under this  
60 article for such taxable year including tax upon any amount of intangible expenses and costs required to  
61 be added to federal taxable income pursuant to subdivision a, to consider evidence relating to the  
62 transaction or transactions between the corporation and a related member or members that resulted in the  
63 corporation's taxable income being increased, as required under subdivision a, for such intangible  
64 expenses and costs.

65 If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and  
66 convincing evidence, that the transaction or transactions between the corporation and a related member  
67 or members resulting in such increase in taxable income pursuant to subdivision a had a valid business  
68 purpose other than the avoidance or reduction of the tax due under this chapter, the Tax Commissioner  
69 shall permit the corporation to file an amended return. For purposes of such amended return, the  
70 requirements of subdivision a shall not apply to any transaction for which the Tax Commissioner is  
71 satisfied (and has identified) that the transaction had a valid business purpose other than the avoidance  
72 or reduction of the tax due under this chapter. Such amended return shall be filed by the corporation  
73 within one year of the written permission granted by the Tax Commissioner and any refund of the tax  
74 imposed under this article shall include interest at a rate equal to the rate of interest established under  
75 § 58.1-15 and such interest shall accrue as provided under § 58.1-1833. However, upon the filing of  
76 such amended return, any related member of the corporation that subtracted from taxable income  
77 amounts received pursuant to subdivision C 21 shall be subject to the tax imposed under this article on  
78 that portion of such amounts for which the corporation has filed an amended return pursuant to this  
79 subdivision. In addition, for such transactions identified by the Tax Commissioner herein by which he  
80 has been satisfied by clear and convincing evidence, the Tax Commissioner may permit the corporation  
81 in filing income tax returns for subsequent taxable years to deduct the related intangible expenses and  
82 costs without making the adjustment under subdivision a.

83 The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of  
84 any petition pursuant to this subdivision, to include costs necessary to secure outside experts in  
85 evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this  
86 subdivision upon payment of such fee.

87 No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision  
88 shall be maintained in any court of this Commonwealth.

89 c. Nothing in subdivision B 8 shall be construed to limit or negate the Department's authority under  
90 § 58.1-446;

91 9. a. For taxable years beginning on and after January 1, 2004, the amount of any interest expenses  
92 and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with  
93 one or more direct or indirect transactions with one or more related members to the extent such  
94 expenses and costs were deductible or deducted in computing federal taxable income for Virginia  
95 purposes. This addition shall not be required for any portion of the interest expenses and costs, if:

96 (1) The related member has substantial business operations relating to interest-generating activities, in  
97 which the related member pays expenses for at least five full-time employees who maintain, manage,  
98 defend or are otherwise responsible for operations or administration relating to the interest-generating  
99 activities; and

100 (2) The interest expenses and costs are not directly or indirectly for, related to or in connection with  
101 the direct or indirect acquisition, maintenance, management, sale, exchange, or disposition of intangible  
102 property; and

103 (3) The transaction giving rise to the expenses and costs between the corporation and the related  
104 member has a valid business purpose other than the avoidance or reduction of taxation and payments  
105 between the parties are made at arm's length rates and terms; and

106 (4) One of the following applies:

107 (i) The corresponding item of income received by the related member is subject to a tax based on or  
108 measured by net income or capital imposed by Virginia, another state, or a foreign government that has  
109 entered into a comprehensive tax treaty with the United States government;

110 (ii) Payments arise pursuant to a pre-existing contract entered into when the parties were not related  
111 members provided the payments continue to be made at arm's length rates and terms;

112 (iii) The related member engages in transactions with parties other than related members that  
113 generate revenue in excess of \$2 million annually; or

114 (iv) The transaction giving rise to the interest payments between the corporation and a related  
115 member was done at arm's length rates and terms and meets any of the following: (a) the related  
116 member uses funds that are borrowed from a party other than a related member or that are paid,  
117 incurred or passed-through to a person who is not a related member; (b) the debt is part of a regular and  
118 systematic funds management or portfolio investment activity conducted by the related member, whereby  
119 the funds of two or more related members are aggregated for the purpose of achieving economies of  
120 scale, the internal financing of the active business operations of members, or the benefit of centralized

management of funds; (c) financing the expansion of the business operations; or (d) restructuring the debt of related members, or the pass-through of acquisition-related indebtedness to related members.

b. A corporation required to add to its federal taxable income interest expenses and costs pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return for the taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under this article for such taxable year including tax upon any amount of interest expenses and costs required to be added to federal taxable income pursuant to subdivision a, to consider evidence relating to the transaction or transactions between the corporation and a related member or members that resulted in the corporation's taxable income being increased, as required under subdivision a, for such interest expenses and costs.

If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and convincing evidence, that the transaction or transactions between the corporation and a related member or members resulting in such increase in taxable income pursuant to subdivision a had a valid business purpose other than the avoidance or reduction of the tax due under this chapter and that the related payments between the parties were made at arm's length rates and terms, the Tax Commissioner shall permit the corporation to file an amended return. For purposes of such amended return, the requirements of subdivision a shall not apply to any transaction for which the Tax Commissioner is satisfied (and has identified) that the transaction had a valid business purpose other than the avoidance or reduction of the tax due under this chapter and that the related payments between the parties were made at arm's length rates and terms. Such amended return shall be filed by the corporation within one year of the written permission granted by the Tax Commissioner and any refund of the tax imposed under this article shall include interest at a rate equal to the rate of interest established under § 58.1-15 and such interest shall accrue as provided under § 58.1-1833. However, upon the filing of such amended return, any related member of the corporation that subtracted from taxable income amounts received pursuant to subdivision C 21 shall be subject to the tax imposed under this article on that portion of such amounts for which the corporation has filed an amended return pursuant to this subdivision. In addition, for such transactions identified by the Tax Commissioner herein by which he has been satisfied by clear and convincing evidence, the Tax Commissioner may permit the corporation in filing income tax returns for subsequent taxable years to deduct the related interest expenses and costs without making the adjustment under subdivision a.

The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of any petition pursuant to this subdivision, to include costs necessary to secure outside experts in evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this subdivision upon payment of such fee.

No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision shall be maintained in any court of this Commonwealth.

c. Nothing in subdivision B 9 shall be construed to limit or negate the Department's authority under § 58.1-446.

d. For purposes of subdivision B 9:

"Arm's length rates and terms" means that (i) two or more related members enter into a written agreement for the transaction, (ii) such agreement is of a duration and contains payment terms substantially similar to those that the related member would be able to obtain from an unrelated entity, (iii) the interest is at or below the applicable federal rate compounded annually for debt instruments under § 1274(d) of the Internal Revenue Code that was in effect at the time of the agreement, and (iv) the borrower or payor adheres to the payment terms of the agreement governing the transaction or any amendments thereto.

"Valid business purpose" means one or more business purposes that alone or in combination constitute the motivation for some business activity or transaction, which activity or transaction improves, apart from tax effects, the economic position of the taxpayer, as further defined by regulation.

C. There shall be subtracted to the extent included in and not otherwise subtracted from federal taxable income:

1. Income derived from obligations, or on the sale or exchange of obligations, of the United States and on obligations or securities of any authority, commission or instrumentality of the United States to the extent exempt from state income taxes under the laws of the United States including, but not limited to, stocks, bonds, treasury bills, and treasury notes, but not including interest on refunds of federal taxes, interest on equipment purchase contracts, or interest on other normal business transactions.

2. Income derived from obligations, or on the sale or exchange of obligations of this Commonwealth or of any political subdivision or instrumentality of this Commonwealth.

3. Dividends upon stock in any domestic international sales corporation, as defined by § 992 of the Internal Revenue Code, 50 percent or more of the income of which was assessable for the preceding year, or the last year in which such corporation has income, under the provisions of the income tax laws

182 of the Commonwealth.

183 4. The amount of any refund or credit for overpayment of income taxes imposed by this  
184 Commonwealth or any other taxing jurisdiction.

185 5. Any amount included therein by the operation of the provisions of § 78 of the Internal Revenue  
186 Code (foreign dividend gross-up).

187 6. The amount of wages or salaries eligible for the federal Targeted Jobs Credit which was not  
188 deducted for federal purposes on account of the provisions of § 280C (a) of the Internal Revenue Code.

189 7. Any amount included therein by the operation of § 951 of the Internal Revenue Code (subpart F  
190 income).

191 8. Any amount included therein which is foreign source income as defined in § 58.1-302.

192 9. [Repealed.]

193 10. The amount of any dividends received from corporations in which the taxpaying corporation  
194 owns 50 percent or more of the voting stock.

195 11. [Repealed.]

196 12, 13. [Expired.]

197 14. For taxable years beginning on or after January 1, 1995, the amount for "qualified research  
198 expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not  
199 deducted, on account of the provisions of § 280C (c) of the Internal Revenue Code.

200 15. For taxable years beginning on or after January 1, 2000, the total amount actually contributed in  
201 funds to the Virginia Public School Construction Grants Program and Fund established in Chapter 11.1  
202 (§ 22.1-175.1 et seq.) of Title 22.1.

203 16. For taxable years beginning on or after January 1, 2000, the gain derived from the sale or  
204 exchange of real property or the sale or exchange of an easement to real property which results in the  
205 real property or the easement thereto being devoted to open-space use, as that term is defined in  
206 § 58.1-3230, for a period of time not less than 30 years. To the extent a subtraction is taken in  
207 accordance with this subdivision, no tax credit under this chapter for donating land for its preservation  
208 shall be allowed for three years following the year in which the subtraction is taken.

209 17. For taxable years beginning on and after January 1, 2001, any amount included therein with  
210 respect to § 58.1-440.1.

211 18. For taxable years beginning on and after January 1, 1999, income received as a result of (i) the  
212 "Master Settlement Agreement," as defined in § 3.1-1106; (ii) the National Tobacco Grower Settlement  
213 Trust dated July 19, 1999; and (iii) the Tobacco Loss Assistance Program, pursuant to 7 C.F.R. Part  
214 1464 (Subpart C, §§ 1464.201 through 1464.205), by (a) tobacco farming businesses; (b) any business  
215 holding a tobacco marketing quota, or tobacco farm acreage allotment, under the Agricultural  
216 Adjustment Act of 1938; or (c) any business having the right to grow tobacco pursuant to such a quota  
217 allotment.

218 19. Effective for all taxable years beginning on and after January 1, 2002, but before January 1,  
219 2005, the indemnification payments received by contract poultry growers and table egg producers from  
220 the U.S. Department of Agriculture as a result of the depopulation of poultry flocks because of low  
221 pathogenic avian influenza in 2002. In no event shall indemnification payments made to owners of  
222 poultry who contract with poultry growers qualify for this subtraction.

223 20. For taxable years beginning on and after January 1, 2002, any gain recognized as a result of the  
224 Peanut Quota Buyout Program of the Farm Security and Rural Investment Act of 2002 pursuant to 7  
225 C.F.R. Part 1412 (Subpart H, §§ 1412.801 through 1412.811) as follows:

226 a. If the payment is received in installment payments pursuant to 7 C.F.R. § 1412.807(a) (2), then the  
227 entire gain recognized may be subtracted.

228 b. If the payment is received in a single payment pursuant to 7 C.F.R. § 1412.807(a) (3), then 20  
229 percent of the recognized gain may be subtracted. The taxpayer may then deduct an equal amount in  
230 each of the four succeeding taxable years.

231 21. For taxable years beginning on and after January 1, 2004, any amount of intangible expenses and  
232 costs or interest expenses and costs added to the federal taxable income of a corporation pursuant to  
233 subdivision B 8 or B 9 shall be subtracted from the federal taxable income of the related member that  
234 received such amount if such related member is subject to Virginia income tax on the same amount.

235 22. *For taxable years beginning on and after January 1, 2008, any gain recognized as a result of*  
236 *the sale of passenger tickets on a suborbital spaceflight conducted by a spaceflight entity as defined in*  
237 *§ 8.01-227.8.*

238 23. *For taxable years beginning on and after January 1, 2008, any gain recognized as a result of*  
239 *resupply services contracts entered with the Commercial Orbital Transportation Services division of the*  
240 *National Aeronautics and Space Administration.*

241 D. For taxable years beginning on and after January 1, 2006, there shall be subtracted from federal  
242 taxable income contract payments to a producer of quota tobacco or a tobacco quota holder as provided  
243 under the American Jobs Creation Act of 2004 (P.L. 108-357) as follows:

1. If the payment is received in installment payments, then the recognized gain, including any gain recognized in taxable year 2005, may be subtracted in the taxable year immediately following the year in which the installment payment is received.

2. If the payment is received in a single payment, then 10% of the recognized gain may be subtracted in the taxable year immediately following the year in which the single payment is received. The taxpayer may then deduct an equal amount in each of the nine succeeding taxable years.

E. Adjustments to federal taxable income shall be made to reflect the transitional modifications provided in § 58.1-315.

§ 58.1-609.3. Commercial and industrial exemptions.

The tax imposed by this chapter or pursuant to the authority granted in §§ 58.1-605 and 58.1-606 shall not apply to the following:

1. Personal property purchased by a contractor which is used solely in another state or in a foreign country, which could be purchased by such contractor for such use free from sales tax in such other state or foreign country, and which is stored temporarily in Virginia pending shipment to such state or country.

2. (i) Industrial materials for future processing, manufacturing, refining, or conversion into articles of tangible personal property for resale where such industrial materials either enter into the production of or become a component part of the finished product; (ii) industrial materials that are coated upon or impregnated into the product at any stage of its being processed, manufactured, refined, or converted for resale; (iii) machinery or tools or repair parts therefor or replacements thereof, fuel, power, energy, or supplies, used directly in processing, manufacturing, refining, mining or converting products for sale or resale; (iv) materials, containers, labels, sacks, cans, boxes, drums or bags for future use for packaging tangible personal property for shipment or sale; or (v) equipment, printing or supplies used directly to produce a publication described in subdivision 3 of § 58.1-609.6 whether it is ultimately sold at retail or for resale or distribution at no cost. Machinery, tools and equipment, or repair parts therefor or replacements thereof, shall be exempt if the preponderance of their use is directly in processing, manufacturing, refining, mining or converting products for sale or resale. The provisions of this subsection do not apply to the drilling or extraction of oil, gas, natural gas and coalbed methane gas. In addition, the exemption provided herein shall not be applicable to any machinery, tools, and equipment, or any other tangible personal property used by a public service corporation in the generation of electric power, except for raw materials that are inputs to production of electricity, including fuel.

3. Tangible personal property sold or leased to a public service corporation engaged in business as a common carrier of property or passengers by railway, for use or consumption by such common carrier directly in the rendition of its public service.

4. Ships or vessels, or repairs and alterations thereof, used or to be used exclusively or principally in interstate or foreign commerce; fuel and supplies for use or consumption aboard ships or vessels plying the high seas, either in intercoastal trade between ports in the Commonwealth and ports in other states of the United States or its territories or possessions, or in foreign commerce between ports in the Commonwealth and ports in foreign countries, when delivered directly to such ships or vessels; or tangible personal property used directly in the building, conversion or repair of the ships or vessels covered by this subdivision. This exemption shall include dredges, their supporting equipment, attendant vessels, and fuel and supplies for use or consumption aboard such vessels, provided the dredges are used exclusively or principally in interstate or foreign commerce.

5. Tangible personal property purchased for use or consumption directly and exclusively in basic research or research and development in the experimental or laboratory sense.

6. Tangible personal property sold or leased to an airline operating in intrastate, interstate or foreign commerce as a common carrier providing scheduled air service on a continuing basis to one or more Virginia airports at least one day per week, for use or consumption by such airline directly in the rendition of its common carrier service.

7. Meals furnished by restaurants or food service operators to employees as a part of wages.

8. Tangible personal property including machinery and tools, repair parts or replacements thereof, and supplies and materials used directly in maintaining and preparing textile products for rental or leasing by an industrial processor engaged in the commercial leasing or renting of laundered textile products.

9. (i) Certified pollution control equipment and facilities as defined in § 58.1-3660, except for any equipment that has not been certified to the Department of Taxation by a state certifying authority pursuant to such section and (ii) effective retroactive to July 1, 1994, and ending July 1, 2006, certified pollution control equipment and facilities as defined in § 58.1-3660 and which, in accordance with such section, have been certified by the Department of Mines, Minerals and Energy for coal, oil and gas production, including gas, natural gas, and coalbed methane gas.

10. Parts, tires, meters and dispatch radios sold or leased to taxicab operators for use or consumption

305 directly in the rendition of their services.

306 11. High speed electrostatic duplicators or any other duplicators which have a printing capacity of  
307 4,000 impressions or more per hour purchased or leased by persons engaged primarily in the printing or  
308 photocopying of products for sale or resale.

309 12. From July 1, 1994, and ending July 1, 2011, raw materials, fuel, power, energy, supplies,  
310 machinery or tools or repair parts therefor or replacements thereof, used directly in the drilling,  
311 extraction, or processing of natural gas or oil and the reclamation of the well area. For the purposes of  
312 this section, the term "natural gas" shall mean "gas," "natural gas," and "coalbed methane gas" as  
313 defined in § 45.1-361.1. For the purposes of this section, "drilling," "extraction," and "processing" shall  
314 include production, inspection, testing, dewatering, dehydration, or distillation of raw natural gas into a  
315 usable condition consistent with commercial practices, and the gathering and transportation of raw  
316 natural gas to a facility wherein the gas is converted into such a usable condition. Machinery, tools and  
317 equipment, or repair parts therefor or replacements thereof, shall be exempt if the preponderance of their  
318 use is directly in the drilling, extraction, refining, or processing of natural gas or oil for sale or resale, or  
319 in well area reclamation activities required by state or federal law.

320 13. Beginning July 1, 1997, and ending July 1, ~~2011~~ 2015, (i) the sale, lease, use, storage,  
321 consumption, or distribution of an orbital or suborbital space facility, space propulsion system, space  
322 vehicle, satellite, or space station of any kind possessing space flight capability, including the  
323 components thereof, irrespective of whether such facility, system, vehicle, satellite, or station is returned  
324 to this Commonwealth for subsequent use, storage or consumption in any manner when used to conduct  
325 spaceport activities; (ii) the sale, lease, use, storage, consumption or distribution of tangible personal  
326 property placed on or used aboard any orbital or suborbital space facility, space propulsion system,  
327 space vehicle, satellite or space station of any kind, irrespective of whether such tangible personal  
328 property is returned to this Commonwealth for subsequent use, storage or consumption in any manner  
329 when used to conduct spaceport activities; (iii) fuels of such quality not adapted for use in ordinary  
330 vehicles, being produced for, sold and exclusively used for space flight when used to conduct spaceport  
331 activities; (iv) the sale, lease, use, storage, consumption or distribution of machinery and equipment  
332 purchased, sold, leased, rented or used exclusively for spaceport activities and the sale of goods and  
333 services provided to operate and maintain launch facilities, launch equipment, payload processing  
334 facilities and payload processing equipment used to conduct spaceport activities; *and (v) the sale of*  
335 *spaceflight services or activities to spaceflight participants, as defined in § 8.01-227.8.*

336 For purposes of this subdivision, "spaceport activities" means activities directed or sponsored at a  
337 facility owned, leased, or operated by or on behalf of the Virginia Commercial Space Flight Authority.

338 The exemptions provided by this subdivision shall not be denied by reason of a failure,  
339 postponement or cancellation of a launch of any orbital or suborbital space facility, space propulsion  
340 system, space vehicle, satellite or space station of any kind or the destruction of any launch vehicle or  
341 any components thereof.

342 14. Semiconductor cleanrooms or equipment, fuel, power, energy, supplies, or other tangible personal  
343 property used primarily in the integrated process of designing, developing, manufacturing, or testing a  
344 semiconductor product, a semiconductor manufacturing process or subprocess, or semiconductor  
345 equipment without regard to whether the property is actually contained in or used in a cleanroom  
346 environment, touches the product, is used before or after production, or is affixed to or incorporated into  
347 real estate.

348 15. Semiconductor wafers for use or consumption by a semiconductor manufacturer.

349 16. Railroad rolling stock when sold or leased by the manufacturer thereof.