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**HOUSE BILL NO. 966**

Offered January 13, 2016

Prefiled January 12, 2016

*A BILL to amend and reenact §§ 58.1-408, 58.1-414, 58.1-416, and 58.1-422 of the Code of Virginia and to repeal §§ 58.1-422.1 and 58.1-422.2 of the Code of Virginia, relating to the apportionment of income to Virginia by corporations for purposes of computing income taxes.*

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Patrons—Davis and Albo

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Referred to Committee on Finance

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**Be it enacted by the General Assembly of Virginia:**

**1. That §§ 58.1-408, 58.1-414, 58.1-416, and 58.1-422 of the Code of Virginia are amended and reenacted as follows:**

**§ 58.1-408. What income apportioned and how.**

~~The~~ *A. For taxable years beginning before January 1, 2017, the* Virginia taxable income of any corporation, except those subject to the provisions of § 58.1-417, 58.1-418, 58.1-419, 58.1-420, 58.1-422, 58.1-422.1, or 58.1-422.2, excluding income allocable under § 58.1-407, shall be apportioned to the Commonwealth by multiplying such income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four; however, where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus one.

*B. For taxable years beginning on or after January 1, 2017, but prior to January 1, 2019, the Virginia taxable income of any corporation, except those subject to the provisions of § 58.1-417, 58.1-418, 58.1-419, 58.1-420, 58.1-422, 58.1-422.1, or 58.1-422.2, excluding income allocable under § 58.1-407, shall be apportioned to the Commonwealth by multiplying such income by the following fractions:*

*1. For taxable years beginning on or after January 1, 2017, but prior to January 1, 2018, the numerator of which is the property factor plus the payroll factor, plus triple the sales factor, and the denominator of which is five; however, where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus two; and*

*2. For taxable years beginning on or after January 1, 2018, but prior to January 1, 2019, the numerator of which is the property factor plus the payroll factor, plus quadruple the sales factor, and the denominator of which is six; however, where the sales factor does not exist, the denominator of the fraction shall be the number of existing factors and where the sales factor exists but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors plus three.*

*C. For taxable years beginning on or after January 1, 2019, the Virginia taxable income of any corporation, except those corporations subject to the provisions of § 58.1-417, 58.1-418, 58.1-419, or 58.1-420 and those manufacturing companies that pursuant to § 58.1-422 elect to continue to be subject to apportionment under subsection A, excluding income allocable under § 58.1-407, shall be apportioned to the Commonwealth by multiplying such income by the sales factor.*

**§ 58.1-414. Sales factor.**

*A. As used in this section:*

*"Communications services" means services subject to tax under § 58.1-648.*

*"Internet access service" means the same as that term is defined under § 58.1-647.*

*"National defense contractor" means a corporation that is principally engaged in the business of entering into contracts with a federal government entity to produce materials or goods or to perform services for national defense, which business would, in accordance with the North American Industrial Classification System (NAICS), United States Manual, United States Office of Management and Budget, 2012 Manual, be included in Sector 33.*

*"Pass-through entity" means the same as that term is defined under § 58.1-390.1.*

*"Qualified communications services" means communications services or Internet access services.*

*"Qualified expenditures" means expenditures related to the provision of qualified communications services for (i) purchases of tangible personal property placed in service in the Commonwealth during the taxable year by a member of the qualified group and (ii) salaries and wages paid during the taxable*

*year for employees employed by a member of the qualified group in the Commonwealth. If the qualified group is an affiliated group, a qualified expenditure shall not include any expenditure incurred by a member of the affiliated group in a transaction with a person who is a member of the same group or any expenditure incurred with a pass-through entity that is controlled by a member of the qualified group.*

*"Qualified group" means an affiliated group or a single entity that meets both of the following criteria: (i) one or more members of the group or the single entity is a qualified member and (ii) the members of the group or the single entity during the taxable year incurs, in the aggregate, qualified expenditures in excess of $100 million.*

*"Qualified member" means a person that is principally engaged in the sale of qualified communications services. If a pass-through entity is a qualified member, then a corporation that owns a controlling interest, either alone or in conjunction with one or more corporations under common control, in such pass-through entity, directly or indirectly through one or more pass-through entities, shall be deemed a qualified member and the qualified expenditures of such pass-through entity shall be deemed the qualified expenditures of such corporation in proportion to its interest in the pass-through entity and not expenditures of the pass-through entity.*

*B.* The sales factor is a fraction, the numerator of which is the total sales of the corporation in the Commonwealth during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year, to the extent that such sales are used to produce Virginia taxable income and are effectively connected with the conduct of a trade or business within the United States and income therefrom is includable in federal taxable income.

*C. If the state to which a sale other than a sale of tangible personal property is to be sourced cannot be determined or reasonably approximated under the provisions of this article, such sale shall be excluded from the denominator of the corporation's sales factor. In addition, if a sale other than a sale of tangible personal property is sourced to one or more states but not the Commonwealth and the taxpayer is not taxable in any state to which the sale is sourced, such sale shall be excluded from the denominator of the corporation's sales factor. For purposes of this subsection, a taxpayer is taxable in another state if (i) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax or (ii) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.*

*D. Sales other than sales of tangible personal property made by a national defense contractor that are attributable to a contract that is (i) for a sale other than a sale of tangible personal property and (ii) subject to the requirements of 48 C.F.R. Parts 201through 253 shall be excluded from the numerator of the contractor's sales factor if (a) a greater proportion of the income-producing activity is performed outside the Commonwealth, based on costs of performance; (b) the laws of another state require that the sale be included in the numerator of the fraction used in apportioning the contractor's income to that state for income tax purposes; and (c) the laws of the state in clause (b) require that such sale be included in such numerator only if the greater proportion of the income-producing activity is performed in that state, based on costs of performance.*

*This subsection shall not apply to any corporation subject to the provisions of § 58.1-417, 58.1-418, 58.1-419, or 58.1-420.*

*E. Each qualified member of a qualified group (or a single entity that is a qualified group) subject to tax imposed under this article shall determine its sales other than sales of tangible personal property in accordance with the provisions of § 58.1-416, except that the total amount determined in accordance with such section shall then be multiplied by 0.5 and the result included in the numerator of such qualified member's sales factor. The method provided by this subsection for determining sales, other than sales of tangible personal property, by a qualified member of a qualified group or by a single entity that is a qualified group shall be the only method for determining such sales for such qualified members or single entities.*

*The remaining provisions of this article shall control in determining all other sales to be included in the numerator of the sales factor of a qualified member of a qualified group or of a single entity that is a qualified group.*

*F. The General Assembly of Virginia finds that job creation and capital investment are essential to the continued fiscal health of the Commonwealth. In this modern economy, states often compete for quality communications services and Internet access services companies, businesses that consistently create many jobs and undertake major investments in infrastructure. Accordingly, the provisions of subsection E relating to the formula for apportioning the income of certain communications services and Internet access services companies are integral for such companies to create new jobs and undertake new capital investment in the Commonwealth. If any provision of subsection E is for any reason held to be invalid or unconstitutional by the decision of a court of competent jurisdiction, then that provision shall not be deemed severable, and all provisions of subsection E shall expire beginning with the* *taxable year that immediately follows the date of such decision.*

**§ 58.1-416. When certain other sales deemed in the Commonwealth.**

*A.* Sales, other than sales of tangible personal property, are in the Commonwealth if~~:~~

~~1. The income-producing activity is performed in the Commonwealth; or~~

~~2. The income-producing activity is performed both in and outside the Commonwealth and a greater proportion of the income-producing activity is performed in the Commonwealth than in any other state, based on costs of performance~~ *the taxpayer has exploited the market provided by the Commonwealth (i) in the case of services, to the extent that the purchaser of the service receives the benefit of the service in the Commonwealth or (ii) in the case of intangible personal property, to the extent that the purchaser of the intangible personal property uses such property in the Commonwealth. In the case of marketable securities, sales are in the Commonwealth if the customer is in the Commonwealth. Sales from the sale, lease, rental, or licensing of real property are in the Commonwealth if the real property is located in the Commonwealth. Sales from the lease, rental, or licensing of tangible personal property are in the Commonwealth if the tangible personal property is located in the Commonwealth*.

*B. The taxes under this article on the sales described under subsection A are imposed to the maximum extent permitted under the Constitutions of Virginia and the United States and federal law. For the collection of such taxes on such sales, it is the intent of the General Assembly that the Tax Commissioner and the Department assert the taxpayer's nexus with the Commonwealth to the maximum extent permitted under the Constitutions of Virginia and the United States and federal law.*

*C. If necessary information is not available to the taxpayer to determine whether a sale other than a sale of tangible personal property is in the Commonwealth pursuant to the provisions of subsection A, the taxpayer may estimate the dollar value or portion of such sale in the Commonwealth, provided that the taxpayer can demonstrate to the satisfaction of the Tax Commissioner that (i) the estimate has been undertaken in good faith, (ii) the estimate is a reasonable approximation of the dollar value or portion of such sale in the Commonwealth, and (iii) in using an estimate the taxpayer did not have as a principal purpose the avoidance of any tax due under this article. The Department may implement procedures for obtaining its approval to use an estimate. The Department shall adopt remedies and corrective procedures for cases in which the Department has determined that the sourcing rules for sales other than sales of tangible personal property have been abused by the taxpayer, which may include reliance on the location of income-producing activity and direct costs of performance under the law and regulations of the Commonwealth as they existed for taxable years beginning prior to January 1, 2017.*

**§ 58.1-422. Manufacturing companies; apportionment.**

A. For taxable years beginning on or after July 1, 2011, the Virginia taxable income of a manufacturing company, excluding income allocable under § 58.1-407, may be apportioned within and without the Commonwealth as provided in *subsection A of* § 58.1-408 or as follows:

1. From July 1, 2011, until July 1, 2013, by multiplying such income by a fraction, the numerator of which is the property factor plus the payroll factor plus triple the sales factor and the denominator of which is five, except when the sales factor does not exist, the denominator of the fraction shall be the number of existing factors, and when the sales factor exists but the payroll factor or property factor does not exist, the denominator of the fraction shall be the number of existing factors plus two;

2. From July 1, 2013, until July 1, 2014, by multiplying such income by a fraction, the numerator of which is the property factor plus the payroll factor plus quadruple the sales factor and the denominator of which is six, except when the sales factor does not exist, the denominator of the fraction shall be the number of existing factors, and when the sales factor exists but the payroll factor or property factor does not exist, the denominator of the fraction shall be the number of existing factors plus three; and

3. From July 1, 2014, and thereafter, by multiplying such income by the sales factor.

B. *1.* If the taxpayer makes one or more of the elections described in subdivision A 1, A 2, or A 3, the taxpayer may not revoke the election ~~for a period of three taxable years~~ *beginning with taxable year 2017 and all taxable years thereafter*.

~~In addition,~~ *2. For taxable years beginning prior to July 1, 2016,* the taxpayer shall certify to the Department that the average weekly wage of its full-time employees is greater than the lower of the state or local average weekly wages for the taxpayer's industry.

C. If the average annual number of full-time employees of a manufacturing company for the first three taxable years (in which the manufacturing company used the alternative apportionment set forth in this section) is less than 90 percent of the base year employment, or the average wage of its full-time employees as certified by the taxpayer is not greater than the lower of the state or local average weekly wage, then the Department of Taxation shall assess the manufacturing company with additional taxes pursuant to this article computed as the difference between (i) the taxes that would have been due under the apportionment formula provided under § 58.1-408*, as such section was in effect as of January 1, 2015,* for such three taxable years~~,~~ minus (ii) the taxes due under the alternative apportionment provided under this section for such three taxable years. Interest shall accrue and shall be assessed on such additional taxes at the rate prescribed under § 58.1-15, with such interest accruing from the original due date for filing of the income tax return to the date of payment of such additional taxes.

Such additional taxes and interest are hereby imposed on manufacturing companies using the alternative apportionment set forth in this section.

*The provisions of this subsection shall expire for taxable years beginning on or after July 1, 2016.*

D. As used in this section, unless the context requires another meaning :

"Base year employment" means the average number of full-time employees employed by the manufacturing company in the Commonwealth in the taxable year that ended immediately prior to the first taxable year in which the manufacturing company used the alternative apportionment set forth in this section.

"Full-time employee" means an employee of a manufacturing company who is employed for an indefinite duration in the Commonwealth for which the standard fringe benefits are paid by the manufacturing company, for which employment requires a minimum of either (i) 35 hours of an employee's time per week for the entire normal year of such manufacturing company's operations, which "normal year" shall consist of at least 48 weeks, or (ii) 1,680 hours per year.

"Manufacturing company" means a domestic or foreign corporation primarily engaged in activities that, in accordance with the North American Industrial Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sector 11, 31, 32, or 33.

E. The General Assembly of Virginia finds that job creation is essential to the continued fiscal health of the Commonwealth. In this modern economy, states often compete for quality manufacturing jobs. Accordingly, the provisions of this section relating to manufacturing companies that increase their employment in Virginia are integral to the purpose of the election allowed pursuant to this section. If any provision of this section is for any reason held to be invalid or unconstitutional by the decision of a court of competent jurisdiction, that provision shall not be deemed severable.

**2. That the Department of Taxation shall prepare a fiscal impact statement on the revenues and expenditures of the Commonwealth from implementation of all provisions of this act. The written fiscal impact statement shall be provided to the Governor and the Chairmen of the House Committee on Appropriations, House Committee on Finance, and Senate Committee on Finance by December 1, 2016. To facilitate the preparation of such fiscal impact statement:**

**A. Every corporation that had income from business activity that was taxable both within and without the Commonwealth for taxable year 2014 and that had Virginia taxable income before apportionment of not less than $50 million on its return filed for such taxable year pursuant to Article 10 (§ 58.1-400 et seq.) of Chapter 3 of Title 58.1 of the Code of Virginia must submit information to the Department of Taxation showing the computation of its taxable year 2014 sales factor using market-based sourcing as described under the amendments in this act to subsection A of § 58.1-416 of the Code of Virginia.**

**B. The required information shall be submitted to the Department of Taxation using a form and containing the information prescribed by the Tax Commissioner. The information shall reconcile to information reported on the taxable year 2014 return of the corporation, provided that if an affiliated group of corporations elected to file a combined return for taxable year 2014 under § 58.1-442 of the Code of Virginia, the required information shall be reported for each affiliate included in the combined return if the aggregate Virginia taxable income of such group for such taxable year before apportionment was not less than $50 million. The Tax Commissioner shall prescribe the form and manner for reporting the required information by each affiliate of an affiliated group of corporations that elected to file a combined return for taxable year 2014.**

**C. The required information must be submitted to the Department of Taxation on or before July 1, 2016, which date shall not be extended. The Department of Taxation is hereby authorized to audit any corporation that is required to submit such information and fails to do so on or before July 1, 2016, or fails to submit such information accurately.**

**D. Any corporation required to submit such information to the Department of Taxation that fails to do so on or before July 1, 2016, or that fails to submit such information accurately shall be subject to a penalty of $5,000. The Tax Commissioner shall have the authority to waive such penalty upon a determination that this submission requirement would cause an undue hardship. All requests for waiver shall be transmitted to the Tax Commissioner in writing.**

**3. That the Department of Taxation shall develop and make publicly available guidelines implementing the provisions of this act, including market-based sourcing. In developing such guidelines, the Department of Taxation shall not be subject to the provisions of the Administrative Process Act (§ 2.2-4000 et seq. of the Code of Virginia) for guidelines promulgated on or before December 31, 2020, but shall cooperate with and seek the counsel of interested groups and shall not promulgate any guidelines, preliminary or final, without first seeking such counsel and**

**conducting a public hearing. Preliminary guidelines shall be promulgated and made publicly available no later than December 31, 2016, and final guidelines shall be promulgated and made publicly available no later than December 31, 2017. Subsequent to December 31, 2017, the guidelines shall next be updated by December 31, 2020, under the same procedures as required for the preliminary and final guidelines. After December 31, 2020, the guidelines shall be subject to the Administrative Process Act and accorded the weight of a regulation under § 58.1-205 of the Code of Virginia.**

**4. That §§ 58.1-422.1 and 58.1-422.2 of the Code of Virginia are repealed for taxable years beginning on or after January 1, 2019.**

**5. That the amendments in subdivision B 2 and subsection C of § 58.1-422 of the Code of Virginia pursuant to the provisions of this act and the second and third enactments of this act shall become effective on July 1, 2016. All other provisions of this act (including all other amendments in § 58.1-422) shall become effective for taxable years beginning on or after January 1, 2017, only if the provisions of this act are not estimated to reduce the Commonwealth's official forecasted general fund revenues by more than $50 million for any fiscal year included in the fiscal impact statement described under the second enactment of this act. The Commonwealth's official forecasted general fund revenues shall be those official general fund revenue estimates that are in effect immediately prior to the completion of the fiscal impact statement by the Department of Taxation.**

**6. That the Tax Commissioner by September 1 of each year beginning in 2018 shall make a written certification to the Governor and the General Assembly reporting any net additional revenues attributable to the provisions of this act, if any, received in the state treasury for the immediately prior fiscal year. The next regular session of the General Assembly shall provide an amount of tax relief that is at least equal to the amount certified by the Tax Commissioner.**