

Virginia Update: Final Guidelines on Single Sales Factor Election for Manufacturers and Phase-in of Single Sales Factor Apportionment for Retailers

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Overview

The Virginia Department of Taxation (the “Department”) recently issued final guidelines with respect to the manufacturer’s election to use single-sales factor apportionment for corporate income tax purposes.¹ The election, codified at Va. Code Ann. § 58.1-422, allows qualifying manufacturers to use a modified apportionment factor for tax years beginning after July 1, 2011.² The Department had issued amended draft guidelines on August 30, 2012 regarding the election.³ The final guidelines incorporate the changes resulting from the 2012 General Assembly (H.B. 460 Chapter 427 of the 2012 Acts of the Assembly) and certain public comments received regarding the draft guidelines.

Also, in 2012 Virginia adopted mandatory single-sales factor corporate income tax apportionment for retailers.⁴ This mandatory apportionment formula is being phased in beginning July 1, 2012.

In this Tax Alert we summarize these Virginia apportionment provisions.

Manufacturer Election to Use Single-sales Factor Apportionment

Taxpayers in Virginia generally use a three-factor apportionment formula (with double-weighted sales). Va. Code Ann. § 58.1-422 allows qualified Virginia manufacturers to elect to use a modified apportionment factor that, when fully phased in, will provide for single-sales factor apportionment. The election is binding for three years.

Phase-in of Single-Sales Factor Apportionment

The single-sales factor will be gradually phased in over three years according to the following schedule:

- From July 1, 2011, through June 30, 2013, the sales factor will be triple-weighted, plus payroll and property, with a denominator of five;
- From July 1, 2013, through June 30, 2014, the sales factor will be quadruple-weighted, plus payroll and property, with a denominator of six; and
- From July 1, 2014, and thereafter, a single sales factor will be used.

Who Qualifies as a “Manufacturer” for Purposes of the Election?

Va. Code Ann. § 58.1-422 defines a “manufacturing company” as a domestic or foreign corporation primarily engaged in activities that in accordance with the North American Industry Classification System (“NAICS”) would be included in Sectors 11, 31, 32, or 33.⁵ Under the guidelines, “primarily engaged” means that either fifty percent or more of the gross receipts are derived from the sale of goods that are manufactured by the taxpayer, or fifty percent or more of the employees are engaged in manufacturing activities.⁶

¹ The Department’s guidelines were issued on January 7, 2013, and as of January 18, 2013 may be accessed at:

http://www.tax.virginia.gov/Documents/2012_Single_Sales_Factor_Guidelines.pdf.

² H.B. 2437, Chapter 821 of the 2009 Acts of the Assembly.

³ Our September 18, 2012, External Multistate Tax Alert summarizing the Amended Draft Guidelines is available at:

http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_multistate_VA_Tax%20Alert.pdf.

⁴ Va. Code Ann. § 58.1-422.1 as added by H.B. 154, Chapter 86 of the 2012 Acts of the Assembly, and S.B. 49, Chapter 666 of the 2012 Acts of the Assembly.

⁵ NAICS is used to classify businesses according to the type of activity. Activities are grouped by Sectors. Sector 11 includes Agriculture, Forestry, Fishing, and Hunting. Sectors 31-33 cover a variety of Manufacturing Activities. The full list of Sector Codes can be viewed at: <http://www.naics.com/info.htm>.

⁶ The amended draft guidelines defined “primarily engaged” to mean that either fifty percent or more of the gross receipts are derived from the sale of goods that are manufactured in Virginia, or fifty percent or more of the employees are

- Under the statute, a manufacturing company must also meet certain wage requirements and maintain a base number of employees for at least three years (including the year of election).⁷ Manufacturing companies must be prepared to certify to the Department that they meet the wage and employee requirements.⁸ Under the guidelines, the average weekly wage of the taxpayer's employees must be greater than the lower of the state or local average weekly wages according to the labor market data provided by the Virginia Employment Commission. In addition, the taxpayer must certify that the average annual number of full-time employees for the average of the first three taxable years the manufacturer's election is in place is at least 90% of the base year (first taxable year of the election). After the third year, the taxpayer is no longer required to meet the employee requirement, though the salary requirement will still apply.
- Va. Code Ann. § 58.1-422 further defines full-time employees as those who are employed by the taxpayer for an indefinite duration for at least 35 hours a week for the entire year (minimum of 48 weeks) or 1,680 hours. The final guidelines restrict taxpayers from including seasonal or temporary positions, contractors, subcontractors or positions that are ancillary to the manufacturing activities in determining the employment level. In addition, the final guidelines state that two part-time employees may be combined to qualify as one "equivalent" full-time employee.
- Pursuant to the final guidelines, the taxpayer is not required to provide a separate statement to make the election. However, the taxpayer should maintain records documenting that it has met the applicable criteria for each year the modified apportionment method is used. The records must be made available to the Department on request.

Losing the Modified Apportionment Method; Recapture Provisions

Under the statute, once the election is made, it is binding for three years.⁹ The taxpayer is not permitted to revoke the election or amend prior year returns to change the method. However, if the Department finds that the taxpayer did not meet the requirements of the election, the Department will force the taxpayer to apply the regular apportionment method. The guidelines define the Department's method to "recapture" any tax due with respect to a tax year where the taxpayer does not qualify for the special apportionment method. The amount of the recapture will consist of the amount of tax the taxpayer would have paid using the standard apportionment method less the amount of tax paid under the modified apportionment method. The applicable rate of interest will apply to the recapture amounts. The original version of the statute also imposed a 10% penalty on the recaptured portion of the tax. However, H.B. 460 eliminated this penalty provision.

Clarification to the Employment Requirement

The final guidelines restrict taxpayers from including *positions that are ancillary to its manufacturing activities* in determining the employment level. The Department has informally clarified that the phrase "positions that are ancillary to its manufacturing activities" is intended to expand on the terms "contractors" and "subcontractors" that precedes the phrase. The Department also informally clarified that a non-employee of a manufacturer cannot be counted as an employee of the company even if the worker is based full-time at the manufacturer's facilities.¹⁰

Timing of Election to use Single-sales Factor Apportionment

The final guidelines do not address the potential of making an election on an amended return. In an informal communication, the Department indicated that a single-sales factor election cannot be made with an amended return.

Affiliated Groups, Mergers and Spin-offs

The amended draft guidelines also provide examples of how the modified apportionment methods and requirements are affected by affiliated groups, mergers, and spin-offs.

engaged in manufacturing activities within Virginia. These controversial requirements limiting the election to companies with certain levels of manufacturing activity within Virginia were not embodied in the final guidelines.

⁷ Va. Code Ann. § 58.1-422 (B).

⁸ *Id.*

⁹ *Id.*

¹⁰ Informal guidance from the Department is not binding on the Department and is subject to change.

Retailer Mandatory Single Sales Factor Apportionment

For retailers, a mandatory single-sales factor apportionment formula is being phased in beginning July 1, 2012.¹¹ Currently, the only requirement for this mandatory apportionment provision is that the “retail company” must be a domestic or foreign corporation primarily engaged in activities that, in accordance with NAICS, would be included in Sectors 44-45. For retailers, the sales factor will be gradually phased in over three years according to the following schedule:

- From July 1, 2012, until July 1, 2014, retail companies are required to use a triple-weighted sales factor;
- From July 1, 2014, until July 1, 2015, retail companies are required to use a quadruple-weighted sales factor; and
- From July 1, 2015, retail companies are required to use a single sales factor.¹²

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¹¹ Va. Code Ann. § 58.1-422.1 as added by H.B. 154, Chapter 86 of the 2012 Acts of the Assembly, and S.B. 49, Chapter 666 of the 2012 Acts of the Assembly.

¹² Va. Code Ann. §58.1 – 422.1.