



COMMONWEALTH of VIRGINIA

Department of Taxation

Memorandum

TO: Richard Waugh, Audit Supervisor

FROM: Tim Winks *Tim*
Assistant Commissioner
Office of Tax Policy

DATE: February 16, 1995

SUBJECT: Real Estate Transactions

QUESTIONS

#1) How should a real estate firm report its income - i.e. physical location of agency, physical location of property being sold, physical location of closing, etc?

Answer: For any real estate firm physically located outside of Virginia, income derived from services provided (i.e. listing and selling of realty) in connection with the sale of Virginia realty would be Virginia source income as defined by Code of Virginia § 58.1-302.

Firms located outside of Virginia doing business as corporations would determine Virginia taxable income using allocation and apportionment. S corporations, partnerships and limited liability companies with nonresident shareholders, partners or members would also use apportionment and allocation to determine income from Virginia sources. Nonresident sole proprietorships would determine net income from Virginia sources based upon proportional gross receipts related to the sales of real estate. (See answer to Question #4 for additional detail.)

#2) What is the method that a firm should report the commissions to its individual agents - should the commissions be identified by source property, or would that fall as a responsibility of the individual agent?

Answer: Real estate brokers and agents may be recognized as either independent businesses or as employer-employee for federal income tax purposes. (See I.R.C. § 3508.) When the broker and agent are separate businesses, the broker would be responsible for identifying the source of their commissions only. Agents are responsible for identifying the source of their own commissions. (Please note brokers may be designated as the "real estate reporting person", as defined in I.R.C. § 6045(e), and thus be subject to the reporting requirements of Code of Virginia § 58.1-317 on the sales of real property by nonresidents of Virginia.)

In the case of a nonresident agent/employee whose primary method of compensation is commissions, income from Virginia sources would be determined by reference to commissions derived from sales of Virginia realty.

If the nonresident agent/employee's compensation consists of a base amount in addition to a commission, a portion of the base pay will be apportioned to Virginia. The proper method of determining the amount of base pay subject to Virginia individual income tax is to apportion this income based on the amount of time spent performing services in Virginia to the total amount of time spent performing services everywhere. For example, if employees are paid by the hour, keep track of the hours spent performing services in Virginia. (See PD 90-120.)

#3) Does the location of the actual closing have any ramifications on the source of the commissions?

Answer: No, Code of Virginia § 58.1-302 would control. (i.e. services performed by a firm or persons in connection with the sale of real property located in Virginia.)

#4) If a firm is to report income based on the situs of a parcel, would the agency be able to appropriate office expenses to the Virginia fees received, if the agency's office is located in Tennessee?

Answer: Corporations with income from sources both within and without Virginia must allocate and apportion its Virginia taxable income. S corporations, partnerships and limited liability companies with nonresident shareholders, partners or members will compute the Virginia source income of these nonresidents in accordance with the corporate statutory formula. See enclosed PD 88-165 and PD 90-114. (See also, VR § 630-4-391 (C).)

A nonresident sole proprietor with income from business activity in Virginia will utilize an apportionment formula based on the gross receipts related to sales of real estate. Net income or loss from Virginia sources will be determined by applying a gross receipts factor to the net income or loss of the proprietorship reported on federal Schedule C. The gross receipts factor is a fraction, the numerator of which is the gross receipts related to the sales of real estate in Virginia and the denominator of which is the gross receipts related to the sales of real estate everywhere.

#5) Are the commissions treated any differently when received by an agent who is resident of a state with which Virginia has reciprocity? What are the ramifications of this situation, if any?

Answer: For the states that Virginia practices statutory reciprocity under Code of Virginia § 58.1-332 (B), Virginia nonresident individuals are eligible for a credit against their income tax liability for taxes paid to their state of residence. For tax year 1994, Virginia practices this type of reciprocity with Arizona, California, the District of Columbia and Oregon.

Under Code of Virginia § 58.1-342, Virginia practices reciprocity by both statute or agreement for those individuals who commute daily to Virginia for employment purposes. Code of Virginia § 58.1-342 designates special situations where nonresidents with Virginia source income from salaries and wages are not liable for the Virginia individual income tax. Code of Virginia § 58.1-342 is inapplicable to the extent individuals receive income other than salaries and wages. Therefore, income from real estate commissions would not fall under the protection of Code of Virginia § 58.1-342.

Virginia currently has written agreements with Maryland, Pennsylvania and West Virginia as authorized by Code of Virginia § 58.1-342 (B). The District of Columbia and Kentucky are reciprocity states by virtue of the operation of Code of Virginia § 58.1-342 (A).

SCENARIOS

>A Tennessee resident works as a commissioned agent for a real estate firm physically located in Tennessee. The agent is licensed in both Tennessee and Virginia and actively shows and sells property in both states. The agent makes a sale of real estate located in Virginia for which a commission is generated.

Is the commission treated as Virginia source income which should be reported as such on a nonresident tax return?

Answer: Yes, the commission would be Virginia source income as defined by Code of Virginia § 58.1-302.

The agency for which the agent works will also receive a fee - is this amount also deemed Virginia source income to the agency's owner/operator if a sole proprietorship, partners if a partnership, or the corporation?

Answer: Yes, the commission received by the agency for the service of listing the property would be Virginia source income. Also, corporations, partnerships and sole proprietorships (see PD 88-212) which list and sell real estate cannot avail themselves of protection under Public Law 86-272. Public Law 86-272 applies to sales of tangible personal property and would be inapplicable to services.

If the actual closing takes place at a Tennessee location (i.e. the attorney's office, the agency etc), does this have any impact?

Answer: No, see answer to question #3 above.

>A Tennessee agency holds the listing for a Virginia parcel. The parcel is included in a multi-listing service so that other agents may have the opportunity to show and sell the property. When this property is sold, the agency holding the listing usually receives a commission as well as the agent making the sale and his/her associated agency.

a) How is the commission received by the agency holding the listing treated for income tax purposes? b) Does the source of the income change since the agency holding the listing is once removed from the actual sale?

Answer: Part a) : The commission received by a Tennessee agency for the service of listing a Virginia property would be Virginia source income per the answer to question #1 above.

Part b) : The character of the income to the listing agency is not dependant upon who actually sells the property. Both parties to the transaction will have Virginia source income.