COMMONWEALTH *of* VIRGINIA

Department of Taxation
Richmond, Virginia 23282

Compromises

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Manufacturers
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MEMORANDUM

TO: Jerry Peterson, Manager
Department of Information Technology

DATE: March 26, 1985

SUBJECT: Inventory of Alcoholic Beverages in State-Owned Warehouse

You have inquired into the state tax consequences of the housing in a state-owned warehouse in Richmond of alcoholic beverages of various distillers who have no place of business in Richmond. Title to such beverages would remain with the distillers until the beverages were shipped to various ABC stores.

Because we have no information as to the employees of the distiller, we will not address the requirements of estimated and withholding taxes. Our discussion will be limited to intangible personal property and income taxes. We understand that you have directed to the locality any questions concerning local property taxation.

Intangible Personal Property Tax. Effective January 1, 1985, intangible personal property as defined by Virginia Code § 58.1-1101 (which would include alcoholic beverages held as manufacturers' inventory) is exempt from state and local taxation. However, any property which is deemed to be merchants' capital could be subject to local taxation. Of course, to be merchants' capital, the owner of the property would have to be operating as a merchant. If the management of the warehouse were outside the distillers' control and the warehousing operation considered similar to a public warehouse, the beverages would retain their character as manufacturers' inventory and would not be subject to the merchants' capital tax.

Corporate Income Tax. Any out-of-state distiller who is already subject to Virginia corporate income tax would have to apportion its modified federal taxable income by use of a three-factor formula based on property, payroll and sales within Virginia. Thus, it would include in the formula all property owned by the distiller, including beverages stored in Virginia (whether by means of a bailment or not), and all revenue derived from the sale of beverages shipped to a destination in Virginia. (On the facts presented, there is no payroll activity in Virginia attributable to the sale of beverages.)

Many distillers are currently exempt from Virginia income tax by virtue of federal Public Law 86-272 even though they have income from the sale of beverages in Virginia. Public Law 86-272 prohibits a state from imposing a net income tax on a foreign corporation which has no place of business within Virginia, whose sole activity within Virginia is solicitation of orders which are accepted and filled by shipment via common carrier from places outside Virginia. Whether or not additional activities would be sufficient to subject the corporation to Virginia income tax would depend on the facts of each case.

Thus the major issue is whether the storage in Virginia of alcoholic beverages owned by a distiller is sufficient additional activity to subject the distiller to Virginia income tax.

Under Virginia Reg. § 630-3-401G consideration is given to the nature, continuity, frequency and regularity of the additional business activity beyond soliciting orders. Generally, ownership of property for purposes of the property factor is determined by title to the property. Thus, storage of property in a public warehouse located in Virginia would subject a manufacturer to Virginia income tax.

However, the nature of the warehousing agreement may be such that the storage of alcoholic beverages in a state-operated warehouse may not be considered property owned by the distiller for Virginia income tax purposes even though title has not passed and the State has not paid for the beverages. Such factors may include: storage, handling and insurance costs; risk of loss; control over shipment out of the warehouse; ability of distiller to ship to its out-of-state customers; and ability of the State to return unwanted beverages.

In other words, transfer of title is not controlling for income tax. We would look at the totality of the circumstances to see which incidents of ownership and control were retained by the distiller and which were assumed by the State.

I trust this information will be helpful, albeit of a general nature. Of course, any final decision would depend on the specific facts presented, and the final determination as to local matters would be with the locality.

Danny M. Payne, Director
Tax Policy Division

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