Certified Company Apportionment Guidelines for Business Conducted in Certain Disadvantaged Localities

During the 2018 Session, the Virginia General Assembly enacted House Bill 222 (2018 *Acts of Assembly*, Chapter 802) and Senate Bill 883 (2018 *Acts of Assembly*, Chapter 801), which allow certain companies that have been certified by the Virginia Economic Development Partnership Authority ("certified companies") to decrease the amount of income taxed by Virginia by making specific modifications to their apportionment of income ("certified company apportionment").

These guidelines are published by the Department of Taxation ("the Department") to provide guidance to taxpayers regarding certified company apportionment, as required by the second enactment clause of 2018 House Bill 222 and 2018 Senate Bill 883. These guidelines are not rules or regulations subject to the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 et seq.) and are being published in accordance with the Tax Commissioner's general authority to supervise the administration of the tax laws of the Commonwealth pursuant to *Va. Code* § 58.1-202. As necessary, additional information will be published and posted on the Department's website, www.tax.virginia.gov.

These guidelines complement the Department's existing Corporation Income Tax Regulation (23 *Virginia Administrative Code* ("VAC") 10-120-10 et seq.) and its Single Sales Factor Election for Manufacturers Guidelines (P.D. 13-6). To the extent that there is a conflict between the Department's existing guidance and *Va. Code* §§ 58.1-405, 58.1-408, 58.1-417 through 58.1-420, 58.1-422, 58.1-422.1, and 58.1-422.2, the provisions of those sections of the *Code of Virginia*, as interpreted by these guidelines, supersede existing guidance.

These guidelines represent the Department's interpretation of the relevant laws. They do not constitute formal rulemaking and hence do not have the force and effect of law or regulation. In the event that the final determination of any court holds that any provision of these guidelines is contrary to law, taxpayers who follow these guidelines will be treated as relying on erroneous written advice for purposes of waiving penalty and interest under *Va. Code* §§ 58.1-105, 58.1-1835, and 58.1-1845. To the extent there is a question regarding the application of these guidelines, taxpayers are encouraged to write to the Department and seek a written response to their question.

General Overview of Certified Company Apportionment

Multistate Companies

Virginia generally requires the Virginia taxable income of a multistate company to be apportioned to Virginia by multiplying such income by an apportionment percentage. Under Virginia's standard apportionment method, the apportionment percentage is calculated by adding together a company's property factor plus its payroll factor, plus twice its sales factor, and by dividing such sum by four. In addition to Virginia's standard apportionment method, Virginia has specialized apportionment methods for calculating the apportionment percentage of multistate manufacturing companies, retail companies, companies with enterprise data center operations, motor carriers, railway companies, financial corporations, and construction corporations. Effective for Taxable Year 2018 and thereafter, multistate certified companies may decrease the amount of income apportioned to and taxed by Virginia using certified company apportionment.

Instate Companies

A company that transacts or conducts its entire business within Virginia ("instate company") is not generally permitted to apportion its Virginia taxable income based upon an apportionment percentage. See *Va. Code* § 58.1-405 and 23 VAC 10-120-120. Instead, an instate company is generally required to pay state income tax based upon its entire Virginia taxable income. Effective for Taxable Year 2018 and thereafter, instate certified companies may decrease the amount of income taxed by Virginia using certified company apportionment.

Requirements to Become a Certified Company

Eligibility Criteria

A company seeking to use certified company apportionment is eligible to use such apportionment method if it is a corporation or pass-through entity that:

- Does not have any existing property or payroll in Virginia as of January 1, 2018; and

- On or after January 1, 2018, but before January 1, 2025:

    - Creates at least 50 new jobs in a qualified locality or qualified localities;

    - Is a traded-sector company; and

    - Generates a positive fiscal impact.

A lower 10 new job threshold applies, in lieu of the 50 new job threshold, if the company spends at least $5 million on new capital investment in a qualified locality or qualified localities on or after January 1, 2018, but before January 1, 2025. A company seeking certification as a certified company with the 10 new job threshold is still required to be a traded-sector company and generate a positive fiscal impact to receive such certification.

Certification by VEDP

In addition, a company is required to be annually certified by the Virginia Economic Development Partnership Authority ("VEDP") as meeting the above eligibility criteria to use certified company apportionment. For each taxable year, a company is required to submit an application for certification or re-certification to VEDP. Applications will be accepted during the period beginning on January 1 and ending April 1 of the calendar year immediately following the taxable year for which certification or re-certification is sought. To remain a certified company able to use certified company apportionment for any taxable year, the company is required to be recertified by VEDP for such taxable year.

For additional information about regarding the eligibility requirements and certification or annual re-certification, please visit VEDP's website, www.vedp.org.

Disadvantaged Localities Qualified for Certified Company Apportionment

A company seeking certification as a certified company is required to create jobs and, if applicable, make investments in certain disadvantaged localities specified in *Va. Code* § 58.1-405.1(A) as qualified localities. Once certified, the computation of the company's apportionment also depends upon the extent to which the company's business activities are conducted in such localities. The qualified localities are:

- The Counties of Alleghany, Bland, Buchanan, Carroll, Craig, Dickenson, Giles, Grayson, Lee, Russell, Scott, Smyth, Tazewell, Washington, Wise, or Wythe or the Cities of Bristol, Galax, or Norton;

- The Counties of Amelia, Appomattox, Buckingham, Charlotte, Cumberland, Halifax, Henry, Lunenburg, Mecklenburg, Nottoway, Patrick, Pittsylvania, or Prince Edward, or the Cities of Danville or Martinsville;

- The Counties of Accomack, Caroline, Essex, Gloucester, King and Queen, King William, Lancaster, Mathews, Middlesex, Northampton, Northumberland, Richmond, or Westmoreland; or

- The Counties of Brunswick or Dinwiddie, or the City of Petersburg.

Effective July 1, 2019, Page County is a qualified locality for purposes of certified company apportionment. See House Bill 2776 (2019 *Acts of Assembly*, Chapter 262) and Senate Bill 1498 (2019 *Acts of Assembly*, Chapter 263).

In addition, a qualified development site may be treated as a qualified locality. A qualified development site is real property that is in a locality adjacent to a qualified locality and, before January 1, 2018, either:

- Was owned or partly owned by a qualified locality or an industrial development authority of which a qualified locality is a member; or

- Was owned or partly owned by a locality or industrial development authority, was leased to a private party, and was subject to a revenue-sharing agreement providing that a portion of the revenues from the lease would be distributed to a qualified locality.

A qualified development site does not include real property that is not owned by Virginia or a political subdivision thereof.

Filing Requirements

Once a company receives certification or re-certification in writing from VEDP for a taxable year, such certified company may apportion its income on its Virginia income tax return based upon certified company apportionment. Any certified company that elects to use certified company apportionment is required to maintain the certification letter and any other documentation that substantiates its eligibility for, and calculation of, its certified company apportionment, including, but not limited to, any documentation showing the amount of property and payroll reported to and accepted by VEDP as generating a positive fiscal impact. Such documentation is required to be provided to the Department upon request.

A certified company may use certified company apportionment for up to seven years, the taxable year in which it is first certified and for the six subsequent, consecutive taxable years (“the eligibility period”). However, a company that used the 50 new job threshold to become eligible may not use certified company apportionment for any year during the eligibility period in which:

- The company's number of jobs in a qualified locality or qualified localities falls below the 50 job initial threshold; or

- The company fails to receive re-certification from VEDP in writing.

If the company used the 10 new job threshold to become eligible, then such company may not use certified company apportionment for any year during the eligibility period in which:

- The company's number of jobs in a qualified locality or qualified localities falls below the 10 job initial threshold;

- The company's capital investment falls below $5 million initial threshold; or

- The company fails to receive re-certification from VEDP in writing.

Failure to Receive Re-Certification

A company's failure to receive re-certification for a particular taxable year by not meeting the applicable thresholds or failing to timely apply for re-certification makes it ineligible to use certified company apportionment for that year. Nevertheless, a company may remedy these failures and may use certified company apportionment for a taxable year occurring after the year of the failure and during the eligibility period by meeting the applicable threshold(s) and receiving re-certification for the later year. A company's failure to receive re-certification for a taxable year does not extend the company's overall seven-year eligibility period.

Certified Company Apportionment by Multistate Certified Companies

A multistate company that qualifies as a certified company and elects to use certified company apportionment may use such apportionment method to modify the numerator(s) of its apportionment factor(s). The computation for a multistate certified company depends upon whether such company is subject to Virginia's standard apportionment method or a specialized apportionment method.

Standard Apportionment Method

If a certified company is required or is eligible to elect to use Virginia's standard apportionment method and opts to do so, the company may modify the application of such method by making certain modifications to the numerator of each of its apportionment factors.

Modifications to the Property Factor

The numerator of a certified company's property factor may be reduced by the value of its qualifying Virginia property:

$$\text{Modified Property Factor} = \frac{\text{All Virginia Property} - \text{Qualifying Virginia Property}}{\text{Property Everywhere}}$$

Qualifying Virginia property is Virginia property:

- Acquired on or after January 1, 2018, but before January 1, 2025; and
- Located in a qualified locality.

The certified company is required to follow the principles in *Va. Code* §§ 58.1-409, 58.1-410, and 58.1-411, and 23 VAC 10-120-160 and 23 VAC 10-120-170 to determine the value of property that is located in a qualified locality.

The total amount of property used to reduce the property factor numerator may not exceed the amount of the property reported to and approved by VEDP during the company's most recent annual certification.

Modifications to the Payroll Factor

The numerator of a certified company's payroll factor may be reduced by the value of its qualifying Virginia payroll:

$$\text{Modified Payroll Factor} = \frac{\text{All Virginia Payroll} - \text{Qualifying Virginia Payroll}}{\text{Payroll Everywhere}}$$

Qualifying Virginia payroll is Virginia payroll:

- Attributable to jobs created on or after January 1, 2018, but before January 1, 2025; and

- Located in a qualified locality.

The certified company is required to follow the principles in *Va. Code* §§ 58.1-412 and 58.1-413, and 23 VAC 10-120-190 and 23 VAC 10-120-200 to determine the payroll that is located in a qualified locality.

The total amount of payroll used to reduce the payroll factor numerator may not exceed the amount of the payroll reported to and approved by VEDP during the company's most recent annual certification.

Modifications to the Sales Factor

The numerator of a certified company's sales factor may be reduced by the value of all its Virginia sales. Therefore, a certified company's sales factor will always be zero.

Example 1. A multistate company with $100,000 of Virginia taxable income has apportionment factors as follows:

	Property	Payroll	Sales
Virginia	$25,000	$40,000	$100,000
Everywhere	$100,000	$120,000	$1,000,000
Percentage	25%	33.33%	10%

Under Virginia's standard apportionment method, the apportionment percentage is 19.58% ([25% + 33.33% + 2(10%)] / [4]). Therefore, using Virginia's standard apportionment method, such company would generally be required to pay Virginia income tax on $19,580 of its income (19.58% apportionment percentage X $100,000 of income). The remaining $80,420 of its income would be untaxed by Virginia because it is deemed attributable to other states.

However, if the multistate company is a certified company and all its Virginia property is qualifying (i.e., property acquired on or after January 1, 2018, but before January 1, 2025, in any qualified locality) and all its Virginia payroll is qualifying (i.e., payroll attributable to jobs created on or after January 1, 2018, but before January 1, 2025, in any qualified locality), the numerator of its property and payroll factors may be reduced using certified company apportionment, as shown below:

$$\text{Modified Property Factor} = \frac{\$25{,}000-\$25{,}000}{\$100{,}000} = \frac{\$0}{\$100{,}000}$$

$$\text{Modified Payroll Factor} = \frac{\$40{,}000-\$40{,}000}{\$120{,}000} = \frac{\$0}{\$120{,}000}$$

As with all certified companies, this company's sales factor is 0%.

Therefore, the multistate company's factors after applying certified company apportionment will be as follows:

	Property	Payroll	Sales
Virginia	$0	$0	$0
Everywhere	$100,000	$120,000	1,000,000
Percentage	0%	0%	0%

Under Virginia's standard apportionment method as modified by certified company apportionment, the company's apportionment percentage is 0%. As a result, this company's income subject to Virginia tax is $0 under certified company apportionment rather than $19,580 under the standard apportionment for non-certified companies.

Example 2. Same as Example 1, but only $10,000 of its property is qualifying Virginia property and only $10,000 of its payroll is qualifying Virginia payroll for purposes of certified company apportionment. The numerator of its property and payroll factors may be reduced using certified company apportionment, as shown below:

$$\text{Modified Property Factor} = \frac{\$25{,}000-\$10{,}000}{\$100{,}000} = \frac{\$15{,}000}{\$100{,}000}$$

Modified Payroll Factor	=	$40,000-$10,000 / $120,000	=	$30,000 / $120,000

As with all certified companies, this company's sales factor is 0%.

Therefore, the multistate company's factors after applying certified company apportionment are as follows:

	Property	Payroll	Sales
Virginia	$15,000	$30,000	$0
Everywhere	$100,000	$120,000	$1,000,000
Percentage	15%	25%	0%

Under Virginia's standard apportionment method as modified by certified company apportionment, the company's apportionment percentage is as follows:

10% ([15% + 25% + 2(0%)] / [4])

As a result, this company's income subject to Virginia tax is $10,000 (10% apportionment percentage X $100,000 of Virginia taxable income) under certified company apportionment rather than $19,580 under standard apportionment for non-certified companies.

Specialized Apportionment Methods Based Upon a Single Sales Factor

In addition to Virginia's standard apportionment method, a certified company using a single sales factor apportionment method as a manufacturing company, a retail company, or an enterprise data center may modify its apportionment factor numerator, as explained below:

- **Manufacturing Companies.** A certified company that is a manufacturing company electing to apportion its income using a single factor apportionment method based on sales may use certified company apportionment to reduce the numerator of such factor by an amount equal to the value of its sales in Virginia.

- **Retail Companies.** A certified company that is a retail company required to apportion its income using a single factor apportionment method based on sales may use certified company apportionment to reduce the numerator of such factor by an amount equal to the value of its sales in Virginia.

- **Taxpayers with Enterprise Data Center Operations.** A certified company that is a taxpayer with enterprise data center operations required to apportion its income using a single factor apportionment method based on sales may use certified company apportionment to reduce the numerator of such factor by an amount equal to the value of its sales in Virginia.

Because a certified company may use the value of all of its Virginia sales to reduce the numerator of its sales factor, the apportionment percentage for certified companies using one of these single sales factor apportionment methods will always be zero.

In order to use a single sales factor apportionment method, the certified company is required to independently qualify for it. Therefore, no certified company may use such unless it is also a manufacturing company, a retail company, or a taxpayer with an enterprise data center operation that is required or, if not required, has properly elected to use such method.

Effective for Taxable Year 2019 and thereafter, Virginia law requires debt buyers to use a single sales factor apportionment method. A debt buyer is not permitted to use certified company apportionment to reduce the numerator of its single sales factor because neither 2018 House Bill 222 nor Senate Bill 883 provided for such a modification.

Example 3. A multistate company's factors are as follows:

	Property	Payroll	Sales
Virginia	$25,000	$40,000	$100,000
Everywhere	$100,000	$120,000	$1,000,000
Percentage	25%	33.33%	10%

If the multistate company is a manufacturing company electing to use single sales factor apportionment, such company's apportionment percentage is 10% because its apportionment is based solely on its sales factor. Therefore, using Virginia's apportionment method for manufacturing companies such company would generally be required to pay Virginia income tax on $10,000 of its income (10% apportionment percentage X $100,000 of income).

However, if the company is a certified company, the sales factor will equal 0%. Because the company is using a single sales factor apportionment method, its apportionment percentage will therefore be 0% as well. As a result, this company's income subject to Virginia tax is $0 under certified company apportionment rather than $10,000 under the apportionment method for manufacturing companies.

Specialized Apportionment Methods Based Upon a Single Factor Other Than Sales

A certified company using a single factor apportionment method not based upon sales may modify the numerator of its apportionment factor, as explained below:

- **Motor Carriers**. A certified company that is a motor carrier of property or passengers is permitted to modify its single factor apportionment method based on vehicle miles by using certified company apportionment to reduce the numerator of such factor by an amount equal to its vehicle miles traveled in any qualified locality.

- **Railway Companies.** A certified company that is a railway company may modify its single factor apportionment method based on revenue car miles by using certified company apportionment to reduce the numerator of such factor by an amount equal to its revenue car miles traveled in any qualified locality.

- **Financial Corporations**. A certified company that is a financial corporation may modify its single factor apportionment method based on its business conducted in Virginia by using certified company apportionment to reduce the numerator of such factor by an amount equal to the value of its business within any qualified locality.

- **Construction Corporations**. A certified company that is a construction corporation may modify its single factor apportionment method based on business conducted in Virginia by using certified company apportionment to reduce the numerator of such factor by an amount equal to the value of its business within any qualified locality.

In order to use a single factor apportionment method not based upon sales, the certified company is required to independently qualify for it. Therefore, no certified company may use such method unless it is a motor carrier, railway company, financial corporation, or construction corporation permitted or required to use such method.

Certified Company Apportionment by Instate Certified Companies

An instate company that qualifies as a certified company and elects to use certified company apportionment may apportion Virginia taxable income as if they were a multistate company and use certified company apportionment to modify the numerator(s) of their apportionment factor(s). This is an exception to the general rule prohibiting the use of apportionment by instate companies. As with certified multistate companies, the computation of such numerator(s) for instate certified companies depends upon whether such companies are subject to Virginia’s standard apportionment method or a specialized apportionment method.

Example 4. A company with $100,000 of Virginia taxable income has all of its property, payroll, and sales located in Virginia, as shown below:

	Property	Payroll	Sales
Qualified localities	$10,000	$10,000	$10,000
Non-qualified localities	$15,000	$30,000	$90,000
All of Virginia	$25,000	$40,000	$100,000

Assume that all of its property and payroll located in qualified localities constitutes qualifying Virginia property and qualifying Virginia payroll, respectively. Because the company is instate company, it would generally be required to pay Virginia income tax on all $100,000 of its income. However, if the company is a certified company, then it may apportion its Virginia taxable income within Virginia based upon an apportionment percentage. The company would calculate its property and payroll factors as follows:

	Property	Payroll
Non-qualified localities	$15,000	$30,000
All of Virginia	$25,000	$40,000
Percentage	60%	75%

As with all certified companies, this company's sales factor would be 0%. Under Virginia's standard three-factor formula with double-weighted sales, the company's apportionment percentage is 33.75% ([60% + 75% + 2(0%)] / [4]). As a result, this company's income subject to Virginia tax is $33,750 (33.75% apportionment percentage X $100,000 of Virginia taxable income) under certified company apportionment rather than $100,000 under the standard rules for non-certified instate companies.

Treatment of Pass-through Entities

Pass-through entities ("PTEs") are required to use corporate apportionment to determine the portion of their income that is from Virginia sources for purposes of allocating a share of that income to nonresident individuals. This will affect the amount that nonresident individuals report on their Virginia nonresident income tax returns or that the PTE reports on behalf of its nonresident owners, and the amount for which the PTE may be required to withhold from Virginia income. See the PTE Guidelines (P.D. 15-240) for more information.

Certified Company Apportionment Guidelines for Business Conducted in Certain Disadvantaged Localities

A corporate owner of a PTE may be required to include its share of the PTE's property, payroll, and sales in the corporation's own apportionment factors. (See P.D. 95-19, 95-263, and 99-76.) If the PTE meets the requirements of a certified company, it may use certified company apportionment under the same conditions applicable to corporations. The corporate owners would include in their factors only their share of the PTE's factors for the applicable taxable year.

Documentation and Record Keeping

A certified company is required include with its income tax return information regarding the amounts subtracted from the numerators of the relevant apportionment factors. The Department is required to use such information to compute the fiscal savings to such companies and is required to report annually by the first day of each regular session of the General Assembly to the Chairmen of the House Committee on Appropriations, the House Committee on Finance, and the Senate Committee on Finance:

- The number of returns processed during the prior fiscal year for certified companies that used certified company apportionment;

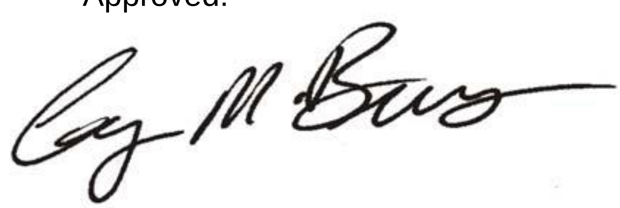
- The estimated revenue impact of certified company apportionment.

A certified company is required to retain records demonstrating its eligibility to use certified company apportionment, including any certification letters received from VEDP, and provide such information to the Department on request.

Additional Information

These guidelines are available online on the Virginia Regulatory Town Hall website, located at https://townhall.virginia.gov, and on the Guidance Documents section of the Department's website, located at http://tax.virginia.gov/guidance-documents. For additional information, please contact the Department at (804) 367-8037.

Approved:



Craig M. Burns
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