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Virginia proposals would remove penalties for manufacturers, amend apportionment for retailers and allow full deduction under I.R.C. Sec. 199

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Update. House Bill 154 was enacted on March 6, 2012, House Bill 1153 was enacted on March 22, 2012, and House Bill 460 was enacted on March 30, 2012.

On February 9, 2012, the Virginia House of Delegates unanimously passed legislation ([H.B. 460](#)) that would remove penalties that apply to manufacturers electing a phased-in single sales factor if they fail to maintain certain employment levels; on February 17, the Virginia Senate passed and cleared for consideration by Governor Bob McDonnell legislation ([H.B. 154](#)) that phases-in a single sales factor for "retail companies;" and on February 14, the House unanimously approved a measure ([H.B. 1153](#)) that would adopt the full deduction under I.R.C. Sec. 199 for domestic production activities.

Manufacturers

Background. In 2009, Virginia enacted legislation ([H.B. 2437](#)) that allows manufacturers to elect to triple-weight the sales factor for taxable years beginning on or after July 1, 2011, quadruple the sales factor for years beginning on or after July 1, 2013, and use a single sales factor for years beginning on or after July 1, 2014. (Manufacturers declining to make such election will still be able to use the generally-



applicable double-weighted sales factor formula.) The legislation provides that if the manufacturer's average annual number of full-time employees for the first three taxable years in which it used alternative apportionment is less than the average number of such employees in the taxable year immediately preceding the use of such election, the Department of Taxation must assess the amount of additional taxes that would have been due if the manufacturer had used the generally applicable double-weighted sales factor formula. Additionally, a 10 percent penalty will be assessed on the amount of such additional taxes, and interest will accrue from the original due date for filing of the income tax return to the date of payment.

2012 Change. Under [H.B. 460](#), the provisions requiring the Department to assess tax, upon a manufacturer's failure to maintain the requisite number of employees, and the imposition of the 10 percent penalty would be repealed.

Retailers

Under [H.B. 154](#), a "retail company" would be required to apportion its income to Virginia under a triple weighted sales factor formula from July 1, 2012 until July 1, 2014, a quadruple weighted sales factor formula from July 1, 2014 until July 1, 2015, and a single sales factor formula thereafter. A retail company would be defined as a domestic or foreign corporation primarily engaged in activities that, in accordance with the North American Industry Classification System, United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sectors 44-45.

Domestic production activities

Under [H.B. 1153](#), taxpayers would be allowed to claim the full amount of the deduction under I.R.C. Sec. 199 for domestic production activities, effective for tax years beginning on or after January 1, 2013. Presently, taxpayers are only allowed to claim two-thirds of the federal deduction for Virginia tax purposes.

PwC Observes

"These three bills address issues of concern to Virginia's business community, which for several years has sought to create a broad single sales factor for corporations and bring Virginia into full conformity with Section 199," says Tim Winks, SALT Managing Director with PwC in Tyson's Corner, Virginia.

"The repeal of the single sales factor penalty for manufacturers and the enactment of an eventual single sales factor for retailers inches Virginia closer to using the single sales factor for all in future years. The chief impediment to a broad-based solution so far has been the uncertain fiscal impact of the change, coupled with weak revenue growth since 2008," Winks explains. "Full conformity to Section 199 beginning in 2013 will also bring Virginia a step closer to returning to full conformity to the Internal Revenue Code, another goal long sought by the business community, if not many Virginia tax administrators."

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