VIRGINIA CHAMBER OF COMMERCE
HJR 681 RECOMMENDATIONS

September 10, 2009

Virginia's corporate income tax is basically sound and fair. No major changes are needed. Some areas to consider for possible changes are noted below:

1. **Simplification.** The original intent of Virginia's income tax was to conform to the federal tax laws as closely as possible in order to provide taxpayers and tax administrators with an easy to follow and administer tax. Virginia now conforms "annually" instead of automatically. The Department of Taxation often declines to conform to federal law on procedural issues. Virginia does not conform, for example, to federal net operating loss (or "NOL") and depreciation rules. There are also a host of special credits and deductions. **Every effort should be made to return to the simple tax system that income tax conformity originally envisioned.**

2. **Apportionment. Virginia's three factor (double weighted sales) apportionment should be analyzed to determine if its application to particular industries presents fairness issues or discourages investment in Virginia.** The study commissioned by HJR 177 (2008), for example, identified service providers as an industry that has problems with being double taxed under Virginia's current methodology. The same study recommended moving manufacturers to single sales factor apportionment as a way to help that key industry and avoid discouraging investment in Virginia. HB 2437 (2009) fell far short of the study's recommendations.

4. **Consolidated returns.** Virginia currently requires taxpayers to make an irrevocable election to file a consolidated income tax return in the first year that two or more affiliates are subject to Virginia income taxation. The effect of a consolidated return is to treat the members of the affiliated group as a single taxpayer. Permission to change into or out of a consolidated return election is rarely -almost never- granted. **These rules need more flexibility, especially to reflect changing needs as companies grow and the nature of their business changes.**

5. **Separate return state.** Virginia has long been a separate return state, and that has served the Commonwealth well. The focus of some states on "mandatory combined reporting," which treats members of a "unitary" group of affiliated entities as one taxpayer, to balance stressed budgets will not prove beneficial in the long term. Although the Department of Taxation needs tools to combat tax gimmicks that distort Virginia taxable income, the current vagaries of Virginia Code §58.1-446, which can allow the Department of Taxation to require a "combined" return by affiliates, and the "addback" provisions of Virginia Code §58.1-402B(8)(intangibles) and (9)(interest) do not provide the certainty needed by business. The problem is exacerbated by the repeal of the long standing regulations under §58.1-446 that provided the guidance that the business community relied on in these areas.

6. **Investment tax credits.** To encourage investment in Virginia, there should be (a) an investment tax credit and (b) an R&D tax credit.

7. **Administrative appeals.** Virginia's administrative appeal system for taxes, both state and local, is one of the best and most user friendly systems in the US. Nevertheless, it can be made better by the use of independent hearing officers and the provision of sufficient funding to permit the time for obtaining decisions to be shortened.