

SENATE BILL NO. _____ HOUSE BILL NO. _____

****WORKING DRAFT****

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A BILL to amend and reenact the Code of Virginia by amending section 58.1-402 relating to corporate income tax exemptions for spaceflight activities in Virginia.

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended and reenacted by amending section 58.1-402 as follows:

§ 58.1-402. Virginia taxable income.

A. For purposes of this article, Virginia taxable income for a taxable year means the federal taxable income and any other income taxable to the corporation under federal law for such year of a corporation adjusted as provided in subsections B, C, D, and E.

For a regulated investment company and a real estate investment trust, such term means the "investment company taxable income" and "real estate investment trust taxable income," respectively, to which shall be added in each case any amount of capital gains and any other income taxable to the corporation under federal law which shall be further adjusted as provided in subsections B, C, D, and E.

B. There shall be added to the extent excluded from federal taxable income:

1. Interest, less related expenses to the extent not deducted in determining federal taxable income, on obligations of any state other than Virginia, or of a political subdivision of any such other state unless created by compact or agreement to which the Commonwealth is a party;

2. Interest or dividends, less related expenses to the extent not deducted in determining federal taxable income, on obligations or securities of any authority, commission or instrumentality of the United States, which the laws of the United States exempt from federal income tax but not from state income taxes;

3. [Repealed.]

4. The amount of any net income taxes and other taxes, including franchise and excise taxes, which are based on, measured by, or computed with reference to net income, imposed by the

25 Commonwealth or any other taxing jurisdiction, to the extent deducted in determining federal taxable
26 income;

27 5. Unrelated business taxable income as defined by § 512 of the Internal Revenue Code;

28 6. The amount of employee stock ownership credit carry-over deducted by the corporation in
29 computing federal taxable income under § 404 (i) of the Internal Revenue Code;

30 7. The amount required to be included in income for the purpose of computing the partial tax on
31 an accumulation distribution pursuant to § 667 of the Internal Revenue Code;

32 8. a. For taxable years beginning on and after January 1, 2004, the amount of any intangible
33 expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or
34 indirectly with one or more direct or indirect transactions with one or more related members to the
35 extent such expenses and costs were deductible or deducted in computing federal taxable income for
36 Virginia purposes. This addition shall not be required for any portion of the intangible expenses and
37 costs if one of the following applies:

38 (1) The corresponding item of income received by the related member is subject to a tax based
39 on or measured by net income or capital imposed by Virginia, another state, or a foreign government
40 that has entered into a comprehensive tax treaty with the United States government;

41 (2) The related member derives at least one-third of its gross revenues from the licensing of
42 intangible property to parties who are not related members, and the transaction giving rise to the
43 expenses and costs between the corporation and the related member was made at rates and terms
44 comparable to the rates and terms of agreements that the related member has entered into with parties
45 who are not related members for the licensing of intangible property; or

46 (3) The corporation can establish to the satisfaction of the Tax Commissioner that the intangible
47 expenses and costs meet both of the following: (i) the related member during the same taxable year
48 directly or indirectly paid, accrued or incurred such portion to a person who is not a related member, and
49 (ii) the transaction giving rise to the intangible expenses and costs between the corporation and the
50 related member did not have as a principal purpose the avoidance of any portion of the tax due under
51 this chapter.

52 b. A corporation required to add to its federal taxable income intangible expenses and costs
53 pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return
54 for the taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under
55 this article for such taxable year including tax upon any amount of intangible expenses and costs
56 required to be added to federal taxable income pursuant to subdivision a, to consider evidence relating to
57 the transaction or transactions between the corporation and a related member or members that resulted in
58 the corporation's taxable income being increased, as required under subdivision a, for such intangible
59 expenses and costs.

60 If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and
61 convincing evidence, that the transaction or transactions between the corporation and a related member
62 or members resulting in such increase in taxable income pursuant to subdivision a had a valid business
63 purpose other than the avoidance or reduction of the tax due under this chapter, the Tax Commissioner
64 shall permit the corporation to file an amended return. For purposes of such amended return, the
65 requirements of subdivision a shall not apply to any transaction for which the Tax Commissioner is
66 satisfied (and has identified) that the transaction had a valid business purpose other than the avoidance
67 or reduction of the tax due under this chapter. Such amended return shall be filed by the corporation
68 within one year of the written permission granted by the Tax Commissioner and any refund of the tax
69 imposed under this article shall include interest at a rate equal to the rate of interest established under §
70 58.1-15 and such interest shall accrue as provided under § 58.1-1833. However, upon the filing of such
71 amended return, any related member of the corporation that subtracted from taxable income amounts
72 received pursuant to subdivision C 21 shall be subject to the tax imposed under this article on that
73 portion of such amounts for which the corporation has filed an amended return pursuant to this
74 subdivision. In addition, for such transactions identified by the Tax Commissioner herein by which he
75 has been satisfied by clear and convincing evidence, the Tax Commissioner may permit the corporation
76 in filing income tax returns for subsequent taxable years to deduct the related intangible expenses and
77 costs without making the adjustment under subdivision a.

78 The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of
79 any petition pursuant to this subdivision, to include costs necessary to secure outside experts in
80 evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this
81 subdivision upon payment of such fee.

82 No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision
83 shall be maintained in any court of this Commonwealth.

84 c. Nothing in subdivision B 8 shall be construed to limit or negate the Department's authority
85 under § 58.1-446;

86 9. a. For taxable years beginning on and after January 1, 2004, the amount of any interest
87 expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or
88 indirectly with one or more direct or indirect transactions with one or more related members to the
89 extent such expenses and costs were deductible or deducted in computing federal taxable income for
90 Virginia purposes. This addition shall not be required for any portion of the interest expenses and costs,
91 if:

92 (1) The related member has substantial business operations relating to interest-generating
93 activities, in which the related member pays expenses for at least five full-time employees who
94 maintain, manage, defend or are otherwise responsible for operations or administration relating to the
95 interest-generating activities; and

96 (2) The interest expenses and costs are not directly or indirectly for, related to or in connection
97 with the direct or indirect acquisition, maintenance, management, sale, exchange, or disposition of
98 intangible property; and

99 (3) The transaction giving rise to the expenses and costs between the corporation and the related
100 member has a valid business purpose other than the avoidance or reduction of taxation and payments
101 between the parties are made at arm's length rates and terms; and

102 (4) One of the following applies:

103 (i) The corresponding item of income received by the related member is subject to a tax based on
104 or measured by net income or capital imposed by Virginia, another state, or a foreign government that
105 has entered into a comprehensive tax treaty with the United States government;

106 (ii) Payments arise pursuant to a pre-existing contract entered into when the parties were not
107 related members provided the payments continue to be made at arm's length rates and terms;

108 (iii) The related member engages in transactions with parties other than related members that
109 generate revenue in excess of \$2 million annually; or

110 (iv) The transaction giving rise to the interest payments between the corporation and a related
111 member was done at arm's length rates and terms and meets any of the following: (a) the related member
112 uses funds that are borrowed from a party other than a related member or that are paid, incurred or
113 passed-through to a person who is not a related member; (b) the debt is part of a regular and systematic
114 funds management or portfolio investment activity conducted by the related member, whereby the funds
115 of two or more related members are aggregated for the purpose of achieving economies of scale, the
116 internal financing of the active business operations of members, or the benefit of centralized
117 management of funds; (c) financing the expansion of the business operations; or (d) restructuring the
118 debt of related members, or the pass-through of acquisition-related indebtedness to related members.

119 b. A corporation required to add to its federal taxable income interest expenses and costs
120 pursuant to subdivision a may petition the Tax Commissioner, after filing the related income tax return
121 for the taxable year and remitting to the Tax Commissioner all taxes, penalties, and interest due under
122 this article for such taxable year including tax upon any amount of interest expenses and costs required
123 to be added to federal taxable income pursuant to subdivision a, to consider evidence relating to the
124 transaction or transactions between the corporation and a related member or members that resulted in the
125 corporation's taxable income being increased, as required under subdivision a, for such interest expenses
126 and costs.

127 If the corporation can demonstrate to the Tax Commissioner's sole satisfaction, by clear and
128 convincing evidence, that the transaction or transactions between the corporation and a related member
129 or members resulting in such increase in taxable income pursuant to subdivision a had a valid business

130 purpose other than the avoidance or reduction of the tax due under this chapter and that the related
131 payments between the parties were made at arm's length rates and terms, the Tax Commissioner shall
132 permit the corporation to file an amended return. For purposes of such amended return, the requirements
133 of subdivision a shall not apply to any transaction for which the Tax Commissioner is satisfied (and has
134 identified) that the transaction had a valid business purpose other than the avoidance or reduction of the
135 tax due under this chapter and that the related payments between the parties were made at arm's length
136 rates and terms. Such amended return shall be filed by the corporation within one year of the written
137 permission granted by the Tax Commissioner and any refund of the tax imposed under this article shall
138 include interest at a rate equal to the rate of interest established under § 58.1-15 and such interest shall
139 accrue as provided under § 58.1-1833. However, upon the filing of such amended return, any related
140 member of the corporation that subtracted from taxable income amounts received pursuant to
141 subdivision C 21 shall be subject to the tax imposed under this article on that portion of such amounts
142 for which the corporation has filed an amended return pursuant to this subdivision. In addition, for such
143 transactions identified by the Tax Commissioner herein by which he has been satisfied by clear and
144 convincing evidence, the Tax Commissioner may permit the corporation in filing income tax returns for
145 subsequent taxable years to deduct the related interest expenses and costs without making the adjustment
146 under subdivision a.

147 The Tax Commissioner may charge a fee for all direct and indirect costs relating to the review of
148 any petition pursuant to this subdivision, to include costs necessary to secure outside experts in
149 evaluating the petition. The Tax Commissioner may condition the review of any petition pursuant to this
150 subdivision upon payment of such fee.

151 No suit for the purpose of contesting any action of the Tax Commissioner under this subdivision
152 shall be maintained in any court of this Commonwealth.

153 c. Nothing in subdivision B 9 shall be construed to limit or negate the Department's authority
154 under § 58.1-446.

155 d. For purposes of subdivision B 9:

156 "Arm's length rates and terms" means that (i) two or more related members enter into a written
157 agreement for the transaction, (ii) such agreement is of a duration and contains payment terms
158 substantially similar to those that the related member would be able to obtain from an unrelated entity,
159 (iii) the interest is at or below the applicable federal rate compounded annually for debt instruments
160 under § 1274(d) of the Internal Revenue Code that was in effect at the time of the agreement, and (iv)
161 the borrower or payor adheres to the payment terms of the agreement governing the transaction or any
162 amendments thereto.

163 "Valid business purpose" means one or more business purposes that alone or in combination
164 constitute the motivation for some business activity or transaction, which activity or transaction
165 improves, apart from tax effects, the economic position of the taxpayer, as further defined by regulation.

166 C. There shall be subtracted to the extent included in and not otherwise subtracted from federal
167 taxable income:

168 1. Income derived from obligations, or on the sale or exchange of obligations, of the United
169 States and on obligations or securities of any authority, commission or instrumentality of the United
170 States to the extent exempt from state income taxes under the laws of the United States including, but
171 not limited to, stocks, bonds, treasury bills, and treasury notes, but not including interest on refunds of
172 federal taxes, interest on equipment purchase contracts, or interest on other normal business transactions.

173 2. Income derived from obligations, or on the sale or exchange of obligations of this
174 Commonwealth or of any political subdivision or instrumentality of this Commonwealth.

175 3. Dividends upon stock in any domestic international sales corporation, as defined by § 992 of
176 the Internal Revenue Code, 50 percent or more of the income of which was assessable for the preceding
177 year, or the last year in which such corporation has income, under the provisions of the income tax laws
178 of the Commonwealth.

179 4. The amount of any refund or credit for overpayment of income taxes imposed by this
180 Commonwealth or any other taxing jurisdiction.

181 5. Any amount included therein by the operation of the provisions of § 78 of the Internal
182 Revenue Code (foreign dividend gross-up).

183 6. The amount of wages or salaries eligible for the federal Targeted Jobs Credit which was not
184 deducted for federal purposes on account of the provisions of § 280C (a) of the Internal Revenue Code.

185 7. Any amount included therein by the operation of § 951 of the Internal Revenue Code (subpart
186 F income).

187 8. Any amount included therein which is foreign source income as defined in § 58.1-302.

188 9. [Repealed.]

189 10. The amount of any dividends received from corporations in which the taxpaying corporation
190 owns 50 percent or more of the voting stock.

191 11. [Repealed.]

192 12, 13. [Expired.]

193 14. For taxable years beginning on or after January 1, 1995, the amount for "qualified research
194 expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not
195 deducted, on account of the provisions of § 280C (c) of the Internal Revenue Code.

196 15. For taxable years beginning on or after January 1, 2000, the total amount actually contributed
197 in funds to the Virginia Public School Construction Grants Program and Fund established in Chapter
198 11.1 (§ 22.1-175.1 et seq.) of Title 22.1.

199 16. For taxable years beginning on or after January 1, 2000, the gain derived from the sale or
200 exchange of real property or the sale or exchange of an easement to real property which results in the
201 real property or the easement thereto being devoted to open-space use, as that term is defined in § 58.1-
202 3230, for a period of time not less than 30 years. To the extent a subtraction is taken in accordance with
203 this subdivision, no tax credit under this chapter for donating land for its preservation shall be allowed
204 for three years following the year in which the subtraction is taken.

205 17. For taxable years beginning on and after January 1, 2001, any amount included therein with
206 respect to § 58.1-440.1.

207 18. For taxable years beginning on and after January 1, 1999, income received as a result of (i)
208 the "Master Settlement Agreement," as defined in § 3.1-1106; (ii) the National Tobacco Grower
209 Settlement Trust dated July 19, 1999; and (iii) the Tobacco Loss Assistance Program, pursuant to 7

210 C.F.R. Part 1464 (Subpart C, §§ 1464.201 through 1464.205), by (a) tobacco farming businesses; (b)
211 any business holding a tobacco marketing quota, or tobacco farm acreage allotment, under the
212 Agricultural Adjustment Act of 1938; or (c) any business having the right to grow tobacco pursuant to
213 such a quota allotment.

214 19. Effective for all taxable years beginning on and after January 1, 2002, but before January 1,
215 2005, the indemnification payments received by contract poultry growers and table egg producers from
216 the U.S. Department of Agriculture as a result of the depopulation of poultry flocks because of low
217 pathogenic avian influenza in 2002. In no event shall indemnification payments made to owners of
218 poultry who contract with poultry growers qualify for this subtraction.

219 20. For taxable years beginning on and after January 1, 2002, any gain recognized as a result of
220 the Peanut Quota Buyout Program of the Farm Security and Rural Investment Act of 2002 pursuant to 7
221 C.F.R. Part 1412 (Subpart H, §§ 1412.801 through 1412.811) as follows:

222 a. If the payment is received in installment payments pursuant to 7 C.F.R. § 1412.807(a) (2), then
223 the entire gain recognized may be subtracted.

224 b. If the payment is received in a single payment pursuant to 7 C.F.R. § 1412.807(a) (3), then 20
225 percent of the recognized gain may be subtracted. The taxpayer may then deduct an equal amount in
226 each of the four succeeding taxable years.

227 21. For taxable years beginning on and after January 1, 2004, any amount of intangible expenses
228 and costs or interest expenses and costs added to the federal taxable income of a corporation pursuant to
229 subdivision B 8 or B 9 shall be subtracted from the federal taxable income of the related member that
230 received such amount if such related member is subject to Virginia income tax on the same amount.

231 22. For taxable years beginning on and after January 1, 2009, any gain recognized as a result of
232 the sale of passenger tickets on a suborbital or orbital spaceflight conducted by a spaceflight entity as
233 defined in § 8.01-227.8.

234 23. For taxable years beginning on and after January 1, 2009, any gain recognized as a result of
235 resupply services contracts entered with the Commercial Orbital Transportation Services division of the
236 National Aeronautics and Space Administration.

237 D. For taxable years beginning on and after January 1, 2006, there shall be subtracted from
238 federal taxable income contract payments to a producer of quota tobacco or a tobacco quota holder as
239 provided under the American Jobs Creation Act of 2004 (P.L. 108-357) as follows:

240 1. If the payment is received in installment payments, then the recognized gain, including any
241 gain recognized in taxable year 2005, may be subtracted in the taxable year immediately following the
242 year in which the installment payment is received.

243 2. If the payment is received in a single payment, then 10% of the recognized gain may be
244 subtracted in the taxable year immediately following the year in which the single payment is received.
245 The taxpayer may then deduct an equal amount in each of the nine succeeding taxable years.

246 E. Adjustments to federal taxable income shall be made to reflect the transitional modifications
247 provided in § 58.1-315.

248 **2. That the provisions of this act shall expire on January 1, 2013.**

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