Is Your Client Overpaying BPOL Tax?

by Craig D. Bell and J. Christian Tennant

For more than a hundred years, the Business, Professional, and Occupational License (BPOL) tax has been a bane for all Virginia businesses. The tax is imposed on a company's gross receipts in a locality, without any adjustment for the business's income or the deductible expenses incurred by the business. A company that exceeds a minimum level of gross receipts will have a BPOL tax liability even if the business fails to turn a profit in the same year. However, some Virginia localities during the 1980s and early 1990s administered the BPOL tax as if it were a tax on gross income, regardless of where such income was earned.

Contributing greatly to the business community's distaste for the BPOL tax was the inconsistent nature in which the BPOL tax was administered from locality to locality over the years. With more than one hundred Virginia localities imposing the BPOL tax, one does not have to stretch the imagination too far to notice different localities both claiming a company's source of gross receipts as part of their respective tax bases when a business conducts its activities at multiple locations throughout the commonwealth.

The legislation was a classic political compromise.

In 1993, the Virginia General Assembly tasked a joint subcommittee to study the BPOL tax and make recommendations to either replace the tax or restructure it to make it more efficient to administer.[1] The joint subcommittee studied the tax for three years and in 1996 the General Assembly adopted the joint subcommittee's recommendations to reform the BPOL tax.[2] The legislation was a classic political compromise. The business community made an all-out press for repeal of the BPOL tax, believing it to be fundamentally unfair and its aggressive administration by some Virginia localities to be over-reaching. Local governments' emphasis was on retaining the revenues this tax provided. After concluding that a replacement revenue source could not be found, a compromise plan that focused on reforming the administration of the tax was passed by the General Assembly in 1996.[3]

As a result of the legislation, the Virginia Department of Taxation was given a large role in the administration of the BPOL tax.[4] The tax department was tasked with promulgating guidelines for the administration of the BPOL tax.[5] In addition, taxpayers were allowed to request advisory rulings and appeal the results of local audits to the state tax commissioner for an impartial determination or review.[6] The need for an independent arbitrator's review of the BPOL tax can be seen clearly in the number of rulings issued by the state tax commissioner in the first few years after the passage of the legislation. In 1997 the commissioner issued 109 rulings and decisions on the BPOL tax.[7] The number of BPOL rulings and appeal decisions that the tax commissioner issues each year decreases significantly as the administration of the BPOL tax becomes more standard or uniform across the state. In 2008, the state tax commissioner issued just nine rulings and decisions on the BPOL tax.[8]

The decreased number of BPOL determinations appealed to the tax commissioner may suggest that localities have been administering the tax more uniformly in accordance with the 1996 reformation of the BPOL tax statutes and the adoption of BPOL guidelines that have the force and effect of regulations.[9] Yet, in the words of

ESPN college football analyst Lee Corso, "Not so fast, my friend!"

Trial Court Decision: No Throwback Allowed

Expecting more than one hundred Virginia localities to rapidly alter how they administer the BPOL tax is like herding cats. Despite the 1996 BPOL reform legislation, a number of localities still incorrectly believe that if a business earns gross receipts in a locality that does not impose the BPOL tax, the gross receipts are "thrown back" and subjected to tax in the locality where the business has its principal location.

In 2004 the City of Lynchburg assessed English Construction Company Inc. and W.C. English Inc. (collectively referred to as English) with additional BPOL tax based on thrown back receipts.[10] English is a construction contractor with a principal place of business in Lynchburg and other definite places of business in localities throughout Virginia.[11] Lynchburg assessed English with BPOL tax on all of the gross receipts English received from projects in other localities that did not impose the tax.[12]

English initiated a lawsuit challenging Lynchburg's assessment of taxes on its BPOL receipts received, but not taxed, in the other localities.[13]

The Lynchburg Circuit Court held there is no express authority for Lynchburg to tax the untaxed gross receipts English earned from other localities where English maintained a definite place of business, and held that Lynchburg's assessments for such taxes are invalid and abated.[14] Lynchburg appealed the circuit court's decision to the Supreme Court of Virginia. Lynchburg's appeal provided the Court with the opportunity to address the BPOL tax statutes for the first time since its substantial revision and reformation in 1996.[15] The question before the Court was whether the City of Lynchburg could tax gross receipts attributable to the activities of a business conducted outside of Lynchburg simply because the outside localities do not tax gross receipts.[16]

Supreme Court Decision: No Throwback Permitted

The Court agreed with the Lynchburg Circuit Court that the *Code of Virginia* did not provide Lynchburg with authority to tax English's gross receipts earned in other localities where English maintained a definite place of business.[17] The Supreme Court stated that a local governing body must have clear statutory authority to impose a tax.[18]

Virginia Code § 58.1-3703.1(A)(3) specifies, as a general rule for purposes of the BPOL tax, gross receipts to be included in the taxable measure are only those attributable to the exercise of a privilege subject to licensure at a definite place of business within Lynchburg. Furthermore, Virginia Code § 58.1-3715 contains no language granting Lynchburg the authority to levy a tax on gross receipts from services performed by a contractor in other localities in which it has a definite place of business. Lynchburg sought such authority by implication. The Court refused to recognize any authority to impose the tax by implication and noted that Lynchburg's interpretation of the code renders parts of the code meaningless and ignores the clear legislative intent underlying the General Assembly's 1996 revision of the business license tax laws. [19]

Relevant Statutory Analysis

The general rule set forth in Virginia Code § 58.1-3703.1(A) is that a business is taxable locally only if it has a "definite place of business" in the locality. And then a business is taxable only with respect to the gross receipts attributed to that definite place of business.[20]

Providing further definition to a locality's taxing power, Code § 58.1-3703.1(A)(3) sets forth rules for attributing gross receipts. A locality can tax "only those gross receipts attributed to the exercise of a privilege subject to licensure at a definite place of business within this jurisdiction."[21] The primary attribution rule for contractors such as English is based on where the work is performed:

> The gross receipts of a contractor shall be attributed to the definite place of business at which his services are performed, or if his services are not performed at any definite place of business, then the definite place of business from which his services are directed or controlled, unless the contractor is subject to the provisions of section 58.1-3715.[22]

The *English* case concerned the first part of this statute; that is, the allocation of gross receipts between definite places of business — not a locality taxing a contractor's receipts earned at a job site in another locality where the contractor does not have a place of business (e.g., an electrician, plumber, or other contractor doing small jobs while working out of an established office in

another jurisdiction). More simply, the issue in this case was whether Lynchburg could tax receipts attributable to a place of business in a locality that chooses not to tax.

Virginia Code § 58.1-3703.1(A)(3) provides a rule of apportionment when a business has places of business in more than one locality and each of those places of business works on the same contract. This method of operation is not unusual, especially in large government contracts staffed by employees working in different cities and even different states. The rule in such cases is payroll apportionment.[23] The General Assembly made absolutely clear even in such cases that what each locality can tax depends on its local activities, not on what any other taxing jurisdiction may have done in taxing or not taxing:

> b. Apportionment. If the licensee has more than one definite place of business and it is impractical or impossible to determine to which definite place of business gross receipts should be attributed under the general rule, the gross receipts of the business shall be apportioned between the definite places of businesses on the basis of payroll. Gross receipts shall not be apportioned to a definite place of business unless some activities under the applicable general rule occurred at, or were controlled from, such definite place of business. *Gross receipts attributable to a definite place of business in another jurisdiction shall not be attributed to this jurisdiction solely because the other jurisdiction does not impose a tax on the gross receipts attributable to the definite place of business in such other jurisdiction.*[24]

This statutory scheme makes perfectly clear that a locality's ability to tax rests with the activities that occur at a local place of business and the attribution of gross receipts to that local place of business under set statutory rules. The ancient argument of localities that "gross receipts" means "everything is taxable" was rejected by the General Assembly. More importantly for this case, the argument that a locality could tax anything not taxed by another locality first was expressly rejected by the Supreme Court. Virginia's BPOL tax statutes were carefully drafted to eliminate the "throwback" concept of taxation, and it is a variation of throwback on which Lynchburg relied in this case.

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What Was Lynchburg Thinking?

Under the principles of BPOL reform the meaning of Virginia Code § 58.1-3715 is apparent. The statute provides a unique rule allowing localities where there is no definite place of business to require a BPOL tax when local contracts exceed $25,000 in value and, to avoid double taxation, requiring these receipts to be deducted from the tax base in the locality where the contractor has its "principal office or any other office." The statute provides, in part:

> A. When a contractor has paid any local license tax required by the county, city or town in which his principal office and any branch office or offices may be located, no further license or license tax shall be required by any other county, city or town for conducting any such business within the confines of this Commonwealth. However, when the amount of business done by any such contractor in any other county, city or town exceeds the sum of $25,000 in any year, such other county, city or town may require of such contractor a local license, and the amount of business done in such other county, city or town in which a license tax is paid may be deducted by the contractor from the gross revenue reported to the county, city or town in which the principal office or any branch office of the contractor is located.

This statute allows a very limited form of throwback applicable when a contractor performs work in a locality without having a definite place of business in that locality. In such cases, the locality where the work is performed (performance locality) can tax if the value of the local contracts exceeds $25,000. If the performance locality does not tax, then those receipts are thrown back to the "definite place of business locality" for taxation under the general rules. More accurately, those receipts are not deducted from the otherwise taxable receipts of the definite place of business locality.

The *English* case did not concern the rule set forth in Code § 58.1-3715. Lynchburg was not trying to tax receipts that it is entitled to tax under the usual allocation rules of § 58.1-3703.1(A)(3). Rather, Lynchburg was trying to tax receipts that are earned by and allocated to English's other definite places of business. In the words of the statute quoted above, Lynchburg, as the situs of English's "principal office," was trying to tax receipts attributable to a "branch place of business" of English. Lynchburg's position was directly contrary to the clear mandate of the BPOL reform legislation. Lynchburg was trying to tax activities that are not performed in Lynchburg.[25] Lynchburg was trying to tax English's gross receipts, not based on what English does in Lynchburg, but based on the fact that, for example, Pulaski did not choose to tax English's place of business there.[26]

Are Localities Now on the Same Page with the Law?

With such a definitive answer from the Court that localities may not tax a business's gross receipts earned in another locality where the business has a "definite place of business," a reasonable person must assume that localities will now abide by the law and not seek to tax these receipts. Again, not so fast.

It is conceivable that it still may take more time for the Court's decision to find its way down to the more than one hundred localities that impose the BPOL tax. Hopefully, the most sophisticated localities have reviewed the opinion, have communicated the implications to its staff, and have made any adjustments that are necessary and consistent with the opinion. Unfortunately, it would not surprise us if a handful of localities ignore the *English* case.

Recently one of our clients was informed by a local commissioner of the revenue, during a BPOL tax audit, that if the business's gross receipts are not taxed by another locality, such receipts will be thrown back and taxed in that locality where our client has its principal place of business. This commissioner of the revenue obviously still believes that all gross receipts are thrown back to the principal place of business when not taxed elsewhere.

We have also heard from other state and local tax lawyers that some localities, starved for revenues, intend to take the position that the Court's opinion only applies to construction companies. These extreme and uninformed positions by Virginia localities are not surprising. It is likely that a few Virginia localities will choose to ignore the Court's opinion. If your client has multiple places of business in different Virginia localities, you should advise them to be on the lookout. Companies and their advisors must remain vigilant and make sure businesses are not overpaying their BPOL tax if one of their places of business is in a locality that does not tax gross receipts, while the locality where a second place of business is located does tax receipts received. ■

Endnotes:

1 *See* H. Doc. 59 (1995), Report of the Joint Subcommittee Studying the Business, Professional, and Occupation License Tax to the Governor and the General Assembly of Virginia (hereafter, H. Doc. 59), at 9.
2 Act of Apr. 6, 1996, ch. 720, 1996 Va. Acts 1247.
3 *See* H. Doc. 59 at 14.
4 *See* Va. Code § 58.1-3700 *et seq.*
5 Under Virginia Code § 58.1-3701, the "guidelines" had the effect of regulations in 2001. They are now published in the Virginia Administrative Code at 23 VAC 10-500-10, *et. seq.*
6 Va. Code § 58.1-3701.
7 *See* Virginia Department of Taxation Tax Policy Library (http://www.policylibrary.tax.virginia.gov/OTP/policy.nsf) (Click Advanced Search, then restrict search to all Rulings of the Tax Commissioner under BPOL Tax issued between 1/1/97 and 12/31/97).
8 *See* Virginia Department of Taxation Tax Policy Library (http://www.policylibrary.tax.virginia.gov/OTP/policy.nsf) (Click Advanced Search, then restrict search to all Rulings of the Tax Commissioner under BPOL Tax issued between 1/1/08 and 12/31/08).
9 Under Virginia Code § 58.1-3701, the "guidelines" had the effect of regulations in 2001. They are now published in the Virginia Administrative Code, 23 VAC 10-500-10, *et. seq.*
10 *City of Lynchburg v. English Construction Company, Inc., et al.*, 277 Va. 574,579; 675 S.E.2nd 197, 199 (2009).
11 *Id.* At 578.
12 *Id.* At 579
13 *Id.*
14 *Id.*
15 Briefs *amici curiae* were filed by the Local Government Attorneys of Virginia, the Commissioners of the Revenue Association of Virginia, the Treasurers Association of Virginia, and the Virginia Municipal League, in support of Lynchburg, and by the Virginia Chamber of Commerce, in support of *English*. Mr. Bell was a co-author of the brief submitted by the Virginia Chamber of Commerce.
16 *English Construction*, 277 Va. at 580.
17 *Id.* at 584.
18 *Id.* at 583.
19 *Id.* at 584.
20 Va. Code § 58.1-3703.1(A)
21 See also Virginia Code§ 58.1-3703.1(A)(9) setting the local audit standard as determining whether gross receipts are "directly attributable to the taxable privilege exercised" in the locality.
22 Va. Code § 58.1-3703.1(A)(3)(a)(1).
23 Va. Code § 58.1-3703.1(A)(3)(b).
24 *Id.* (Emphasis added.)
25 *See* Virginia Code § 58.1-3703.1(A)(3)(b)(no taxation under apportionment rules simply because another locality does not tax).
26 *See* Virginia Code § 58.1-3703.1(A)(3)(a) (taxable only with respect to gross receipts earned from activities at a local place of business).