

# INSTRUCTIONS FOR PREPARING

## 2016

## FORM 502

### VIRGINIA PASS-THROUGH ENTITY RETURN OF INCOME AND RETURN OF NONRESIDENT WITHHOLDING TAX



COMMONWEALTH OF VIRGINIA  
DEPARTMENT OF TAXATION  
RICHMOND, VIRGINIA



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**INSTRUCTIONS FOR PREPARING FORM 502**  
**VIRGINIA PASS-THROUGH ENTITY INCOME TAX RETURNS FOR 2016**

**What's New**

**Advancement of Virginia's Fixed Date Conformity with the Internal Revenue Code**

Virginia's date of conformity with the Internal Revenue Code (IRC) was advanced from December 31, 2014 to December 31, 2015, with limited exceptions. Virginia will continue to deconform from the bonus depreciation allowed for certain assets under federal law; the five-year carryback of certain federal net operating loss (NOL) deductions generated in Taxable Year 2008 or 2009; the federal income tax treatment of applicable high yield discount obligations; and the federal income tax treatment of cancellation of debt income realized in connection with certain business debts.

At the time these instructions went to print, the only required fixed date conformity adjustments were those mentioned above. However, if legislation is enacted that results in changes to the IRC for the 2016 taxable year, taxpayers may need to make adjustments to their Virginia returns that are not described in these instructions. Information about any such adjustments will be posted on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov).

**Tax Credit for Food Crop Donation to a Nonprofit Food Bank**

For taxable years beginning on and after January 1, 2016, but before January 1, 2022, a tax credit is allowed for taxpayers that are engaged in the business of farming for growing food crops in the Commonwealth and donating such crops to a nonprofit food bank. The amount of the credit is equal 30% of the fair market value of such crops. No taxpayer is permitted to claim more than \$5,000 in credits for a taxable year. This credit is subject to a \$250,000 annual credit cap.

To the extent a credit is allowed for growing food crops in the Commonwealth and donating such crops to a nonprofit food bank, an addition is required for any amount claimed by the taxpayer as a federal income tax deduction for such donation.

**Modified Method of Apportionment for Taxpayers with Enterprise Data Center Operations**

A taxpayer with an enterprise data center operation that enters into a memorandum of understanding with the Virginia Economic Development Partnership Authority ("VEDP") to make a new capital investment of at least \$150 million in an enterprise data center in Virginia is required to apportion Virginia taxable income using a single sales factor method of apportionment. This modified method of apportionment is phased in as follows:

- From July 1, 2016 until July 1, 2017, qualifying taxpayers are required to use a quadruple-weighted sales factor; and
- From July 1, 2017, and thereafter, qualifying taxpayers are required to use the single sales factor method of apportionment.

**Changes to Research and Development Expenses Tax Credit**

For taxable years beginning on and after January 1, 2016, several changes were made to the existing Research and Development Expenses Tax Credit. Such changes include increasing the annual credit cap from \$6 million to \$7 million; increasing the amount of credits each taxpayer may claim; allowing a taxpayer to determine the credit using a simplified method in lieu of the primary statutory method; extending the sunset date for the credit from taxable years beginning before January 1, 2019 to taxable years beginning before January 1, 2022; and prohibiting a taxpayer from claiming both this credit and the new Major Research and Development Expenses Tax Credit for the same taxable year.

**Major Research and Development Expenses Tax Credit**

Taxpayers with Virginia qualified research and development expenses in excess of \$5 million for a taxable year may claim the new Major Research and Development Expenses Tax Credit. The amount of the credit is equal to 10% of the difference between the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year; and 50% of the average Virginia qualified research and development expenses paid or incurred by the taxpayer for the 3 taxable years immediately preceding the taxable year for which the credit is being determined. If the taxpayer did not pay or incur Virginia qualified research and development expenses in any one of the 3 taxable years immediately preceding the taxable year for which the

credit is being determined, the credit is equal to 5% of the Virginia qualified research and development expenses paid or incurred by the taxpayer during the taxable year. The total amount of Major Research and Development Tax Credits that may be issued for each fiscal year is limited to \$20 million.

### **Exception to the Captive REIT Addition**

For taxable years beginning on or after January 1, 2016, any voting power or value of the beneficial interests or shares in a real estate investment trust ("REIT") that are held in a separate asset account of a life insurance corporation are excluded from consideration for purposes of determining whether a REIT is a captive REIT subject to the Virginia income tax addition for captive REITs.

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### **Assistance**

**[www.tax.virginia.gov](http://www.tax.virginia.gov)**

The Department's website contains valuable information to help you.

- **Online Services** - Link to online registration, filing, payment, and other electronic services.
- **Laws, Rules & Decisions** – Access the Code of Virginia, Tax Regulations, Legislative Summaries, Rulings by the Tax Commissioner, Tax Bulletins, and Attorney General Opinions.
- **e-Alerts** – Sign up and stay informed. By subscribing, you will periodically receive automatic e-mail notifications regarding legislative changes, filing reminders, and other relevant information.

### **Contact the Department**

#### **Customer Service Inquiries**

Department of Taxation  
P.O. Box 1115  
Richmond, Virginia 23218-1115

**Phone:** (804) 367-8037  
**FAX:** (804) 254-6111

#### **Forms Request Unit**

Department of Taxation  
P.O. Box 1317  
Richmond, Virginia 23218-1317

**Phone:** (804) 367-8037

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# INSTRUCTIONS FOR PREPARING FORM 502 VIRGINIA PASS-THROUGH ENTITY RETURN OF INCOME

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## GENERAL INFORMATION

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### Pass-Through Entities Required to File

Every pass-through entity (PTE) doing business in Virginia or having income from Virginia sources is required to electronically file a Form 502 for each taxable year.

Pass-through entities include S corporations, general partnerships, limited partnerships, limited liability partnerships (LLPs), limited liability companies (LLCs), electing large partnerships, and business trusts. A PTE is any entity that is recognized as a separate entity for federal income tax purposes and the entity's owners report their distributive or pro rata shares of the entity's income, gains, losses, deductions, and credits on their own income tax returns. Unlike C corporations, a PTE typically does not pay income tax itself; rather, the entity's income and related items are reported by the owners on their personal returns and the tax is computed and paid at the owner level. Estates and trusts that file Virginia Form 770 are not subject to the Form 502 filing requirements.

An owner of a PTE may be an individual, a corporation, a partnership, or any other type of entity that is treated as a shareholder, partner, or member of a PTE for federal income tax purposes.

An owner of a PTE may itself be a PTE and have other pass-through entities as its owners so that income, gains, losses, and deductions may pass through several levels of ownership before reaching an owner that is taxable. All pass-through entities that are subject to filing in Virginia are required to file their own returns regardless of the ownership hierarchy. There are no "consolidated" or "multilevel" PTE returns.

A PTE has Virginia source income if it has:

1. Any items of income, gain, loss, or deduction related to either:
  - a) the ownership of real or tangible personal property in Virginia, or
  - b) a business, trade, profession, or occupation carried on in Virginia;

OR

2. Any income or gain from intangible property to the extent that such property is used by the entity in a business, trade, profession, or occupation carried on in Virginia.

If a PTE does not conduct its entire business within Virginia, then it must determine the Virginia-source portion of its total income through allocation and apportionment. See Page 10 of the Form 502 instructions for more information on allocation and apportionment. In general, a non-Virginia entity will have income from Virginia sources if it has enough activity or presence in Virginia to make any apportionment factor (property, payroll, or sales) positive. Therefore, it

may be deemed to have Virginia-source income under the apportionment formulas even if no specific portion of its gross or net income is separately identifiable as being derived directly from Virginia.

### **Single-Member LLC**

A single-member LLC that is disregarded as a separate entity for federal income tax purposes will be similarly treated for Virginia income tax purposes. Its income, gains, losses, and deductions will be included with those of its owner on the owner's income tax return. The disregarded entity is not required to file Form 502.

### **Investment Pass-Through Entities**

Previous rulings of the Tax Commissioner have held that pass-through entities that are established solely to invest in intangible personal property, such as stocks and bonds, and that have no employees and no real or tangible property, are not considered to be carrying on a trade or business. Thus, the income from the intangible property that is held by an investment PTE is not income from Virginia sources, and these types of pass-through entities are not required to file Form 502.

### **Period Covered by the Return**

A PTE's taxable year for Virginia purposes is the same as its taxable year for federal income tax purposes.

### **Withholding Tax Payments for Nonresident Owners**

Every PTE that does business in the Commonwealth and has taxable income derived from Virginia sources must withhold and pay Virginia income tax on behalf of each of its nonresident owners, unless the entity or the owner meets an exception. See the section heading "Exceptions to the Requirement for Withholding." If an owner was a nonresident owner for only a portion of the taxable year, the income allocated to such owner must be prorated by the number of days of residence outside of Virginia in order to determine the amount on which the withholding tax must be paid. The tax is equal to 5% of the share of taxable income from Virginia sources that is allocable to each nonresident owner. In determining the amount of tax, the entity may apply any tax credits that pass through to nonresident owners, but the tax liability of any nonresident owner may not be reduced to less than zero. **To avoid penalties, the payment must be equal to the lesser of: 90% of the withholding tax liability that was reported for the current taxable year or 100% of the withholding tax liability reported for the previous taxable year, provided that the return for the previous year covered a 12-month period and reflected a withholding tax liability.**

### **Due Date for Payment**

Payment of the withholding tax is due by the original due date for filing Form 502 (i.e., April 15 for a calendar year return). The automatic 6-month filing extension for Form 502

does not apply to the withholding tax payment. If the entity chooses to use the automatic filing extension for Form 502, the withholding tax payment **must be** submitted electronically no later than the original due date for filing Form 502.

Note: Virginia does not recognize Emancipation Day, occurring annually on April 16 in Washington DC.

### **Penalties and Interest**

If a PTE that is subject to the withholding tax requirement fails to pay the minimum tax amount described above by the original due date, penalties may apply. The penalties are computed in the same manner as the extension penalty and late payment penalty for individual income taxes. The late filing penalty is computed in the manner prescribed under *Va. Code* § 58.1-394.1.

If Form 502 is filed within the 6-month extension period, but the required minimum withholding tax amount was not paid by the original due date, the extension penalty will apply. The extension penalty is imposed at the rate of 2% per month or part of month on the balance of the tax due from the due date through the date the return is filed, up to a maximum of 12% of the tax due.

If Form 502 is filed within the 6-month extension period and full payment is not included with the return, the late payment penalty will apply. The late payment penalty is imposed at the rate of 6% per month from the date of filing of Form 502 through the date of payment, up to a maximum of 30% of the tax due. If the entity fails to pay the minimum tax amount required as described AND fails to make full payment with a return filed within the 6-month extension period, both the extension penalty and the late payment penalty will apply. The extension penalty will be imposed from the original due date through the date that the return is filed, and the late payment penalty will begin to accrue on the day after the return is filed.

If Form 502 is filed more than 6 months after the due date or more than 30 days after the federal extended due date, whichever is later, the greater of the late payment penalty, imposed at the rate of 30% of the tax due, or a late filing penalty of \$1,200 will apply.

Any balance of unpaid tax is also subject to accrual of interest at the rate specified under IRC § 6621, plus 2%, from the due date until the date of payment. For details on computing the penalty and interest charges, see the line-by-line instructions for Page 2 of Form 502.

### **Exceptions to the Requirement for Withholding**

Publicly traded partnerships and disregarded entities are not subject to the withholding requirement. A PTE with an owner that is a disregarded entity does not withhold on behalf of the disregarded entity. The disregarded entity does not withhold on behalf of its individual owner. For all other pass-through entities, no withholding of Virginia income tax is required on behalf of the following nonresident owners: (1) individuals who are exempt from paying federal income taxes, who are exempt from Virginia income taxes, or whose credit for taxes paid to other states is sufficient to offset all Virginia income tax attributable to the shares of income distributed by the PTE; (2) individuals included on a composite return (Form 765);

(3) entities other than individuals and corporations that are exempt from paying federal income taxes by reason of their purpose or activities; (4) real estate investment trusts (REITs) that are not Captive REITs; and (5) corporations exempt from Virginia income tax.

The exemption from federal income tax for entities other than individuals and corporations must apply to the entity's share of the PTE's income.

Examples of such exempt entities include:

(1) Other PTEs. Generally, a PTE does not need to withhold for a nonresident owner that is also a PTE. These nonresident owner PTEs are responsible for filing their own PTE returns of income and must pay the withholding tax for their nonresident owners' shares of income from Virginia sources. If a PTE is notified by a nonresident owner PTE that the nonresident owner PTE is not going to file a Virginia PTE return, then the PTE is required to withhold on the nonresident owner PTE.

**CAUTION:** As a general rule, a PTE should not withhold tax on behalf of another PTE. If a PTE does withhold on a nonresident owner PTE, the nonresident owner PTE cannot claim credit on its Form 502 for such withholding. PTE withholding is not "generation skipping" and does not pass through an intermediate PTE to owners that are more than one level of ownership away. In the event that a PTE erroneously withholds for a nonresident owner PTE, the PTE should file an amended Form 502. See the amended returns section for additional information.

(2) Entities that are exempt by reason of diplomatic immunity or pursuant to treaties between the United States and other countries. An entity claiming this exemption must provide a statement to the PTE stating that it has diplomatic immunity from federal income tax.

(3) Any nonresident person who is a part of a PTE that owns and leases 4 or fewer dwelling units in the Commonwealth, provided that the PTE discloses the name and federal taxpayer identification number for all such owners in its return for the taxable year filed under *Va. Code* § 58.1-392. For this purpose, the term "person" is defined using the definition of "person" in *Va. Code* § 55-248.4.

See the Laws, Rules and Decisions page on the Department's website for any additional exceptions that may apply.

If paying the withholding tax imposes an undue hardship on the PTE, the PTE may request a waiver of the payment requirement. To request a waiver, the PTE must write a letter to the Tax Commissioner describing the facts and circumstances creating the hardship. The letter must provide information to enable the Tax Commissioner to compare and evaluate the cost of the PTE's compliance with the withholding requirements and the cost to the Commonwealth of collecting income tax from any nonresident owners that do not voluntarily file Virginia income tax returns and pay the tax.

To indicate an exception for the PTE, the entity must enter the appropriate exception code on Form 502, Line d.

To indicate an exception for the entity or for any or all nonresident owners, the entity must enter the appropriate exception code on Line f of the nonresident owner's Schedule VK-1, and enclose a list of all of the nonresident owners that are claiming an exception to the Form 502. See Page 9 of these instructions for a list of exemption codes.

### **Accounting Method**

A PTE's accounting method for its Virginia return of income is the same as its accounting method for federal income tax purposes.

### **Allocation and Apportionment**

If a PTE's entire business is conducted within Virginia, then all of its income is Virginia source income; no income is allocated to another state, and the entity's Virginia apportionment is 100%. If a PTE conducts its business in Virginia and elsewhere in a manner such that its income would be subject to a tax on net income in Virginia and at least one other state, the entity must allocate and apportion its income in the same manner that is provided in Virginia law for corporations. This applies to all types of pass-through entities (partnerships, LLPs, LLCs, and S corporations). Dividends received are to be allocated to the state of commercial domicile, but all other income must be apportioned. ***An entity may not apportion its income based on divisional or separate accounting, or any other alternate method unless it has requested and received permission to do so in advance from the Department.***

The effect of the PTE's apportionment may vary from one owner to another, depending on the entity types of the owners. For instance:

- a Virginia resident individual owner is taxable on all of his or her PTE income regardless of the entity's apportionment;
- a nonresident individual owner uses the entity's Virginia apportioned income in determining his or her own Virginia nonresident percentage; and
- a corporate owner may need to include the PTE's property, payroll, and sales factors in determining its own apportionment percentage.

### **Alternative Method of Apportionment for Manufacturers**

Qualifying manufacturing companies may elect to determine their Virginia taxable income by using a single sales factor method of apportionment based on sales. This modification will be phased in as follows:

- A triple-weighted sales factor may be elected for taxable years beginning on or after July 1, 2011, but before July 1, 2013;
- A quadruple-weighted sales factor may be elected for taxable years beginning on or after July 1, 2013, but before July 1, 2014; and
- A single sales factor may be elected for taxable years beginning on and after July 1, 2014.

For purposes of this election, a manufacturing company is defined as a domestic or foreign corporation primarily engaged in activities in accordance with the North American Industry Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sector 11, 31, 32, or 33. See the instructions for Schedule 502A for details on how to compute apportionment factors.

### **Alternative Method of Apportionment for Retail Companies**

Beginning on and after July 1, 2015, retail companies are required to use a single sales factor method of apportionment.

For purposes of this requirement, a retail company is defined as a domestic or foreign corporation primarily engaged in activities that, in accordance with the North American Industry Classification System (NAICS), United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sectors 44-45.

See Schedule 502A and the Form 502 instructions for more information about allocation and apportionment. Also see the Form 502 instructions for Lines 4 - 7 on Page 10.

### **Apportionment for Certain Enterprise Data Center Operations**

A taxpayer with an enterprise data center operation that enters into a memorandum of understanding with the Virginia Economic Development Partnership Authority ("VEDP") to make a new capital investment of at least \$150 million in an enterprise data center in Virginia is required to apportion Virginia taxable income using a single sales factor method of apportionment. This modified method of apportionment is phased in as follows:

- From July 1, 2016 to July 1, 2017, qualifying taxpayers are required to use a quadruple-weighted sales factor; and
- From July 1, 2017, and thereafter, qualifying taxpayers are required to use the single sales factor method of apportionment.

### **General Filing Requirements**

#### **When to File**

The PTE return must be submitted on or before the 15th day of the 4th month after the close of the entity's taxable year.

#### **How to File**

The Department requires that all pass-through entities (PTEs) file their withholding tax payments, extension payments, annual tax returns, and final payments electronically. There are two options available. Returns may be filed through the Federal/State e-File program, or certain Virginia PTEs may qualify to electronically file a Form 502EZ using the eForms system on the Department's website. If the PTE is unable to file and pay electronically by the effective date, the PTE may request a waiver. Visit the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov) to access a waiver form and the mailing address.

#### **e-File (Form 502)**

The e-File system is supported by numerous commercial software programs. e-File software will automatically check

for completeness, correct errors, generate the applicable schedules, and electronically transmit the return and payment to the e-File processing systems. A list of approved commercial software is available on the Department's website. If a tax due payment is required, the payment can be made through the e-File system as a direct debit by using eForms or with an ACH Credit established through the PTE's bank.

In order to successfully e-File, the pass-through entity must:

- Use an approved commercial e-File software product. Approved e-File software is listed on the Department's website.
- You must be able to create a readable PDF file for any document or schedule that is required for backup to the return. You must either have a scanner that allows you to scan documents into a PDF file or software that allows you to save a file as a PDF document. This feature will allow you to e-File your state return if the Internal Revenue Service (IRS) does not support the federal return and/or schedules through the federal e-File system by attaching the federal return as a PDF file to the state return's electronic transmission.
- The Virginia e-File program has been designed to accept transmission of the federal and state return together or separately (often referred to as a state-only transmission). The state-only transmission option can be used when the federal return being filed is not supported by the federal e-File system. This allows the state return to be e-Filed by itself. Most software vendors support both the electronic transmission of the federal and state together (linked) or separately (unlinked).
- Large Pass-Through Entities must decide whether to use an Electronic Return Originator (ERO) to electronically file the return or prepare and e-File the return themselves. Please note, if a partnership chooses to prepare and e-File the return themselves, they may have to register and apply with the IRS to obtain an Electronic Filing Identification Number (EFIN) and possibly an Electronic Transmitter Identification Number (ETIN) depending upon the e-File option chosen. Please see the Department's website for detailed information.
- Small Pass-Through Entities may use an online provider to avoid having to register with the IRS for an Electronic Filing Identification Number (EFIN).

### **eForms (Forms 502EZ, 502W, and 502V)**

An online return, Form 502EZ, is available through the eForms application on the Department's website. This return is a shorter version of the existing Form 502, and is designed to simplify the filing process. In addition, you can submit pass-through entity withholding payments (Form 502W) and return payments (Form 502V) using eForms. Using eForms is a fast and free way to file and pay state taxes.

**To be eligible to file Form 502EZ, the PTE must meet all of the criteria below:**

- 100% of the PTE's business is in Virginia

- 100% of the PTE's income is from Virginia sources
- The PTE's commercial domicile is in Virginia
- The PTE does not have more than 10 owners
- The PTE is not required to file a Virginia Corporation Income tax return (Form 500)
- The PTE passes no Schedule CR credits to its owners for the year
- The PTE has no Fixed Date Conformity modifications or adjustments to pass to its owners
- The total taxable income of the PTE must be greater than or equal to \$0 and does not exceed \$40,000 for the taxable year of the return
- The total Additions to and Subtractions from income are less than \$1,000

The 502EZ is free, secure, available 24/7, and does not require registration or login credentials. For more information, go to [www.tax.virginia.gov/eforms](http://www.tax.virginia.gov/eforms).

### **Waiver Request**

If the requirement to file and pay electronically creates an undue hardship for a taxpayer, the PTE may request a waiver. All requests for waivers must be submitted to the Department in writing using the PTEs Tax Electronic Filing Waiver Request form on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov).

### **Extension of Time to File**

An automatic extension of time to file is granted to the date 6 months after the due date for filing Form 502 or 30 days after the extended due date for filing the federal income tax return, whichever is later. The automatic extension of time to file does not extend the payment due date for withholding tax. The withholding tax payment is due on the due date of the PTE's return regardless of whether the extension to file Form 502 is used. Use Form **502W** to make the withholding tax payment by the due date.

### **Penalties**

If Form 502 is not filed within the automatic extension period or more than 30 days after the extended federal due date, the extension will be invalid and the greater of the late payment penalty or the late filing penalty will apply. The late payment penalty is equal to 6% of the tax due per month, with a maximum penalty of 30% of the tax due. The late filing penalty is \$1,200 when filed after the automatic extension period of 6 months.

If the failure to file continues for more than 6 months, the Department may assess the PTE with a late filing penalty equal to 6% of the Virginia taxable income that the owners derive from the entity. The Department may estimate this taxable income using any method it deems reasonable and with any information in its possession. The 6% penalty will be reduced by any monthly penalty that has already been assessed pursuant to Va. Code § 58.1-394.1(A), or the 6% penalty may be assessed instead of the monthly penalty. The 6% penalty will also be reduced to the extent that any owner

has paid Virginia income tax on his or her share of the entity's income for the same taxable year.

### **Penalty for Returned Check or EFT Nonpayment**

If the PTE's bank does not honor a payment to the Department, the Department may impose a penalty of \$35, as authorized by Va. Code § 2.2-614.1. This penalty will be assessed in addition to other penalties due.

### **Signature**

The return must be signed by an officer of the S corporation, a general partner, or an authorized LLC member, as appropriate for the type of entity. An owner's signature on the return shall be prima facie evidence that the owner is authorized to sign on behalf of the PTE. If the return was prepared wholly or in substantial part by a person other than an owner or an employee of the entity, that person must also sign the return.

### **Virginia Schedules and Enclosures**

In addition to Form 502, the return must include Schedule(s) VK-1 or VK-1 Consolidated indicating the owner's share of income and Virginia modifications and credits for each owner. Also, Schedule 502ADJ and Schedule 502A, are usually required. To claim certain tax credits, specific documentation must be enclosed with the return. See the Schedule 502ADJ, Section C - Virginia Tax Credits section of these instructions for more information. If an entry is made on Section C, Line 1 of Form 502ADJ for state income tax paid, a supporting schedule must be enclosed. If the PTE and the qualifying nonresident owners elect, a composite return, Form 765, Virginia Unified Nonresident Income Tax Return may also be filed. This is a separate return and should not be included with Form 502.

A copy of the PTE's federal return of income, as filed with the IRS, is required to be enclosed with the Virginia return. The required enclosure includes the federal Form 1120S, Form 1065, or Form 1065B, with Schedule K. Do not include federal Schedule K-1 because it is not required. If the federal return is so voluminous that it is impractical to include a complete copy with the Virginia return, enclose the Form 1120S, Form 1065, or Form 1065B along with the Schedule K, and a statement that the complete return will be made available upon request.

#### Order of Documents

- Form 502
- Schedule 502ADJ, if applicable
- Schedule 502A, if applicable
- Schedule(s) VK-1 or VK-1 Consolidated
- Schedule 500AB, if applicable
- A copy of your federal return

Do not enclose federal Schedules K-1 to your Virginia return.

### **Report of Change in Federal Return**

If the amount of any item of distributive or pro rata income, or deduction on the PTE's federal return of income is changed or corrected by the IRS or any other competent authority, or through renegotiation of a contract with the United States, the entity must notify the Department and issue an amended Schedule VK-1 to each owner within 1 year of the federal

change. If a PTE amends its federal return of income in any manner that would affect its Virginia return or the Virginia returns or tax liabilities of its owners, the entity must file an amended Virginia return and issue an amended Schedule VK-1 to each owner with full disclosure of the federal amendment.

### **Amended Returns**

A PTE may amend its return through PTE e-File. The "amended return" indicator must be marked on the return within the software package. If the original return was filed through eForms using 502EZ, the PTE may use the eForms application to amend the return. Enter the corrected figures for Form 502 and supporting schedules. An explanation of any changes made must be documented with the e-File submission, including any supporting forms or schedules. In addition, the PTE must issue an amended Virginia Schedule VK-1 to each owner. To amend a return that was originally filed through eForms using Form 502EZ, the PTE must submit Form 502.

If the amended return includes an adjustment to the total withholding due for nonresident owners, complete Schedule 502ADJ, Section D - Amended Return, to compute any additional tax due or refund resulting from the amended return.

If a PTE files Form 502 and later finds it did not include all Schedule(s) VK-1 or Schedule(s) VK-1 Consolidated with the return, but no other changes to the return are necessary, the entity should not file an amended Form 502. Instead, it should submit the additional schedule(s) to the Department with a cover letter that includes the notation "Additional Schedule(s) VK-1 or Schedule(s) VK-1 Consolidated Enclosed with Previously Filed Return."

In the event the PTE that filed the Form 502 erroneously withheld for an owner, such as a nonresident owner PTE, and no other changes to the original Form 502 are necessary, the PTE should file an amended Form 502, completing all lines and schedules, reflecting a reduced withholding amount on Line c, Form 502, and in Section 1, Form 502. Also, the PTE should complete Section D of Schedule 502ADJ to determine the amount of withholding overpaid with the original return and now due to the PTE as a refund. Attach revised Schedules VK-1, marked amended, only for the owners for which withholding was erroneously reported indicating that no withholding was required. **Be sure to issue a corrected Schedule VK-1 to every owner affected by the changes to the return, with a notice alerting the owners to the potential need to amend their own Virginia returns.** Upon receipt of the amended return, the Department will review the amended return and, as applicable, refund to the PTE the amount the PTE withheld in error on the nonresident owner PTE.

### **Supplemental Information for Multistate Activity**

If the entity files composite returns in other states, or is taxed as a corporation in other states, it must provide a statement to each of its owners. The statement must confirm the owner's election to participate in the composite filing in the other state and provide the owner's share of gross income, taxable income, and tax paid. This statement will be used

to determine the credit amount on the Virginia individual income tax return. A sample reporting format is available on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov) under the topic of Credit for Taxes Paid to Another State.

### **Composite Return Filing for Nonresident Individual Owners (Form 765)**

When a PTE is required to file a Virginia return of income, the owners of the entity are typically required to file a Virginia income tax return to report their respective shares of income. To simplify the filing requirement for qualified individual nonresident owners, the PTE may file a composite Virginia income tax return on their behalf, using Form 765, provided that certain conditions described in the Form 502 instructions are met. The PTE is not required to pay the withholding tax on behalf of the individual nonresident owners for whom it files Form 765, and should not withhold for those owners. Accordingly, there is no provision on Form 765 for claiming credit for such withholding. A PTE may file a composite return for only a portion of its qualified nonresident owners, provided that the PTE pays the PTE withholding tax for any qualified nonresident owners who are not included in the composite return.

The Form 765 is an individual income tax return that is completed separately and filed in addition to the PTE's return. Accordingly, Form 765 may not be filed unless the entity has also filed its Form 502, or if the entity is a trust or estate, its Form 770. Do not submit Form 765 with Form 502 or Form 770, or include Form 765 as an enclosure with those returns.

Form 765 may be downloaded from the Department's website, [www.tax.virginia.gov](http://www.tax.virginia.gov), or requested by calling the Department's Forms Request Unit at (804) 367-8037.

### **Qualified Nonresident Owner**

A qualified nonresident owner is generally defined as an individual who is a nonresident of Virginia for income tax purposes and who is a direct owner of the entity. For taxable years beginning prior to January 1, 2008, a qualified owner may only derive Virginia source income from the PTE that is filing the composite return. For taxable years beginning on or after January 1, 2008, a qualified owner may derive Virginia source income from more than one PTE (and thereby be included in multiple composite returns), or from other sources. If the qualified owner also receives income from sources other than pass-through entities, or from entities that do not file composite returns, the owner must also file an individual income tax return on Form 763 to account for any Virginia source income that is not reported in a composite return. Corporations, regardless of where domiciled, Virginia resident individuals, and individuals who are not direct owners of the entity, regardless of their residency status, are not qualified nonresident owners and may not be included in a composite return.

Multiple pass-through entities under common ownership that wish to file a consolidated Form 765 must request permission from the Department to do so. Address requests to the Tax Commissioner, **Virginia Department of Taxation, P.O. Box 2475, Richmond, VA 23218-2475.**

### **Conditions for Filing a Composite Return**

The PTE must obtain the consent of each qualified nonresident owner, as defined above, to be included in the return. Such consent must indicate that the nonresident owner agrees to be taxed under the following conditions:

1. The PTE must provide a schedule containing the total income of the entity and the amount that is attributable to Virginia under either the applicable state apportionment formula, as provided in *Va. Code* §§ 58.1-408 through 58.1-420, or by using an alternative method of apportionment that is approved by the Tax Commissioner as provided in *Va. Code* § 58.1-421.
2. The return will include each qualified nonresident owner's name, address, and Social Security Number, and the Virginia taxable income attributable to each qualified nonresident owner.
3. The amount of tax is computed on the Virginia taxable income by applying the highest tax rate for individual income tax specified in *Va. Code* § 58.1-320 or by reference to the tax tables that are published by the Department, without regard to the number of participants. The tax is computed on the entity's income that is attributable to the qualified nonresident owners without the benefit of itemized deductions, standard deductions, personal exemptions, credit for income taxes paid to states of residence, or credit for Virginia income tax withheld on behalf of the owners.
4. An owner, officer, or employee of the PTE who is authorized to act on behalf of the PTE in tax matters (authorized representative) must sign the composite return. By signing the return, the signer is declaring that he or she is the authorized representative of the PTE and that each participant has signed a consent form authorizing the PTE to act on the participant's behalf in the matter of composite returns, and acknowledging the participant's understanding and acceptance of all of the terms and conditions of participation in a composite return. The consent form must continue in force indefinitely until it is revoked in writing by the participant, and permit the PTE to file amendments or take other actions concerning the composite return without additional authorization from the participant. The consent forms must be maintained by the PTE and provided to the Department for inspection upon demand. Participation in the composite return will indicate the consent of the nonresident owner to be taxed by the Commonwealth of Virginia.
5. Estimated income tax payments made on behalf of owners included in a composite return must be made on a composite basis, using the name and account number or federal employer identification number (FEIN) of the PTE.

Automatic extensions of time to file Form 502 or Form 770 and Form 765 are separate and independent of each other. A payment may be required for an extension for Form 765 if 90% of the liability has not been paid by the original due date.

## INSTRUCTIONS FOR PAGE 1 OF FORM 502

### Taxpayer Information

Fiscal year or short period filers: Enter the beginning and ending dates for the PTE's fiscal or short year. Enter as MM/DD/YYYY.

Check boxes at top of page: Mark the appropriate box for any condition that applies:

- Schedules VK-1 filed by Web Upload;
- The Department is authorized to discuss this return with the undersigned preparer;
- The return is the initial return filed by the entity;
- The return is an amendment of a previously filed return;
- The return is the final return that the entity will have to file with Virginia (i.e., the entity has been dissolved or no longer operates in Virginia);
- The name or address shown represents a change that should be reflected in the Department's records;
- The entity's fiscal year has changed;
- A Virginia Composite Nonresident Individual Income Tax Return, Form 765, will be filed for the same taxable year;
- The entity is an electing large partnership;
- The entity is subject to Bank Franchise Tax. If this box is checked, the S corporation will provide the shareholders with the pertinent information concerning their allocable share of the income or gain, losses, or deductions or the value of any distributions paid or distributed to the shareholder by the S corporation.

Federal Employer ID Number: Enter the PTE's FEIN.

Name and Address: Enter the entity's name and address in the space provided.

Date of Formation, Date Operations Began in Virginia, and State or Country Where Incorporated: Enter the entity's date of formation, the date operations began in Virginia, and the state or country where it is incorporated or organized in the space provided.

Entity Type: (Note: A proper entry in this field is required.) Enter the code that corresponds to the type of entity filing this return.

<u>Type</u>	<u>Code</u>
S Corporation .....	SC
General Partnership .....	PG
Limited Partnership.....	PL
Limited Liability Company.....	LL
Limited Liability Partnership.....	LP
Other.....	OB

NAICS Code: Enter the 6-digit NAICS code. A list of these codes can be accessed from the Businesses section on the Department's website, [www.tax.virginia.gov](http://www.tax.virginia.gov).

Description of Business Activity: Enter a 1 to 2 word description of the primary activity in which the business is engaged.

### Number and Types of Owners

- a. Enter the total number of owners. The total number of owners should be the same as the number of shareholders who were shareholders during any part of the taxable year (see federal Form 1120S, Page 1, Line I) or the number of Schedules K-1 filed with the PTE's federal return (see federal Forms 1065 or 1065B, Page 1, Line I).
- b. Enter the total number of owners that are not residents of Virginia. If the residency status is not known, enter the number of owners whose address of record is not in Virginia.
- c. Enter the total amount withheld for all nonresident owners from Line e of each Schedule VK-1 filed with this return.
- d. If the entity claims an exemption from paying the withholding tax, enter the exemption code from the Withholding Exemption Reason list below in the space provided.

### Entities Exempt From Withholding

The PTE will not be required to pay the withholding tax if it:

- is a Publicly Traded Partnership
- is a Disregarded Entity
- files a composite return on behalf of all nonresident owners
- the PTE owns and leases 4 or fewer dwelling units

Please note that, because only individuals may be included on a composite return, PTEs that have both individual and corporate and/or other entity members may be exempt from paying the withholding tax for the individual members, but will still be required to pay the withholding tax on behalf of the corporate and/or other entity members. In that case, the PTE should not indicate that it is exempt from paying the withholding tax. Instead, it will indicate on the individual members' Schedules VK-1 that it is not required to pay the withholding tax for them because they are included on a composite return.

<u>Withholding Exemption Reason</u>	<u>Code</u>
Entity files a composite nonresident income tax return for <u>ALL</u> nonresident owners.....	03
Publicly traded partnership.....	04
Undue hardship waiver granted.....	06
PTE's income is from rents with four or fewer dwelling units.....	07

### Undue Hardship

If a PTE believes that the withholding requirement causes an undue hardship, the PTE may apply to the Tax Commissioner requesting an exemption. In addition to any other information that is pertinent to the PTE's petition for relief, the letter shall provide information that will enable the Tax Commissioner to compare and evaluate the cost to the PTE of complying

with the withholding tax requirements and the cost to the Commonwealth of collecting income tax from any nonresident owners who do not voluntarily file Virginia income tax returns and pay the tax. For purposes of requesting an undue hardship exemption, the withholding tax liability itself is not considered to be part of the cost of compliance, nor is a PTE's inability to pay the tax a basis for exemption.

**Distributive or Pro Rata Income and Deductions**

**Line 1. Total of taxable income amounts.**

Enter the total of all the various categories of taxable income shown in the "Income" section of Schedule K of the PTE's federal Form 1065 or Form 1120S. It may be helpful to use the worksheet below to summarize the income, but note that the worksheet lines may not correspond exactly to every item on the Schedule K. If you are an "electing large partnership," see the paragraph labeled "Electing large partnerships" following the Line 3 instructions below.

Ordinary income (loss) from trade or business	_____
Net income (loss) from rental real estate	_____
Net income (loss) from other rental activity	_____
Interest income	_____
Dividend income	_____
Royalty income	_____
Other portfolio income	_____
Net short-term capital gain (loss)	_____
Net long-term capital gain (loss)	_____
Net IRC § 1231 gain (loss)	_____
Other taxable income (loss)	_____
Total of taxable income amounts (This is a Virginia calculation; there is not a total on Schedule K of federal Form 1065 or Form 1120S.)	_____

**Caution**

The Schedule K of federal Forms 1065 and 1120S does not include a total taxable income amount, and the correct amount to enter on Form 502 is not necessarily the sum of all entries in the "Income" section of Schedule K. Schedule K may have entries that overlap for a particular category of income (for instance, a yearly amount and the amount through a certain date because of a midyear federal law change). For each category of income, include only the yearly total in the Virginia computation; do not omit, duplicate, or count any amounts twice.

**Line 2. Total deductions.**

Enter the total of the various categories of deductions shown in the "Deductions" section of Schedule K of the PTE's federal Form 1065 or 1120S. This may include charitable contributions, the IRC § 179 expense deduction and "other" deductions.

**Line 3. Tax-exempt interest income.**

Enter the total tax-exempt interest income shown in the "Other" section of the PTE's federal Schedule K.

**Electing large partnerships.** An electing large partnership, which files federal Form 1065B, combines items of income, gain, loss, and deduction before reporting to the partners, rather than reporting such items separately to partners as do other partnerships. The Schedule K for Form 1065B is, therefore, significantly different from Schedule K for Forms 1065 and 1120S. From the Schedule K (Form 1065B), combine total taxable income (loss) from passive loss limitation activities (without regard to general or limited partner allocation), taxable income (loss) from other activities, qualified dividends from other activities, and any net capital gain or other taxable income from Schedule K that is not included in the above amounts. Enter the result on Line 1, Total taxable income amounts. Leave Line 2 blank. Enter the amount of tax-exempt interest income from Schedule K on Line 3.

**Allocation and Apportionment**

**Lines 4-7.** All pass-through entities must complete this section. If the PTE conducted its business entirely within Virginia, and no income is allocated or apportioned elsewhere, then leave Lines 4 and 5 blank, repeat the amount from Line 1 on Line 6, and enter "100%" on Line 7. In all other cases, complete Schedule 502A first to determine the entries for Lines 4-7 as described below. See Schedule 502A and its instructions for more information on who is eligible to allocate and apportion income. If the PTE is electing the alternative method of apportionment for manufacturers for taxable years beginning on and after July 1, 2011, mark the box to the right of the allocation and apportionment heading.

Virginia law provides that dividends that are received are to be allocated to the state of commercial domicile, and that all other income must be apportioned as directed in *Va. Code* §§ 58.1-408 through 58.1-420. Virginia law does not allow for subtractions from apportionable income based on separate or divisional accounting, or for the exclusion of non-Virginia investment income. Except as provided below, an alternative method of allocation and apportionment may not be used without prior written approval from the Department.

Some entities may be entitled to an alternative method of allocation and apportionment if they can demonstrate that the application of Virginia's apportionment law to their particular facts for the taxable year would be contrary to the principles set forth in *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768 (1992).

In *Allied-Signal*, the Court reaffirmed the continued validity of apportionment of any income received directly by the taxpayer, including investment income such as capital gains, unless the capital transaction serves an investment function that is completely unrelated to any of its operational activities carried on in the state. The Court also reinforced the principle that investment income may be included in apportionable income if there is a unitary relationship between the taxpayer and the entity in which the taxpayer has invested. However, the Court

made it clear that the absence of a unitary relationship does not necessarily preclude apportionment.

Such an adjustment for unrelated investment function income is only available to a multistate entity that is entitled to allocate and apportion its income, and that proves by clear and cogent evidence that the assets producing the income serve an investment function unrelated to operational functions. If investment function income is excluded from apportionable income, the denominator of the relevant apportionment factors must also be adjusted to exclude items related to the investment assets.

Any entity that qualifies for an alternative method of allocation and apportionment for this type of income is required to add back any loss included in federal taxable income that is attributable to the acquisition, ownership, management, stewardship, sale, or exchange of investment assets that are unrelated to the taxpayer's operational function. If the entity previously claimed a subtraction for nonapportionable investment function income with respect to any investment assets, an addition is required for any subsequent losses generated by such assets.

**Burden of Proof:** As a prerequisite to claiming an adjustment on Lines 3b and 3d in Section C of Schedule 502A (which effectively allocates income other than dividends) the entity must be able to demonstrate that the application of Virginia law to its particular facts will be unconstitutional. The burden is on the entity to prove by clear and cogent evidence that the capital investment was completely separate from its operations, and that the taxpayer's investment function was located outside of Virginia. The entity must also demonstrate that the classification of the capital asset and its income for Virginia purposes is consistent with the manner in which the income has been allocated and apportioned with other state tax authorities. The entity will be under a particularly heavy burden of proof in cases where the asset was clearly operational at any time. Objective evidence is required; an unsubstantiated statement as to the entity's intent, purpose or state of mind will be insufficient to meet the burden. An entity claiming this exclusion for nonapportionable income must enclose a statement with the return stating the nature of the adjustment and the basis for the position that the relief is in accordance with *Allied-Signal*. The entity *must* include with the return all evidence necessary to support its position. For additional information, see Virginia Tax Bulletin 93-4 (also designated Public Document ("PD") 93-93B).

**Other alternative methods of allocation or apportionment:** If any PTE believes that the method of allocation or apportionment specified by the Department will subject it or its owners to taxation on a greater portion of the entity's net income than is reasonably attributable to business or sources within Virginia, it is entitled to file with the Department a statement of its objections and of the alternative method of allocation or apportionment that it believes to be proper under the circumstances, with such detail and proof and within such time as the Department may reasonably prescribe. If the Department concludes that the method of allocation or apportionment employed is, in fact, inapplicable or inequitable,

it shall redetermine the allocation or apportionment by such other method as it deems best calculated to assign to the state for taxation the portion of the income reasonably attributable to business and sources within the state, not exceeding, however, the amount which would be arrived at by the application of the statutory rules for allocation or apportionment.

The policy of the Department is that the statutory method is the most equitable method of determining the portion of income that is attributable to business activity in Virginia. Permission to use an alternative method of allocation or apportionment will be granted only in extraordinary circumstances.

**Line 4.**

Enter the amount from Schedule 502A, Section C, Line 2.

**Line 5.**

Enter the amount from Schedule 502A, Section C, Line 3(e).

**Line 6.**

Enter the amount from Schedule 502A, Section C, Line 4. If the PTE conducted its business entirely within Virginia and no income was allocated or apportioned elsewhere, enter the amount from Form 502, Line 1.

**Line 7.**

Enter the apportionment percentage from Schedule 502A, Section B, Line 1 or Line 2(g). If the PTE conducted its business entirely within Virginia and no income was allocated or apportioned elsewhere, enter 100% on Line 7.

**Virginia Modifications to Income (Additions and Subtractions)**

Virginia Modifications (Additions and Subtractions) should be allocated among owners in proportion to each owner's percentage of ownership or participation in the PTE, or as provided in the partnership agreement or other entity document. However, each owner may only claim the modifications that are allowed on the owner's Virginia income tax return. Therefore, an individual owner reports only modifications applicable to individual income tax and a corporate owner reports only those modifications applicable to Virginia corporate income tax.

**Fixed Date Conformity Update for 2016**

Virginia's date of conformity with the Internal Revenue Code (IRC) was advanced from December 31, 2014 to December 31, 2015, with limited exceptions.

**Bonus Depreciation:** Virginia will continue to disallow any bonus depreciation claimed for certain assets under IRC § 168(k) during Taxable Year 2001 and thereafter. Virginia will also continue to disallow bonus depreciation claimed under IRC §§ 168(l), 168(m), 1400L, and 1400N. To the extent that such bonus depreciation was claimed for federal income tax purposes, the depreciation deduction must be recomputed for Virginia income tax purposes. For taxable years when the recomputed Virginia depreciation deduction is less than the federal deduction, the taxpayer must claim a Virginia addition equal to the difference. For taxable years when the recomputed Virginia depreciation deduction is more than

the federal deduction, the taxpayer may claim a Virginia subtraction equal to the difference.

**Applicable High Yield Discount Obligations:** Virginia will continue to deconform from IRC § 163(e)(5)(F), which suspends the application of the applicable high yield debt obligation (“AHYDO”) rules for certain debts issued between September 30, 2008, and December 31, 2009. For federal purposes, special rules generally apply to computing the interest deduction that applies to certain high-yield original issue discount obligations. Because Virginia will continue to deconform from the federal provision that suspends the AHYDO rules, such rules will continue to apply for Virginia income tax purposes. Any resulting difference in the federal and Virginia deduction should be claimed as a modification on your Virginia return.

**Cancellation of Debt Income:** Under IRC § 108(i), taxpayers were permitted to defer the income realized upon the reacquisition of certain business debt during 2009 and 2010, and instead report such income in Taxable Years 2014 through 2018.

Virginia deconformed from this federal provision and required taxpayers to claim a Virginia addition equal to the amount of the federal exclusion. However, for transactions completed on or before April 21, 2010, taxpayers were permitted to partially defer such income by claiming the Virginia addition over three taxable years.

A taxpayer who previously claimed the Virginia cancellation of debt addition may claim a subtraction on his or her Taxable Year 2016 Virginia income tax return, to the extent such income was reported on his or her 2016 federal income tax return.

At the time these instructions went to print, the only required adjustments for “fixed date conformity” were those mentioned above. However, if federal legislation is enacted that results in changes to the IRC for the 2016 taxable year, taxpayers will be required to make adjustments to their Virginia returns that are not described in the instruction booklet. Information about any such adjustments will be posted on the Department’s website at [www.tax.virginia.gov](http://www.tax.virginia.gov).

Use the following line instructions for reporting Virginia additions to income.

**Line 8. Fixed Date Conformity – Depreciation.** Enter the amount that should be added to federal taxable income based upon the recomputation of allowable depreciation. If depreciation was included in the computation of your federal taxable income and one or more of the depreciable assets received the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016, then depreciation must be recomputed for Virginia purposes as if such assets did not receive the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016. If the total 2016 Virginia depreciation is less than 2016 federal depreciation, then the difference must be recognized as an addition. For further instructions, see Virginia Tax Bulletins 10-8, 11-1, 12-1, 13-3, 14-1, 15-1, and 16-1 which are available on the Department’s website at [www.tax.virginia.gov](http://www.tax.virginia.gov), or call (804) 367-8037.

**Line 9. Fixed Date Conformity — Other. (1) Disposed Asset.** If an asset was disposed in 2016 and such asset received the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016, and a gain or loss was recognized for federal purposes, then the gain or loss must be recomputed as if such asset did not receive the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016. The adjustment will be the difference in the federal and Virginia basis of the asset when sold. If the federal basis of the asset is greater than the Virginia basis (resulting in a lower gain reported for federal purposes), then the difference between the bases is an addition on the Virginia return. For further instructions, see Virginia Tax Bulletins 10-8, 11-1, 12-1, 13-3, 14-1, 15-1, and 16-1 which are available on the Department’s website at [www.tax.virginia.gov](http://www.tax.virginia.gov), or call (804) 367-8037.

**(2) Other Changes Not Listed.** Please refer to the Department’s website, [www.tax.virginia.gov](http://www.tax.virginia.gov), for information on any other additions due to federal tax legislation that passed after the publication deadline for these instructions. The Department’s website will also reflect any action by the Virginia General Assembly to advance the date of conformity to the IRC that may take place before the due date for your return. Enter any amounts described on [www.tax.virginia.gov](http://www.tax.virginia.gov). Also, please enclose a schedule and explanation of such additions to Form 502.

**Line 10. Net Income Tax.** Enter 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 this state or any other taxing jurisdiction, to the extent they are deducted in determining federal taxable income. Income tax of any sort and by any name is not an allowable deduction in determining Virginia taxable income. Note that this item may be related to the income tax paid on Schedule 502ADJ, Section C, Line 1, but is defined differently and is not necessarily the same amount.

**Line 11. Interest on Obligations Other Than Virginia.** Enter interest income received, less related expenses to the extent they are not deducted in determining federal taxable income, on obligations of any state other than Virginia, or of a political subdivision or agency of any such other state unless it was created by compact or agreement to which Virginia is a party.

**Line 12. Total Additions From Schedule 502ADJ.** First complete Schedule 502ADJ, Section A. See the Schedule 502ADJ instructions on Page 14. Enter the total additions from Schedule 502ADJ, Section A, Line 5.

### Virginia Subtractions

Use the following line instructions for reporting Virginia subtractions from income.

Subtractions should be allocated among owners in proportion to each owner’s percentage of ownership or participation in the PTE, or as provided in the partnership agreement or other entity document. However, each owner may only claim the subtractions allowed on the owner’s Virginia income

tax return. Therefore, an individual owner may only claim subtractions applicable to individual income tax, while a corporate owner may claim only those subtractions applicable to Virginia corporate income tax.

**Line 14. Fixed Date Conformity – Depreciation.** Enter the amount that should be subtracted from federal taxable income based upon the recomputation of allowable depreciation. If depreciation was included in the computation of your federal taxable income and one or more of the depreciable assets received the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016, then depreciation must be recomputed for Virginia purposes as if such assets did not receive the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016. If the total 2016 Virginia depreciation is more than 2016 federal depreciation, then the difference must be recognized as a subtraction. For further instructions, see Virginia Tax Bulletins 10-8, 11-1, 12-1, 13-3, 14-1, 15-1, and 16-1 which are available on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov), or call (804) 367-8037.

**Line 15. Fixed Date Conformity — Other. (1) Disposed Asset.** If an asset was disposed of in 2016 and such asset received the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016, and a gain or loss was recognized for federal purposes, then the gain or loss must be recomputed as if such asset did not receive the special 30% or 50% bonus depreciation deduction for federal purposes in any taxable year from 2001 through 2016. The adjustment will be the difference in the federal and Virginia basis of the asset when sold. If the federal basis of the asset is lower than the Virginia basis (resulting in a greater gain for federal purposes), then the difference between the two bases is a subtraction on the Virginia return. For further instructions, see Virginia Tax Bulletins 10-8, 11-1, 12-1, 13-3, 14-1, 15-1, and 16-1 which are available on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov), or call (804) 367-8037.

**(2) Other Changes Not Listed.** Please refer to the Department's website, [www.tax.virginia.gov](http://www.tax.virginia.gov), for information on any other subtractions due to federal tax legislation that was passed after the publication deadline for the Form 502 instructions. The Department's website will also reflect any action by the Virginia General Assembly to advance the date of conformity to the IRC that may take place before the due date for your return. Enter any amounts described on [www.tax.virginia.gov](http://www.tax.virginia.gov). Also, please attach a schedule and explanation of such subtractions.

**Line 16. Interest on Obligations of the United States.** Enter the amount of income (interest, dividends and gain) derived from obligations or the sale or exchange of obligations of the United States, and on obligations or securities of any authority, commission or instrumentality of the United States to the extent they are included in federal adjusted gross income but exempt from state income taxes under the laws of the United States. This includes, but is not limited to, stocks, bonds, treasury bills and treasury notes. It does not include interest on refunds of federal taxes, equipment purchase contracts or normal business transactions.

**Line 17. Total Subtractions from Schedule 502ADJ.** First complete Schedule 502ADJ, Section B. See the Schedule 502ADJ instructions later in this book. Enter the total subtractions from Schedule 502ADJ, Section B, Line 5.

**Line 18. Total Subtractions.** Add Lines 14 through 17.

### Virginia Tax Credits

**Line 19.** Enter the total nonrefundable credits from Schedule 502ADJ, Section C, Line 38.

**Line 20.** Enter the total refundable credits from Schedule 502ADJ, Section C, Line 46.

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## INSTRUCTIONS FOR PAGE 2 OF FORM 502

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### Section 1 - Withholding Tax Payment Reconciliation

**Line 1. Total withholding tax due for nonresident owners.** Enter the total tax required to be withheld on behalf of the nonresident owners. The total withholding tax due is generally 5% of each nonresident owner's share of income from Virginia sources (including additions and subtractions). The amount of withholding tax may be reduced by any tax credits that were earned by the PTE that pass through to nonresident owners provided the credits are applicable to the owners' income tax return. Reminder: the PTE is not required to pay the withholding tax on behalf of the individual nonresident owners for whom it files Form 765 and should **not** withhold for those owners.

**Line 2. Total withholding tax paid.** Enter the amount of withholding tax paid by the PTE that is named on Form 502 and submitted directly to the Department prior to the return filing. Do not enter any amount that was withheld by another PTE in which this PTE is a nonresident owner and was issued a Schedule VK-1 reflecting an amount that was withheld by the other PTE. Only amounts paid directly to the Department by the PTE filing Form 502 should be recorded on Line 2. If another PTE has withheld erroneously on the PTE filing Form 502, then the PTE should contact the other PTE and request reimbursement of the amount withheld in error.

**Line 3. Overpayment.** If Line 2 is greater than Line 1, enter the difference here.

**Line 4. Balance of withholding tax due.** If Line 2 is less than Line 1, enter the difference here.

### Section 2 - Penalty and Interest Charges on Withholding Tax

**Line 5. Extension penalty.** The extension penalty may apply if the balance due on Line 4 is more than 10% of Line 1. Virginia law provides for an automatic extension of time for filing Form 502 for a period of 6 months after the original due date, or 30 days after the extended federal due date, whichever is later. **Note:** The automatic extension for filing federal partnership and estate and trust returns has been reduced to 5 months. This extension does not apply to the payment of the income tax withheld on behalf of the entity's nonresident owners. If the entity does not pay at least 90% of the required withholding tax by the original due date for filing Form 502 (or 100% of the previous year's liability), provided

that the return for the previous year covered a 12-month period and reflected a tax liability, an extension penalty will apply to the balance of tax due after subtracting the payments on Line 2 from the tax liability on Line 1. The penalty is assessed at the rate of 2% per month or part of a month from the original due date for filing Form 502 through the date that the Form 502 is filed. The maximum extension penalty is 12%. The extension penalty applies only if the Form 502 is filed within the extension period.

**Extension Penalty Worksheet**

- A. Tax due after timely payments as reported on Line 2. \_\_\_\_\_
- B. Date the Form 502 was filed. \_\_\_\_\_
- C. Number of months from the due date through the date filed (count in 30-day increments and round up to the next full month). \_\_\_\_\_
- D. Extension penalty percentage.  
Multiply Line C by 2% (.02). Do not exceed 12%. \_\_\_\_\_ %
- E. Extension penalty. Multiply Line A by Line D. \_\_\_\_\_

**Line 6. Late payment penalty on withholding tax due.** The late filing penalty will apply if there is a balance due on Line 4 and Form 502 is being filed more than 6 months after the original due date or more than 30 days after the federal extended due date (federal extension of 5 months), whichever is later. If Form 502 is being filed after the specified dates, compute a late filing penalty of 30% of the tax due on Line 4. The extension penalty does not apply in cases where the return is subject to the late filing penalty.

**Line 7. Interest.** Interest may apply if there is a balance due on Line 4. If Line 4 reflects a balance of tax due and Form 502 is being filed after the original due date, interest must also be accrued on the balance of tax due. Interest is accrued at the underpayment rate established by IRC § 6621, plus 2%, from the due date of the return through the date the tax is paid. For current interest rates, visit the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov).

**Line 8. Total penalty and interest due.** Add Line 5, or Line 6, (whichever applies) to Line 7.

**Section 3 - Penalty for Late Filing of Form 502**

**Line 9. Penalty for Late Filing of Form 502.** If Form 502 is being filed more than 6 months after the original due date, or more than 30 days after the federal extended due date, enter \$1,200.

**Section 4 - Withholding Overpayment**

Any overpayment reported on Line 3 of Section 1 must be offset against any penalty and interest charges computed in Sections 2 and 3.

**Line 10. Net overpayment.**

- If Line 8 or Line 9 exceeds Line 3, go to Line 13 below to compute the total payment due.

- Compare Line 6 and Line 9. If Line 6 is greater than Line 9, subtract Line 8 from Line 3.
- If Line 9 is greater than Line 6, subtract the sum of Line 7 and Line 9 from Line 3.
- Otherwise, enter overpayment from Line 3.

**Line 11. Amount of withholding overpayment to be credited to 2017.** Enter the amount of the net overpayment from Line 10 that you want to apply as credit to income tax withheld for nonresident owners for Taxable Year 2017.

**Line 12. Amount of withholding overpayment to be refunded.** Enter the amount of the net overpayment from Line 10 to be refunded to the entity. Subtract Line 11 from Line 10. The total of Lines 11 and 12 cannot exceed the amount on Line 10.

**Section 5 - Tax, Penalty, and Interest Due**

**Line 13. Balance of tax due plus extension penalty, if applicable.** If there is an amount due on Line 4, enter the amount from Line 4, plus the extension penalty on Line 5, if applicable. If there is an overpayment on Line 3 and Line 8 or Line 9 is greater than Line 3, enter Line 5 minus Line 3.

**Line 14. Interest charges on withholding tax.** Enter the amount of interest due from Line 7.

**Line 15. Late filing penalty.** Enter the greater of Line 6 or Line 9.

**Line 16. Total payment due.** Add Line 13, Line 14 and Line 15.

**Section 6 - Amount Due or Refund**

**Line 17. Motion Picture Production Tax Credit to be refunded directly to PTE.** If the PTE elects to have this credit refunded at the entity level, enter the amount of credit authorized by Virginia Film Office in their certification letter. For more information about this credit, see **Motion Picture Production Tax Credit** in the Schedule 500CR instructions or contact: **Virginia Film Office, 901 East Byrd Street, Richmond, VA 23219-4048**, or call **(800) 854-6233**.

**Line 18. Research and Development Expenses Tax Credit to be refunded directly to PTE.** If the PTE elects to claim this credit at the entity level, enter the amount of credit available.

**Line 19. Total Amount of Tax Credit Refund.** Add Line 17 and Line 18.

**Line 20. Amount Due.** If there is an amount due on Line 16 and the amount exceeds the amount on Line 19, subtract Line 19 from Line 16.

**Line 21. Amount of Refund.** If there is an amount due on Line 16 and the amount is less than the amount on Line 19, subtract Line 16 from Line 19. If there is an amount on Line 12, add Line 12 and Line 19.

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**INSTRUCTIONS FOR SCHEDULE 502ADJ**

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**Sections A and B - Virginia Modifications**

To report Virginia Modifications (Additions and Subtractions)

enter the 2-digit code and amount for the type of modification in Sections A and B below. Use Section A to report Additions and Section B to report Subtractions from the codes indicated below. If you have more than 4 additions to report in Section A, lines 1 – 4, enter the total additions on Section A, Line 1 and enter Code “00.” If you have more than 4 subtractions to report in Section B, lines 1 – 4, enter the total subtractions on Section B, Line 1 and enter Code “00.” When you report Virginia modifications using Code “00,” you must attach an explanation of the amount entered to your return, including any applicable addition or subtraction codes.

**Section A – Addition Codes**

Use the following codes to report amounts for Virginia Additions in Section A.

**Code**

**10 Interest on federally exempt U.S. obligations**

Enter the amount of interest or dividends that are exempt from federal income tax, but taxable in Virginia, less related expenses. (*Va. Code* §§ 58.1-322 B.2; 58.1-402 B.2.)

**13 Deduction for bad debts**

The deduction for bad debts allowed in computing federal taxable income for a state or federal savings and loan association. (*Va. Code* § 58.1-403 1.)

**14 Unrelated business taxable income**

The amount of unrelated business taxable income as defined by IRC § 512. (*Va. Code* § 58.1-402 B.5.)

**15 Royalty addback for intangible expenses**

See the instructions for Schedule 500AB for additional information. Attach Schedule 500AB to Form 502. (*Va. Code* § 58.1-402 B.8.a.)

**16 Interest addback for intangible expenses**

See the instructions for Schedule 500AB for additional information. Attach Schedule 500AB to Form 502. (*Va. Code* § 58.1-402 B.9.a.)

**18 Income from Dealer Disposition of Property**

Enter the amount that would be reported under the installment method from certain dispositions of property. If, in a prior year, the taxpayer was allowed a subtraction for certain income from dealer dispositions of property made on or after January 1, 2009, in the years following the year of disposition, the taxpayer is required to add back the amount that would have been reported under the installment method. Each disposition must be tracked separately for purposes of this adjustment. (*Va Code* § 58.1-402 F.)

**20 Telework Expenses**

Pass-through entities that claim the Virginia Telework Expenses Tax Credit are not allowed to exclude those expenses from Virginia income. To the extent excluded from federal taxable income, any expenses

incurred by a taxpayer used to claim the Telework Expenses Tax Credit must be added to the Virginia return.

**21 Food Crop Donation Tax Credit**

To the extent a credit is allowed for growing food crops in the Commonwealth and donating such crops to a nonprofit food bank, an addition is required for any amount claimed by the taxpayer as a federal income tax deduction for such donation.

**99 Other (Attach Explanation)**

This must include the amount of losses or deductions of an S Corporation that is subject to the Bank Franchise Tax, or the amount of any distributions from such an S Corporation. This addition will be claimed as a negative deduction (Code 112) on Line 8a of the shareholder’s Schedule ADJ. See the worksheet in the individual income tax instruction booklet.

**Section B – Subtraction Codes**

Use the following codes to report amounts for Virginia Subtractions in Section B.

**Code**

**10** Any amounts included under the provisions of IRC § 78. (*Va. Code* § 58.1-402 C.5.)

**11** The amount of any refund or credit for overpayment of income taxes imposed by this state or any other taxing jurisdiction. (*Va. Code* § 58.1-402 C.4.)

**12** Any amount included therein by the operation of IRC § 951 (subpart F income). (*Va. Code* § 58.1-402 C.7.)

**13** Any amount included in federal taxable income that is foreign source income and defined as follows:

1) Interest other than interest derived from sources within the United States;

2) Dividends other than dividends derived from sources within the United States;

3) Rents, royalties, license, and technical fees from property located or services performed without the United States or from any interest in such property including rents, royalties, or fees for the use of or the privilege of using without the United States any patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, and other like properties; and

4) Gains, profits, or other income from the sale of intangible or real property located without the United States.

In determining the source of income for purposes of items 1 through 4 above, the provisions of IRC §§ 861, 862, and 863 shall be applied. (*Va. Code* § 58.1-402 C.8.)

**14** The amount of any dividends received from corporations in which the taxpaying corporation owns

50% more of the voting stock, to the extent included in federal taxable income and to the extent not otherwise subtracted from federal taxable income. (Va. Code § 58.1-402 C.10.)

- 15 The dividends of a Domestic International Sales Corporation, 50% or more of the income of which was assessable for the preceding year, or the last year, in which such corporation has income under the provision of the income tax laws of Virginia. (Va. Code § 58.1-402 C.3.)
- 16 The amount that could have been deducted by a gas supplier, pipeline distribution company, or gas utility company, as a net operating loss carryover or net capital loss in arriving at taxable income except that such loss or portion thereof had been carried back for federal purposes to a taxable year before it became subject to Virginia income tax. To the extent that the recomputed loss is carried back more than 2 years, it may be subject to the modification for deconformity. (Va. Code § 58.1-403 (9).)
- 17 A gas supplier, pipeline distribution company, gas utility company, or electric supplier (except an electric cooperative) that was subject to the state license tax on gross receipts in 2000, and became subject to Virginia income tax in 2001, may amortize its Virginia tax basis using the straight-line method over a period of 30 years, beginning on the adjustment date. The Virginia tax basis is the aggregate adjusted book basis less aggregate adjusted tax basis of assets placed in service prior to the first day of the taxable year that the company became subject to Virginia income tax. (Va. Code § 58.1-440.1.)
- 20 The amount of income derived from Virginia obligations or the sale or exchange of Virginia obligations that are included in federal adjusted gross income. (Va. Code §§ 58.1-402 C.2.; 58.1-322 C.2.)
- 21 The amount of wages and salaries eligible for the Federal Work Opportunity Tax Credit that are not deducted for federal tax purposes. (Va. Code §§ 58.1-402 C.6; 58.1-322 C.6.)
- 22 The amount of intangible expenses and costs or interest expenses and costs added to the federal taxable income of a corporation shall be subtracted from the federal taxable income of the related member if the related member is subject to Virginia income tax on the same amount. See the Form 500 instructions for additional information. Attach Schedule 500AB to Form 502 (Va. Code § 58.1-402 C.21.)
- 41 The amount of income received as a result of payments made under the Tobacco Master Settlement Agreement, the National Tobacco Grower Settlement Trust and the Tobacco Loss Assistance Program. (Va. Code §§ 58.1-402 C.18.; 58.1-322 C.27.)
- 43 The amount contributed to the Virginia Public School Construction Grants Program and Fund that has not

been claimed as a deduction on the taxpayer's federal income tax return. (Va. Code §§ 58.1-402 C.15; 58.1-322 D.8.) **Note:** This deduction will be claimed as a deduction (Code 107) on the owner's individual income tax return.

- 48 The amount of payments received in the preceding year in accordance with the Tobacco Quota Buyout Program of the American Jobs Creation Act of 2004 to the extent they are included in federal taxable income. For example, on the 2016 return the taxpayer may subtract the portion of such payments received in 2015 that is included in the taxpayer's 2015 federal taxable income; while payments received in 2016 may generate a subtraction on the 2017 Virginia return. If the taxpayer chooses to accept payment in installments, the gain from the installment received in the preceding year may be subtracted. If, however, the taxpayer opted to receive a single payment, 10% of the gain recognized for federal purposes in the year that the payment was received may be subtracted in the following year and in each of the 9 succeeding taxable years. (Va. Code §§ 58.1-402 D; 58.1-322 D.11.) **Note:** This deduction will be claimed as a deduction (Code 108) on the owner's individual income tax return.
- 49 **Income from Dealer Disposition of Property -** An adjustment is allowed for certain income from dealer dispositions of property made on or after January 1, 2009. In the year of disposition the adjustment will be a subtraction for gain attributable to installment payments that are to be made in future taxable years provided that (i) the gain arises from an installment sale for which federal law does not permit the dealer to elect installment reporting of income, and (ii) the dealer elects installment treatment of the income for Virginia purposes on or before the due date prescribed by law for filing the taxpayer's income tax return. In subsequent taxable years, the adjustment will be an addition for gain attributable to any payments made during the taxable year with respect to the disposition. Each disposition must be tracked separately for purposes of this adjustment. (Va. Code §§ 58.1-402 F; 58.1-322 H.)
- 50 **Gains from Land Preservation -** Enter the amount of federal gain or income recognized as a result of the sale of Land Preservation Tax Credits. A subtraction is allowed for any gain or income recognized by a taxpayer on the application of Land Preservation Tax Credits against Virginia income tax liability to the extent the gain is included in and not otherwise subtracted from federal adjusted gross income. The transfer of the credit and its application against a tax liability shall not create gain or loss for the transferor or the transferee.
- 51 **Certain Long-Term Capital Gain -** Provided the long-term capital gain or investment services partnership income is attributable to an investment in a "qualified

business” as defined in Va. Code § 58.1-339.4 or any other technology business approved by the Secretary of Technology, it may be allowed as a subtraction. The business must have its principal facility in Virginia and less than \$3 million in annual revenues for the fiscal year preceding the investment. The investment must be made between the dates of April 1, 2010, and June 30, 2020. Taxpayers claiming the Qualified Equity and Subordinated Debt Investments Credit cannot claim this subtraction relating to investments in the same business. In addition, no investment is “qualified” for this subtraction if the business performs research in Virginia on human embryonic stem cells.

- 52 Gain from Historic Rehabilitation** - To the extent that it is included in federal taxable income, any amount of gain or income recognized by a taxpayer in connection with the Historic Rehabilitation Tax Credit is allowed as a subtraction on the Virginia return.
- 99 Other** (Attach Explanation). This must include the amount of income or gain of an S corporation that is subject to Bank Franchise Tax. This deduction (Code 112) will be claimed on the shareholder’s income tax return. See the worksheet in the individual income tax instructions.

### Section C - Virginia Tax Credits

Tax credits based on a PTE’s activities are passed through to the owners, generally in proportion to each owner’s percentage of ownership or participation in the entity (although the legislation for a particular credit may allow for other allocation). When the credit is subject to a limitation, the limitation applies to the total credit of the PTE (the aggregate of the owners’ shares), not to each owner’s share separately.

#### Pass-through entities do not use or compute credit carryovers.

A PTE passes through to each owner the owner’s share of each credit earned by the PTE for that year. Each owner must then determine the manner in which, with respect to its own circumstances, the credits can be used (including carryovers).

For most credits, specific documentation must be attached to the return of the PTE and the return of the owner. See the instructions for Schedule CR or Schedule 500CR, or visit the Department’s website, [www.tax.virginia.gov](http://www.tax.virginia.gov), for more information about each credit and its required documentation.

**Without proper documentation, the credit will not be allowed.**

For information on specific credits, see either the Schedule CR instructions (Individuals) or the Tax Credits section of the Form 500 instructions.

Exception: There are currently two refundable credits that the PTE may elect to have refunded at the entity level. They are the Motion Picture Production Tax Credits and the Research and Development Expenses Tax Credit. If the PTE makes this election, the full amount of the credit(s) will be refunded to the PTE reduced by any outstanding tax assessments.

State Income Tax Paid: Many states follow the federal tax treatment of pass-through entities and apply income tax to the entity’s income only at the owner level. Some states,

however, may not recognize the federal S corporation election or may otherwise impose an income tax directly on a PTE. If the PTE properly paid a direct state income tax, owners who are **individuals** may qualify to claim the “credit for tax paid to another state” on their Virginia individual income tax returns, based on their proportional shares of the tax paid by the PTE.

The credit for tax paid to another state is based only on an income tax on earned or business income, or gain on the sale of an asset. Other taxes do not qualify, including any franchise, license, excise, unincorporated business or occupation tax, or any tax characterized as such by the taxing jurisdiction, even if the tax is based on earned or business income. A tax that would be illegal or unauthorized in the taxing jurisdiction if it were characterized as an income tax or a commuter tax does not qualify.

If the PTE paid a direct state income tax for which an individual owner could claim the credit for tax paid to another state based on his or her proportional share, enter the total amount of such tax paid by the entity, and attach a schedule identifying each taxing jurisdiction with a description of the tax and the amount paid.

Do not include any taxes paid by the entity that reflect another state’s income tax withholding requirement on behalf of specific owners, or that were paid in connection with another state’s equivalent to Form 765 on behalf of specific owners. These amounts may be shown with appropriate descriptions on the Schedule VK-1 of each specific owner that is affected, but should not be included in the amount on Section C, Line 1, of Form 502 ADJ, which will be distributed to all owners based on each owner’s participation percentage.

#### **Credit Allocation**

The following credits must be allocated among owners in proportion to each owner’s percentage of ownership or participation in the PTE:

- State Income Tax Paid (See above)
- Neighborhood Assistance Act Credit
- Enterprise Zone Act General Tax Credit
- Conservation Tillage Equipment Credit
- Biodiesel and Green Diesel Fuels Tax Credit
- Precision Fertilizer and Pesticide Application Equipment Credit
- Recyclable Materials Processing Equipment Credit
- Clean-Fuel Vehicle Job Creation Tax Credit
- Major Business Facility Job Tax Credit
- Day-Care Facility Investment Tax Credit
- Agricultural Best Management Practices Tax Credit
- Worker Retraining Tax Credit
- Waste Motor Oil Burning Equipment Credit
- Riparian Forest Buffer Protection for Waterways Tax Credit
- Communities of Opportunity Tax Credit
- Green Jobs Creation Tax Credit

- Farm Wineries and Vineyards Tax Credit
- International Trade Facility Tax Credit
- Port Volume Increase Tax Credit
- Barge and Rail Usage Tax Credit
- Livable Home Tax Credit
- Telework Expenses Tax Credit
- Education Improvement Scholarships Tax Credit
- Food Crop Donation Tax Credit

These credits may be allocated among owners in proportion to each owner's percentage of ownership or participation in the PTE, or as the owners may mutually agree, or as provided in the partnership agreement or other entity document.

- Enterprise Zone Act Zone Investment Tax Credit
- Clean-Fuel Vehicle Credit and Vehicle Emissions Testing Equipment Credit
- Historic Rehabilitation Tax Credit
- Land Preservation Tax Credit
- Qualified Equity and Subordinated Debt Investments Tax Credit
- Virginia Coal Employment and Production Incentive Tax Credit
- Research and Development Expenses Tax Credit
- Major Research and Development Expenses Tax Credit

#### **Form PTE - Virginia Pass-Through Credit Allocation**

Form PTE must be filed with the Tax Credit Unit to allocate certain tax credits to owners before they can be claimed by the owners on their Virginia Income Tax Returns. See Form PTE for a list of those credit types. Form PTE must be filed with the Tax Credit Unit by the pass-through entity within 30 days of certification of the credit but at least 90 days prior to the participants filing their income tax returns.

For more information, write to: **Virginia Department of Taxation, Tax Credit Unit, P.O. Box 715, Richmond, VA 23218-0715**, or call **(804) 786-2992**.

**Line 38. Total nonrefundable credits.** Add Lines 1-19 and Lines 22-37.

**Lines 39-45.** These credits provide for refunds of amounts that exceed the tax due.

- Coalfield Employment Enhancement Tax Credit
- Virginia Coal Employment and Production Incentive Tax Credit
- Motion Picture Production Tax Credits
- Research and Development Expenses Tax Credit

**Line 46. Total refundable credits.** Add Lines 42, 44, and 45. All pass-through entities distributing credits to owner(s), shareholders, partners, or members must give each a Schedule VK-1, Owner's Share of Income and Virginia Modifications and Credits. Also, a Schedule VK-1 Consolidated must be included with the return. If the Schedule VK-1 Consolidated is completed, do not enclose each owners Schedule VK-1.

#### **Section D - Amended Return**

If the PTE is filing an amended return, complete Form 502 using the corrected figures, as if it were the original return. Do not make any adjustments to the amended return to show that the PTE received a refund or paid a balance due as the result of the original return. Then complete Form 502ADJ, Section D, Lines 1-6 to determine if the PTE is due a refund or any additional tax is due with the amended return. When completing Line 1, enter tax paid prior to filing the return, tax paid with the return, and additional tax paid after the return was filed.

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### **INSTRUCTIONS FOR VIRGINIA SCHEDULE VK-1 AND SCHEDULE VK-1 CONSOLIDATED - OWNER'S SHARE OF INCOME AND VIRGINIA MODIFICATIONS AND CREDITS**

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#### **General Instructions**

Schedule VK-1 or Schedule VK-1 Consolidated is prepared by the PTE to show each owner's distributive or pro rata share of the entity's income, Virginia modifications and Virginia credits, and other information necessary for an owner to be able to include the effect of participation in the entity in the owner's income tax return. Schedule VK-1 does not replace federal Schedule K-1; it is a supplement to the federal schedule for those state tax issues that require additional information. The PTE will prepare a Schedule VK-1 for each owner; a copy should be given to each owner, and a copy should be included with the entity's Form 502 submission to the Department. Use the Web Upload application on the Department's website, **www.tax.virginia.gov**, to submit Schedules VK-1 electronically.

#### **Schedule VK-1 Consolidated**

Use this template only if the PTE has been granted a waiver from the electronic filing mandate. Schedule VK-1 Consolidated allows taxpayers to report multiple owners on one Excel summary sheet. The PTE will continue to send a copy of the Schedule VK-1 to each owner for filing purposes, but will not need to send a copy of each owner's Schedule VK-1 to the Department. In its place, a summary of each owner's share will be reported on the Schedule VK-1 Consolidated and sent to the Department for processing. Use the Form 502 instructions with the Schedule VK-1 Consolidated form layout for field computations, additions, subtractions, tax tables, and mailing addresses. To avoid the disclosure of confidential taxpayer information, the PTE must not send the summary to its owners.

If filing by paper, PTEs reporting 10 or more owners must use the Schedule VK-1 Consolidated to report the owner's share of income, modifications, allocations, and the total additions, subtractions, and credits reported on the Schedule VK-1.

A Schedule VK-1 Consolidated template is available for download from the Corporation and Pass-Through Entity Forms section of the Department's website. Users may create their own forms using the form layout; however, they must adhere to the form layout requirements and specifications

in the Schedule VK-1 Consolidated Summary to ensure accurate processing of the Schedule VK-1 Consolidated. The Schedule VK-1 Consolidated Summary is available on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov). The Summary's Appendix contains detailed steps for using Excel, including screen shots.

**Additional Owner Information**

**Line a: Date Owner Acquired Interest in the PTE.** Enter in MM/DD/YYYY format.

**Line b: Owner's Entity Type.** Enter the code that corresponds to the owner's entity type:

<u>Entity Type</u>	<u>Code</u>
Individual Who Was a Virginia Resident.....	RES
Individual Who Was Not a Virginia Resident .....	NON
General Partnership .....	PG
Limited Partnership.....	PL
Limited Liability Company.....	LL
Limited Liability Partnership.....	LP
S Corporation .....	SC
C Corporation .....	CC
Trust or Estate .....	TE
Other.....	OB

**Line c: Owner's Participation Type.** Enter the code that corresponds to the owner's type of membership or participation in the PTE:

<u>Participant Type</u>	<u>Code</u>
General Partner .....	GPT
Limited Partner .....	LPT
LLC/LLP Member .....	LLM
S Corporation Shareholder .....	SHR
Other.....	OTR

**Line d: Owner's Participation Percentage.** For an S corporation shareholder, enter the owner's percentage of stock ownership for the taxable year, as shown on the owner's federal Schedule K-1 (Form 1120S), Line F. For a partner or other recipient of federal Schedule K-1 (Form 1065), enter the ending percentage for the partner's profit share as shown on the Schedule K-1, under Line J.

For a partner in an electing large partnership, the federal Schedule K-1 (Form 1065B) does not indicate a participation percentage, but the partnership must determine such a percentage in order to distribute Virginia modifications and credits among the owners. The percentage should be determined in a manner substantially similar to the profit sharing percentage at the end of the year provided for a regular partnership, unless there is compelling reason to use another method.

The participation percentages as shown on Schedules VK-1 for all owners of the PTE should equal 100%.

The participation percentage should be entered as a percent with two decimal places. For instance, the participation percentage for an S corporation shareholder who holds one-third ownership is entered as "33.33%."

**Line e: Amount Withheld by PTE for Owner.** Enter the amount withheld by the PTE for the nonresident owner.

**Line f: Withholding Exemption.** If the entity does not have to pay the withholding tax or if it is not required to include the income of an owner in its withholding tax calculations, enter the exemption code in the space provided.

<u>Withholding Exemption Reason</u>	<u>Code</u>
Exempt from federal or Virginia income tax (individuals) .....	01
Entities other than individuals and corporations that are exempt from federal income taxes .....	02
Individual owner is included in a composite return.....	03
PTE is a publicly traded partnership .....	04
Corporations exempt from Virginia income tax; or noncaptive REITs.....	05
Undue hardship (PTE).....	06
PTE's income is from rents with 4 or fewer dwelling units.....	07

**Line Instructions**

**Page 1, Lines 1 - 18 and Page 2 - Virginia Tax Credits.** These items on Schedule VK-1 correspond to related items with the same line numbers on Lines 1-11 of Form 502 and to certain lines of Sections A, B, and C of Form 502ADJ. In general, Form 502 and Form 502ADJ show the PTE's total amount for the item, while each Schedule VK-1 shows one owner's share of the item. The owner's share of an item is usually determined by the owner's participation percentage (see above), but some partnership agreements may provide for special allocations. The entries on each line of the Schedules VK-1 for all owners of the PTE should equal the corresponding entry on Form 502 and Form 502ADJ, except for Line 7. The entry on Line 7 will be the same for all owners of the entity and the same as Line 7 of Form 502 (the PTE's Virginia apportionment percentage).

Additions, subtractions, and credits should be allocated among owners in proportion to each owner's percentage of ownership or participation in the PTE, or as provided in the partnership agreement or other entity document. However, each owner may only claim the additions, subtractions, or credits allowed on the owner's Virginia income tax return. Therefore, an individual owner may only claim additions, subtractions or credits applicable to individual income tax, while a corporate owner may claim only those additions, subtractions, or credits applicable to the Virginia corporate income tax.

The Virginia Public School Construction Grants Program and Fund (Code 43) and the Tobacco Quota Buyout Program (Code 48) deductions must be claimed as deductions on the shareholder's individual income tax return. The deduction for

an S-corporation subject to Bank Franchise Tax is reported as an “other” addition or subtraction on Schedule VK-1 and as a positive or negative deduction on the owner’s individual income tax return. For the Schedule VK-1 Consolidated, report Lines 1-11 and totals from Lines 13, 18, and 46.

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## **INSTRUCTIONS FOR SCHEDULE 502A - ALLOCATION AND APPORTIONMENT OF INCOME FOR PASS-THROUGH ENTITIES**

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### **General Information**

A PTE must determine the extent to which its income is from Virginia sources. This determination is made in the same manner as provided by law for corporations (*Va. Code* §§ 58.1-405 through 58.1-421), with such accommodation as may be necessary considering the differences between regular taxing corporations and pass-through entities (PTE).

### **Retail Company Apportionment Factor Change**

For taxable years beginning on and after July 1, 2015, retail companies are required to use a single sales factor method of apportionment.

### **Apportionment Factor for Enterprise Data Center Operations**

For taxable years beginning on or after July 1, 2016 until July 1, 2017, a taxpayer with an enterprise data center operation who enters into a memorandum of understanding with the Virginia Economic Development Partnership (VEDP) to make a new approved capital investment of at least \$150 million in an enterprise data center in Virginia are required to apportion income within and without the Commonwealth using a quadruple-weighted sales factor. For taxable years beginning on or after July 1, 2017, such taxpayers must use a single-weighted sales factor method of apportionment.

### **When Income Is All from Virginia Sources**

If a PTE conducts its entire business within Virginia, then all of its income is Virginia source income. A PTE is presumed to be doing business entirely within Virginia unless it is subject to (or would be subject to if it were a regular taxing corporation) one of the following taxes in another state: 1) a tax imposed on net income; 2) a franchise or other tax measured by net income; or 3) a franchise tax for the privilege of doing business. An entity is “subject to” such a tax if it carries on sufficient activity within a state that the state has jurisdiction to impose the tax, whether or not the state actually imposes the tax. The activities must be considered in the light of Public Law (“P.L.”) 86-272 (15 U.S.C. §§ 381-384). If federal law would prohibit the state from imposing the tax because the entity’s activities in the state were not of a certain type or did not exceed a certain threshold, then the state does not have jurisdiction, and the entity is not subject to the state’s tax for purposes of allowing the entity to allocate and apportion income away from Virginia. In addition, an entity is not subject to a tax in a state if it voluntarily pays the tax but is not required to do so by the laws of that state, or if it pays a fee for qualification, organization, or the privilege of doing business in the state but either: 1) does not actually engage in business in the state; or 2) engages in some business in

the state, not sufficient for nexus, and the tax or fee bears no relation to the entity’s activities in the state.

### **When Income Is from Virginia and Other States**

If a PTE’s income is not all Virginia source income, as defined above, and the entity conducts its business in Virginia and in one or more other states, then the portion of total income that is Virginia source income is determined through allocation and apportionment. *Allocation* is the assignment of income, or a piece of income, wholly to one state or another. *Apportionment* is the division of income among states according to the ratio of activities in one place to activities everywhere.

### **Who Must Use Schedule 502A**

Schedule 502A is used to show the amount of allocated income and to determine the apportionment percentage.

If the PTE’s income is all from Virginia, then the entity does not allocate and apportion income; the Virginia apportionment percentage is 100%, and Schedule 502A is not required. In all other cases, the PTE must prepare a Schedule 502A and attach it to Form 502. The owners may also need a copy of Schedule 502A from the PTE in order to prepare their own returns properly (see the next section).

### **Effect of Schedule 502A on Owners of the PTE**

A PTE does not calculate a net taxable income amount for each owner. Rather, it determines each owner’s distributive share of various types of income, gains, losses, deductions and credits. Each owner then uses that information as applicable, plus the PTE’s allocation and apportionment information from Schedule 502A, in determining its Virginia taxable income. How each owner uses the PTE’s information will vary, however, depending on the owner’s entity type. Refer to the Form 502 instructions for more information.

### **Allocable and Apportionable Income**

Virginia law provides that dividends received are to be allocated to the state of commercial domicile, and that **all** other income must be apportioned as directed in *Va Code* §§ 58.1-408 - 58.1-420. Virginia law does not allow for subtractions from apportionable income based on separate or divisional accounting, or for the exclusion of non-Virginia investment income.

### **Line Instructions**

Enter the company’s name and FEIN.

If filing a composite return (Form 765), check the box as indicated. The “unified (composite) nonresident return filed” check box must also be marked on Form 502. Please attach a completed Schedule 502A with Form 765 if a composite return is filed by the business owners.

### **Section A - Apportionable Method**

All income of the PTE except the class of income allocable as specified in the instructions for Section C, Line 3 is apportioned to this state in accordance with the items below. (*Va. Code* § 58.1-408.)

**Line 1. Motor carriers.** If a motor carrier and an exception applies, check the proper box for Exception 1 or Exception 2. See the instructions for Section B, Line 1 for more information.

**Line 2. Financial companies.** Check this box if the PTE is a financial company. Financial companies must apportion income based on cost of performance in Virginia versus cost of performance everywhere. See the instructions for Section B, Line 1 for more information.

**Line 3. Construction companies.** Check this box if the PTE is a construction company that has elected to report income on the completed contract basis. Construction companies that have made this election must apportion income as provided in the instructions for Section B, Line 1.

**Line 4. Railway companies.** Check this box if the PTE is a railway company. Railway companies must determine their net apportionable income by using revenue car miles. See the instructions for Section B, Line 1 for more information.

**Line 5. Retail Company Apportionment.** Check this box if the company is a retail company.

For purposes of this requirement, a retail company is defined as a domestic or foreign company primarily engaged in activities that, in accordance with the NAICS, United States Manual, United States Office of Management and Budget, 1997 Edition, would be included in Sectors 44-45.

A retail company is required to apportion its income using a single sales factor method of apportionment for taxable years beginning on and after July 1, 2015.

**Line 6. Manufacturer's modified apportionment method:** Check this box if a manufacturer is electing the modified apportionment method under *Va. Code* § 58.1-422. See the publications section on the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov) to download the guidelines for this apportionment method.

**Which Manufacturers Qualify:** An electing manufacturer must certify to the Department that the average weekly wage of its *full-time employees* was greater than the lower of the state or local average weekly wage for the taxpayer's industry. (*Va. Code* § 58.1-422.)

In addition, the PTE must maintain 90% of the base year level of employment in Virginia for the first 3 taxable years after making the election. If a PTE fails to meet this requirement, it will be required to reapportion income based on the standard apportionment and provide the owners with corrected income amounts. The owners will be required to pay the difference between taxes calculated under the standard method of apportionment and taxes calculated under the election, as well as interest and a 10% penalty. (*Va. Code* § 58.1-422.)

Effective for taxable years on or after July 1, 2011, manufacturing pass-through entities may elect to use the modified apportionment method. Once a manufacturing PTE makes this election, it generally may neither revoke such election for 3 taxable years nor amend the return on which such election was made to change its method of apportionment. The manufacturing company will be required to use the apportionment factor that is effective at the time that the modified apportionment method election is made, and any apportionment factor that becomes effective in the first 3 taxable years after the election.

**Line 6a.** Enter the beginning date (MM/DD/YY) of the election year.

**Line 6b.** A taxpayer making this election must certify that the average weekly wage of its full-time employees is greater than the lower of the state or local average weekly wages for its industry and that the average annual number of full-time employees of the manufacturing company is at least 90% of the base year employment. Check the box certifying that the company meets the requirements. The wage and employment certification box should be checked for each year that the manufacturer's election is claimed.

**Manufacturer does not maintain employment levels for modified apportionment method election.** A manufacturer will be subject to additional tax (recapture) and interest if the average weekly wage of its full-time employees is lower than the state or local weekly wage for its industry or its number of full-time employees do not equal or exceed 90 % of its base year employment level. The amount of the recapture is equal to the difference between the tax that would have been due under the standard apportionment method and the amount of tax that was due using the modified apportionment method for each of the first 3 years in which the average weekly wage of its full-time employees was lower than the state or local weekly wage for its industry or its number of full-time employees did not equal or exceed 90% of its base year employment level. The Department will generally assess the manufacturer with the amount required to be recaptured and any interest due. However, a manufacturer that fails, or anticipates that it will fail, to meet the wage and employment requirements may file returns for the taxable years for which recapture would be required, using the statutory apportionment method, and pay any taxes and interest due on such returns in lieu of waiting to receive an assessment of such amounts due from the Department. Such company must submit a written explanation with its return detailing why it is changing to the statutory apportionment method.

If you file an amended return and voluntarily change your apportionment method because you anticipate that you will fail to meet the wage and employment requirements, file an amended return by completing a new return for the year of adjustment using the corrected figures, as if it were the original return. Do not make any adjustments to the amended return to show that the you received a refund or paid a balance due as the result of the original return. Be sure to check the amended return box on Form 502, complete a revised Schedule 502A, and the Amended Return section on Page 2 of Schedule 502ADJ.

**Line 7. Enterprise Data Center Operation:** For taxable years beginning on or after July 1, 2016 until July 1, 2017, a taxpayer with an enterprise data center operation that enters into a memorandum of understanding with the Virginia Economic Development Partnership (VEDP) to make a new capital investment of at least \$150 million in an enterprise data center in Virginia is required to apportion Virginia taxable income using a quadruple-weighted sales factor. For taxable years beginning on or after July 1, 2017, such taxpayers are required to use the single sales factor method of apportionment.

**Line 8. Multi-Factor Formula with Double-Weighted Sales Factor:** Check if using the multi-factor apportionment formula with a double-weighted sales factor.

### **Section B - Apportionable Percentage**

**Line 1. Single Factor Computations:** Motor Carriers, Financial Companies, Construction Companies, Railway Companies, Retail Companies and Manufacturers who elected the Modified Apportionment Method in Section A.

For taxpayers using the single-factor computation, check the appropriate box for the PTE's entity type (motor carrier, financial corporation, construction corporation, railway company, retail company, qualified manufacturer's modified apportionment) on Lines 1 through 6 of Section A. Based on the appropriate computation method for your entity type or election, enter the total, Virginia, and percentage on Line 1, Section B. For example: railway companies are to use the ratio of revenue car miles in Virginia to total revenue miles of the corporation everywhere.

**Motor carriers:** Motor carriers of property or passengers using highways of this state must, unless they meet one of the two exceptions set forth below, apportion their net apportionable income to Virginia using the ratio of vehicle miles in this state to total vehicle miles everywhere. "Vehicle miles" means miles traveled by vehicles, owned or operated by the taxpayer, hauling property, or carrying passengers for a charge or fare.

A carrier meeting either of the exceptions set forth below is not required to apportion income to Virginia. In such cases, a return must be filed, but it is necessary only to enter the name and address on appropriate lines, enter zero on Line 7, Form 502, check the appropriate box(es) on Schedule 502A, Section A, Line 1 and complete Section B, Line 1 of Schedule 502A. (*Va. Code* § 58.1-417.)

Exception 1: A carrier which neither owns nor rents real or tangible personal property inside this state except vehicles, makes no pickups or deliveries inside this state, and travels no more than 50,000 "vehicle miles" inside this state; provided that the Virginia "vehicle miles" are less than 5% of total vehicle miles.

Exception 2: A carrier which neither owns nor rents real or tangible personal property inside this state except vehicles, and which makes no more than 12 round trips into this state during the taxable year, either hauling property or carrying passengers; provided that the Virginia "vehicle miles" are less than 5% of total vehicle miles traveled during the taxable year.

**Financial companies:** A financial company is a company that is not exempted from the imposition of tax under the provisions of *Va. Code* § 58.1-401, which derives more than 70% of its gross income from the classes of income enumerated in items 1 through 4 below, without reference to the state where the income is earned, including, but not limited to, small loan companies, sales finance companies, brokerage companies, and investment companies:

1. Fees, commissions, other compensation for financial services rendered;

2. Gross profits from trading in stocks, bonds, or other securities;
3. Interest; and
4. Dividends that are included in Virginia taxable income. In computing the amounts referred to in items 1 through 4 above, any amount received by a member of an affiliated group (determined under IRC § 1504(a), but without reference to whether any such company is an includible company under IRC § 1504(b)) from another member of such group, will be included only to the extent that the amount exceeds the related expenses of the recipient.

The Virginia taxable income of a financial company, as defined in *Va. Code* § 58.1-418, excluding income allocable under *Va. Code* § 58.1-407, shall be apportioned within and without this state in the ratio that the business within Virginia is to total business of the corporation. Business within this state shall be based on cost of performance in Virginia over cost of performance everywhere. (*Va. Code* § 58.1-418.)

### **Cost of Performance Factor**

(a) The cost of performance is the cost of all activities directly performed by the taxpayer for the ultimate purpose of obtaining gains or profit, except activities directly performed by the taxpayer for the ultimate purpose of obtaining dividends allocable under the provisions of *Va. Code* § 58.1-407.

(i) Such activities do not include those performed on behalf of a taxpayer, such as those performed by an independent contractor.

(ii) The cost of performance does not include the cost of funds (interest, etc.), but does include the cost of activities required to procure loans or other financing.

(b) Activities constituting the cost of performance are deemed performed at the situs of real and tangible personal property or the place at which or from which activities are performed by employees of a taxpayer.

(c) Cost of performance of a financial institution within and without Virginia shall be determined without regard to the location of borrowers, location of property in which the financial company has only a security interest, or the cost to the financial company of the funds which it lends. (23 Virginia Administrative Code (VAC) 10-120-250.)

**Construction companies:** Construction companies which have elected to report income on the completed contract basis for federal income tax purposes must apportion income within and without this state in the ratio that the business within this state is to total business of the company. The business within and without this state is based upon "sales" as defined by *Va. Code* § 58.1-302, to the extent that it is included in taxable income, and is determined as provided by *Va. Code* §§ 58.1-414 through 58.1-419. All other construction companies must determine Virginia taxable income by reference to *Va. Code* §§ 58.1-406 through 58.1-416.

**Railway companies:** Railway companies must determine their net apportionable income to this state by multiplying Virginia taxable income of such company, excluding the

income allocable under *Va. Code* § 58.1-407, by the use of the ratio of revenue car miles in this state to total revenue car miles of the company everywhere.

“Revenue car mile” in the case of railway carriers of property or passengers means the movement of a unit of loaded car equipment a distance of one mile. The loaded car miles must be determined in accordance with the Uniform System of Accounts for Railroad Companies of the Interstate Commerce Commission. (*Va. Code* § 58.1-420.)

**Manufacturers Modified Apportionment Method:** Use the single sales factor apportionment if the PTE elected the Manufacturer’s Modified Apportionment Method in Section A with a taxable year beginning on or after July 1, 2014. Enter the **Total, Virginia,** and **Percentage** on Section B, Line 1.

**Line 2. Multifactor Computation:** Three-Factor Formula - Multistate companies are generally required to use a three-factor formula of property, payroll and double-weighted sales. The sum of the property factor, payroll factor and twice the sales factor is divided by 4 to arrive at the final apportionment factor. For taxable years beginning on or after July 1, 2015, retail companies are required to apportion their income using a single sales factor method of apportionment. See the specific instructions that follow.

**Line 2a. Property factor:** The property factor is a fraction, the numerator of which is the average value of the company’s real and tangible personal property that is owned and used or rented and used in this state during the taxable year, and the denominator of which is the average value of all the company’s real and tangible property owned and used or rented and used during the taxable year and located everywhere; to the extent that such property is used to produce Virginia taxable income and is effectively connected with the conduct of a trade or business within the United States and income derived therefrom is includible in federal taxable income. (*Va. Code* § 58.1-409.)

Property owned by the company is valued at its original cost plus the cost of additions and improvements. Property rented by the company is valued at 8 times the property’s annual rental rate. (*Va. Code* § 58.1-410.)

The average value of property is determined by averaging the value at the beginning and ending of the tax period, but the Department may require the averaging of monthly values during the tax period if it is reasonably required to reflect properly the average value of the corporation’s property. (*Va. Code* § 58.1-411.)

**Line 2b. Payroll factor:** The payroll factor is a fraction, the numerator of which is the total amount paid or accrued in this state during the tax period by the company for compensation, and the denominator of which is the total compensation paid or accrued everywhere during the tax period; to the extent that such payroll is used to produce Virginia taxable income and is effectively connected with the conduct of a trade or business within the United States, and the income derived is includible in federal taxable income. (*Va. Code* § 58.1-412.)

“Compensation” means wages, salaries, commissions, and any other form of remuneration that is paid or accrued to employees for personal services. (*Va. Code* § 58.1-302.)

Compensation is paid or accrued in this state if:

- (a) the employee’s service is performed entirely within the state; or
- (b) the employee’s service is performed both within and without the state, but the service performed without the state is incidental to the employee’s service within the state; or
- (c) some of the service is performed in the state and:
  - (i) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state; or
  - (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee’s residence is in this state. (*Va. Code* § 58.1-413.)

**Line 2c: Sales factor.** The sales factor is a double-weighted in the three-factor formula which consists of sales, property and payroll factors. The sales factor is a fraction, the numerator of which is the total sales of the company in this state during the tax period, and the denominator of which is the total sales of the company everywhere during the tax period, to the extent that such sales are used to produce Virginia taxable income and are effectively connected with the conduct of a trade or business within the United States and income derived is includible in federal taxable income. (*Va. Code* § 58.1-414.) “Sales” means all gross receipts of the company other than dividends, except that, in the case of the sale or other disposition of intangible property, only the net gain is included. Net gain is determined on a per transaction basis. (*Va. Code* § 58.1-302.)

Sales of tangible personal property are in this state if the property is received in this state by the purchaser. In the case of delivery by common carrier or other means of transportation, the place at which such property is ultimately received after all transportation has been completed is considered the place at which such property is received by the purchaser. Direct delivery in this state, other than for purposes of transportation, to a person or firm designated by a purchaser, constitutes delivery to the purchaser in this state, and such direct delivery outside of this state to a person or firm designated by the purchaser does not constitute delivery to the purchaser in this state, regardless of where title passes, or other conditions of sale. (*Va. Code* § 58.1-415.)

Sales, other than sales of tangible personal property, are in Virginia if: (a) the income-producing activity is performed in Virginia; or (b) the income-producing activity is performed in and outside of Virginia and a greater proportion of this activity is performed in Virginia than in any other state, based on costs of performance. (*Va. Code* § 58.1-416.)

**Line 2d. Standard Apportionment Sales Factor.** Multiply Line 2c by 2 and enter the result. The sales factor is a double-weighted.

**Line 2e. Quadruple-Weighted Sales Factor Apportionment:** If you are a PTE with an enterprise data center operation from July 1, 2016 until July 1, 2017, with an approved investment

of at least \$150 million, multiply the sales factor from Line 2(c) by 4. The sales factor is quadruple-weighted.

**Line 2f. Sum of Percentages.** If the standard multi-state factor with double-weighted sales factor is used, add Lines 2(a), 2(b) and 2(d). If the PTE is using a quadruple-weighted sales factor, add Lines 2(a), 2(b) and Line 2(e).

**Line 2g. Multifactor Percentage.** Line 2(f) divided by the number 4 (doubled-weighted sales) or 6 (quadruple-weighted) reduced by the number of factors, if any, having no denominator.

Standard apportionable income is apportioned by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor, plus 2 times the sales factor, and the denominator of which is 4. However, if the sales factor does not exist, the denominator of the fraction shall be the number of existing factors. If the sales factor exists, but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors.

**Quadruple-Weighted Sales:** If the PTE is an enterprise data center operation which enters into a memorandum of understanding with VEDP to make a new capital investment of at least \$150 million with a taxable year beginning on July 1, 2016 and ending July 1, 2017, the numerator consists of the property factor, plus the payroll factor, plus 4 times the sales factor, and the denominator of which is 6. If the sales factor does not exist, the denominator of the fraction shall be the number of existing factors. If the sales factor exists, but the payroll factor or the property factor does not exist, the denominator of the fraction shall be the number of existing factors (sales-1 factor, and payroll or property, if they exist, plus 3). Note: for taxable years beginning July 1, 2017 and thereafter, qualifying entities are required to use the single sales factor method to apportion Virginia taxable income.

### **Section C - Allocable and Apportionable Income.**

**Line 1. Total of Taxable Income Amounts.** Enter Total of Taxable Income Amounts from Form 502, Line 1.

**Line 2. Dividends.** If the commercial domicile is in Virginia, enter the dividends received. Also, enter this amount on Form 502, Line 4.

**Line 3a. Dividends-Commercial Domicile Is Not Virginia.** If the PTE's commercial domicile is not in Virginia, enter the dividends received.

**Line 3b. Nonapportionable Investment Function Income.** Enter the nonapportionable investment function income from assets producing income serving an investment function unrelated to the operational functions of the business.

**Line 3c. Subtotal.** Add Lines 3a and 3b.

**Line 3d. Nonapportionable Investment Function Loss.** Enter the nonapportionable investment function loss from assets that are producing losses from an investment function unrelated to the operational functions of the business.

**Line 3e. Allocable Income.** Subtract Line 3d from Line 3c. Enter the amount on Form 502, Line 5.

**Line 4. Apportionable Income.** If domiciled in Virginia, subtract Line 2 from Line 1. If not domiciled in Virginia, subtract Line 3e from Line 1.

**Alternative method of allocation or apportionment.** If any company believes that the method of allocation or apportionment administered by the Department will subject it to taxation on a greater portion of its net income than is reasonably attributable to business or sources within this state, it is entitled to file with the Department a statement of its objections and of such alternative method of allocation or apportionment as it believes to be proper under the circumstances with such detail and proof and within such time as the Department may reasonably prescribe. If the Department concludes that the method of allocation or apportionment employed is, in fact, inapplicable or inequitable, it shall redetermine the taxable income by such other method of allocation or apportionment as seems best calculated to assign to Virginia for taxation the portion of the income reasonably attributable to business and sources within the Virginia, not exceeding, however, the amount which would be arrived at by application of the statutory rules for allocation or apportionment. (*Va. Code* § 58.1-421.)

A company requesting permission to use an alternative method of allocation or apportionment of income must comply with Virginia Corporation Income Tax Regulation 23 VAC 10-120-130. The policy of the Department is that the statutory method is the most equitable method of determining the portion of a multistate company's income that is attributable to business activity in Virginia. Permission to use an alternative method of allocation and apportionment will be granted only in extraordinary circumstances.