BUSINESS, PROFESSIONAL AND OCCUPATIONAL LICENSE (BPOL) Auditing 102

VALTA
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History of BPOL

- The BPOL Tax was established to fund the war of 1812
- In 1850 it was policy to levy a license tax on businesses and professionals. It was initially a flat fee that varied.
- In 20th century system changed to tax based on gross receipts
- In 1996 the Code of Virginia §58.1-3700 governing BPOL was amended to ensure uniform local administration.
- BPOL Guidelines issued 1997, revised in 2000, 2008 became regulations of the Virginia Administrative Code § 23 VAC 10-500

BPOL TAX

- Attorney General opinions to resolve BPOL issues were replaced by rulings issued by the Virginia Department of Taxation as Public Documents.
- The tax is imposed by local ordinance which must be similar to uniform provisions.
- Localities are authorized to impose local license tax on businesses within their jurisdiction unless they levy a merchants capital tax.
- Local tax or fee on the privilege of doing business in the locality
- Most common method of assessing BPOL tax is on the gross receipts of a business **or fee on the *privilege of doing business* within a locality**

SITUS

- Situs means the definite place of business that generated taxable gross receipts.
- Definite place of business is an office or location which occurs a regular and continuous course of dealing for thirty consecutive days or more. Examples: office, home, trailer, a desk at a clients location.
- PD 15-24 list items to look for to establish a definite place of business for situs
  - Continuous presence
  - Phone
  - Mail
  - Employees
- BOTH situs and definite place of business are needed to impose the BPOL tax on a business

Situs and Definite Place of Business

- BPOL tax based on gross receipts includes only those receipts attributable to the exercise of a licensable privilege at a definite place of business within the locality.

- Gross receipts of the business earned outside the definite place of business cannot be taxed by the locality

GROSS RECEIPTS

- Gross receipts means the whole, entire, total receipts of money or other consideration received by the taxpayer as a result of transactions with others besides himself and which are derived from the exercise of the licensed privilege to engage in business or profession in the ordinary course of business without deductions or exclusion except as provided by law.

Exemptions from BPOL

- Localities may not impose a license tax or fee on certain persons and privileges per Virginia Code §58.1-3703 C.
- There are currently 21 exemptions and the most common are:
  - Public Service Companies and motor carriers formerly certified by Interstate Commerce Commission (ICC) or registered for insurance purpose with the Surface Transportation Board of the US Dept. of Transportation. A website www.safersys.org can be used to help determine if motor carriers qualify
  - Printing and publishing any newspaper, magazine, and newsletter on a daily basis or regularly at average intervals not exceeding three months.
  - Insurance companies subject to taxation under Chapter §58.1-2500
  - Bank or Trust Company subject to taxation under Chapter §58.1-1200
  - Certain nonprofit organizations & charitable organizations. The IRS and GuideStar are good sites to check to see if they qualify
  - For selling farm or domestic products or nursery products, ornamental or otherwise, or for the planting of nursery products, as an incident to the sale thereof, outside of the regular market houses and sheds of such county, city or town, provided such products are grown or produced by the person offering them for sale;
  - Transaction between certain affiliated groups and companies

EXCLUSIONS FROM GROSS RECEIPTS

- Code of Virginia §58.1-3732 A
- Exclusions are **not** included in gross receipts
- Amounts not derived from the exercise of the licensed privilege §58.1-3732 A
- Most common exclusions:
  - Tax collection and remittance to proper authorities
  - Bank interest
  - Return of Capital or loan principal

Deductions from Gross Receipts

- Deductions are not exclusions as they are **deducted** from gross receipts that would otherwise be taxable

Code of Virginia §58.1-3732 B 1

- Amounts paid for computer hardware or software sold to the U.S. or state government provided certain holding and contractual requirements are met

Deductions from Gross Receipts

Code of Virginia §58.1-3732 B 2

- Receipts attributable to a business conducted in another state or foreign country in which the taxpayer is liable for an income or other tax based upon income, whether a tax is actually paid or not.
- Recent developments- TAX has issued numerous rulings PD 10-228, PD 10-229,
  PD 12-88, PD 12-89, PD 14-29, PD 15-170
- Local courts & Supreme Court have ruled Nielsen Company vs Arlington County.

Is it Gross Receipts for BPOL?

- Interest from Checking Account?
- Bad debt previously written off that became collectible?
- Sale of Capital Asset?
- Sales tax collected?
- Lottery Ticket Sales?-PD 97-118
- Providing services for monies to the federal government?

Situs and Classification

- Once there is situs and a definite place of business the tax rate depends on the business activity

- Major Classifications for BPOL are:
  - Contractor
  - Retail Sales
  - Wholesale Sales
  - Services
    - Financial
    - Real Estate
    - Professional
    - Repair
    - Personal
    - Business
    - Other Services

Situs and Contractors

- Virginia Code §58.1-3714 defines contractor–a person who accepts contracts to perform or performs or engages others to perform work this type of work

  Examples:

  - Doing any work on or in any building or structure, requiring the use of paint, stone, brick, mortar, wood, cement, structural iron or steel, sheet iron, galvanized iron, metallic piping, tin, lead, or other metal or any other building material;
  - contracts to do any paving, curbing or other work on sidewalks, streets, alleys, or highways, or public or private property, using asphalt, brick, stone, cement, concrete, wood or any composition;
  - contract to excavate earth, rock, or other material for foundation or any other purpose or for cutting, trimming or maintaining rights-of-way;
  - contracts for doing any work on or in any building or premises involving the erecting, installing, altering, repairing, servicing, or maintaining electric wiring, devices or appliances permanently connected to such wiring, or the erecting, repairing or maintaining of lines for the transmission or distribution of electric light and power; or
  - The business of plumbing and steam fitting.
  - Accept an order or contract to construct any sewer of stone, brick, terra cotta or other material;

Code of Virginia §58.1-3715

Special situs provision for contractors

- §58.1-3715-When a contractor derives gross receipts in excess of $25,000 in a locality and does not maintain a definite place of business the locality may still require the BPOL tax.
- If a contractor maintains a definite place of business in a Virginia locality the contractor may deduct the amount of business done in another locality where it is subject to BPOL per §58.1-3715
- There is NO statutory authority to assess license taxes on gross receipts when the contractor has a definite place of business in a locality even if those gross receipts are not taxed by that locality. English Construction vs City of Lynchburg
- There is never a double taxation of gross receipts. The maximum rate for contractors is sixteen cents per $100 of gross receipts per §58.1-3706

Is the business a contractor?

- Person who subdivides and improves real estate?
- Subdivision of land into lots without more?
- Install water or sewer systems?
- Acting as own contractor to build or improve building in which intend to occupy?
- Installing merchandise that requires openings in a wall for wiring, plumbing?
- Deliver and install merchandise where openings and wirings previously done?

Is the business a contractor?

- Selling a prefabricated building or structure?
- Companies who have a Class A or B contractors license issued by the Va Board of Contractors?
- Doing major overhaul or repair of aircraft carriers? PD 07-179
- Build and install custom kitchen cabinets?
- Sell floor coverings and install as part of sale? PD 99-012 need to look at all factors
- Install floor coverings?

Retail Sales and Situs

- Retail Sale is the sale of goods, wares, and merchandise for use or consumption by the purchaser who is the end user.
- Gross receipts are attributed to the definite place of business where the sales solicitation occurs. IF the sales solicitation does not occur at a definite place of business in a locality then the gross receipts are sitused to where the sales solicitation activities are initiated, directed or controlled.
- The maximum rate for retail sale is twenty cents per $100 of gross receipts per §58.1-3706

Wholesale sales and Situs

- Wholesale sales is the sale of good, wares and merchandise for resale by the purchaser, including sales when the goods will be incorporated into goods for sale. The purchaser is not the end user as it is in a retail sale.
- Sales to institutional, commercial, industrial and government users which because of the facts and circumstances surrounding the sale, such as the quantity, price or other terms indicate they are wholesale.
- Instead of gross receipts most wholesalers are assessed on gross purchases and generally the maximum rate is five cents per $100 of gross purchases per §58.1-3716.
- There are some localities that are grandfathered to assess a BPOL tax on gross receipts.

Situs of wholesale sales

- Situs for a wholesaler in which the BPOL is based on purchases is the definite place of business where the goods are physically delivered to customers or at the shipping point to customers.
- PD 15-159 Tax ruling on wholesale and things to consider when trying to determine if the sales is wholesale

Wholesale or retail things to consider

- Characteristics of the purchaser and the purchasers use of the merchandise.
- Does the purchaser use the merchandise in their productive process? PD 98-160 & PD 02-59
- Productive process includes assembly, manufacturing , processing or similar operations. Also includes the creation of goods and services to produce wealth and value and "process" includes the method, mode or operation whereby a result or effect is produced.

Wholesale or retail things to consider

- Are the sales made to government and industrial entities consumed by such entities for business needs as supplies or equipment?

- Price and quantity are also things to consider- even though PD 15-159 states it one of the lesser things to consider

Wholesale or Retail

- Sale is to the end user and for personal use?
- Merchandise sold to contractor who uses the item for their residential or commercial customers?
- Locality purchases 100 computers for various departments to be used in their daily activities?

Service Providers

- Services is defined as offering for sale a product which does not have physical characteristics , or which is not goods, wares or merchandise   For BPOL the types of services are the following:
- Financial, Real Estate and Professional
- Repair, Personal Business Service

Financial Service Providers

- Any person rendering a service for compensation in the form of a credit agency, an investment company, a broker or dealer in securities and commodities, or a security or commodity exchange is providing a financial service, unless such service is specifically provided for under another section of the BPOL Regulations. For purposes of this classification, the term:

- 1. "Broker" means an agent of a buyer or a seller who buys or sells stocks, bonds, commodities, or services, usually on a commission basis.
- 2. "Commodity" means staples such as wool, cotton, etc. that are traded on a commodity exchange and on which there is trading in futures.
- 3. "Dealer" means any person engaged in the business of buying and selling securities for his own account, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business.
- 4. "Security" shall have the same meaning as in the Securities Act § 13.1-501 et seq. of the Code of Virginia) or in similar laws of the United States regulating the sale of securities.

- EXAMPLES: Money Lenders, Mortgage companies or brokers. The maximum rate for financial service providers is fifty eight cents per $100 of gross receipts per §58.1-3706

Financial Service Providers Exempt

The following although providing a financial service is exempt:

- Banks and trust companies subject to the Virginia bank franchise tax are exempt from local license tax by Code of Virginia §58.1-1202, except as to sales of tangible personal property;
- Savings institutions and state chartered credit unions are limited to a local license tax of $50 by Code of Virginia§ 58.1-3730 Virginia; and
- Federal credit unions are exempt under the Federal Credit Union Act, 12 USC § 1768.

Real Estate Service Providers

- Defined as any person rendering a service for compensation as lessor, buyer, seller, agent, or broker is providing a real estate service unless the service is specifically provided for under another section of the BPOL Regulations.
- EXAMPLES: Appraisers of real estate, real estate agents & brokers, lessors of real estate. The maximum rate for real estate service providers is fifty eight cents per $100 of gross receipts per §58.1-3706

Exceptions for Real Estate Brokers

- Code of Virginia § 58.1-3732.2 Gross receipts of real estate brokers for license tax purposes under Chapter 37 of this title shall not include amounts received by any broker that arise from real estate sales transactions to the extent that such amounts are paid to a real estate agent as a commission on any real estate sales transaction and the agent is subject to the business license tax on such receipts. The broker claiming the exclusion shall identify on its license application each agent to whom the excluded receipts have been paid, and the jurisdiction in the Commonwealth of Virginia to which the agent is subject to business license taxes.

- In the event that a real estate agent receives the full commission from the broker less an adjustment for the business license tax paid by the broker on such commissions and the agent pays a desk fee to the broker, the desk fee and other overhead costs paid by the agent to a broker shall not be included in the broker's gross receipts. If the agent files separately, the agent must identify on its license application the broker to whom such excluded receipts have been paid, and the amount of such receipts that were included in the broker's license application.

- In order for the broker to exclude the amounts the broker must have paid the **tax** on the license and not the fee.

Professional Services

- Occupation in which a professed knowledge of some department of science or learning gained by prolonged course of specialized instruction and used to guide, teach or advise others. It implies a professed knowledge as distinguished from a skill.
- The guidelines give an encompassing list and also titles listed in the U.S Department of Labor's Dictionary of Occupational titles.
- http://www.oalj.dol.gov/libdot.htm
- Practitioners of the healing arts (the arts and sciences dealing with the prevention, diagnosis, treatment and cure or alleviation of human physical or mental ailments, conditions, diseases, pain or infirmities),
- The maximum rate for professional service providers is fifty eight cents per $100 of gross receipts per §58.1-3706

Examples:

- CPA
- Attorney
- Doctor
- Licensed Nurse Practitioners –PD 03-18
- Engineers PD 15-68 gives guidance as some job titles use this term but not professional for example computer engineer.

Repair, Personal Business Service

- Business that are not classified as financial, real estate or professional.
- The maximum rate for personal service providers is thirty six cents per $100 of gross receipts per §58.1-3706
  - Bookkeeper
  - Pawnbroker
  - Research & development labs
  - Repair shops that sell parts as part of the service

Questionable areas
Personal or Professional service

- Staffing firm that provides medical personnel Personal service PD 05-119 look to business for classification not employees
- Registered Nurses PD 03-18
- Computer Engineer PD 15-68
- Consulting-will depend on the nature of the service provided
- CPA that does bookkeeping and taxes PD 15-68
- Business that offers therapeutic massage PD 97-347

Situs for Service Providers

- Gross receipts from performance of services are attributed to:
  - Place where the services are performed if at a definite place of business
  - If not performed if a definite place of business than where services are directed and controlled
  - Example: outside auditor performs year end at clients for two weeks of the year- no definite place of business goes back to where directed and controlled from
  - PD 15-174 confirms that a customer location can be a definite place of business
  - PD 14-193 confirms the hierarchy of situs
    - Definite place of business fist where the services are performed if not then look at where directed and controlled

Multiple Lines of Business

- Complex business may have multiple streams of revenue
- Does the activity constitute a separate business
- Not ancillary – the activity must stand alone
- Does the business separately account for gross receipts for each activity
- Percentage of activity receipts to total gross receipts

Manufacturers

- Manufacturers are exempt from BPOL per Code of Virginia §58.1-3703 (C) (4) on a manufacturer for the privilege of manufacturing and selling goods, wares and merchandise at wholesale at the place of manufacturer.
- However, the Code of Virginia does not give definition of manufacturer. The Supreme Court has ruled there are 3 components:
    - Raw or original material
    - Process whereby the original material is changed and
    - Resulting product that is different in character from the original material

Manufacturers

- The City of Hampton has a separate application for manufacturers that is a two part process.
- Part I- Description of activities in Hampton and outside of Hampton. A detail description of the raw materials used and the process to transform the materials
- Part II- employees, capital investment, facility info
- After the two applications are received we do an inspection of the facility

Assessment Limitations

- Code of Virginia §58.1-3903 allows the Commissioner of the Revenue to assess omitted local taxes for the current year and the three preceding tax year. Tax years 2015, 2014, 2013, 2012 currently in statue to audit
- Code of Virginia §58.1-3703.1 A(4) (b) if there is fraud or failure to apply for a license the local assessor may assess for the current license year and the six preceding license years

Interest & Penalty

- The Code of Virginia §58.1-3703.1 A 2 relates to penalty on interest and penalty
- Interest can be as high as 10% on additional assessments
- Penalty can be for late filing or late payment
- In Hampton we do not currently assess penalty or interest on audit assessments but we are revisiting that currently.

Appeals

- Code of Virginia §58.1-3703.1 (A) (5)
- Provides taxpayers with an option for problem resolution, without incurring the costly time and expense that can be associated with legal proceedings.
- Certain criteria need to be meet:
- Appealable event increase in assessment, denial of refund, new assessment resulting from a review of taxpayer records
- Time deadlines to appeal assessment

Appeals

Time deadlines to appeal

- Virginia Code § 58.1-3703.1 A 5 b
- One year from last day of tax year of assessment or within one year from date of appealable event whichever is later.

DEFINITIONS OF AUDIT

- **Audit *is the process of accumulating and evaluating financial records and <u>other evidence</u> in order to determine conformity with the applicable state and local tax laws.***

- **Tax audits are compliance audits to verify local tax assessments. Analyze for reasonableness.**

AUDITS CAN BE

Desk Audits

- Done at office
- Compare internal documents-
  - business license and excise filings
  - building permits to business license

- Compare external documents-
  - compare sales tax reporting to business license
  - request tax returns from Department of Taxation to compare to business license
  - request subcontractor listings from large contractors in locality
  - review social media for certain taxes- admission charges

Field Audits

- Prepare first by reviewing desk audit information
- Done outside of office- at taxpayers facility or CPA office to review records
- Have accessibility to all documents of business
- Enables communication with the taxpayer
- Yields greater benefits and accuracy of audit

Where to begin

To expedite the audit and to be more efficient schedule appointment in advance at location and request the following:

- Date and time of audit
- Records that need to be available for inspection
- Business owners presence to answer questions

Give taxpayers time to respond to ensure date and records are available

Benefits of Field Audits

Address Classification Issues:

Tour the facility

- Essential to ensure complete understanding of business operations-may have multiple lines of business operations to consider
- Manufacturers- assist in determining where the manufacturing process begins and ends
- Determine if the business is manufacturing or processing based on the operations
- Determine the types of customers? Retail-Wholesale?

Benefits of Field Audits

Business License/Excise Tax

Field Audits enable auditor to gather additional information

- Observe customer payments- cash or credit ?
- Cash registers- how many?
- Test cash registers for accurate excise tax charged
- Review Z tapes to ensure all sales are being reported-no sales or voided sales
- Does seating capacity support reasonable of reported gross receipts?
- Advertising
- Review source documents-invoices, bank statements and detail financial records
- Rapport with taxpayers

Closing Thoughts

- BPOL continues to be a hot topic before our General Assembly with desire of many businesses to abolish the BPOL tax
- Many businesses are opposed to a tax based on gross receipts
- BPOL is a major source of local revenue