

INSTRUCTIONS FOR PREPARING FORM 502

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

RETURN FOR 2009



COMMONWEALTH OF VIRGINIA
DEPARTMENT OF TAXATION
RICHMOND, VIRGINIA

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Forms and Information

Tenemos servicios disponible en Español.

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) 440-2541
FAX: (804) 236-2759

Forms and Information can also be found on our Website - www.tax.virginia.gov.

WHAT'S NEW

Live Chat



Need Help? The Tax Website has lots of information to help you with your tax filing responsibilities. However, if you still can't find what you're looking for try our Live Chat feature. A Tax Representative is available online to assist you.

e-Subscription

Sign up to receive customized e-mails that contain information on the specific tax types and related topics you're interested in, reminders about return due dates and other useful information. Visit www.tax.virginia.gov for additional information about these features.

Other Web Services

- File Online: You can pay your estimated taxes on-line through iFile.
- Forms Online: Virginia tax forms are available for download.
- Secure E-mail: Use our iFile Secure Message Center.
- Other Inquiries: Call 804-367-8037 or write Department of Taxation, P.O. Box 1115, Richmond, VA 23218-1115.

Disregarded and Multilevel Pass-Through Entities

Disregarded and multilevel pass-through entities should review instructions on page 2 under "Exceptions to the Requirement For Withholding" regarding their responsibility for withholding on nonresident owners.

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

The 2009 General Assembly enacted legislation that moved Virginia's fixed date conformity with the Internal Revenue Code (IRC) from December 31, 2007, to December 31, 2008. At the time these instructions went to print, the only required adjustments for "fixed date conformity" were: (i) the special 30% and 50% bonus depreciation allowance for certain assets under the IRC, and (ii) the 5-year net operating loss (NOL) carryback allowed for net operating losses generated in taxable year 2001 or 2002. If federal legislation is enacted that results in changes to the IRC for the 2009 taxable year, taxpayers may be required to make adjustments to their Virginia returns that are not described in the instruction booklet. Supplemental instructions will be posted on our website at www.tax.virginia.gov. See pages 6 and 7 for additional information.

Minimum Tax on Non-corporate Telecommunications Companies and Electric Suppliers

House Bill 2378 and Senate Bill 946 continue to subject telecommunications Companies to the greater of either the Corporate Income Tax or the Minimum Tax. The same treatment of non-corporate entities continues to apply to the Virginia Minimum Tax on Certain Electric Suppliers. Additionally, the acts clarify that this and other taxes may also be imposed on non-corporate entities.

Captive Real Estate Investment Trusts ("REIT")

A captive REIT is required to pay income tax on the business it does in Virginia by adding back any federal deduction for dividends paid to its shareholders. It will then allocate and apportion income, and pay Virginia income tax, in the same manner as other corporations. It will not affect publicly traded REITs, or other widely held REITs in which a single corporate entity does not own 50% or more of the REIT's shares.

Qualifying Dispositions of Real Property

Individual and corporate taxpayers may elect to recognize income from certain dispositions of real property under the installment method for Virginia tax purposes, even though the entire gain is reported as income in the year of the disposition for federal income tax purposes. Qualifying dispositions are those in which the real property is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business. The election must be made on or before the due date of the taxpayer's tax return for the taxable year in which the disposition occurred. TAX has established guidelines that outline the restrictions or conditions associated with qualifying dispositions. These guidelines are available on our website at www.tax.virginia.gov.

Major Business Facility Job Tax Credit

The sunset date for the authorization of tax credits allowed under the Major Business Facility Job Tax Credit has been extended from January 1, 2009, to January 1, 2020. The act allows taxpayers to claim the credit amount over two years instead of three. The provision that allows the taxpayer to claim one-half of the credit amount for two years is effective only for credit years whose taxable year begins on or after January 1, 2009, but before December 31, 2010.

Neighborhood Assistance Act Tax Credit

- **Veterinarians, Extend Sunset-** The professional services eligible for tax credits under the Neighborhood Assistance Act include services provided by veterinarians. The bill also extends the sunset date for the authorization of Neighborhood Assistance Act Tax credits from July 1, 2009, to July 1, 2011.
- **Education** - Senate Bill 1325 increases the annual cap for tax credits allowed under the Neighborhood Assistance Act (NAA) from \$8 million to \$11.9 million. The funds are allocated as follows: \$4.9 million for approved education proposals; and \$7 million for other qualified NAA programs. The aggregate amount of tax credits allowed in a fiscal year to a neighborhood organization or to a group of neighborhood organization affiliates is \$500,000.

Gains from Land Preservation

Allows a subtraction for the amount of federal gain or income recognized as a result of the sale of Land Preservation credits.

Land Preservation Tax Credit

The amount of Land Preservation Credits that may be claimed on income tax returns has been reduced from \$100,000 per taxpayer to \$50,000 per taxpayer effective for credits claimed for taxable years beginning on and after January 1, 2009, but before January 1, 2011. The carryover period has been extended by two years for those affected by this limitation. This reduction in the amount of credit that can be claimed on the return does not reduce the amount of credit that may be earned or held by the taxpayer.

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

GENERAL INFORMATION

Pass-Through Entities Required to File

Effective for taxable years beginning on or after January 1, 2004, every pass-through entity doing business in Virginia or having income from Virginia sources is required to file a return of income for each taxable year with the Department of Taxation.

Pass-through entities include Subchapter S corporations, general partnerships, limited partnerships, limited liability partnerships (LLPs), limited liability companies (LLCs), electing large partnerships and business trusts. A pass-through entity is any entity that is recognized as a separate entity for federal income tax purposes and the owners of which report their distributive or pro rata shares of the entity's income, gains, losses, deductions and credits on their own income tax returns. Unlike ordinary corporations ("C" corporations), a pass-through entity 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.

The Virginia pass-through entity return of income is Form 502. Previously S corporations were required to file their Virginia income tax return on Form 500S. Beginning with taxable year 2004, S corporations will file Form 502 instead of 500S. Partnerships (including LLCs and other entities treated as partnerships for federal income tax purposes) will also file Form 502.

A single-member LLC that is disregarded as a separate entity for federal income tax purposes will be similarly treated for Virginia income tax. 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.

Estates and trusts will continue to file with Virginia using Form 770, even in years in which some or all of the estate's or trust's income is passed through to beneficiaries.

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

An owner of a pass-through entity may itself be a pass-through entity 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 actually taxable. All pass-through entities subject to filing in Virginia must file their own returns regardless of the ownership hierarchy that may exist. There are no "consolidated" or "multilevel" pass-through entity returns. See page 4 for information regarding filing a unified return for nonresident individual owners.

A pass-through entity 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 such property is used by the entity in a business, trade, profession or occupation in Virginia.

If a pass-through entity does not conduct its entire business within Virginia, then it will determine the Virginia-source portion of its total income through allocation and apportionment (see below). 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. It may therefore 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.

Investment Pass-Through Entities

Previous rulings 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 held by an investment pass-through entity is not income from Virginia sources, and these types of pass-through entities will not be required to file Form 502.

Period Covered by Return

A pass-through entity's taxable year for Virginia is the same as its taxable year for federal income tax purposes.

Withholding Tax Payments for Nonresident Owners

For taxable years beginning on or after January 1, 2008, every pass-through entity doing business in the Commonwealth and having 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 one of the exceptions described below. (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 percent 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 at least 90 percent of the withholding tax liability reported on Form 502.

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 six-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 on Form 502W no later than the original due date for filing.

Penalties and Interest: If a pass-through entity subject to the withholding tax requirement fails to make a timely payment, or fails to pay at least 90 percent of the tax due for its nonresident owners by the original due date, penalties may apply. The penalties are computed in the same manner as

the extension penalty, late payment penalty, and late filing penalty for individual income taxes.

If Form 502 is filed within the six month extension, but less than 90 percent of the tax was paid by the original due date, the extension penalty will apply. The extension penalty is imposed at the rate of two percent per month or part of month on the balance of the tax due from the due date through the date the return is filed, to a maximum of 12 percent of the tax due.

If Form 502 is filed within the six 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 percent per month from the date of filing through the date of payment, to a maximum of 30 percent of the tax due. If the entity fails to pay at least 90 percent of the tax due by the original due date AND fails to make full payment with a return filed within the six-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 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 six months after the due date or more than 30 days after the federal extended date, whichever is later, the late filing penalty will be imposed at the rate of 30 percent of the tax due. Note: The automatic extension for filing the federal partnership, estate and trust returns has been reduced to 5 months. This effectively reduces the Virginia extension based on the federal extension from 7 months to 6 months (5 months federal extension plus 30 days).

These penalties are imposed in addition to the late filing penalty of \$1,200 that may be incurred for filing Form 502 after the expiration of the automatic extension period. Any balance of unpaid tax is also subject to accrual of interest at the rate specified under §6621 of the Internal Revenue Code, plus two percent, 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, beginning on page 8 of this booklet.

Exceptions to the Requirement for Withholding: Publicly traded partnerships and disregarded entities are not subject to the withholding requirement. A PTE with a disregarded owner does not withhold for the disregarded entity. The disregarded entity does not withhold for 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 unified return (Form 765); (3) pass-through entities other than individuals and corporations that are exempt from paying federal income taxes by reason of their purpose or activities. The exemption from federal income tax must apply to the entity's share of the PTE's income. Examples of such exempt entities are:

Other pass-through entities. These pass-through entities will be responsible for paying the withholding tax on their own nonresident owners' shares of income from Virginia sources. An entity claiming this exemption must furnish a statement to the PTE stating that it is treated as a PTE under the Internal Revenue Code.

Entities 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.

If such an entity is a second PTE, it may only be exempt if it agrees to file a PTE Return of Income (Form 502), along with the accompanying schedules and documentation and either file a withholding tax return and pay the applicable tax or file a Unified Nonresident Individual Income Tax Return (Form 765) and pay the applicable tax; (4) real estate investment trusts (REITs) except Captive REITs and (5) corporations exempt from Virginia income tax.

Furthermore, the pass-through entity will not be required to pay the withholding tax if the Tax Commissioner determines that compliance will cause undue hardship. A pass-through entity seeking an undue hardship exemption may write the Tax Commissioner explaining the facts and circumstances creating the hardship. The letter shall provide information for the Tax Commissioner to evaluate the cost of the pass-through entity 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.

To indicate an exception for the pass-through entity, the entity must enter the appropriate exception code on Form 502, line d.

To indicate an exception for any or all nonresident owners, the entity must enter the appropriate exception code on the nonresident owner's Virginia Schedule VK-1, and attach a list of all nonresident owners claiming an exception to the Form 502.

Accounting Methods

A pass-through entity's accounting methods for its Virginia return of income are the same as its accounting methods for federal income tax purposes.

Allocation and Apportionment

If a pass-through entity'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 pass-through entity 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 as provided in Virginia law for corporations. This applies to all types of pass-through entities (partnerships, LLPs, LLCs, S corporations). Dividends received are to be allocated to the state of commercial domicile, but all other income must be apportioned, typically, based on the entity's property, payroll and sales. **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 of Taxation.**

The effect of the pass-through entity'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 pass-through entity 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 pass-through entity's property, payroll and sales factors in determining its own apportionment percentage.

See Schedule 502A and its instructions for more information about allocation and apportionment. Also see the instructions for lines 4 - 7 on page 6.

When and Where to File

The pass-through entity return must be filed with the Department of Taxation no later than the 15th day of the fourth month after the close of the entity's taxable year. Original and any amended returns should be mailed to **Virginia Department of Taxation, P.O. Box 1500, Richmond, VA 23218-1500.**

Extension of Time to File

For taxable years beginning on and after January 1, 2005, an automatic extension of time to file is granted to the date six months after such due date or 30 days after the extended date for filing the federal income tax return, whichever is later. Note: The automatic extension for filing the federal partnership, estate and trust returns has been reduced to 5 months. This effectively reduces the Virginia extension based on the federal extension from 7 months to 6 months (5 months federal extension plus 30 days). Also, 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 the income return (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, the extension will be invalid and the late filing penalty will apply from the original due date of the return. Accordingly, if Form 502 is filed more than six months after the original due date, or more than 30 days after the extended federal due date (federal extension - 5 months), whichever is later, a late filing penalty of \$1,200 will be assessed.

If the failure to file continues for more than six months, the Department of Taxation may assess the pass-through entity a penalty equal to six percent of the Virginia taxable income 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 six percent penalty will be reduced by any monthly penalty already assessed, or the six percent penalty may be assessed instead of the monthly penalty. The six percent penalty will also be reduced to the extent any owner has paid Virginia tax on his or her share of the entity's income for the same tax year.

Penalties assessed for late filing are imposed in addition to any penalties a pass-through entity may incur for late payment or underpayment of the withholding tax, as described on page 2.

Signature

The return must be signed by an officer of the S corporation, a general partner, or an authorized limited liability company 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 pass-through entity. 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.

Virginia Schedules and Attachments

In addition to the Form 502, the return must include a VA Schedule VK-1, Owner's Share of Income and Virginia Modifications and Credits, for each owner. Schedule 502ADJ and Schedule 502A, Allocation and Apportionment, are also usually required. In order to claim certain tax credits, specific documentation must be attached to the return; see the CREDITS section in these instructions for more information. If an entry is made on line 1, Section C, of Form 502ADJ for state income tax paid, a supporting schedule must be attached. If the entity and the qualifying nonresident owners elect, a Form 765, Virginia Unified Nonresident Income Tax Return may be filed also, but that is a separate return and not an attachment to Form 502 (more information below).

A copy of the pass-through entity's federal return of income, as filed with the Internal Revenue Service, is required to be attached to the Virginia return. The required attachment includes the federal Form 1120S, Form 1065 or Form 1065B, with Schedule K and all Schedules K-1. If the federal return is so voluminous that it is impractical to include a complete copy with the Virginia return, attach 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 Attachments

- Form 502
- Schedule 502ADJ, if applicable
- Schedule 502A, if applicable
- Schedule(s) VK-1
- Schedule 500AB, if applicable
- A Copy of Your Federal Return

Report of Change in Federal Return

If the amount of any item of distributive or pro rata income or deduction on the pass-through entity's federal return of income is changed or corrected by the Internal Revenue Service or other competent authority, or through renegotiation of a contract with the United States, the entity must notify the Department of Taxation and issue each owner an amended VA Schedule VK-1 within one year of the federal change. If a pass-through entity 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 each owner an amended VA Schedule VK-1 with full disclosure of the federal amendment.

Amended Returns

If for any reason it becomes necessary for a pass-through entity to amend a previously filed Virginia return, it should prepare a new Form 502 with all attachments (including Schedules VK-1) with the corrected figures and with "amended" marked in the place provided on the front of the return. In addition, the pass-through entity must issue each owner an amended VA Schedule VK-1. The amendment must include an explanation of the changes made. Also, complete and attach Schedule 502ADJ, Section D - Amended Return, to compute any additional tax due or refund resulting from the amended return.

If a pass-through entity files its return (Form 502) and later

finds it did not include all Schedules VK-1 with the return but no other changes to the return are necessary, the entity should not file an amended Form 502. Rather it should just submit the additional Schedules VK-1 to the Department of Taxation with a cover letter that includes the notation "Additional Schedules VK-1 / Attach to Previously Filed Return."

Unified Return for Nonresident Individual Owners (Form 765)

When a pass-through entity 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 pass-through entity may file a unified Virginia income tax return on their behalf, using Form 765, provided certain conditions described in these instructions are met. The pass-through entity is not required to pay the withholding tax on behalf of the individual nonresident owners for whom it files Form 765.

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

Form 765 may be downloaded at our website, **www.tax.virginia.gov**, or requested by calling our Forms Request Unit at **(804) 440-2541**.

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 pass-through entity filing the unified return. For taxable years beginning on or after January 1, 2008, a qualified owner may derive Virginia source income from more than one pass-through entity (and thereby be included in multiple unified 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 unified returns, the owner must also file an individual income tax return on Form 763 to account for any Virginia source income not reported in a unified return. Corporations, regardless of where domiciled, Virginia resident individuals, and individuals who are not direct owners of the entity, regardless of residency status, are not qualified nonresident owners and may not be included in a unified return.

Multiple pass-through entities under common ownership that wish to file a consolidated Form 765 must request permission from the Department of Taxation 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 unified return The pass-through entity must obtain the consent of each qualified nonresident owner, as defined above, to be included in the return. If any qualified nonresident owner refuses to consent, the entity may not file a unified return. Such consent must indicate that the nonresident owner agrees to be taxed under the following conditions:

1. The pass-through entity must provide a schedule

containing the total income of the entity and the amount attributable to Virginia under either the applicable state apportionment formula, as provided in Virginia Code §§ 58.1-408 through 58.1-421, or by using an alternative method approved by the Tax Commissioner.

2. The return will include each qualified nonresident owner's name, address, social security number and Virginia taxable income attributable to each qualified nonresident owner.

3. The amount of tax is computed on the Virginia taxable income by applying the tax rates for individual income tax specified in § 58.1-320 of the *Code of Virginia* or by reference to the tax tables published by the Department, without regard to the number of participants. The tax is computed on the entity's income attributable to the qualified nonresident owners without 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 pass-through entity who is authorized to act on behalf of the pass-through entity in tax matters (authorized representative) must sign the unified return. By signing the return, the signer is declaring that he or she is the authorized representative of the pass-through entity and that each participant has signed a consent form authorizing the pass-through entity to act on the participant's behalf in the matter of unified returns and acknowledging the participant's understanding and acceptance of all of the terms and conditions of participation in a unified return. The consent form must continue in force indefinitely until revoked in writing by the participant and permit the pass-through entity to file amendments or take other actions concerning the unified return without additional authorization from the participant. The consent forms must be maintained by the pass-through entity and provided to the Department for inspection upon demand. Participation in the unified 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 unified return must be made on a unified basis, using the name and account number or federal employer identification number (FEIN) of the pass-through entity.

Note that 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.

LINE-BY-LINE INSTRUCTIONS

Taxpayer Information

Fiscal year or short period filers: Enter the beginning and ending dates for the pass-through entity'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:

- the return is the initial return filed by the entity;
- the name or address shown represents a change that should be reflected in the Department's records;

- the entity's fiscal year has changed;

Federal Employer ID Number: Enter the pass-through entity's federal employer identification number (FEIN), name and address.

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

Date of Formation, Operations began in Virginia and State or Country Incorporated: Enter the entity's date of formation, the date operations began in Virginia and the State or Country where 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.

type	code
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 (North American Industry Classification System) code. You can download a list of these codes from the Business Registration Forms section on our website, www.tax.virginia.gov.

Check boxes below name and address information - Mark the appropriate box for any condition that applies:

- 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);
- a Virginia Unified Nonresident Individual Income Tax Return, Form 765, will be filed for the same tax 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.

Number and Types of Owners

- Enter the total number of owners. The total number of owners should be the same as the number of Schedules K-1 filed with the pass-through entity's federal return (see federal Form 1120S, page 1, line G, or Forms 1065 or 1065B, page 1, line I.)
- 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.
- Enter the total amount withheld for all nonresident owners from line "e" of each VK-1.
- If the entity claims an exemption from paying the withholding tax, enter the exemption code from the following list 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
- Disregarded Entity
- PTE Filing a Unified Return on Behalf of All Owners

Please note that, because only individuals may be included on a unified 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' Schedule VK-1s that it is not required to pay the withholding tax for them because they are included on a unified return.

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 to 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.

Withholding Exemption Reason	Code
Entity files a unified nonresident income tax return for <u>ALL</u> nonresident owners	03
Publicly traded partnerships	04
Undue hardship	06

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 the pass-through entity's federal Schedule K. 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 Section 1231 gain (loss)	_____
Other taxable income	_____
Total of taxable income amounts (This is a Virginia calculation; there is not a total on the federal Schedule K.)	_____

Caution: The federal Schedule K 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 of deductions.

Enter the total of the various categories of deductions shown in the "Deductions" section of the pass-through entity's federal Schedule K. This may include charitable contributions, the Section 179 expense deduction and "other."

Line 3 - Tax-exempt interest income.

Enter the total tax-exempt interest income shown in the "Other" section of the pass-through entity'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 not included in the above amounts. Enter the result on line 1, Total of taxable income amounts. Leave line 2 blank. Enter the amount of tax-exempt interest income from Schedule K on line 3.

Lines 4 - 7 Allocation and Apportionment

All pass-through entities must complete this section. If the pass-through entity 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 and how to do it.

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 Code of Virginia §§ 58.1-408 - 58.1-420. Virginia law does not allow for subtractions from apportionable income based on separate or divisional accounting or for 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 of Taxation.

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, Division of Taxation*, 112 S. Ct. 2251 (1992).

In *Allied Signal, Inc.*, 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 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 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 attach a statement to the return stating the nature of the adjustment and the basis for the position that 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 alternate method of allocation or apportionment: If any pass-through entity believes that the method of allocation or apportionment specified by the Department of Taxation 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 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 allocation or apportionment by such other method as seems 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 application of the statutory rules for allocation or apportionment.

The policy of the Department of Taxation 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 and apportionment will be granted only in extraordinary circumstances.

Line 4.

Enter the amount from Schedule 502A, Part A, line 2.

Line 5.

Enter the amount from Schedule 502A, Part A, line 3e.

Line 6.

Enter the amount from Schedule 502A, Part A, line 4.

Line 7.

Enter the apportionment percentage from Schedule 502A. For most filers, that will be from Schedule 502A, Part B, line 1f, but certain businesses that use a special apportionment method will refer to Schedule 502A, Part B, lines 2 - 5.

Virginia Additions

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

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 year from 2001 through 2009 inclusive, 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 year from 2001 through 2009 inclusive. If the total 2009 Virginia depreciation is less than 2009 federal depreciation, then the difference must be recognized as an addition. For further instructions, see Virginia Tax Bulletins 02-3, 03-01, 04-02, 05-01, 06-01, 07-01, 08-01 and 09-1 at www.tax.virginia.gov or call (804) 367-8037.

Line 9 Fixed Date Conformity — Other.

(1) Disposed Asset

If an asset was disposed of in 2009 and such asset received the special 30% or 50% bonus depreciation deduction for federal purposes in any year from 2001 through 2009 inclusive, 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 year from 2001 through 2009 inclusive. 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 02-3, 03-01, 04-02, 05-01, 06-01 07-01, 08-01 and 09-1 which are available on the Department's website: www.tax.virginia.gov or call (804) 367-8037.

2) Other Changes Not Listed

Please refer to the Supplemental Fixed Date Conformity Instructions on the Department's website, www.tax.virginia.gov for information on any other additions due to federal tax legislation passed after the printing deadline for these instructions. The Department's website will also reflect any action by Virginia's General Assembly to advance the date of conformity to the Internal Revenue Code that may take place before the due date for your return. Enter any amounts described in the Supplemental Fixed Date Conformity Instructions. Also, please attach 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 deducted in determining any 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 line 1, Section C, Schedule 502ADJ, 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 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 created by compact or agreement to which this state is a party.

Line 12 Total Additions from Schedule 502ADJ

First complete Schedule 502ADJ, Section A. See Schedule 502ADJ instructions on page 9. Enter the total additions from Schedule 502ADJ, Section A, line 5.

Virginia Subtractions and Deductions

Subtractions should be allocated among owners in proportion to each owner's percentage of ownership or participation in the pass-through entity 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. That is, 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 year from 2001 through 2009 inclusive, 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 year from 2001 through 2009 inclusive. If the total 2009 Virginia depreciation is more than 2009 federal depreciation, then the difference must be recognized as a subtraction. For further instructions, see Virginia

Tax Bulletins 02-3, 03-01, 04-02, 05-01, 06-01, 07-01, 08-01 and 09-1 at 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 2009 and such asset received the special 30% or 50% bonus depreciation deduction for federal purposes in any of years 2001 through 2009, 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 of years 2001 through 2009. 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 02-3, 03-01, 04-02, 05-01, 06-01, 07-01, 08-01 and 09-1 at www.tax.virginia.gov or call (804) 367-8037.

(2) Other Changes Not Listed

Please refer to the Supplemental Fixed Date Conformity Instructions on the Department's website, www.tax.virginia.gov for information on any other subtractions due to federal tax legislation passed after the printing deadline for these instructions. The Department's website will also reflect any action by Virginia's General Assembly to advance the date of conformity to the Internal Revenue Code that may take place before the due date for your return. Enter any amounts described in the Supplemental Fixed Date Conformity Instructions. Also, please attach a schedule and explanation of such subtractions.

Instructions Form 502 Page 2

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 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 Schedule 502ADJ instructions on page 9. Enter the total subtractions from Schedule 502ADJ, Section B, line 5.

Virginia Tax Credits

Line 19 Enter the total nonrefundable credits from Schedule 502ADJ, Section C, line 26.

Line 20 Enter the total refundable credits from Schedule 502ADJ, Section C, line 32.

Reconciliation of Withholding, Penalties, Interest, and Overpayment / Tax Due

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, which is generally five percent of each nonresident owner's share of income from Virginia sources

less any of the owner's share of any nonrefundable credits. See Form 502W or Form 502V for complete instructions on computing the amount of tax to be withheld.

Line 2. Total withholding tax paid

Enter the amount of withholding tax previously paid.

Line 3. Overpayment

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

Line 4. Balance of 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

Extension penalty (may apply if the balance due on Line 4 is more than 10 percent of Line 1). Virginia law provides for an automatic extension of time for filing the Form 502 for a period of six months after the original due date, or 30 days after the extended federal due date, whichever is later. Note: The automatic extension for filing the federal partnership, 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 percent of the required withholding tax by the original due date for filing Form 502 (or 100 percent of the previous year's liability, effective for taxable year 2009), 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 two percent per month or part of a month, from the original due date for filing Form 502 through the date the Form 502 is filed. The maximum extension penalty is 12 percent. 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 Form 502 filed | _____ |
| C. Number of months from due date through date filed (count in 30-day increments and round up to next full month) | _____ |
| D. Extension penalty percentage
Multiply Line C by .02.
Do not exceed 12%. | _____ % |
| E. Extension penalty.
Multiply line A by Line D. | _____ |

Line 6 Late filing penalty

Late filing penalty will apply if there is a balance due on Line 4 and Form 502 is being filed more than six months after the original due date or more than 30 days after the federal extended due date (federal extension - 5 months), whichever is later. If Form 502 is being filed after the specified dates, compute a late filing penalty of 30 percent 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 that balance. Interest is accrued at the underpayment rate established by Section 6621 of the Internal Revenue Code, plus two percent, from the due date through the date the tax is paid. For current interest rates, visit our website at www.tax.virginia.gov.

Line 8 Total penalty and interest due

Add Lines 5, 6, and 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 six months after the original due date, or more than 30 days after the federal extended due date, enter \$1,200. Note that this penalty is imposed in addition to any penalties incurred in Section 2, above.

Section 4: Disposition of 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

Subtract Lines 8 and 9 from Line 3. If Lines 8 and 9 exceed Line 3, go to Line 13, below. Otherwise, continue to Line 11.

Line 11 Amount of overpayment to be credited to 2010

Enter the amount of the net overpayment from Line 10 that you wish to apply as credit to income tax withheld for nonresident owners for taxable year 2010.

Line 12 Amount of overpayment to be refunded

Enter the amount of the net overpayment from Line 10 to be refunded to the entity. Note: The total of Lines 11 and 12 cannot exceed the amount entered on Line 10.

Section 5: Total Payment Due With Form 502

Line 13 Balance of tax due from Line 4, or total of Lines 8 and 9 less Line 3, whichever is applicable.

Line 14 Penalty and interest charges on withholding tax from Line 8. Enter the amount from Line 8, unless the penalty and interest charges were included in the net balance due on Line 13.

Line 15 Late filing penalty from Line 9. Enter the amount from Line 9, unless the penalty and interest charges were included in the net balance due on Line 13.

Line 16 Total payment due (add Lines 13, 14, and 15)

Enter the amount here and on Form 502V.

INSTRUCTIONS SCHEDULE 502ADJ

Schedule 502 ADJ - Section A - Additions

Enter the two digit addition code and amount for the type of addition from the codes indicated below: If you have more than four additions in Section A, lines 1 - 4, enter the code "00" and the total addition amount on Line 1. Attach an explanation of each addition on your return including the applicable code.

Code

- 10 Interest on federally exempt U.S. obligations.**
Enter the amount of interest or dividends exempt from federal income tax, but taxable in Virginia, less related expenses. (58.1-402 B.2.) (Sec. 58.1-322 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. (Sec. 58.1-403 1.)

14 Unrelated business taxable income

The amount of unrelated business taxable income as defined by Section 512 of the Internal Revenue Code. (Sec. 58.1-402 B.5.)

15 Royalty addback for intangible expenses

See Form 500 Instructions for additional information. Attach Schedule 500AB to Form 502. (Sec. 58.1-402 B.8a.)

16 Interest addback for intangible expenses

See Form 500 Instructions for additional information. Attach Schedule 500AB to Form 502 (Sec. 58.1-402 B.8a.)

17 Reserved for Future Use

This code is reserved in the event that the General Assembly does not conform to all of the federal tax Acts passed in 2009. Please refer to the Department of Taxation website for the latest information.

- 99 Other.** (Attach Explanation). This must include the amount of losses or deductions of an S Corporation 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 worksheet on page 22 of the individual income tax instructions.

Schedule 502ADJ - Section B - Subtractions

Enter the two digit subtraction code and amount for the type of subtraction from the codes indicated below: If you have more than four subtractions in Section B, lines 1 - 4, enter the code "00" and the total addition amount on Line 1. Attach an explanation of each addition on your return.

Code

- 10** Any amounts included under the provisions of Section 78 of the Internal Revenue Code. (Sec. 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. (Sec. 58.1-402 C.4)
- 12** Any amount included therein by the operation of Section 951 of the Internal Revenue Code (subpart F income). (Sec. 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 Section 861, 862 and 863 of the Internal Revenue Code shall

- be applied. (Sec. 58.1-402 C.8)
- 14 The amount of any dividends received from corporations in which the taxpaying corporation owns fifty percent more of the voting stock, to the extent included in federal taxable income and to the extent not otherwise subtracted from federal taxable income. (Sec. 58.1-402 C.10)
- 15 The dividends of a Domestic International Sales Corporation, fifty percent 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 this state. (Sec. 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 two years, it may be subject to the modification for deconformity. (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 over 30 years. 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. (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. (Sec. 58.1-402 C.2.) (Sec 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. (Sec. 58.1-402 C.6) (Sec 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 federal taxable income of the related member if the related member is subject to Virginia income tax on the same amount. See Form 500 Instructions for additional information. Attach Schedule 500AB to Form 502 (Sec. 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. (Sec. 58.1-402 C.18.) (Sec 58.1-322 C.27.)
- 42 The amount of gain from the sale or exchange of land or an easement when such property is devoted to open-space use. To the extent a subtraction is taken under this section, no tax credit for donating land for its preservation shall be allowed for three years following the year in which the subtraction is claimed. (Sec 58.1-402 C.16.) (Sec 58.1-322 C.22.)
- 43 The amount contributed to the Virginia Public School Construction Grants Program and Fund that has not been claimed as a deduction on the corporation's federal income tax return. (58.1-402 C. 15.) (Sec 58.1-322 D. 8.) **Note:** This deduction will be claimed as a deduction (code 107) on the shareholder's individual income tax return.
- 45 The indemnification payments received by qualified contract poultry growers and table egg producers as a result of the depopulation of poultry flocks because of avian influenza in 2002. Indemnification payments made to owners of poultry who contract with poultry growers do not qualify for this subtraction. (Sec. 58.1-402 C. 19.) (Sec 58.1-322 C.30.)
- 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 included in federal taxable income. For example, on the 2009 return the taxpayer may subtract the portion of such payments received in 2008 that is included in the taxpayer's 2008 federal taxable income; while payments received in 2009 may generate a subtraction on the 2010 Virginia return. If the taxpayer chose to accept payment in installments, the gain from the installment received in the preceding year may be subtracted. If, however, you 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 nine succeeding taxable years. **Note:** This deduction will be claimed as a deduction (code 108) on the shareholder'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 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.
- 50 **Gains from Land Preservation** - Enter the amount of federal gain or income recognized as a result of the sale of Land Preservation credits.
- If the Land Preservation credit is taken, for the next three years taxpayers cannot take a subtraction for the gain on the sale of land or easements dedicated to open-space use. A subtraction is allowed for any gain or income recognized by a taxpayer on the application of a Land Preservation tax credit against a 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.
- For taxable years 2009 and 2010 the total amount of credit that may be used per taxpayer per taxable

year may not exceed \$50,000 or the tax liability, whichever is less. For taxpayers affected by the 2009 and 2010 usage limit, an additional 2 year carryforward will be added to the credit. Any unused credit not affected by the carryforward will remain the same (5 years for donations originating prior to January 1, 2007 and 10 years for donations originating on or after January 1, 2007).

- 99** Other. (Attach Explanation). This must include the amount of income or gain of an S corporation subject to bank franchise tax. This deduction (code 112) will be claimed on the shareholder's income tax return. See worksheet in the individual income tax instructions.

Schedule 502ADJ - 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 pass-through entity (the aggregate of the owners' shares), not to each owner's share separately.

Pass-through entities do not use or compute credit carryovers. A pass-through entity passes through to each owner the owner's share of each credit earned by the pass-through entity for that year. Each owner must then determine, with respect to its own situation and its own tax for that year, the manner in which it can use its credits (including carryovers).

For most credits, specific documentation must be attached to the return of the pass-through entity and the return of the owner. See the instructions for Schedule CR, 500CR or visit our website, www.tax.virginia.gov, for more information about each credit and its required documentation. Without proper documentation, the credit will not be allowed.

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 pass-through entity. If the pass-through entity 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 pass-through entity.

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 commuter tax does not qualify.

If the pass-through entity 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 Virginia Form 765 (unified nonresident return) on behalf of specific owners. These amounts may be shown with appropriate descriptions on the VK-1 of each specific owner affected thereby, but should not be included in the amount on Line 1, Section C of Form 502 ADJ, which will be distributed to all owners based on each owner's participation percentage.

Lines 1 - 22.

These credits must be allocated among owners in proportion to each owner's percentage of ownership or participation in the pass-through entity.

- State Income Tax Paid (See above)
- Neighborhood Assistance Act
- Enterprise Zone Act
- Conservation Tillage Equipment
- Biodiesel And Green Diesel Fuels Tax Credit
- Fertilizer & Pesticide Application Equipment
- Recyclable Materials Processing Equipment
- Rent Reduction Program
- Vehicle Emissions Testing Equipment
- Major Business Facility
- Clean Fuel Vehicle Job Creation
- Day-care Facility Investment
- Low-income Housing
- Agricultural Best Management Practices
- Worker Retraining
- Waste Motor Oil Burning Equipment
- Riparian Forest Buffer Protection for Waterways
- Virginia Coal and Production Incentive

Lines 23 - 25.

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

- Historic Rehabilitation
- Land Preservation
- Qualified Equity & Subordinated Debt Investments

Lines 27-34.

These two credits provide for refunds of amounts that exceed the tax due.

- Coalfield Employment Enhancement
- Virginia Coal and Production Incentive

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.

Schedule 502ADJ - Section D - Amended Return

If you are filing an amended return, complete a new return using the corrected figures, as if it were the original return. Do not make any adjustments to the amended return to show that you received a refund or paid a balance due as the result of the original return. Then complete Form 502ADJ, Section D, Lines 1-5 to determine if you are due a refund or any additional tax is due with your amended return.

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

Schedule VK-1 is prepared by the pass-through entity 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 pass-through entity will prepare a Schedule VK-1 for each owner; a copy should be given to each owner, and a copy included with the entity's Virginia return of income (Form 502) filed with the Department of Taxation. Beginning with the 2008 return, there are two additional lines to complete under Additional Owner Information to indicate the amount withheld for each nonresident owner and the exemption code if the pass-through entity is not required to include the income of the owner in its withholding tax calculations.

Additional Owner Information

Line a: Date owner acquired interest in pass-through entity: 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 pass-through entity:

<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 tax year, as shown on the owner's federal Schedule K-1 (Form 1120S), line H. 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 K-1, under line L.

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 otherwise.

The participation percentages as shown on Schedules VK-1 for all owners of the pass-through entity should equal 100% in the aggregate.

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 - Enter the amount withheld by the pass-through entity 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 VA income tax (individuals)	01
Entities other than individuals and corporations that are exempt from federal income taxes	02
This individual owner is included in a unified return	03
Publicly traded partnerships (PTE)	04
Corporations exempt from VA income tax; or noncaptive REITs.	05
Undue hardship (PTE).	06

Lines 1 - 18 and Section C

These items on Schedule VK-1 correspond to related items with the same line numbers on the pass-through entity's return, Form 502 (Lines 1-11) and Sections A, B and C of Form 502ADJ. In general, Form 502 and Form 502ADJ show the pass-through entity'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 pass-through entity should equal, in the aggregate, the corresponding entry on Form 502 and Form 502ADJ, except for line 7.

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 pass-through entity'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 pass-through entity 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. That is, 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 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 shareholder's individual income tax return.

Instructions For Schedule 502A - Allocation And Apportionment Of Income For Pass-Through Entities

A pass-through entity 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 (Code of Virginia §§ 58.1-405 through 58.1-421), with such accommodation as may be necessary considering the differences between regular taxpaying corporations and pass-through entities (PTE).

When Income Is All From Virginia Source

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 taxpaying 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; 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 USCA § 381-384). If federal law would prohibit the state from imposing the tax because the entity's activities in the state did not exceed a certain type or extent, 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, 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 pass-through entity'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 Pass-Through Entity

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 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 Code of Virginia §§ 58.1-408 - 58.1-420. Virginia law does not allow for subtractions from apportionable income based on separate or divisional accounting or for exclusion of non-Virginia investment income.

LINE INSTRUCTIONS

Part A Lines 1- 4 - Allocable and Apportionable Income

For a discussion of what may and may not be included in this section, see **Allocation and Apportionment** on page 6 of Form 502 instructions.

Line 1 – Enter the taxable income amount from Form 502, line 1.

Line 2 – If commercial domicile is in Virginia, enter the dividend amount received.

Line 3 – If business's commercial domicile is not in Virginia, enter dividends received on line 3a, the amount of nonapportionable investment function income on line 3b, and nonapportionable investment function loss on line 3d.

Line 4 – Enter apportionable income. If domiciled in Virginia, subtract Line 2 from Line 1. If not domiciled in Virginia, subtract Line 3e from Line 1.

Part B Lines 1- 5 - Apportionment Factors

All income except the allocable income as entered in Part A is apportioned according to one of the methods described below. Motor carriers, railways, financial companies and some construction companies use the special methods in Part C on lines 2 - 5. Most entities will use the general three-factor method on line 1, based on property, payroll and sales.

Line 1 – Three-Factor Method: Most pass-through entities are generally required to use the 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 four (or four less the number of factors with no denominator) to arrive at the final apportionment percentage. See specific instructions below.

Line 1a – 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 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 is includible in federal taxable income.

Property owned by the company is valued at its original cost plus the cost of additions and improvements. Property rented by the corporation is valued at eight times the annual rental rate. The average value of property is determined by averaging the value at the beginning and ending of the tax period, but the Department of Taxation may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the corporation's property.

Line 1b – Payroll factor: The payroll factor is a fraction, the numerator of which is the total amount paid or accrued in this state during the taxable period by the company for compensation, and the denominator of which is the total compensation paid or accrued everywhere during the taxable 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 income derived is includible in federal taxable income.

"Compensation" means wages, salaries, commissions and any other form of remuneration paid or accrued to employees for personal services. 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.

Any distribution to a partner that is self-employment income pursuant to IRC § 1401 et seq. shall be treated as salary for purposes of the payroll factor.

Line 1c & 1d – Sales factor: The sales factor is a double-weighted element in the three factor formula of sales, property and payroll. The sales factor is a fraction, the numerator of which is the total sales of the company in this state during the taxable period, and the denominator of which is the total sales of the company everywhere during the taxable 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. "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.

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 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.

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.

Line 1e – Add the percentages in Lines 1a through 1d.

Line 1f – Divide Line 1e by 4 or 4 reduced by the number of factors, if any, with no denominator.

PART C. Other Apportionment Factors

Line 2 - Motor carriers: Motor carriers of property or passengers, using highways of this state, must, unless they meet one of the two exceptions referred to 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, hauling property or carrying passengers for a charge or fare. For a carrier meeting either of the exceptions, check the appropriate box on line 2 and enter "0%" in column C.

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 twelve 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.

Line 3 – Railway Companies: Railway companies shall determine their net apportionable income to this state by multiplying Virginia taxable income of such company, excluding the income allocable under Sec. 58.1-407, by the use of the ratio of revenue car miles in

this state to total revenue car miles everywhere. For the purposes of this section the words "revenue car mile" in the case of railway carriers of property or passengers shall mean the movement of a unit of loaded car equipment a distance of one mile. The loaded car miles shall be determined in accordance with the Uniform System of Accounts for Railroad Companies of the Interstate Commerce Commission.

Line 4 – Financial companies: A financial company is one that is a) not exempt from the imposition of tax under the provisions of Sec. 58.1-401 (i.e., banks) and b) derives more than seventy percent 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 Section 1504(a) of the Internal Revenue Code but without reference to whether any such corporation is an includible corporation under Section 1505(b) of the Internal Revenue Code) from another member of such group will be included only to the extent the amount exceeds related expenses of the recipient.

The Virginia taxable income of a financial company, as defined in Sec. 58.1-402, excluding income allocable under Sec. 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 company. Business within this state shall be based on cost of performance in Virginia over cost of performance everywhere.

"Cost of Performance Factor":

- (a) The cost of performance is the cost of all activities directly performed by the company for the ultimate purpose of obtaining gains or profit, except activities performed by the company for the ultimate purpose of obtaining dividends allocable under the provisions of Sec. 58.1-407.
 - (i) Such activities do not include those performed on behalf of a company, such as 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 the company.
- (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.

Line 5 – Construction Companies: Construction companies that have elected for federal income tax purposes to report income on the completed contract basis shall 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 Sec. 58.1-302, to the extent included in taxable income and is determined as provided by Sec. 58.1-414 through 58.1-419.