

Virginia:

In the Circuit Court of the City of Richmond, John Marshall Courts Building

KOHL'S DEPARTMENT)
STORES, INC.,)
)
Plaintiff,)
)
v.)
)
VIRGINIA DEPARTMENT OF)
TAXATION,)
)
Defendant.)
_____)

Case No.: CL12-1774

OPINION and ORDER

On the 31st day of January, 2016, came the parties, by counsel, on both Plaintiff's and Defendant's Cross Motions for Summary Judgment. Upon consideration of the arguments of counsel, as set forth in the briefs and through oral argument, the Court's findings of fact and holdings are as follows:

I. **Background**

The parties filed a stipulation of facts, which are attached and incorporated by reference herein.

The issue for the Court to decide is whether royalties Kohl's paid to Kohl's Illinois falls within the safe harbor provision of Virginia's add back statute. Va. Code § 58.1-402(B)(8)(a). Kohl's argues that it is not required to include in its Virginia taxable income any of the royalties that it paid to Kohl's Illinois because it qualifies for the subject to tax safe harbor. § 58.1-402(B)(8)(a)(1). However, the Department of Taxation (hereinafter "Department") argues that

the plain language of Section 58.1-402(B)(8)(a) requires Kohl's to add back portions of its intangible expenses that were not actually taxed in other jurisdictions.

II. Standard

Summary judgment is appropriate in those cases “in which the only dispute concerns a pure question of law.” *Carwile v. Richmond Newspapers, Inc.*, 196 Va. 1, 5 (1954). Issues of statutory interpretation are pure questions of law. *Northern Virginia Real Estate v. Martins*, 283 Va. 86, 102–03 (2012).

Where a taxpayer seeks an exemption from a tax, the taxpayer has the burden of proving it is entitled to that exemption. *LZM, Inc. v. Va. Dep't of Taxation*, 269 Va. 105, 109 (2005). Further, “the provisions setting forth [an] exemption must be strictly construed against the taxpayer, and any doubt as to whether the exemption applies must be resolved in favor of the Commonwealth.” *Com. v. Manzer*, 207 Va. 996, 1000 (1967). On the other hand, “[t]axing statutes must be construed in the taxpayer’s favor.” *Shelor Motor Co. v. Miller*, 261 Va. 473, 478 (2001). Because the issue before the Court pertains to an exemption to the add back statute, the Court must construe the taxpayer’s claim in the light most favorable to the Commonwealth.

III. Analysis

The parties agree that the sole issue for the Court to decide is the extent in which Kohl's is entitled to the safe harbor exception to the add back statute. Section 58.1-402(B)(8)(a) provides in relevant part:

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

...

8. a. For taxable years beginning on and after January 1, 2004, the amount of any intangible expenses and costs directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with one or more related members to the extent such expenses and costs were deductible or deducted in computing federal taxable income for

Virginia purposes. This addition shall not be required for any portion of the intangible expenses and costs if one of the following applies:

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

Va. Code § 58.1-402(B)(8)(a) (emphasis added).

Kohl's argues that that under the plain meaning of Section 58.1-402(B)(8)(a), if income is included in the computation of a corporation's taxable income in another state, then that income is subject to tax. Based on this interpretation, Kohl's argues that because Kohl's Illinois included the royalty payments it received from Kohl's in its income filings in other states, it is "subject to a tax . . . in another state" and falls within the safe harbor exception. *See* § 58.1-402(B)(8)(a)(1). Kohl's therefore insists that no portion of the royalties it paid to Kohl's Illinois should be added to Kohl's taxable income, even if the amounts listed by Kohl's Illinois in other states was not actually taxed in those states. The Court, however, does not agree with Kohl's interpretation of the statute.

The plain language of the statute states that the exemption applies when intangible expenses paid to related members are "subject to a tax based on or measured by net income or capital *imposed by . . . another state.*" Va. Code § 58.1-402(B)(8)(a)(1) (emphasis added). Therefore, to fall within the safe harbor exception, the intangible expenses paid to a related member must not only be subject to a tax in another state, but that tax must actually be imposed. Kohl's incorrectly reads the statute to exempt royalties that are subject to a tax by another state. However, the statute expressly exempts royalties paid to related members that are "subject to a tax . . . *imposed by . . . another state.*" Va. Code § 58.1-402(B)(8)(a)(1) (emphasis added).

This reading of the statute is also consistent with the General Assembly's intent in enacting the add back statute and its exceptions. *See also, e.g., Surtees v. VFJ Ventures, Inc.*, 8

So. 3d 950 (Ala. Civ. App. 2008), *aff'd sub nom., ex parte VFJ Ventures, Inc.*, 8 So. 3d 983 (Ala. 2008). The purpose of Section 58.1-402(B)(8)(a) is to close a corporate tax loophole and ensure that income attributable to Virginia is taxed. Therefore, the Court's ruling "advances the purposes of the legislature in enacting the add-back statute." *Id.* at 976.

In sum, the plain language of the statute requires Kohl's to add back portions of its intangible expenses that were not actually taxed in another state.

IV. Conclusion

For the foregoing reasons, the Court hereby **GRANTS** the Defendant's Motion for Summary Judgment and **DENIES** the Plaintiff's Motion for Summary Judgment. Objections of parties are noted as to adverse rulings.

Pursuant to Rule 1:13 of the Supreme Court of Virginia, the Court dispenses with the parties' endorsement of this Order.

The Clerk is directed to forward a certified copy of this Order to counsel for the Plaintiff and counsel for the Defendant.

It is so **ORDERED**.

ENTER: 2 / 3 / 16



Walter W. Stout, III, Judge