

Matthew,

I wanted to reiterate two comments that I made at the meeting, as well as provide one additional comments. Please see below.

1. The adoption of market-based sourcing, as the Department indicated at the meeting, will result in the elimination of Department's policy of extending PL 86-272 to services. Thus, the general nexus rules in Virginia will apply. Such rules essentially provide that nexus is established when a taxpayer has a positive apportionment factor. Therefore, but for the application of a *di minimis* rule, an out-of-state service provider that has a sale to a Virginia customer will have nexus. I recommend that the Department discuss this in the report, and propose a new nexus standard that will give taxpayers clarity and predictability with respect to when nexus is established with Virginia.
2. Guidance issued by the Department indicates that pass-through entities (PTE) are required to use the apportionment rules provided for under the corporate income tax rules. I recommend that the Department consider whether PTEs will be required to use the corporate income tax apportionment rules in the event Virginia adopts market-based sourcing. If so, the report should take into account that market-based sourcing will impact revenue from both a corporate income and individual income tax perspective. NOTE – some states that have changed to market-based sourcing have done so only with respect to corporate taxpayers (e.g., Pennsylvania and New York).
3. The Department should consider whether the market-based sourcing rules will include a “throw-out” provision with respect to sales sourced to states in which the taxpayer is not subject to tax. This type of provision, in my opinion, somewhat defeats one of the purposes of the changing to market-based sourcing in that it minimizes the benefit of the change to in-state service providers with customers in multiple jurisdictions. The fact that Virginia does not appear to be considering changing to a single-sales factor formula would likely reduce the need for a throwback rule, as the continued use of the payroll and property factors in the overall apportionment formula will cause in-state service providers to still have a material apportionment percentage in Virginia. NOTE – Maryland's market-based sourcing rules do not have a throw-back rule, while D.C.'s new rules do include a throw-back rule.

Best regards,

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