INSTRUCTIONS FOR SCHEDULE 502ADJ

Sections A and B - Virginia Modifications

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

Section A – Addition Codes

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

Code

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

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

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

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

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

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

20 **Telework Expenses**
Pass-through entities that claim the Virginia Telework Expenses Tax Credit are not allowed to exclude those expenses from Virginia income. To the extent excluded from federal taxable income, any expenses incurred by a taxpayer used to claim the Telework Expenses Tax Credit must be added to the Virginia return.

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

Section B – Subtraction Codes

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

Code

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

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

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

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

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

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

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

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

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

14 The amount of any dividends received from corporations in which the taxpaying corporation owns 50% more of the voting stock, to the extent included in federal taxable income and to the extent not otherwise subtracted from federal taxable income. (*Va. Code* § 58.1-402 C.10.)

15 The dividends of a Domestic International Sales Corporation, 50% or more of the income of which was assessable for the preceding year, or the last year, in which such corporation has income under the provision of the income tax laws of Virginia. (*Va. Code* § 58.1-402 C.3.)

16 The amount that could have been deducted by a gas supplier, pipeline distribution company or gas utility company, as a net operating loss carryover or net capital loss in arriving at taxable income except that such loss or portion thereof had been carried back for federal purposes to a taxable year before it became subject to Virginia income tax. To the extent that the recomputed loss is carried back more than 2 years, it may be subject to the modification for deconformity. (*Va. Code* § 58.1-403 (9).)

17 A gas supplier, pipeline distribution company, gas utility company, or electric supplier (except an electric cooperative) that was subject to the state license tax on gross receipts in 2000, and became subject to Virginia income tax in 2001, may amortize its Virginia tax basis using the straight-line method over a period of 30 years, beginning on the adjustment date. The Virginia tax basis is the aggregate adjusted book basis less aggregate adjusted tax basis of assets placed in service prior to the first day of the taxable year that the company became subject to Virginia income tax. (*Va. Code* § 58.1-440.1.)

20 The amount of income derived from Virginia obligations or the sale or exchange of Virginia obligations that are included in federal adjusted gross income. (*Va. Code* §§ 58.1-402 C.2.; 58.1-322 C.2.)

21 The amount of wages and salaries eligible for the Federal Work Opportunity Tax Credit that are not deducted for federal tax purposes. (*Va. Code* §§ 58.1-402 C.6; 58.1-322 C.6.)

22 The amount of intangible expenses and costs or interest expenses and costs added to the federal taxable income of a corporation shall be subtracted from the federal taxable income of the related member if the related member is subject to Virginia income tax on the same amount. See the Form 500 instructions for additional information. Attach Schedule 500AB to Form 502 (*Va. Code* § 58.1-402 C.21.)

41 The amount of income received as a result of payments made under the Tobacco Master Settlement Agreement, the National Tobacco Grower Settlement Trust and the Tobacco Loss Assistance Program. (*Va. Code* §§ 58.1-402 C.18.; 58.1-322 C.27.)

43 The amount contributed to the Virginia Public School Construction Grants Program and Fund that has not been claimed as a deduction on the taxpayer's federal income tax return. (*Va. Code* §§ 58.1-402 C.15; 58.1-322 D.8.) **Note:** This deduction will be claimed as a deduction (Code 107) on the owner's individual income tax return.

48 The amount of payments received in the <u>preceding</u> year in accordance with the Tobacco Quota Buyout Program of the American Jobs Creation Act of 2004 to the extent they are included in federal taxable income. For example, on the 2015 return the taxpayer may subtract the portion of such payments received in 2014 that is included in the taxpayer's 2014 federal taxable income; while payments received in 2015 may generate a subtraction on the 2016 Virginia return. If the taxpayer chooses to accept payment in installments, the gain from the installment received in the preceding year may be subtracted. If, however, the taxpayer opted to receive a single payment, 10% of the gain recognized for federal purposes in the year that the payment was received may be subtracted in the following year and in each of the 9 succeeding taxable years. (*Va. Code* §§ 58.1-402 D; 58.1-322 D.11.) **Note:** This deduction will be claimed as a deduction (Code 108) on the owner's individual income tax return.

49 **Income from Dealer Disposition of Property -** An adjustment is allowed for certain income from dealer dispositions of property made on or after January 1, 2009. In the year of disposition the adjustment will be a subtraction for gain attributable to installment payments that are to be made in future taxable years provided that (i) the gain arises from an installment sale for which federal law does not permit the dealer to elect installment reporting of income, and (ii) the dealer elects installment treatment of the income for Virginia purposes on or before the due date prescribed by law for filing the taxpayer's income tax return. In subsequent taxable years, the adjustment will be an addition for gain attributable to any payments made during the taxable year with respect to the disposition. Each disposition must be tracked separately for purposes of this adjustment. (*Va. Code* §§ 58.1-402 F; 58.1-322 H.)

50 **Gains from Land Preservation -** Enter the amount of federal gain or income recognized as a result of the sale of Land Preservation Tax Credits. A subtraction is allowed for any gain or income recognized by a taxpayer on the application of Land Preservation Tax Credits against Virginia income tax liability to the extent the gain is included in and not otherwise subtracted from federal adjusted gross income. The transfer of the credit and its application against a tax liability shall not create gain or loss for the transferor or the transferee.

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

52 **Gain from Historic Rehabilitation** - To the extent that it is included in federal taxable income, any amount of gain or income recognized by a taxpayer in connection with the Historic Rehabilitation Tax Credit is allowed as a subtraction on the Virginia return.

99 **Other** (Attach Explanation). This must include the amount of income or gain of an S corporation that is subject to Bank Franchise Tax. This deduction (Code 112) will be claimed on the shareholder's income tax return. See the worksheet in the individual income tax instructions.

Section C - Virginia Tax Credits

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

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

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

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

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

State Income Tax Paid: Many states follow the federal tax treatment of pass-through entities and apply income tax to the entity's income only at the owner level. Some states, however, may not recognize the federal S corporation election or may otherwise impose an income tax directly on a PTE. If the PTE properly paid a direct state income tax, owners who are individuals may qualify to claim the "credit for tax paid to another state" on their Virginia individual income tax returns, based on their proportional shares of the tax paid by the PTE.

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

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

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

Credit Allocation

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

- State Income Tax Paid (See above)
- Neighborhood Assistance Act Credit
- Enterprise Zone Act General Tax Credit
- Conservation Tillage Equipment Credit
- Biodiesel and Green Diesel Fuels Tax Credit
- Precision Fertilizer and Pesticide Application Equipment Credit
- Recyclable Materials Processing Equipment Credit
- Rent Reduction Program Credit
- Clean-Fuel Vehicle Job Creation Tax Credit
- Major Business Facility Job Tax Credit
- Day-Care Facility Investment Tax Credit
- Agricultural Best Management Practices Tax Credit
- Worker Retraining Tax Credit
- Waste Motor Oil Burning Equipment Credit
- Riparian Forest Buffer Protection for Waterways Tax Credit
- Communities of Opportunity Tax Credit
- Green Jobs Creation Tax Credit
- Farm Wineries and Vineyards Tax Credit
- International Trade Facility Tax Credit
- Port Volume Increase Tax Credit
- Barge and Rail Usage Tax Credit
- Livable Home Tax Credit
- Telework Expenses Tax Credit
- Education Improvement Scholarships Tax Credit

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

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

Line 36. Total nonrefundable credits. Add Lines 1-19 and Lines 22-35.

Lines 37-43. These credits provide for refunds of amounts that exceed the tax due.

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

Line 44. Total refundable credits. Add Lines 40, 42 and 43. All pass-through entities distributing credits to owner(s), shareholders, partners or members must give each a Schedule VK-1, Owner's Share of Income and Virginia Modifications and Credits. Also, a Schedule VK-1 Consolidated must be included with the return. If the Schedule VK-1 Consolidated is completed, do not enclose each owners Schedule VK-1.

Section D - Amended Return

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

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

General Instructions

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

Schedule VK-1 Consolidated

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

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

A Schedule VK-1 Consolidated template is available for download from the Corporation and Pass-Through Entity Forms section of the Department's website. Users may create their own forms using the form layout; however, they must adhere to the form layout requirements and specifications in the Schedule VK-1 Consolidated Summary to ensure accurate processing of the Schedule VK-1 Consolidated. The Schedule VK-1 Consolidated Summary is available on the Department's website at **www.tax.virginia.gov.** The Summary's Appendix contains detailed steps for using Excel, including screen shots.

Additional Owner Information

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

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

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

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

Participant Type	Code
General Partner	GPT
Limited Partner	LPT

LLC/LLP Member	LLM
S Corporation Shareholder	SHR
Other	OTR

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

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

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

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

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

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

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

Line Instructions

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

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

The Virginia Public School Construction Grants Program and Fund (Code 43) and the Tobacco Quota Buyout Program (Code 48) deductions must be claimed as deductions on the shareholder's individual income tax return. The deduction for an S-corporation subject to Bank Franchise Tax is reported as an "other" addition or subtraction on Schedule VK-1 and as a positive or negative deduction on the owner's individual income tax return. For the Schedule VK-1 Consolidated, report Lines 1-11 and totals from Lines 13, 18 and 44.

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

General Information

Retail Company Apportionment Factor Change

Effective for taxable years beginning on and after July 1, 2012, retail companies must use a modified apportionment formula based on sales, phased in over 3 taxable years, to determine their Virginia taxable income. The modified apportionment formula will be phased in as follows:

- A triple-weighted sales factor for taxable years beginning on or after July 1, 2012, but before July 1, 2014;
- A quadruple-weighted sales factor for taxable years beginning on or after July 1, 2014, but before July 1, 2015; and
- A single sales factor for taxable years beginning on and after July 1, 2015.

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

When Income Is All from Virginia Sources

If a PTE conducts its entire business within Virginia, then all of its income is Virginia source income. A PTE is presumed to be doing business entirely within Virginia unless it is subject to (or would be subject to if it were a regular taxpaying corporation) one of the following taxes in another state: 1) a tax