

**SANITIZED DECS. – 02-455 FN, 02-454 FN, 02-453 N & 02-452 N – BY –
GEORGE V. PIPER – SUBMITTED FOR DECISION – 07/21/03 -- ISSUED –
11/10/03**

SYNOPSIS

**CORPORATE NET INCOME TAX AND BUSINESS FRANCHISE TAX –
COST OF PERFORMANCE METHOD TO COMPUTE APPORTIONMENT SALES
FACTOR – BURDEN OF PROOF NOT MET BY HOME HEALTH NURSING
BUSINESS BUT MET BY INSURANCE CLAIMS AND SALES BUSINESSES** – For purposes of sales factor apportionment, insurance claims and sales businesses proved that out-of-state costs of performance exceeded in-state costs, but home-health care business failed to carry that burden of proof. W. Va. Code §§ 11-24-7(e)(12)(B) and 11-23-5(m)(2).

FINAL DECISION

The Auditing Division of the Commissioner's Office issued a corporate net income tax assessment against one of the Petitioners, Petitioner 1. This assessment was for the period of January 1, 1998 through December 31, 1999, for tax and interest, through April 30, 2002.

Also, the Commissioner issued a corporate net income tax assessment against one of the Petitioners, Petitioner 2, under the provisions of Chapter 11, Articles 10 and 24 of the West Virginia Code, for the period of January 1, 1998 through February 28, 1999, for tax and interest, through April 30, 2002.

Also, the Commissioner issued a business franchise tax assessment against one of the Petitioners, Petitioner 3, under the provisions of Chapter 11, Articles 10 and 23 of the West Virginia Code, for the period of January 1, 1998 through December 31, 1999, for tax and interest, through April 30, 2002.

Finally, the Commissioner issued a business franchise tax assessment against one of the Petitioners, Petitioner 1 under the provisions of Chapter 11,

Articles 10 and 23 of the West Virginia Code, for the period of January 1, 1998 through December 31, 1999, for tax and interest, through April 30, 2002.

Thereafter, by mail, the Petitioners timely filed with this tribunal, the West Virginia Office of Tax Appeals, their respective petitions for reassessment. See W. Va. Code § 11-10A-8(1) [2002].

Subsequently, and with the agreement of all of these related Petitioners, written notice of a consolidated hearing on the petitions was sent to the Petitioners and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10.

FINDINGS OF FACT

1. Petitioners 1, 2 and 3 are three related companies that were audited by the Auditing Division of the West Virginia State Tax Department. Petitioner 3 is the parent company for Petitioners 1, 2 and several other companies.
2. Petitioner 1 enters into contracts with insurance companies and provides home health care services under those contracts. Petitioner 2 sells insurance policies on behalf of Petitioners 1 and 3, and several other companies. Petitioner 3 provides administrative and claims processing services in accordance with the terms of its contracts with the HMOs and Petitioner 1, an insurance Company.
3. More specifically, Petitioner 1 contracts with insurance companies to provide home health care services to these companies' members. These members are located throughout the United States, and are not considered to be direct customers of Petitioner 1. The services in question are provided by home health nurses to members in the State of West Virginia in their homes, although the assignment, the direction, review, and oversight of the visits and the administrative functions related to the visits are all performed outside of West Virginia. As for Petitioner 2, which sells health insurance, while the sales force are active in West Virginia, the main office is in another state and all direction and control of the sales force is done from the main office. In addition, all of the insurance contracts are written, priced, signed and processed outside of West Virginia. Petitioner 3 administers and processes claims for various health insurers. It has 20 employees in West Virginia that provide services to a network of physicians and

health care practitioners and utilization management services, and it has approximately 1,500 personnel in another state that perform claims processing services.

4. With respect to Petitioner 1, the tax auditor used apportioned sales figures provided by the Petitioner which resulted from its two (2) West Virginia branches.
5. Petitioner 3's computations were based upon the average of the payroll and the property multiplied by total sales to get an estimated sales figure.
6. For Petitioner 2, the tax auditor used a capitation rate times the number of West Virginia members of the insured represented.

DISCUSSION

The sole issue for determination is whether Petitioner has made a showing that the tax auditor erred by failing to apply the "cost of performance" method in computing the sales factor as to all four (4) assessments.

West Virginia Code §§ 11-24-7 and 11-23-5 provide that a company that does not transact all its business in West Virginia must apportion its tax liability based upon the ratio of the business conducted in West Virginia to its total business. This is done through the use of four factors: property, payroll and a double-weighted sales factor. In the cases at issue, the property and payroll factors are not disputed. The dispute centers on the numerator of the sales factor and the use of the "cost of performance" method in computing that number.

The cost of performance method of apportionment is authorized by West Virginia Code § 11-24-7(e)(12) and West Virginia Code § 11-23-5(m). The law provides that when the sales of a company are services and the income-producing activity is performed both within and without the state, the sales factor is computed using the "cost of performance" method. More specifically, the law states as follows:

Allocation of other sales. -- Sales, other than sales of tangible personal property, are in this state if:

The income-producing activity is performed in this state;

or

The income- producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state based on cost of performance;

or

The sale constitutes business income to the taxpayer or the taxpayer is a financial organization not having its commercial domicile in this state, and in either case the sale is a receipt described as attributable to this state[.]

As concluded by Petitioner's counsel, if the 'income-producing activity' is performed within and without the state, and the cost of performance is greater in West Virginia than in other states, then the sales are attributed to West Virginia. If the cost of performance is greater in other states than in West Virginia, then the sales are not attributed to West Virginia.

The term "income producing activity" is defined in West Virginia Code § 11-23-5(n) as follows:

(n) Income-producing activity. – The term 'income-producing activity' applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gain or profit. Such activity does not include transactions and activities performed on behalf of the taxpayer, such as those conducted on its behalf by an independent contractor. 'Income-producing activity' includes, but is not limited to the following:

(1) The rendering of personal services by employees with utilization of tangible and intangible property by the taxpayer in performing a service.

(2) The sale, rental leasing, licensing or other use of real property.

(3) The sale, rental, leasing, licensing or other use of tangible personal property; or

(4) The sale, licensing or other use of intangible personal property. The mere holding of intangible personal property is not, in itself, an income-producing activity; Provided, That the conduct of the business of a financial organization shall constitute an income-producing activity.

See also W. Va. Code § 11-24-7(f).

Upon review this tribunal believes that Petitioner has made a compelling case with respect to Petitioner 3 (administrative and claims processing services) and Petitioner 2 (sale of insurance policies), but not with respect to Petitioner 1, Petitioner 1's income-producing activity is that of providing home-health nursing services to its West Virginia members, and that taxpayer has failed to prove that the costs of performance out-of-state exceed those in this State. Many of the out-of-state costs were indirect and, therefore, not includable, under W. Va. Code §§ 11-24-7(g) and 11-23-5(o).

The same may not be said for claims administration or for the sale of insurance, which, although having a connection with this State because policyholders and claimants live here, are clearly initiated, directed, mostly performed, and concluded outside of West Virginia.

CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the petitioner-taxpayer to show that the assessment is incorrect and contrary to law, in whole or in part. See W. Va. Code § 11-10A-10(e) and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

2. Two of the Petitioners-taxpayers in this matter have carried the burden of proof with respect to their insurance claims and sales businesses, having greater out-of-state costs of performance.

3. On the other hand, one of the Petitioners has failed to carry the burden of proof with respect to the issue of its home-health care service business' having greater out-of-state cost of performance to its insured in the State of West Virginia.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the corporate net income tax assessment issued against Petitioner 1, for the period of January 1, 1998 through December 31, 1999, for tax and interest, should be and is hereby **AFFIRMED**.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the business franchise tax assessment issued against Petitioner 1, for the period of January 1, 1998 through December 31, 1999, for tax and interest, should be and is hereby **AFFIRMED**.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the corporate net income tax assessment issued against Petitioner 2, for the period of January 1, 1998 through February 28, 1999, should be and is hereby **VACATED**, and this Petitioner owes no further corporate net income tax liability for the period in question.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the business franchise tax assessment issued against Petitioner 3, for the period of January 1, 1998 through December 31, 1999, should be and is hereby **VACATED**, and this Petitioner owes no further business franchise tax liability for the period in question.