

**WEST VIRGINIA
SECRETARY OF STATE
NATALIE TENNANT
ADMINISTRATIVE LAW DIVISION**

Form #4

Do Not Mark In this Box

2010 NOV 5 PM 3:15

OFFICE WEST VIRGINIA
SECRETARY OF STATE

NOTICE OF RULE MODIFICATION OF A PROPOSED RULE

AGENCY: State Tax Department TITLE NUMBER: 110

CITE AUTHORITY W. Va. Code §§11-13AA-10; 11-10-5 and 11-10-5d

AMENDMENT TO AN EXISTING RULE: YES _____ NO X

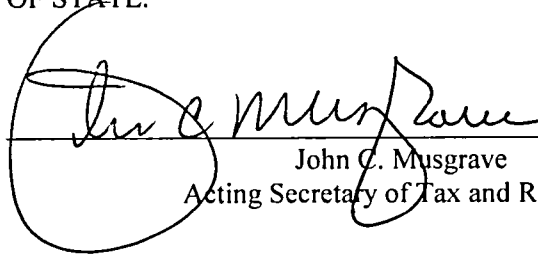
IF YES, SERIES NUMBER OF RULE BEING AMENDED: _____

TITLE OF RULE BEING AMENDED: _____

IF NO, SERIES NUMBER OF RULE BEING PROPOSED: 13Q

TITLE OF RULE BEING PROPOSED: Commercial Patent Incentives Tax Credit

THE ABOVE PROPOSED LEGISLATIVE RULE, FOLLOWING REVIEW BY THE LEGISLATIVE RULE MAKING REVIEW COMMITTEE IS HEREBY MODIFIED AS A RESULT OF REVIEW AND COMMENT BY THE LEGISLATIVE RULE-MAKING REVIEW COMMITTEE. THE ATTACHED MODIFICATIONS ARE FILED WITH THE SECRETARY OF STATE.



John C. Musgrave
Acting Secretary of Tax and Revenue

#21.40

MODIFIED
TITLE 110
LEGISLATIVE RULE
STATE TAX DEPARTMENT

DEC - 1 2010

SERIES 13Q
COMMERCIAL PATENT INCENTIVES TAX CREDIT *Review Committee*

§110-13Q-1. General.

1.1. Scope. -- This Legislative Rule is promulgated to provide for the general administration of the Commercial Patent Incentives Tax Act, West Virginia Code §§ 11-13AA-1, *et seq.* This Rule carries out the policy and purposes of the Statute, provides necessary clarification of the provisions of the Statute, and provides for the general administration of the Statute.

1.2. Authority. -- W. Va. Code §§ 11-13AA-10, 11-10-5 and 11-10-5d(f).

1.3. Filing Date. -- _____.

1.4. Effective Date. -- _____.

1.5. Citation. -- This Legislative Rule may be cited as §110CSR13Q.

§110-13Q-2. Definitions. For purposes of this rule, the following terms shall have the meaning ascribed in this section, unless the context in which used requires a different meaning.

2.1. "Agreement" means a written agreement entered into after December 31, 2010, between a person developing patents in this State and either a corporation formed with respect to Marshall University or West Virginia University as provided in W. Va. Code § 18B-12-3, or a center for economic development and technical advancement formed with respect to Marshall University or West Virginia University as provided in W. Va. Code § 18B-12A-3, for purposes of developing a patent eligible for the credits under this series.

2.2. "Business activity" means all activities engaged in or caused to be engaged in by a person with the object of gain or economic benefit, direct or indirect.

2.3. "Commercial use" means selling, licensing, leasing or otherwise making patents available to a third party for a price, fee, royalty, commission or other consideration called by whatever name. "Commercial use" also means, in the case of patents developed by the developer for the developer's own commercial use, the first use of the patents in a manufacturing or other business activity of the developer.

2.4. "Commissioner" and "Tax Commissioner" are used interchangeably in this section and means the Tax Commissioner of the State of West Virginia, or his or her designee.

2.5. "Copyright" means a copyright that is registered with the United States Copyright Office or with a similar office of a foreign country when the foreign copyright is recognized under federal law.

2.6. "Credit year" means the taxable year in which the person realizes the net profit attributable to a patent. In the case of a license or lease to use patents, "credit year" means each taxable year during the term of the license or lease to use patents.

2.7. "Delegate" in the phrase "or his or her delegate", when used in reference to the Tax Commissioner, means any officer or employee of the Tax Department of the Department of Revenue duly authorized by the Tax Commissioner directly, or indirectly, by one or more redelegations of authority to perform the functions mentioned or described in this rule.

2.8. "Developer" means a person engaged in this State in developing patents for direct use in a manufacturing process or product and who has an agreement, as defined in this section, with Marshall University or West Virginia University.

2.9. "Developing a patent" means the development of certain patentable technologies combined with obtaining a patent for those technologies.

2.10. "Directly used in manufacturing process or product" and "direct use in manufacturing process or product" mean the use of patents directly in those activities or operations which constitute an integral and essential part of the manufacturing processes or products, as contrasted with and distinguished from those activities or operations which are simply incidental, convenient or remote to the manufacturing activity such as those activities that are incidental. Those activities that are incidental to business activities such as billing, marketing, inventory control, order fulfillment, shipping and tracking are not considered an integral and essential part of the manufacturing process or product.

2.11. "Manufacturing" means any business activity classified as having a sector identifier, consisting of the first two digits of the six-digit North American Industry Classification System code number of thirty-one, thirty-two or thirty-three.

2.12. "Mask work" means a series of related images, however fixed or encoded:

2.12.1. Having or representing the predetermined, three-dimensional pattern of metallic, insulating or semiconductor material present or removed from the layers of a semiconductor chip product; and

2.12.2. In which series the relation of the images to one another is that each image has the pattern of the surface of one form of the semiconductor chip product.

2.13. "Net profit attributable to a patent" means that portion of West Virginia taxable income which is directly relative to the use of the patent in a manufacturing process or product as determined under section 5 of this rule.

2.14. "Owner", when used in reference to a pass-through entity, means a person who owns an equity interest in the pass-through entity.

2.15. "Partnership" includes a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation or venture is carried on, which is not a sole proprietorship, trust or estate, and which is treated as a partnership for federal income tax purposes for the taxable year.

2.16. "Pass-through entity" means a partnership, limited liability company, small business corporation (S corporation) or other entity treated as a partnership for federal income tax purposes for the taxable year.

2.17. "Patent" means a United States or foreign national patent grant or United States certificate of invention or certificate of protection under the Plant Variety Protection Office of the United States Department of Agriculture and is limited to patents developed in this State for direct use in a manufacturing process or product, or both developed for use and directly used in a manufacturing process or product in this State. For purposes of this rule, patents do not include copyrights, trademarks, mask works, trade secrets or any intellectual property that is not a patent.

2.18. "Person" includes a natural person, corporation, limited liability company or partnership. A single member liability company that is treated as a disregarded entity for federal income tax purposes is be treated as a disregarded entity for purposes of this rule.

2.19. "Purchase" means a transaction under which title to an item is transferred for consideration, or a license or lease contract for at least three years is executed, regardless of whether title to the item is transferred at the end of the lease or license period.

2.20. "Taxpayer" means any person subject to the tax imposed by West Virginia Code §§ 11-23-1 et seq., or 11-24-1 et seq., or both taxes. In the case of a sole proprietorship that is not subject to either the tax imposed by either of the foregoing taxes, the term "taxpayer" means a natural person who owns a disregarded entity and who is subject to the tax imposed by West Virginia Code §§ 11-21-1 et seq., on his or her income from business activity in this State, or any sole proprietor who is subject to the tax imposed by West Virginia Code §§ 11-21-1 et seq.

2.21. "Trademark" means any trademark, trade name, service mark or other identifying symbol or name that is registered with the United States Patent and Trademark Office or with a similar office of a foreign country when the foreign registration is recognized under federal law.

2.22. "Trade secret" means information, including a formula, pattern, compilation, program device, method, technique or process, that:

2.22.1. Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means, by other persons who can obtain economic value from its disclosure or use; and

2.22.2. Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

§110-13Q-3. Overview of the Credits.

3.1. The tax incentive for developing patents in this State is a credit equal to 20% of the royalties, license fees or other consideration received by the developer of a patent in the taxable year who has an agreement, as defined in Subsection 2.1 of this rule, except as otherwise provided in this section. A new tax credit shall not accrue for any royalties, license fees or other consideration received after December 31, 2016.

3.1.1. A credit is not allowed under Subsection 3.1 or 3.2 of this rule for a patent developed entirely outside this State.

3.1.2. When a patent has been developed through activity in this State under Subsection 3.1., and through activity in one or more other states, any royalties, license fees or other consideration received by the developer of the patent must be multiplied by a fraction, the numerator of which is the direct costs of developing the patent in this State under an agreement, and the denominator of which is the total direct costs of developing the patent. The product of this calculation is to be used when determining the credit allowed under Subsection 3.1 or 3.2 of this rule.

3.1.3. If a person other than a developer of the patent receives a portion of a royalty that would be eligible for a tax credit under Subsection 3.1 or 3.2 of this rule because of a business association, licensing agreement or otherwise, that person may receive the tax credit allowable only as to the portion of royalties that person actually receives;

3.1.4. Unused credit accrued under Subsection 3.1 or 3.2 of this rule may be carried forward until used only for a period of nine consecutive years after the taxable year in which the credit allowed by this section is first available.

3.1.5. A credit is not allowed under Subsection 3.1 or 3.2 of this rule for a patent if it was sold, leased or licensed to a third party prior to January 1, 2011, or before that day if it was reduced to practice for purely commercial purposes by the developer or a person related to the developer, as that term is defined in subsection (b), Section 267 of the Internal Revenue Code of 1986, as amended, and in West Virginia Code §§ 11-21-9 or 11-24-3; and

3.1.6. A credit is not allowed under Subsection 3.1 or 3.2 of this rule beginning with the eleventh taxable year after the patent was first directly used in a manufacturing process or product.

3.2. For any taxable year in which a person who claimed the credit under Subsection 3.1 of this rule in the previous credit year invests an amount equal to at least 80% of the credit claimed under Subsection 3.1 of this rule for that previous credit year in depreciable property for purposes of developing additional patents, the person claiming the credit may take a credit of 30% of the royalties, license fees or other consideration received by the developer of a patent who has an agreement, as defined in Subsection 2.1 of this rule, and was developed in its entirety after January 1, 2011. This tax credit is available as an alternative to the tax credit in Subsection 3.1 of this rule, and may not accrue jointly. A new tax credit shall not accrue for any royalties, license fees or other consideration received after December 31, 2016.

3.3. The tax credit for use in a manufacturing process or product in this State is a credit equal to 20% of the net profit attributable to a patent, as determined under Subsection 5.1, et seq. of this rule that was developed in this State pursuant to the eligibility criteria for the credit in Subsections 3.1 and 3.2 of this rule, and is used in a manufacturing process or product in this State for the first time after January 1, 2011. A tax credit shall not be allowed for any net profit attributable to a patent received after December 31, 2016.

3.4. For any taxable year in which a person claiming the credit under Subsection 3.3 of this rule invests an amount equal to at least 80% of the credit claimed under Subsection 3.3 of this rule for that taxable year in capital improvements to add product lines to or increase productivity in this State during the next taxable year, the person claiming the credit may take a credit of 30% of the net profit attributable to a patent that was developed in this State pursuant to the eligibility criteria for the credit in Subsections 3.1 and 3.2 of this rule, and is used in a manufacturing process or product in this State for the first time after January 1, 2011. This tax credit is available as an alternative to the tax credit in Subsection 3.1 of this rule, and may not accrue jointly. A new tax credit shall not accrue for any net profit attributable to a patent received after December 31, 2016.

§110-13Q-4. Application of the Credits.

4.1. This credit may be applied only after all other allowable credits are applied and may in no case reduce the tax owed to below zero.

4.2. This credit shall be applied against an eligible taxpayer's Business Franchise Tax liability before any remaining credit may be applied against that taxpayer's Corporation Net Income Tax liability. The credit may only be applied to a Personal Income tax liability if the credit holder is either a sole proprietor or a pass-through entity.

4.2.1. In no event may any remaining credit be applied against both Personal Income Tax liability and Corporation Net Income Tax liability, unless:

4.2.1.1. The taxpayer is a pass-through entity treated as a partnership for federal income tax purposes. In that case, the amount of credit remaining, if any, after application against the business franchise tax shall flow through to the partners in the same proportion as distributive share flows through to them and the credit shall apply to the liabilities of the partners for West Virginia income taxes.

4.2.2. In no event may the credit applied exceed the eligible taxpayer's liability for business franchise tax and corporation net income tax for the taxable year, or if the eligible taxpayer is a pass-through entity, the taxpayer's liability for business franchise tax and the liabilities of the partners for West Virginia income taxes, for the taxable year.

4.3. Any amount of credit allowed which remains after being applied against eligible taxes for the tax year may be carried forward for a maximum of 9 years following the taxable year in which the credit first accrued to the taxpayer or until no credit remains, whichever comes first.

4.4. If a taxpayer does not claim the credit in the first tax year when it is available to be used, it is forfeited and may not be used in any other tax year. However, the unclaimed credit

is not forfeited if it is subsequently claimed for that first year on a timely filed amended return.

4.5. The credit may be claimed only by one taxpayer for a given period of time, and may not be assigned to any other taxpayer. However, when the credit is available to be taken against the personal income tax, the credit may be claimed on the joint income tax return if either or both of them is an eligible taxpayer.

§110-13Q-5. Net Profit Attributable to a Patent

5.1. *Net profit attributable to a patent when integrated into an ongoing manufacturing process.* The net profit of a taxpayer that is attributable to a patent when integrated into a current manufacturing process is that amount of West Virginia taxable income that is in excess of the base net profit accrued through the manufacturing process that has an integrated patent eligible for the credit under Subsection 3.1 of this rule.

5.1.1. "Base net profit accrued through the manufacturing process" is equal to that portion of West Virginia taxable income attributable to an ongoing manufacturing process in the year immediately preceding introduction of the patent to the manufacturing process.

5.1.2. "Ongoing manufacturing process" when used in this rule means an integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed at least 50% of which were in operation in this State in the taxable year immediately preceding the introduction of the patent to the manufacturing process.

5.2. *Net profit attributable to a patent when used in a current product.* The net profit of a taxpayer that is attributable to a patent when used in a current product is that amount of West Virginia taxable income that is in excess of base net profit accrued through the sale or lease of a product that has an integrated patent eligible for the credit under Subsection 3.1 of this rule.

5.2.1. "Base net profit accrued through the sale or lease of a product" is equal to that portion of West Virginia taxable income attributable to the sale or lease of a product in the year immediately preceding introduction of the patent to the product.

5.3. *Net profit attributable to a patent when used in a new manufacturing process.* The net profit of a taxpayer that is attributable to a patent that is used in a new manufacturing process is equal to the total net profit accrued through the manufacturing process using the patent multiplied by a fraction, the numerator of which is the total cost of using the patent, the denominator of which is the total cost of the manufacturing process.

5.3.1. "Net profit accrued through the manufacturing process" is equal to that portion of West Virginia taxable income directly attributable to the manufacturing process using the patent.

5.3.2. "Total cost of using the patent" is equal to:

5.3.2.1. The total amount of royalties, license fees or other consideration

paid for the right to use the patent;

5.3.2.2. In the case of the developer of the patent, total cost associated with the development of the patent divided by the 20 year life of the patent; or

5.3.2.3. In the case of any other patent holder, total cost of acquiring the patent divided by the remaining years of 20 year life of the patent.

5.4. *Net profit attributable to a patent when used in a new product.* The net profit of a taxpayer that is attributable to a patent that is used in a new product is equal to the total net profit accrued through the sale or lease of a product using the patent multiplied by a fraction, the numerator of which is the total cost of using the patent, the denominator of which is the total cost of producing the product.

5.4.1. "Total cost of using the patent" is equal to:

5.4.1.1. The total amount of royalties, license fees or other consideration paid for the right to use the patent;

5.4.1.2. In the case of the developer of the patent, total cost associated with the development of the patent divided by the 20 year life of the patent; or

5.4.1.3. In the case of any other patent holder, total cost of acquiring the patent divided by the remaining years of 20 year life of the patent.

§110-13Q-6. Uses of credit; transferability.

6.1. When an eligible taxpayer merges with another entity and the resulting entity remains an eligible taxpayer, but the taxable year of the predecessor eligible taxpayer and the taxable year of the successor eligible taxpayer are different, the amount of credit available to the predecessor is the amount available if the tax years were not different. However, the amount of credit apportioned to the successor is limited to that portion of the predecessor's credit which remains, multiplied by a fraction the numerator of which is the number of days during the same tax year of the successor which coincide with the calendar days remaining in the tax year of the predecessor if it had not merged, and the denominator of which is the number of days remaining in the same tax year of the predecessor if it had not merged. If any of the predecessor's credit which remains cannot be used by the successor in the same tax year, it is forfeited and may not be carried over or carried back to any other tax year.

6.2. A recapture or loss of credit shall not occur merely as a result of a change in the form of conducting the business as long as the successor entity is also an eligible taxpayer, and the successor is entitled to all of the credit for the tax year in which the change occurred.

6.2.1. A change in the form of conducting business is a change in the type of business entity, such as a change from a C corporation to an S corporation or a limited liability company, or from a sole proprietorship to a C or S corporation, limited liability company or partnership.

§110-13Q-7. Confidentiality.

7.1. All information submitted to the Tax Commissioner is confidential and not subject to public disclosure when filed with the Tax Commissioner except as otherwise provided in this rule or the West Virginia Code.

7.2. All records and documentation relating to application, evaluation or qualification of a company or a patent for the tax credits authorized under West Virginia Code §11-13AA-1, *et seq.* is tax information subject to the confidentiality restrictions of the West Virginia Tax Procedure and Administration Act, West Virginia Code §11-10-1, *et seq.*, including, but not limited to, the provisions of West Virginia Code §11-10-5d.

7.3. The confidential information, relating to application to or from the West Virginia Tax Department, including information generated internally by the Tax Department, including but not limited to, internal memoranda and reports, is confidential and not subject to public disclosure, unless otherwise provided by statute or rule.

7.4. All tax returns and tax return information subject to the non-disclosure restrictions of West Virginia Code § 11-10-5d are confidential, except for the information subject to disclosures authorized, mandated or permitted pursuant to the West Virginia Tax Procedure and Administration Act, or West Virginia Code §11-10-5s or West Virginia Code §11-13AA-1, *et seq.*

§110-13Q-8. General Procedure and Administration.

8.1. Requirements to Claim the Tax Credit. – To claim a tax credit, the eligible taxpayer shall comply with West Virginia Code §§11-13AA-1, *et seq.* and this rule and shall timely provide complete and accurate forms, returns, schedules and other information required by the Tax Commissioner.

8.2. Applicability of Various Tax Laws. – Application of this credit and eligibility for this credit shall not abrogate application of the provisions of West Virginia Code §§ 11-23-1, *et seq.* (Business Franchise Tax), West Virginia Code §§ 11-24-1, *et seq.* (Corporation Net Income Tax) and West Virginia Code §§ 11-21-1, *et seq.* (Personal Income Tax), and rules issued pursuant to those statutes, with respect to any eligible taxpayer or owner of any eligible taxpayer to the extent that they may be subject to the provisions of those laws, and shall not abrogate application of the provisions of West Virginia Code §§ 11-10-1, *et seq.* (Procedure and Administration) which provides for administration of those taxes.

8.3. Maintenance of Records. - An eligible company shall maintain the records required to verify the validity of its eligibility for the tax credit and the accuracy of the amount of the tax credit claimed. Failure to do so may result in denial of the tax credit. Specifically, a person who claims any credit under this rule shall maintain sufficient records to establish the following facts about the patent for which a credit is allowed:

8.3.1. For credit accrued under Subsection 3.1 of this rule:

8.3.1.1. The patent number and title;

8.3.1.2. The amount of royalties, license fees or other consideration received for use of the patent;

8.3.1.3. The month and taxable year in which the agreement required under Subsection 3.1 of this rule was entered into;

8.3.1.4. The month and taxable year in which the patent was first used, placed in service or directly used in a manufacturing process or product in this State;

8.3.1.5. The amount of credit taken;

8.3.1.6. The date the patent was disposed of or otherwise ceased to be used in a manufacturing process or product in this State;

8.3.1.7. The direct cost for developing the patent; and

8.3.1.8. The direct cost for developing the patent in this State.

8.3.2. For credit accrued under Subsection 3.2 of this rule:

8.3.2.1. The patent number and title;

8.3.2.2. The amount of royalties, license fees or other consideration received for use of the patent;

8.3.2.3. The month and taxable year in which the agreement required under Subsection 3.1 of this rule was entered into;

8.3.2.4. The month and taxable year in which the patent was first used, placed in service or directly used in a manufacturing process or product in this State;

8.3.2.5. The amount of credit taken;

8.3.2.6. The date the patent was disposed of or otherwise ceased to be used in a manufacturing process or product in this State;

8.3.2.7. Each and every item of depreciable property purchased for purposes of claiming the enhanced credit;

8.3.2.8. The date the depreciable property was purchased, its cost and its estimated useful life determined using straight-line method of depreciation;

8.3.2.9. The date the depreciable property was placed in service or used in the person's business activity in this State; and

8.3.2.10. The date the depreciable property was taken out of service or use in the person's business activity in this State and the reason why the property was taken out of service or use.

8.3.3. For credit accrued under Subsection 3.3 of this rule:

8.3.3.1. The patent number and title;

8.3.3.2. The amount of net profit attributable to the patent along with all information used to derive this figure in accordance with Section 5 of this rule;

8.3.3.3. The month and taxable year in which the agreement required under Subsection 3.1 of this rule was entered into;

8.3.1.4. The month and taxable year in which the patent was first used, placed in service or directly used in a manufacturing process or product in this State;

8.3.3.5. The amount of credit taken; and

8.3.3.6. The date the patent was disposed of or otherwise ceased to be used in a manufacturing process or product in this State.

8.3.4. For credit accrued under Section 3.4 of this rule:

8.3.4.1. The patent number and title;

8.3.4.2. The amount of net profit attributable to the patent along with all information used to derive this figure in accordance with Section 5 of this rule;

8.3.4.3. The month and taxable year in which the agreement required under Subsection 3.1 of this rule was entered into;

8.3.4.4. The month and taxable year in which the patent was first used, placed in service or directly used in a manufacturing process or product in this State;

8.3.4.5. The amount of credit taken;

8.3.4.6. The date the patent was disposed of or otherwise ceased to be used in a manufacturing process or product in this State;

8.3.4.7. Each and every item of depreciable property purchased for purposes of claiming the enhanced credit;

8.3.4.8. The date the depreciable property was purchased, its cost and its estimated useful life determined using straight-line method of depreciation;

8.3.4.9. The date the depreciable property was placed in service or used in the person's business activity in this State; and

8.3.4.10. The date the depreciable property was taken out of service or use in the person's business activity in this State and the reason why the property was taken out of service or use.