

REDACTED DECISION – DK# 15-362 SRDTC

**BY: A.M. “FENWAY” POLLACK, CHIEF ADMINISTRATIVE LAW JUDGE
SUBMITTED FOR DECISION ON DECEMBER 14, 2018
ISSUED ON FEBRUARY 27, 2019**

BEFORE THE WEST VIRGINIA OFFICE OF TAX APPEALS

FINAL DECISION

By letter dated September 14, 2015, the West Virginia Tax Department (hereinafter “Respondent” or “Tax Commissioner”) informed the Petitioner that the applications for West Virginia’s Strategic Research and Development Tax Credit it filed had been denied. Specifically, the Petitioner had applied for the credit for tax years 2011-2013.

Thereafter, on October 23, 2015, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, a petition of appeal. *See* W. Va. Code Ann. §§ 11-10A-8(1); 11-10A-9 (West 2010).

Subsequently, notice of a hearing on the petition was sent to the Petitioner, and, in accordance with the provisions of West Virginia Code Section 11-10A-10, a hearing was held on January 25, 2017, after which the parties filed legal briefs. At the request of the then presiding Administrative Law Judge, a second evidentiary hearing was held on August 15, 2018 to allow for additional fact finding. The parties were provided with an opportunity to file additional legal briefs, which they declined to do. Thereafter, the matter then became ripe for a decision.

FINDINGS OF FACT

1. The Petitioner's formal name is _____, and it is a West Virginia corporation, with its place of operation in a West Virginia City. Tr. #2 P41-42 at 7-5.
2. The Petitioner's business is the manufacturing of components for automobiles.
3. At various times the Petitioner will begin to build these components that are different than those being built at the time (a "pilot project"). Tr. #2 P28 at 14-15.
4. The Petitioner is provided with the plans for these new components by engineers housed at another location, typically, in another State. Tr. #2 P47-48 at 20-3.
5. Once the decision is made to build these new components, the Petitioner begins with an empty space at its location in West Virginia. Tr.#2 P44 at 12-19.
6. In this empty space, the first step is to install manufacturing equipment. Typically, this equipment is new; although, on occasion the Petitioner uses equipment that is already located at the plant. Tr.#2 P46 at 4-13. This new equipment becomes a new assembly line. The design of this assembly line is a collaborative effort between employees of the Petitioner and other engineers from a group in another State. Tr.#2 P48 at 4-11.
7. Once the equipment is installed, the Petitioner begins to build sample components, for the purpose of refining the manufacturing process to the point of commercial production. Tr.#2 P50 at 3-23. During this refinement process, the Petitioner is both designing and modifying the manufacturing process needed, and at times will discover engineering/design flaws in the product itself. Tr.#2 P65 at 4-22.
8. During this period of refinement and testing every department (the Petitioner refers to them as "cost centers") that would be involved in actual production is involved in the pre-production phase. These pilot project cost centers are production, maintenance, engineering,

production control and quality control. All of these employees are learning and refining what their role will be once production begins. Tr.#2 P57-61 & Petitioner's Exhibit 14, Tabs 2013/Pilot Activities. Some cost centers that are not assigned to the pilot project provide employees as well, on a limited basis. Tr.#2 P28-29 at 11-10.

9. A portion of the credit sought by the Petitioner is related to the raw materials used to build these test components, as opposed to labor costs. Tr.#2P at 10-17.

10. During the pilot project, the early attempts at production are scrapped. Eventually, completed components are sent to assembly plants to be used when these plants conduct pilot projects for the assembly of new vehicle models. None of the components built during a pilot project are ever sold for use in a vehicle that could be purchased by a consumer. Tr.#2 P19-20 at 4-20.

11. All of the pilot projects conducted by the Petitioner during tax years 2011-2013, that are the subject of the Tax Department's September 14, 2015 letter, were conducted under the same fact scenarios listed above.

DISCUSSION

We should note at the outset that this matter only concerns the Tax Commissioner's September 24, 2015 letter, denying the Petitioner the requested Strategic Research and Development Tax Credit, and the Petitioner's argument that its activities constitute research and development, as that term is defined in West Virginia Code Section 11-13R-3. The parties agree that if this Tribunal were to rule that the Petitioner were conducting research and development, then the question of the proper amount of credit due to the Petitioner would be taken up at a later date.

The statutory provisions creating the credit at issue defines research and development as:

“Research and development” means systematic scientific, engineering or technological study and investigation in a field of knowledge in the physical, computer or software sciences often involving the formulation of hypotheses and experimentation for the purpose of revealing new facts, theories or principles or increasing scientific knowledge which may reveal the basis for new or enhanced products, equipment or manufacturing processes.

(A) Research and development includes, but is not limited to, design, refinement and testing of prototypes of new or improved products or equipment or the design, refinement and testing of manufacturing processes before commercial sales relating thereto have begun.

W. Va. Code Ann. § 11-13R-3(b)(10) (West 2018),

The Petitioner argues that the “design, refinement and testing of manufacturing processes before commercial sales relating thereto have begun” is exactly what it is doing. The Respondent argues that the Petitioner is merely “tweaking and modifying already existing products.” *See* Respondent’s Reply Brief, P.7. The Respondent further argues that there needs to be something like a “reinvention of the wheel” in order to qualify for the credit. *Id.*

We begin our analysis by noting that we find Subdivision (10) to be clear and unambiguous, and further note that neither party argues otherwise. We rule that the Petitioner is correct when it argues that it is designing, refining and testing a manufacturing process prior to the start of commercial sales. We would further point out that the Petitioner is also refining and testing prototypes of an improved product, as those terms are used in Paragraph (A) of Subdivision (10). We further find that the Petitioner’s activities satisfy the general language of Subdivision (10), because it is systematically conducting engineering and technological study in the field of mechanics/engineering, a sub-theory of physics, one of the physical sciences.¹ We rule as such,

¹ *See* [Margaret J. Osler, J. Brookes Spencer, Stephen G. Brush, Physical science](https://www.britannica.com/science/physical-science), Encyclopedia Britannica, <https://www.britannica.com/science/physical-science> (last visited February 22, 2019); [Ralph J. Smith, Engineering](https://www.britannica.com/technology/engineering), Encyclopedia Britannica <https://www.britannica.com/technology/engineering> (last visited February 22, 2019).

because the un rebutted evidence in this matter is clear. The Petitioner starts with an empty room and designs an assembly line from scratch. During this process it figures out every step of what common knowledge tells us is a manufacturing ballet. The point of this exercise is to refine this process so there are not wasted moments or movements, because again, common knowledge tells us that the Petitioner's goal is to build as many components as quickly and efficiently as possible. Moreover, during this process these refined componens are built and tested for the first time, thereby leading to the design, refinement and testing of an improved product, satisfying the other prong of Paragraph (A).²

We are unpersuaded by the Respondent's arguments for two reasons. First and foremost, he ignores entirely that portion of Paragraph (A) that deals with manufacturing. The credit is not only available for R&D into new or improved products, but also for R&D in manufacturing. Moreover, while the Tax Commissioner argues that the Petitioner is merely "modifying and tweaking" existing products, Paragraph (A) specifically provides the credit for improving a product. As such, the Respondent's contention that the Petitioner would have to be inventing something new is incorrect, based upon the plain language of the statute.

CONCLUSIONS OF LAW

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. §11-1-2 (West 2010).

2. "A statutory provision which is clear and unambiguous and plainly expresses the legislative intent will not be interpreted by the courts but will be given full force and effect."

² We are aware that the initial design of both the manufacturing process and the components are done in location A and location B. However, Petitioner is only seeking the credit for the design, refinement and testing work that is done by its employees.

Syllabus point 2, *State v. Epperly*, 135 W.Va. 877, 65 S.E.2d 488 (1951) Concept Min., Inc. v. Helton, 217 W. Va. 298, 299, 617 S.E.2d 845, 846 (2005).

3. The Legislature finds that the encouragement of research and development in this state is in the public interest and promotes economic growth and development and the general welfare of the people of this state. In order to encourage research and development in this state and thereby increase employment and economic development, there is hereby provided a strategic research and development tax credit. W. Va. Code Ann. § 11-13R-2 (West).

4. “Research and development” means systematic scientific, engineering or technological study and investigation in a field of knowledge in the physical, computer or software sciences often involving the formulation of hypotheses and experimentation for the purpose of revealing new facts, theories or principles or increasing scientific knowledge which may reveal the basis for new or enhanced products, equipment or manufacturing processes.(A) Research and development includes, but is not limited to, design, refinement and testing of prototypes of new or improved products or equipment or the design, refinement and testing of manufacturing processes before commercial sales relating thereto have begun. W. Va. Code Ann. § 11-13R-3(b)(10) (West 2018).

5. West Virginia Code Section 11-13R-3(b)(10) is clear and unambiguous.

6. All of the pilot projects that are the subject of this matter involved both the “design, refinement and testing of prototypes of new or improved products or equipment or the design, refinement and testing of manufacturing processes before commercial sales relating thereto have begun”, as those terms are defined in West Virginia Code Section 11-13R-3(b)(10).

7. In proceedings before the West Virginia Office of Tax Appeals, the burden of proof is upon the Petitioner. *See* W. Va. Code Ann. §11-10A-10(e) (West 2010).

8. The Petitioner has met its burden of proof in showing that the Tax Commissioner's September 14, 2015 letter, denying the Petitioner's request for a Strategic Research and Development Tax Credit was an error of law, clearly wrong, or arbitrary and capricious.

DISPOSITION

Based upon the above, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the Tax Commissioner's September 14, 2015 letter, denying the Petitioner's request for a Strategic Research and Development Tax Credit should be and is hereby **REVERSED**.

WEST VIRGINIA OFFICE OF TAX APEALS

By: _____
A.M. "Fenway" Pollack
Chief Administrative Law Judge

Date Entered