

H. B. 2993

(BY DELEGATES WHITE AND T. CAMPBELL)
[BY REQUEST OF THE TAX AND REVENUE DEPARTMENT]

[Introduced February 2, 2011; referred to the
Committee on Finance.]

A BILL to amend and reenact §11-13AA-3, §11-13AA-4, §11-13AA-5, §11-13AA-7, §11-13AA-11 and §11-13AA-12 of the Code of West Virginia, 1931, as amended, all relating to the West Virginia Commercial Patents Incentives Tax Act, defining terms; clarifying carryover provisions; specifying when credit accrues; disallowing credit based on related party transactions; disallowing application of credit in addition to specified other tax credits; making technical corrections to use appropriate terminology; and retroactively adjusting the effective date language.

Be it enacted by the Legislature of West Virginia:

That §11-13AA-3, §11-13AA-4, §11-13AA-5, §11-13AA-7, §11-13AA-11 and §11-13AA-12 of the Code of West Virginia, 1931, as amended, be amended and reenacted, all to read as follows:

**ARTICLE 13AA. COMMERCIAL PATENT INCENTIVES
TAX ACT.**

§11-13AA-3. Definitions.

1 (a) *General.* -- When used in this article, or in the
2 administration of this article, terms defined in subsection (b)
3 of this section have the meanings ascribed to them by this
4 section, unless a different meaning is clearly required by
5 either the context in which the term is used, or by specific
6 definition, in this article.

7 (b) *Terms defined.* --

8 (1) “Agreement” means any agreement or contractual
9 relationship entered into after the effective date of this
10 section between Marshall University or West Virginia
11 University and a person developing patents in this state ~~and~~
12 that is either:

13 (A) A corporation established under the laws of this state
14 that meet the requirements of section three, article twelve,
15 chapter eighteen-b of this code; or

16 (B) A center for economic development and
17 technological advancement created pursuant to section three,
18 article twelve-a, chapter eighteen-b of this code.

19 (2) “Business activity” means all activities engaged in or
20 caused to be engaged in by a person with the object of gain
21 or economic benefit, direct or indirect. For purposes of this
22 definition, the term “gain or economic benefit, direct or
23 indirect” does not include income realized by any person in
24 the form of wages, salary or income that is reported on
25 federal form W-2.

26 (3) “Commercial use” means selling, licensing, leasing or
27 otherwise making patents available to a third party for a
28 price, fee, royalty, commission or other consideration called
29 by whatever name. “Commercial use” also means, in the
30 case of patents developed by the developer for the
31 developer’s own commercial use, the first use of the patents

32 in a manufacturing or other business activity of the
33 developer. “Commercial use” does not include any selling,
34 licensing, leasing or otherwise making patents available to a
35 third party when done by a broker or by any person who does
36 not own the patent sold, licensed, leased or otherwise made
37 available.

38 (4) “Commissioner” and “Tax Commissioner” are used
39 interchangeably herein and mean the Tax Commissioner of
40 the State of West Virginia or his or her designee.

41 (5) “Copyright” means a copyright that is registered with
42 the United States Copyright Office or with a similar office of
43 a foreign country when the foreign copyright is recognized
44 under federal law.

45 ~~(6) “Credit year” means the taxable year in which the~~
46 ~~person realizes the net profit attributable to a patent. In the~~
47 ~~case of a license or lease to use patents, “credit year” means~~
48 ~~each taxable year during the term of the license or lease to~~
49 ~~use patents.~~

50 ~~(7)~~ (6) “Delegate” in the phrase “or his or her delegate”,
51 when used in reference to the Tax Commissioner, means any
52 officer or employee of the Tax Department of the
53 Department of Revenue duly authorized by the Tax
54 Commissioner directly, or indirectly, by one or more
55 redelegations of authority to perform the functions mentioned
56 or described in this article.

57 (7) “Development of a patent,” “developing patents” or
58 “development” means the act of fostering, causing or
59 accelerating the progress of a process, or a machine, or the
60 manufacturing of product, or a composition of matter, or
61 improvement thereto through significant investment of
62 money, performance of research, or application of design or
63 engineering expertise, which culminates in the issuance of a
64 patent, as defined in this article, for that process, machine,
65 manufacturing of a product, composition of matter, or
66 improvement.

67 (8) “Developer” means a person engaged in this state in
68 developing patents for direct use in a manufacturing process

69 or product and who has an agreement, as defined in this
70 section, with Marshall University or West Virginia
71 University.

72 (9) “Directly used in manufacturing process or product,”
73 and “direct use in manufacturing process or product” with
74 reference to patents ~~mean the use of patents directly in those~~
75 ~~activities or operations which constitute an integral and~~
76 ~~essential part of the manufacturing processes and products,~~
77 ~~as contrasted with and distinguished from those activities or~~
78 ~~operations which are simply incidental, convenient or remote~~
79 ~~to the manufacturing activity such as those activities that are~~
80 ~~incidental. Those activities that are incidental to business~~
81 ~~activities such as bills, marketing, inventory control, order~~
82 ~~fulfillment, shipping and tracking are not considered an~~
83 ~~integral and essential part of the manufacturing process or~~
84 product means application or incorporation of a patented
85 process, machine, manufactured article or composition of
86 matter, in manufacturing operations or processes, or in
87 manufactured products, in circumstances where United States

88 or foreign patent laws require that the specific patent for the
89 process, machine, manufactured article or composition of
90 matter be owned by the manufacturer, or purchased, leased,
91 licensed or authorized by contract to be applied or
92 incorporated in the manufacturing operation, processes or
93 product, and where such lawful ownership, purchase, lease,
94 licensure or contractual authorization is in effect.

95 (10) “Manufacturing” means any business activity
96 classified as having a sector identifier, consisting of the first
97 two digits of the six-digit North American Industry
98 Classification System code number of thirty-one, thirty-two
99 or thirty-three.

100 (11) “Mask work” means a series of related images,
101 however fixed or encoded:

102 (A) Having or representing the predetermined, three-
103 dimensional pattern of metallic, insulating or semiconductor
104 material present or removed from the layers of a
105 semiconductor chip product; and

106 (B) In which series the relation of the images to one
107 another is that each image has the pattern of the surface of
108 one form of the semiconductor chip product.

109 (12) “Owner”, when used in reference to a pass-through
110 entity, means a person who owns an equity interest in the
111 pass-through entity.

112 (13) “Partnership” includes a syndicate, group, pool, joint
113 venture or other unincorporated organization through or by
114 means of which any business, financial operation or venture
115 is carried on, which is not a sole proprietorship, trust or
116 estate, and which is treated as a partnership for federal
117 income tax purposes for the taxable year.

118 (14) “Pass-through entity” means a partnership, limited
119 liability company, small business corporation (S corporation)
120 or other entity treated as a partnership for federal income tax
121 purposes for the taxable year.

122 (15) “Patent” means a United States or foreign national
123 patent grant or United States certificate of invention or
124 certificate of protection under the Plant Variety Protection

125 Office of the United States Department of Agriculture and is
126 limited to patents developed in this state for direct use in a
127 manufacturing process or product, or both developed for use
128 and directly used in a manufacturing process or product in
129 this state. For purposes of this article, patents do not include
130 copyrights, trademarks, mask works, trade secrets or any
131 intellectual property that is not a patent.

132 (16) "Person" includes a natural person, corporation,
133 limited liability company or partnership. A single member
134 liability company that is treated as a disregarded entity for
135 federal income tax purposes is be treated as a disregarded
136 entity for purposes of this article.

137 (17) "Purchase" means a transaction under which title to
138 an item is transferred for consideration, or a license or lease
139 contract for at least three years is executed, regardless of
140 whether title to the item is transferred at the end of the lease
141 or license period.

142 (18) "Taxpayer" means any person subject to the tax
143 imposed by article twenty-three or twenty-four of this chapter

144 or to both taxes. In the case of a sole proprietorship that is
145 not subject to either the tax imposed by article twenty-three
146 or twenty-four of this chapter, the term “taxpayer” means a
147 natural person who owns a disregarded entity and who is
148 subject to the tax imposed by article twenty-one of this
149 chapter on his or her income from business activity in this
150 state, or any sole proprietor who is subject to the tax imposed
151 by article twenty-one of this chapter.

152 (19) “Trademark” means any trademark, trade name,
153 service mark or other identifying symbol or name that is
154 registered with the United States Patent and Trademark
155 Office or with a similar office of a foreign country when the
156 foreign registration is recognized under federal law.

157 (20) “Trade secret” means information, including a
158 formula, pattern, compilation, program device, method,
159 technique or process, that:

160 (A) Derives independent economic value, actual or
161 potential, from not being generally known to, and not being
162 readily ascertainable by proper means, by other persons who
163 can obtain economic value from its disclosure or use; and

164 (B) Is the subject of efforts that are reasonable under the
165 circumstances to maintain its secrecy.

§11-13AA-4. Tax incentive for developing patents in this state.

1 (a) *Allowance of credit.* -- A person engaging in this state
2 in developing patents for direct use in a manufacturing
3 process or product and who has an agreement, as defined in
4 section three of this article, with Marshall University or West
5 Virginia University is allowed a credit, when computing the
6 person's liability for business franchise tax imposed by
7 article twenty-three of this chapter and corporation net
8 income tax imposed by article twenty-four of this chapter, in
9 the amount allowed under subsection (b) of this section.
10 When the developer is a sole proprietor or a pass-through
11 entity, that amount of the credit remaining after first applying
12 it against the tax liability under article twenty-three of this
13 chapter for the taxable year is allowed when computing the
14 tax imposed by article twenty-one of this chapter on income
15 from the person's business activity. No credit is allowed
16 under this article for any activity, investment, assets, or

17 expenditures for which any of the tax credits authorized
18 under articles thirteen-d, thirteen-e, thirteen-q, thirteen-r,
19 thirteen-s, or thirteen-x of this chapter, has been authorized,
20 taken or allowed. No credit is allowed under this article for
21 any activity, investment, assets, or expenditures for which the
22 tax credits authorized under article thirteen, chapter eighteen-
23 b, has been authorized, taken or allowed.

24 (b) *Amount of credit.* -- The amount of credit allowed
25 under this section is equal to twenty percent of the royalties,
26 license fees or other consideration received by the developer
27 during the taxable year from the sale, lease or licensing of a
28 patent developed in this state for direct use in a
29 manufacturing process or product by the person in taxable
30 years beginning on or after January 1, 2011: *Provided*, That
31 the amount of credit allowed under this section is thirty
32 percent, rather than twenty percent, when the person
33 reinvests at least eighty percent of the amount of the credit
34 claimed for the taxable year in depreciable property
35 purchased for purposes of developing additional patents in

36 this state in taxable years beginning on or after January 1,
37 2011, or improving upon a patent developed in this state or
38 contributing to a stipend to retain a graduate or post-doctoral
39 student in this state integral to the development of the patents
40 or related technology in taxable years beginning on or after
41 January 1, 2011, during the next taxable year of the person,
42 and the person has an agreement, as defined in section three
43 of this article, for the development of a patent.

44 (c) *Rules for application of credit.* -- The amount of
45 credit computed under this section is allowed in accordance
46 with the following rules and applied as provided in
47 subsection (d) of this section:

48 (1) No credit is allowed under this section for royalties,
49 rents, license fees or other consideration received by the
50 developer of the patent for a patent developed outside this
51 state, except as provided in subdivision (2) of this subsection;

52 (2) When the person developed the patent for direct use
53 in a manufacturing process or product through that person's
54 activity in this state and through that person's activity in one

55 or more other states, the consideration received by the
56 developer during the taxable year from the sale, lease or
57 license of the patent developed through multistate activity of
58 the developer is multiplied by a fraction, the numerator of
59 which is the direct costs of developing the patent in this state
60 and the denominator of which is the total direct costs of
61 developing the patent. The product of this computation
62 establishes the consideration to be used in subsection (b) of
63 this section;

64 (3) If a person receives a portion of a royalty that would
65 be eligible for a tax credit under this section because of a
66 business association, licensing agreement or otherwise, the
67 person may receive the tax credit allowable to the portion of
68 royalties that person receives provided the person has an
69 agreement, as defined in section three of this article, with
70 Marshall University or West Virginia University and
71 otherwise meets the requirements for entitlement to this
72 credit, as set forth in subsection (a) of this section;

73 (4) Unused credit may be carried forward until the earlier
74 of the tax year when the credit is used up or used for a period
75 of nine the ninth consecutive tax year ~~after the taxable year~~
76 ~~in which the credit allowed by this section accrues to the~~
77 ~~person~~ the first tax year in which the taxpayer is eligible to
78 claim the credit. When the person is an owner of a pass-
79 through entity, credit ~~accrues to~~ may be taken by the owner
80 beginning in the tax year when it accrues to credit may be
81 taken by the pass-through entity or when the pass through
82 entity gains entitlement to the credit;

83 (5) No credit is allowed under this section for
84 consideration received by the developer for patents
85 developed for direct use in a manufacturing process or
86 product before the taxable year beginning January 1, 2011.
87 For purposes of this subdivision, a patent was developed for
88 direct use in a manufacturing process or product before
89 January 1, 2011, if ~~before that date~~ it was sold, leased or
90 licensed to a third party prior to January 1, 2011, or before
91 that day it was reduced to practice for purely commercial

92 purposes by the developer or a person related to the
93 developer, as defined in subsection (b), Section 267 of the
94 Internal Revenue Code of 1986, as amended; ~~and as defined~~
95 ~~in section nine, article twenty-one of this chapter or section~~
96 ~~three, article twenty-four of this chapter; and~~

97 (6) No credit is allowed under this section for
98 consideration received by the developer from a person related
99 to the developer, as defined in subsection (b), Section 267 of
100 the Internal Revenue Code of 1986, as amended for patents
101 developed for direct use in a manufacturing process or
102 product; and

103 ~~(6)~~ (7) No credit is allowed under this section beginning
104 with the eleventh taxable year after the patent was first
105 directly used in a manufacturing process or product.

106 (d) *Application of credit.* -- The amount of the credit
107 computed under this section is allowed as a credit against tax
108 as provided in this subsection, but the credit may not reduce
109 the tax below zero.

110 (1) *Business franchise tax.*-- The amount of the allowable
111 credit shall first be taken as a credit against the tax liability
112 of the developer for the taxable year under article twenty-
113 three of this chapter.

114 (2) *Corporation net income tax.* -- The amount of the
115 allowable credit remaining, if any, after first applying the
116 credit against the tax imposed by article twenty-three of this
117 chapter shall then be taken as a credit when computing the
118 liability of the developer for the taxable year under article
119 twenty-four of this chapter.

120 (3) *Personal income tax on business income.* --

121 (A) When the developer is a sole proprietor, the amount
122 of the allowable credit is taken as a credit when computing
123 the liability of the developer for the taxable year on business
124 income under article twenty-one of this chapter.

125 (B) When the developer is a pass-through entity, the
126 amount of allowable credit remaining, if any, after first
127 applying the credit against the tax imposed by article twenty-
128 three of this chapter for the taxable year is allowed as a credit

129 against the tax imposed for the taxable year on the West
130 Virginia source income of the pass-through entity under
131 article twenty-one of this chapter and the amount of the credit
132 is distributed to the owners of the pass-through entity in the
133 same manner as items of partnership income, gain loss or
134 deduction are distributed or allocated for the taxable year.

**§11-13AA-5. Tax credit for use of a patent in a manufacturing
process or product in this state that was
developed in this state.**

1 (a) *Allowance of credit.* -- A person directly using a
2 patent developed in this state in a manufacturing process or
3 product in this state is allowed a credit against the person's
4 liability for business franchise tax imposed by article twenty-
5 three of this chapter and corporation net income tax imposed
6 by article twenty-four of this chapter, the amount computed
7 under subsection (b) of this section. When the user of a
8 patent is a sole proprietor or a pass-through entity, that
9 amount of credit allowed against income taxes shall be
10 against the tax imposed by article twenty-one of this chapter.

11 (b) *Amount of credit.* -- The amount of credit allowed
12 under this section is equal to twenty percent of the net profit
13 attributable to the patent: *Provided,* That the amount of
14 credit allowed under this section is equal to thirty percent of
15 the net profit attributable to the patent when the person
16 claiming the credit reinvests in capital improvements to add
17 product lines to or increase productivity in this state during
18 the next taxable year an amount equal to at least eighty
19 percent of the tax credit amount used for the taxable year.
20 For purposes of this article, the term “net profits” means
21 West Virginia taxable income as determined for purposes of
22 article twenty four of this chapter, before application of this
23 credit and after application of all credits allowable under this
24 chapter except this credit. In the case of taxpayers that are
25 not subject to the tax imposed by article twenty-four, “net
26 profits” means West Virginia taxable income as determined
27 for purposes of article twenty-one of this chapter, before
28 application of this credit and after application of all credits
29 allowable under this chapter except this credit. In

30 circumstances where net profit is not solely attributable to
31 and the exclusive result of the direct use of a patent in a
32 manufacturing process or product in this state, the taxpayer
33 shall determine net profit solely attributable to and the
34 exclusive result of the direct use of a patent in a
35 manufacturing process or product in this state, and net profit
36 for purposes of determining the amount of credit allowable
37 under this article shall be the net profit solely attributable to
38 and the exclusive result of the direct use of a patent in a
39 manufacturing process or product in this state.

40 (c) *Rules for application of credit.* -- The amount of
41 credit computed under this section is allowed in accordance
42 with the following rules and applied as provided in
43 subsection (d) of this section:

44 (1) The credit allowed by this section is applied after all
45 other credits allowed by this chapter have been applied
46 against the person's business franchise tax and West Virginia
47 income tax liabilities for the taxable year under this chapter;

48 (2) Unused credit may be carried forward until the earlier
49 of the tax year when the credit is used up or used for a period
50 of nine the ninth consecutive tax year after the taxable year
51 in which the credit allowed by this section accrues to the
52 person the first tax year in which the taxpayer is eligible to
53 claim the credit. When the person is an owner of a pass-
54 through entity, credit ~~accrues to~~ may be taken by the owner
55 beginning in the tax year when it accrues to credit may be
56 taken by the pass-through entity or when the pass through
57 entity gains entitlement to the credit;

58 (3) Any credit not used within the ten-year period
59 described in subdivision (2) of this subsection is forfeited
60 beginning with the eleventh taxable year after the ~~taxable~~
61 year in which the credit accrued to the person first tax year in
62 which the taxpayer is eligible to claim the credit;

63 (4) No credit is allowed under this section for using a
64 patent in this state when the person began using the patent
65 before January 1, 2011;

66 (5) No credit is allowed under this section for using a
67 patent in this state for which the taxpayer is allowed credit
68 under another article of this chapter.

69 (6) No credit is allowed under this section for any patent
70 acquired from, by or between, leased from, by or between,
71 licensed from, by or between, or otherwise authorized to be
72 used from, by or between related persons, as defined in
73 subsection (b), Section 267 of the Internal Revenue Code of
74 1986, as amended.

75 (7) Amounts received from, by or between related
76 persons, as defined in subsection (b), Section 267 of the
77 Internal Revenue Code of 1986, as amended, are disallowed
78 when calculating net profit attributable to a patent.

79 (d) *Application of credit.* -- The amount of the credit
80 computed under this section is allowed as a credit against tax
81 as provided in this subsection, but the credit may not reduce
82 the tax below zero.

83 (1) *Business franchise tax.* -- The amount of the
84 allowable credit shall first be taken as a credit against the tax

85 liability of the person allowed the credit for the taxable year
86 under article twenty-three of this chapter.

87 (2) *Corporation net income tax.* -- The amount of the
88 allowable credit remaining, if any, after first applying the
89 credit against the tax imposed by article twenty-three of this
90 chapter shall then be taken as a credit when computing the
91 liability of the corporation for the taxable year under article
92 twenty-four of this chapter.

93 (3) *Personal income tax on business income.* --

94 (A) When the person allowed the credit is a sole
95 proprietor, the amount of the allowable credit is taken as a
96 credit when computing the liability of the person allowed the
97 credit for the taxable year on business income under article
98 twenty-one of this chapter.

99 (B) When the person allowed the credit is a pass-through
100 entity, the amount of allowable credit remaining, if any, after
101 first applying the credit against the tax imposed by article
102 twenty-three of this chapter for the taxable year is allowed as
103 a credit against the tax imposed for the taxable year on the

104 West Virginia source income of the pass-through entity
105 under article twenty-one of this chapter and the amount of the
106 credit is distributed to the owners of the pass-through entity
107 in the same manner as items of partnership income, gain loss
108 or deduction are distributed or allocated for the taxable year.

§11-13AA-7. Identification of a patent and required records.

1 (a) *Required records.* -- Every developer of a patent in
2 this state for direct use in a manufacturing process or product
3 and every person who uses a patent directly in a
4 manufacturing process or product in this state who claims a
5 credit under this article shall maintain sufficient records to
6 establish the following facts for each item of a patent for
7 which a credit is allowed under this article:

8 (1) Its identity;

9 (2) The amount of net profit attributable to the patent;

10 (3) The month and taxable year in which the patent was
11 first used, placed in service or directly used in the person's
12 manufacturing process or product in this state;

13 (4) The amount of credit taken; and

14 (5) The date the patent was disposed of or otherwise
15 ceased to be directly used in the person's manufacturing
16 process or product in this state.

17 (b) *Enhanced ~~deduction~~ of credit.* -- Any person who
18 claims the enhanced credit under section four or five of this
19 article shall maintain sufficient records to clearly establish
20 entitlement to claim the amount of the enhanced credit. At
21 a minimum those records shall identify:

22 (1) Each and every item of depreciable property
23 purchased for purposes of claiming the enhanced credit;

24 (2) The date the depreciable property identified in
25 subdivision (1) of this subsection was purchased, its cost and
26 its estimated useful life determined using ~~strait~~ straight-line
27 method of depreciation;

28 (3) The date the depreciable property identified in
29 subdivision (1) of this subsection was placed in service or
30 used in the person's business activity in this state;

31 (4) The date the depreciable property identified in
32 subdivision (1) of this subsection was taken out of service or

33 use in the person's business activity in this state and the
34 reason why the property was taken out of service or use; and

35 (5) Other information that the Tax Commissioner may
36 reasonably require by rule promulgated as provided in
37 section eleven of this article.

38 (c) *New jobs*. -- Every person who claims a credit under
39 this article shall also maintain sufficient records to establish
40 the number and types of new jobs, if any created, the wages
41 and benefits paid to employees filling the new jobs and the
42 duration of each job.

43 (d) *Exception*. -- This section does not apply to an owner
44 of a pass-through entity that develops or uses a patent for
45 which a credit is allowed under this article.

§11-13AA-11. Interpretation and construction.

1 (a) No inference, implication or presumption of
2 legislative construction or intent may be drawn or made by
3 reason of the location or grouping of any particular section,
4 provision or portion of this article; and no legal effect may be
5 given to any descriptive matter or heading relating to any
6 section, subsection or paragraph of this article.

7 (b) The provisions of this article shall be ~~reasonably~~
 8 strictly construed in order to effectuate the legislative intent
 9 recited in section two of this article.

§11-13AA-12. Effective date.

1 The provisions of this article retroactively become
 2 effective on ~~July~~ January 1, 2011, and apply only to a patent
 3 developed in this state ~~after the taxable years~~ in tax years
 4 beginning on or after January 1, 2011, and to a patent
 5 purchased, leased or licensed for use on or after that date for
 6 direct use in the taxpayer's manufacturing process or product
 7 in this state.

NOTE: The purpose of this bill is to make technical changes to correct some infirmities related to incorrect terminology, unworkable effective dates, and to disallow some related transactions within the Commercial Patent Incentives Tax Act.

Strike-throughs indicate language that would be stricken from the present law, and underscoring indicates new language that would be added.

Finance Committee Title Amendment Pending

H. B. 2993 -- "A BILL to amend and reenact §11-13AA-3, §11-13AA-4, §11-13AA-5, §11-13AA-7, §11-13AA-11 and §11-13AA-12 of the Code of West Virginia, 1931, as amended, all relating to modifying the provisions of the West Virginia Commercial Patents Incentives Tax Act generally; defining terms; providing for tax credit carryover and accrual; restricting eligibility for tax credit; providing for disallowance of tax credit; providing for strict construction; and retroactively adjusting the effective date of the provisions of the Act."