

**Senate Bill No. 389**

(By Senators Prezioso, D. Facemire, Unger, Foster, Klempa and  
Minard)

[Introduced February 2, 2011; referred to the Committee on the  
Judiciary; and then 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 Patent 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:

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

2 **§11-13AA-3. Definitions.**

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

9 (b) *Terms defined.* --

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

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

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

20 (2) "Business activity" means all activities engaged in or  
21 caused to be engaged in by a person with the object of gain or  
22 economic benefit, direct or indirect. For purposes of this  
23 definition, the term "gain or economic benefit, direct or indirect"  
24 does not include income realized by any person in the form of

1 wages, salary or income that is reported on federal form W-2.

2 (3) "Commercial use" means selling, licensing, leasing or  
3 otherwise making patents available to a third party for a price,  
4 fee, royalty, commission or other consideration called by whatever  
5 name. "Commercial use" also means, in the case of patents  
6 developed by the developer for the developer's own commercial use,  
7 the first use of the patents in a manufacturing or other business  
8 activity of the developer. "Commercial use" does not include any  
9 selling, licensing, leasing or otherwise making patents available  
10 to a third party when done by a broker or by any person who does  
11 not own the patent sold, licensed, leased or otherwise made  
12 available.

13 (4) "Commissioner" and "Tax Commissioner" are used  
14 interchangeably herein and mean the Tax Commissioner of the State  
15 of West Virginia or his or her designee.

16 (5) "Copyright" means a copyright that is registered with the  
17 United States Copyright Office or with a similar office of a  
18 foreign country when the foreign copyright is recognized under  
19 federal law.

20 ~~(6) "Credit year" means the taxable year in which the person~~  
21 ~~realizes the net profit attributable to a patent. In the case of~~  
22 ~~a license or lease to use patents, "credit year" means each taxable~~  
23 ~~year during the term of the license or lease to use patents.~~

24 ~~(7)~~ (6) "Delegate" in the phrase "or his or her delegate",

1 when used in reference to the Tax Commissioner, means any officer  
2 or employee of the Tax Department of the Department of Revenue duly  
3 authorized by the Tax Commissioner directly, or indirectly, by one  
4 or more redelegations of authority to perform the functions  
5 mentioned or described in this article.

6 (7) "Development of a patent," "developing patents" or  
7 "development" means the act of fostering, causing or accelerating  
8 the progress of a process, or a machine, or the manufacturing of  
9 product, or a composition of matter, or improvement thereto through  
10 significant investment of money, performance of research, or  
11 application of design or engineering expertise, which culminates in  
12 the issuance of a patent, as defined in this article, for that  
13 process, machine, manufacturing of a product, composition of  
14 matter, or improvement.

15 (8) "Developer" means a person engaged in this state in  
16 developing patents for direct use in a manufacturing process or  
17 product and who has an agreement, as defined in this section, with  
18 Marshall University or West Virginia University.

19 (9) "Directly used in manufacturing process or product, "and  
20 "direct use in manufacturing process or product" with reference to  
21 patents ~~mean the use of patents directly in those activities or~~  
22 ~~operations which constitute an integral and essential part of the~~  
23 ~~manufacturing processes and products, as contrasted with and~~  
24 ~~distinguished from those activities or operations which are simply~~

1 ~~incidental, convenient or remote to the manufacturing activity such~~  
2 ~~as those activities that are incidental. Those activities that are~~  
3 ~~incidental to business activities such as bills, marketing,~~  
4 ~~inventory control, order fulfillment, shipping and tracking are not~~  
5 ~~considered an integral and essential part of the manufacturing~~  
6 process or product means application or incorporation of a patented  
7 process, machine, manufactured article or composition of matter, in  
8 manufacturing operations or processes, or in manufactured products,  
9 in circumstances where United States or foreign patent laws require  
10 that the specific patent for the process, machine, manufactured  
11 article or composition of matter be owned by the manufacturer, or  
12 purchased, leased, licensed or authorized by contract to be applied  
13 or incorporated in the manufacturing operation, processes or  
14 product, and where such lawful ownership, purchase, lease,  
15 licensure or contractual authorization is in effect.

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

20 (11) "Mask work" means a series of related images, however  
21 fixed or encoded:

22 (A) Having or representing the predetermined, three-  
23 dimensional pattern of metallic, insulating or semiconductor

1 material present or removed from the layers of a semiconductor chip  
2 product; and

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

6 (12) "Owner", when used in reference to a pass-through entity,  
7 means a person who owns an equity interest in the pass-through  
8 entity.

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

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

19 (15) "Patent" means a United States or foreign national patent  
20 grant or United States certificate of invention or certificate of  
21 protection under the Plant Variety Protection Office of the United  
22 States Department of Agriculture and is limited to patents  
23 developed in this state for direct use in a manufacturing process  
24 or product, or both developed for use and directly used in a

1 manufacturing process or product in this state. For purposes of  
2 this article, patents do not include copyrights, trademarks, mask  
3 works, trade secrets or any intellectual property that is not a  
4 patent.

5 (16) "Person" includes a natural person, corporation, limited  
6 liability company or partnership. A single member liability  
7 company that is treated as a disregarded entity for federal income  
8 tax purposes is be treated as a disregarded entity for purposes of  
9 this article.

10 (17) "Purchase" means a transaction under which title to an  
11 item is transferred for consideration, or a license or lease  
12 contract for at least three years is executed, regardless of  
13 whether title to the item is transferred at the end of the lease or  
14 license period.

15 (18) "Taxpayer" means any person subject to the tax imposed by  
16 article twenty-three or twenty-four of this chapter or to both  
17 taxes. In the case of a sole proprietorship that is not subject to  
18 either the tax imposed by article twenty-three or twenty-four of  
19 this chapter, the term "taxpayer" means a natural person who owns  
20 a disregarded entity and who is subject to the tax imposed by  
21 article twenty-one of this chapter on his or her income from  
22 business activity in this state, or any sole proprietor who is  
23 subject to the tax imposed by article twenty-one of this chapter.

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

6           (20) "Trade secret" means information, including a formula,  
7 pattern, compilation, program device, method, technique or process,  
8 that:

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

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

15 **§11-13AA-4. Tax incentive for developing patents in this state.**

16           (a) *Allowance of credit.* -- A person engaging in this state in  
17 developing patents for direct use in a manufacturing process or  
18 product and who has an agreement, as defined in section three of  
19 this article, with Marshall University or West Virginia University  
20 is allowed a credit, when computing the person's liability for  
21 business franchise tax imposed by article twenty-three of this  
22 chapter and corporation net income tax imposed by article twenty-  
23 four of this chapter, in the amount allowed under subsection (b) of  
24 this section. When the developer is a sole proprietor or a pass-



1 through entity, that amount of the credit remaining after first  
2 applying it against the tax liability under article twenty-three of  
3 this chapter for the taxable year is allowed when computing the tax  
4 imposed by article twenty-one of this chapter on income from the  
5 person's business activity. No credit is allowed under this  
6 article for any activity, investment, assets, or expenditures for  
7 which any of the tax credits authorized under articles thirteen-d,  
8 thirteen-e, thirteen-g, thirteen-h, thirteen-i, thirteen-j, thirteen-k,  
9 thirteen-l, thirteen-m, thirteen-n, thirteen-o, thirteen-p, thirteen-q,  
10 thirteen-r, thirteen-s, or thirteen-x of  
11 this chapter, has been authorized, taken or allowed. No credit is  
12 allowed under this article for any activity, investment, assets, or  
13 expenditures for which the tax credits authorized under article  
14 thirteen, chapter eighteen-b, has been, authorized, taken or  
15 allowed.

14 (b) *Amount of credit.* -- The amount of credit allowed under  
15 this section is equal to twenty percent of the royalties, license  
16 fees or other consideration received by the developer during the  
17 taxable year from the sale, lease or licensing of a patent  
18 developed in this state for direct use in a manufacturing process  
19 or product by the person in taxable years beginning on or after  
20 January 1, 2011: *Provided,* That the amount of credit allowed under  
21 this section is thirty percent, rather than twenty percent, when  
22 the person reinvests at least eighty percent of the amount of the  
23 credit claimed for the taxable year in depreciable property  
24 purchased for purposes of developing additional patents in this

1 state in taxable years beginning on or after January 1, 2011, or  
2 improving upon a patent developed in this state or contributing to  
3 a stipend to retain a graduate or post-doctoral student in this  
4 state integral to the development of the patents or related  
5 technology in taxable years beginning on or after January 1, 2011,  
6 during the next taxable year of the person, and the person has an  
7 agreement, as defined in section three of this article, for the  
8 development of a patent.

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

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

17       (2) When the person developed the patent for direct use in a  
18 manufacturing process or product through that person's activity in  
19 this state and through that person's activity in one or more other  
20 states, the consideration received by the developer during the  
21 taxable year from the sale, lease or license of the patent  
22 developed through multistate activity of the developer is  
23 multiplied by a fraction, the numerator of which is the direct  
24 costs of developing the patent in this state and the denominator of

1 which is the total direct costs of developing the patent. The  
2 product of this computation establishes the consideration to be  
3 used in subsection (b) of this section;

4 (3) If a person receives a portion of a royalty that would be  
5 eligible for a tax credit under this section because of a business  
6 association, licensing agreement or otherwise, the person may  
7 receive the tax credit allowable to the portion of royalties that  
8 person receives provided the person has an agreement, as defined in  
9 section three of this article, with Marshall University or West  
10 Virginia University and otherwise meets the requirements for  
11 entitlement to this credit, as set forth in subsection (a) of this  
12 section;

13 (4) Unused credit may be carried forward until the earlier of  
14 the tax year when the credit is used up or used for a period of  
15 nine the ninth consecutive tax year after the taxable year in which  
16 the credit allowed by this section accrues to the person the first  
17 tax year in which the taxpayer is eligible to claim the credit.  
18 When the person is an owner of a pass-through entity, credit  
19 ~~accrues to~~ may be taken by the owner beginning in the tax year when  
20 ~~it accrues to~~ credit may be taken by the pass-through entity or  
21 when the pass through entity gains entitlement to the credit;

22 (5) No credit is allowed under this section for consideration  
23 received by the developer for patents developed for direct use in  
24 a manufacturing process or product before the taxable year

1 beginning January 1, 2011. For purposes of this subdivision, a  
2 patent was developed for direct use in a manufacturing process or  
3 product before January 1, 2011, if ~~before that date~~ it was sold,  
4 leased or licensed to a third party prior to January 1, 2011, or  
5 before that day it was reduced to practice for purely commercial  
6 purposes by the developer or a person related to the developer, as  
7 defined in subsection (b), Section 267 of the Internal Revenue Code  
8 of 1986, as amended; ~~and as defined in section nine, article~~  
9 ~~twenty-one of this chapter or section three, article twenty-four of~~  
10 ~~this chapter; and~~

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

16 ~~(6)~~ (7) No credit is allowed under this section beginning with  
17 the eleventh taxable year after the patent was first directly used  
18 in a manufacturing process or product.

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

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

1 of the developer for the taxable year under article twenty-three of  
2 this chapter.

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

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

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

13       (B) When the developer is a pass-through entity, the amount of  
14 allowable credit remaining, if any, after first applying the credit  
15 against the tax imposed by article twenty-three of this chapter for  
16 the taxable year is allowed as a credit against the tax imposed for  
17 the taxable year on the West Virginia source income of the pass-  
18 through entity under article twenty-one of this chapter and the  
19 amount of the credit is distributed to the owners of the pass-  
20 through entity in the same manner as items of partnership income,  
21 gain loss or deduction are distributed or allocated for the taxable  
22 year.

1 **§11-13AA-5. Tax credit for use of a patent in a manufacturing**  
2 **process or product in this state that was developed**  
3 **in this state.**

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

14 (b) *Amount of credit.* -- The amount of credit allowed under  
15 this section is equal to twenty percent of the net profit  
16 attributable to the patent: *Provided,* That the amount of credit  
17 allowed under this section is equal to thirty percent of the net  
18 profit attributable to the patent when the person claiming the  
19 credit reinvests in capital improvements to add product lines to or  
20 increase productivity in this state during the next taxable year an  
21 amount equal to at least eighty percent of the tax credit amount  
22 used for the taxable year. For purposes of this article, the term  
23 "net profits" means West Virginia taxable income as determined for  
24 purposes of article twenty four of this chapter, before application

1 of this credit and after application of all credits allowable under  
2 this chapter except this credit. In the case of taxpayers that are  
3 not subject to the tax imposed by article twenty-four, "net  
4 profits" means West Virginia taxable income as determined for  
5 purposes of article twenty-one of this chapter, before application  
6 of this credit and after application of all credits allowable under  
7 this chapter except this credit. In circumstances where net profit  
8 is not solely attributable to and the exclusive result of the  
9 direct use of a patent in a manufacturing process or product in  
10 this state, the taxpayer shall determine net profit solely  
11 attributable to and the exclusive result of the direct use of a  
12 patent in a manufacturing process or product in this state, and net  
13 profit for purposes of determining the amount of credit allowable  
14 under this article shall be the net profit solely attributable to  
15 and the exclusive result of the direct use of a patent in a  
16 manufacturing process or product in this state.

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

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

1           (2) Unused credit may be carried forward until the earlier of  
2 the tax year when the credit is used up or ~~used for a period of~~  
3 ~~nine~~ the ninth consecutive tax year after ~~the taxable year in which~~  
4 ~~the credit allowed by this section accrues to the person~~ the first  
5 tax year in which the taxpayer is eligible to claim the credit.  
6 When the person is an owner of a pass-through entity, credit  
7 ~~accrues to~~ may be taken by the owner beginning in the tax year when  
8 ~~it accrues to~~ credit may be taken by the pass-through entity or  
9 when the pass through entity gains entitlement to the credit;

10           (3) Any credit not used within the ten-year period described  
11 in subdivision (2) of this subsection is forfeited beginning with  
12 the eleventh taxable year after the ~~taxable year in which the~~  
13 ~~credit accrued to the person~~ first tax year in which the taxpayer  
14 is eligible to claim the credit;

15           (4) No credit is allowed under this section for using a patent  
16 in this state when the person began using the patent before January  
17 1, 2011;

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

21           (6) No credit is allowed under this section for any patent  
22 acquired from, by or between, leased from, by or between, licensed  
23 from, by or between, or otherwise authorized to be used from, by or



1 between related persons, as defined in subsection (b), Section 267  
2 of the Internal Revenue Code of 1986, as amended.

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

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

11 (1) *Business franchise tax.* -- The amount of the allowable  
12 credit shall first be taken as a credit against the tax liability  
13 of the person allowed the credit for the taxable year under article  
14 twenty-three of this chapter.

15 (2) *Corporation net income tax.* -- The amount of the allowable  
16 credit remaining, if any, after first applying the credit against  
17 the tax imposed by article twenty-three of this chapter shall then  
18 be taken as a credit when computing the liability of the  
19 corporation for the taxable year under article twenty-four of this  
20 chapter.

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

22 (A) When the person allowed the credit is a sole proprietor,  
23 the amount of the allowable credit is taken as a credit when  
24 computing the liability of the person allowed the credit for the

1 taxable year on business income under article twenty-one of this  
2 chapter.

3       (B) When the person allowed the credit is a pass-through  
4 entity, the amount of allowable credit remaining, if any, after  
5 first applying the credit against the tax imposed by article  
6 twenty-three of this chapter for the taxable year is allowed as a  
7 credit against the tax imposed for the taxable year on the West  
8 Virginia source income of the pass-through entity under article  
9 twenty-one of this chapter and the amount of the credit is  
10 distributed to the owners of the pass-through entity in the same  
11 manner as items of partnership income, gain loss or deduction are  
12 distributed or allocated for the taxable year.

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

14       (a) *Required records.* -- Every developer of a patent in this  
15 state for direct use in a manufacturing process or product and  
16 every person who uses a patent directly in a manufacturing process  
17 or product in this state who claims a credit under this article  
18 shall maintain sufficient records to establish the following facts  
19 for each item of a patent for which a credit is allowed under this  
20 article:

21       (1) Its identity;

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

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

4           (4) The amount of credit taken; and

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

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

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

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

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

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

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

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

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

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

14 **§11-13AA-11. Interpretation and construction.**

15 (a) No inference, implication or presumption of legislative  
16 construction or intent may be drawn or made by reason of the  
17 location or grouping of any particular section, provision or  
18 portion of this article; and no legal effect may be given to any  
19 descriptive matter or heading relating to any section, subsection  
20 or paragraph of this article.

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

24 **§11-13AA-12. Effective date.**

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