WEST VIRGINIA LEGISLATURE

2021 REGULAR SESSION

Introduced

House Bill 2026

By Delegates Hanshaw (Mr. Speaker) and Skaff

By Request of the Executive

[Introduced February 22, 2021; Referred to the

Committee on Finance]

A BILL to amend the Code of West Virginia, 1931, as amended, by adding thereto a new section, designated §11-21-31; and to amend and reenact §11-24-7, relating to the modernization of the collection of income taxes by adopting uniform provisions relating to the mobile workforce; removing the "throw out" provision; replacing origin sourcing with market sourcing for services and intangible property; and changing the apportionment of multi-state income from a four factor formula to a single sales factor.

Be it enacted by the Legislature of West Virginia:

ARTICLE 21. PERSONAL INCOME TAX.

§11-21-31. Mobile employee exclusion from state source income.

(a) Compensation subject to withholding pursuant to §11-21-1 *et seq*. of this code, without regard to any withholding tax exception set forth in §11-21-71a of this code, which is received by a nonresident for employment duties performed in this state, shall be excluded from state source income if:

(1) The nonresident has no other income from sources within this state for the tax year in which the compensation was received;

(2) The nonresident is present in this state to perform employment duties for not more than 30 days during the tax year in which the compensation is received, where presence in this state for any part of a day constitutes presence for that day unless such presence is purely for purposes of transit through the state; and

(3) The nonresident's state of residence provides a substantially similar exclusion or does not impose an individual income tax.

(b) This section shall not apply to compensation received by:

(1) A person who is a professional athlete or member of a professional athletic team;

(2) A professional entertainer who performs services in the professional performing arts;

(3) A person of prominence who performs services for compensation on a per-event basis;

(4) A person who performs construction services to improve real property, predominantly

on construction sites, as a laborer;

(5) A person who performs services in the production of natural resources, predominately as a laborer or commercial driver; or

(6) A person who is a key employee, without regard to ownership or the existence of a benefit plan, for the year immediately preceding the current tax year pursuant to Section 416(i) of the Internal Revenue Code.

Key employee -- A person who is an employee of a non-corporate employer, and who would be a key employee, without regard to ownership or the existence of a benefit plan, for the year immediately preceding the current tax year pursuant to Section 416(i) of the Internal Revenue Code, if the term "employee" were substituted for the term "officer" in Section 416(i)(l)(A)(i) and if such person is one of the non-corporate employer's 50 highest paid employees without regard to whether such person is an officer.

(c) This section shall not prevent the operation, renewal or initiation of any agreement with another state authorized pursuant to this code.

(d) This section creates an exclusion from non-resident compensation under certain de minimis circumstances and has no application to this state's jurisdiction to impose this or any other tax on any taxpayer.

(e) The provisions of this section shall be effective on July 1, 2021.

ARTICLE 24. CORPORATION NET INCOME TAX.

§11-24-7. Allocation and apportionment.

(a) General. -- Any taxpayer having income from business activity which is taxable both in this state and in another state shall allocate and apportion its net income as provided in this section. For purposes of this section, the term "net income" means the taxpayer's federal taxable income adjusted as provided in section six of this article.

(b) "Taxable in another state" defined. -- For purposes of allocation and apportionment of net income under this section, a taxpayer is taxable in another state if:

(1) In that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporation stock tax; or

(2) That state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether, in fact, that state does or does not subject the taxpayer to the tax.

(c) Business activities entirely within West Virginia. -- If the business activities of a taxpayer take place entirely within this state, the entire net income of the taxpayer is subject to the tax imposed by this article. The business activities of a taxpayer are considered to have taken place in their entirety within this state if the taxpayer is not “taxable in another state”: Provided, That for tax years beginning before January 1, 2009, the business activities of a financial organization having its commercial domicile in this state are considered to take place entirely in this state, notwithstanding that the organization may be “taxable in another state”: *Provided*, however, That for tax years beginning on or after January 1, 2009, the income from the business activities of a financial organization that are taxable in another state shall be apportioned according to the applicable provisions of this article.

(d) Business activities partially within and partially without West Virginia; allocation of nonbusiness income. -- If the business activities of a taxpayer take place partially within and partially without this state and the taxpayer is also taxable in another state, rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income of the taxpayer, shall be allocated as provided in subdivisions (1) through (4), inclusive, of this subsection: *Provided*, That to the extent the items constitute business income of the taxpayer, they may not be so allocated but they shall be apportioned to this state according to the provisions of subsection (e) of this section and to the applicable provisions of section seven-b of this article.

(1) Net rents and royalties. --

(A) Net rents and royalties from real property located in this state are allocable to this state.

(B) Net rents and royalties from tangible personal property are allocable to this state:

(i) If and to the extent that the property is utilized in this state; or

(ii) In their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(C) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(2) Capital gains. --

(A) Capital gains and losses from sales of real property located in this state are allocable to this state.

(B) Capital gains and losses from sales of tangible personal property are allocable to this state if:

(i) The property had a situs in this state at the time of the sale; or

(ii) The taxpayer’s commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(C) Capital gains and losses from sales of intangible personal property are allocable to this state if the taxpayer’s commercial domicile is in this state.

(D) Gains pursuant to Section 631 (a) and (b) of the Internal Revenue Code of 1986, as amended, from sales of natural resources severed in this state shall be allocated to this state if they are nonbusiness income.

(3) Interest and dividends are allocable to this state if the taxpayer’s commercial domicile

is in this state. --

(4) Patent and copyright royalties. --

(A) Patent and copyright royalties are allocable to this state:

(i) If and to the extent that the patent or copyright is utilized by the payer in this state; or

(ii) If and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer’s commercial domicile is in this state.

(B) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer’s commercial domicile is located.

(C) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer’s commercial domicile is located.

(5) Corporate partner’s distributive share. --

(A) Persons carrying on business as partners in a partnership, as defined in Section 761 of the Internal Revenue Code of 1986, as amended, are liable for income tax only in their separate or individual capacities.

(B) A corporate partner’s distributive share of income, gain, loss, deduction or credit of a partnership shall be modified as provided in section six of this article for each partnership. For taxable years beginning on or after December 31, 1998, the distributive share shall then be allocated and apportioned as provided in this section using the partnership’s property, payroll and sales factors. The sum of that portion of the distributive share allocated and apportioned to this state shall then be treated as distributive share allocated to this state; and that portion of distributive share allocated or apportioned outside this state shall be treated as distributive share allocated outside this state, unless the taxpayer requests or the Tax Commissioner, under subsection (h) of this section requires that the distributive share be treated differently.

(C) This subdivision shall be null and void and of no force or effect for tax years beginning on or after January 1, 2009.

(e) Business activities partially within and partially without this state; apportionment of business income. -- All net income, after deducting those items specifically allocated under subsection (d) of this section, shall be apportioned to this state by multiplying the net income by a fraction, the numerator of which is the property factor plus the payroll factor plus two times the sales factor and the denominator of which is four, reduced by the number of factors, if any, having no denominator: *Provided*, That for tax years beginning on or after January 1, 2022, all net income, after deducting those items specifically allocated under subsection (d) of this section, shall be apportioned to this state by multiplying the net income by the sales factor described in this subsection.

(1) Property factor. -- The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used by it in this state during the taxable year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used by the taxpayer during the taxable year, which is reported on Schedule L Federal Form 1120, plus the average value of all real and tangible personal property leased and used by the taxpayer during the taxable year.

(2) Value of property. -- Property owned by the taxpayer shall be valued at its original cost, adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc.: *Provided*, That where records of original cost are unavailable or cannot be obtained without unreasonable expense, property shall be valued at original cost as determined under rules of the Tax Commissioner. Property rented by the taxpayer from others shall be valued at eight times the annual rental rate. The term “net annual rental rate” is the annual rental paid, directly or indirectly, by the taxpayer, or for its benefit, in money or other

consideration for the use of property and includes:

(A) Any amount payable for the use of real or tangible personal property, or any part of the property, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

(B) Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and the other items.

(3) Movable property. -- The value of movable tangible personal property used both within and without this state shall be included in the numerator to the extent of its utilization in this state. The extent of the utilization shall be determined by multiplying the original cost of the property by a fraction, the numerator of which is the number of days of physical location of the property in this state during the taxable period and the denominator of which is the number of days of physical location of the property everywhere during the taxable year. The number of days of physical location of the property may be determined on a statistical basis or by other reasonable method acceptable to the Tax Commissioner.

(4) Leasehold improvements. -- Leasehold improvements shall, for purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Leasehold improvements shall be included in the property factor at their original cost.

(5) Average value of property. -- The average value of property shall be determined by averaging the values at the beginning and ending of the taxable year: *Provided*, That the Tax Commissioner may require the averaging of monthly values during the taxable year if substantial fluctuations in the values of the property exist during the taxable year, or where property is acquired after the beginning of the taxable year, or is disposed of, or whose rental contract

ceases, before the end of the taxable year.

(6) Payroll factor. -- The payroll factor is a fraction, the numerator of which is the total compensation paid in this state during the taxable year by the taxpayer for compensation and the denominator of which is the total compensation paid by the taxpayer during the taxable year, as shown on the taxpayer’s federal income tax return as filed with the Internal Revenue Service, as reflected in the schedule of wages and salaries and that portion of cost of goods sold which reflects compensation or as shown on a pro forma return.

(7) Compensation. -- The term “compensation” means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or to any other person not properly classifiable as an employee shall be excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered as paid directly to employees include the value of board, rent, housing, lodging and other benefits or services furnished to employees by the taxpayer in return for personal services, provided the amounts constitute income to the recipient for federal income tax purposes.

(8) Employee. -- The term “employee” means:

(A) Any officer of a corporation; or

(B) Any individual who, under the usual common-law rule applicable in determining the employer-employee relationship, has the status of an employee.

(9) Compensation. -- Compensation is paid or accrued in this state if:

(A) The employee’s service is performed entirely within this state; or

(B) The employee’s service is performed both within and without this state, but the service performed without the state is incidental to the individual’s service within this state. The word “incidental” means any service which is temporary or transitory in nature or which is rendered in connection with an isolated transaction; or

(C) Some of the service is performed in this state and:

(i) The employee’s base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state; or

(ii) The base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the employee's residence is in this state.

The term "base of operations" is the place of more or less permanent nature from which the employee starts his or her work and to which he or she customarily returns in order to receive instructions from the taxpayer or communications from his or her customers or other persons or to replenish stock or other materials, repair equipment or perform any other functions necessary to the exercise of his or her trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

(10) Sales factor. -- The sales factor is a fraction, the numerator of which is the gross receipts of the taxpayer derived from transactions and activity in the regular course of its trade or business in this state during the taxable year (business income), less returns and allowances. The denominator of the fraction is the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business during the taxable year (business income) and reflected in its gross income reported and as appearing on the taxpayer's Federal Form 1120 and consisting of those certain pertinent portions of the (gross income) elements set forth: *Provided*, That if either the numerator or the denominator includes interest or dividends from obligations of the United States government which are exempt from taxation by this state, the amount of such interest and dividends, if any, shall be subtracted from the numerator or denominator in which it is included.

(11) Allocation of sales of tangible personal property. --

(A) Sales of tangible personal property are in this state if:

(i) The property is received in this state by the purchaser, other than the United States government, regardless of the f.o.b. point or other conditions of the sale. In the case of delivery by common carrier or other means of transportation, the place at which the property is ultimately received after all transportation has been completed is the place at which the property is received by the purchaser. Direct delivery in this state, other than for purposes of transportation, to a person or firm designated by the purchaser, is delivery to the purchaser in this state and direct delivery outside this state to a person or firm designated by the purchaser is not delivery to the purchaser in this state, regardless of where title passes or other conditions of sale; or

(ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this state and the purchaser is the United States government.

(B) All other sales of tangible personal property delivered or shipped to a purchaser within a state in which the taxpayer is not taxed, as defined in subsection (b) of this section, shall be excluded from the denominator of the sales factor.

<u>(C) For sales made on or after January 1, 2022, the provisions of paragraph (B) of this subdivision shall no longer apply.</u>

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

(A) The income-producing activity is performed in this state; or

(B) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance; <u>or</u>

(C) <u>The sale is made on or after January 1, 2022, and:</u>

<u>(i) In the case of sale of a service, if and to the extent the service is delivered to a location in this state; and</u>

<u>(i) In the case of intangible property, that is rented, leased, or licensed, if and to the extent the property is used in this state: *Provided*, That intangible property utilized in marketing a good or service to a consumer is “used in this state” if that good or service is:</u>

<u>(I) Purchased by a consumer who is in this state; and</u>

(II) Is sold, if and to the extent the property is used in this state.

(D) A contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is "used in this state" if the geographic area includes all or part of this state;

(E) Receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as sales receipts from the rental, lease or licensing of such intangible property under this paragraph; and

(F) All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the sales factor; or

~~(C)~~ (G) The sale constitutes business income to the taxpayer, or the taxpayer is a financial organization not having its commercial domicile in this state, and in either case the sale is a receipt described as attributable to this state in §11-24-7b of this code.

(13) Financial organizations and other taxpayers with business activities partially within and partially without this state. -- Notwithstanding anything contained in this section to the contrary, in the case of financial organizations and other taxpayers, not having their commercial domicile in this state, the rules of this subsection apply to the apportionment of income from their business activities except as expressly otherwise provided in §11-24-7b of this code.

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

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

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

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

(4) The sale, licensing or other use of intangible personal property.

The mere holding of intangible personal property is not, in itself, an income-producing activity: *Provided*, That the conduct of the business of a financial organization is an income-producing activity.

(g) Cost of performance. -- The term “cost of performance” means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

(h) Other methods of allocation and apportionment. --

(1) General. -- If the allocation and apportionment provisions of subsections (d) and (e) of this section do not fairly represent the extent of the taxpayer's business activities in this state, the taxpayer may petition for or the Tax Commissioner may require, in respect to all or any part of the taxpayer's business activities, if reasonable:

(A) Separate accounting;

(B) The exclusion of one or more of the factors;

(C) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(D) The employment of any other method to effectuate an equitable allocation or apportionment of the taxpayer’s income. The petition shall be filed no later than the due date of the annual return for the taxable year for which the alternative method is requested, determined without regard to any extension of time for filing the return and the petition shall include a statement of the petitioner’s objections and of the alternative method of allocation or apportionment as it believes to be proper under the circumstances with detail and proof as the Tax Commissioner requires.

(2) Alternative method for public utilities. -- If the taxpayer is a public utility and if the allocation and apportionment provisions of subsections (d) and (e) of this section do not fairly

represent the taxpayer's business activities in this state, the taxpayer may petition for, or the Tax Commissioner may require, as an alternative to the other methods provided in subdivision (1) of this subsection, the allocation and apportionment of the taxpayer’s net income in accordance with any system of accounts prescribed by the Public Service Commission of this state pursuant to the provisions of §24-2-8 of this code: *Provided*, That the allocation and apportionment provisions of the system of accounts fairly represent the extent of the taxpayer’s business activities in this state for the purposes of the tax imposed by this article.

(3) Burden of proof. -- In any proceeding before the Tax Commissioner or in any court in which employment of one of the methods of allocation or apportionment provided in subdivision (1) or (2) of this subsection is sought, on the grounds that the allocation and apportionment provisions of subsections (d) and (e) of this section do not fairly represent the extent of the taxpayer’s business activities in this state, the burden of proof is:

(A) If the Tax Commissioner seeks employment of one of the methods, on the Tax Commissioner; or

(B) If the taxpayer seeks employment of one of the other methods, on the taxpayer.

NOTE: The purpose of this bill is to modernize the collection of income taxes by adopting uniform treatment of mobile employee income and by ending the “throw out” rule, which provided that gross receipts from untaxed sales of tangible personal property are excluded from the denominator of the sales factor when apportioning the business income of the taxpayer, which resulted in higher state income taxes. This bill also changes the apportionment of sales of services and intangible personal property to market sourcing instead of origin sourcing, which would make West Virginia’s treatment similar to treatment by the majority of jurisdictions. Lastly, this bill eliminates the payroll and property factors and thus apportions income on a single sales factor only.

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