

WEST VIRGINIA COMMERCIAL PATENT INCENTIVES TAX CREDIT

TAX CREDIT REVIEW AND ACCOUNTABILITY REPORT

March 18, 2014

Submitted by:
West Virginia State Tax Department
Mark W. Matkovich
State Tax Commissioner

WEST VIRGINIA COMMERCIAL PATENT INCENTIVES TAX CREDIT

As enacted in 2010, the West Virginia Commercial Patent Incentives Tax Credit Act requires an annual Tax Credit Review and Accountability Report. Specifically, West Virginia Code §11-13AA-9(a) states the following:

“Beginning on February 1, 2013, and continuing annually on February 1, the Tax Commissioner shall submit to the Governor, the President of the Senate and the Speaker of the House of Delegates a tax credit review and accountability report evaluating the cost effectiveness of the credits allowed under this article during the most recent year for which information is available. The criteria to be evaluated include, but are not limited to, for each year:

- (1) The numbers of taxpayers claiming the credit;
- (2) The net number, type and duration of new jobs created by all taxpayers claiming the credit and the wages and benefits paid;
- (3) The cost of the credit;
- (4) The cost of the credit per new job created; and
- (5) A comparison of employment trends for the industry and for taxpayers within the industry that claim the credit or deduction.”

The following report is provided in conformity with the above requirement. This report provides information on the Commercial Patent Incentives Tax Credit reported on tax returns in State Tax Department databases as of March 14, 2014.

Introduction

The purpose of the West Virginia Commercial Patent Incentives Tax Credit Act as stated in West Virginia Code §11-13AA-2 is “The legislature finds that encouraging the development and use of commercial intellectual properties in the state is in the public interest and promotes the general welfare of the people of this state.”

Mirroring the legislative purpose, the Commercial Patent Incentives Tax Credit Act provides a tax credit for the development of patents in West Virginia and a tax credit for the commercial use of a patent in a manufacturing process or product in West Virginia. For purposes of the West Virginia Commercial Patent Incentives Tax Credit, “patent” means a United States patent issued pursuant to 35 U.S.C. §101, et seq. or the Patent Cooperation Treaty done at Washington, on June 19, 1970 and is limited to plant patents, design patents and patents developed in West Virginia for direct use in a manufacturing process or product, or both developed for use and directly used in a manufacturing process or product in West Virginia. And, for purposes of the West Virginia Commercial Patent Incentives Tax Credit, patents do not

include copyrights, trademarks, mask works, trade secrets or any intellectual property that is not a patent.

As summarized from West Virginia Code §11-13AA-4, the Commercial Patent Incentives Tax Credit incentive for developing patents in West Virginia pertains to the development of patents in taxable years beginning on or after January 1, 2011. The amount of credit allowed is equal to:

1. Twenty percent of the royalties, license fees or other consideration received by the developer during the taxable year from the sale, lease or licensing of a patent developed in West Virginia for direct use in a manufacturing process or product; or
2. Thirty percent of the royalties, license fees or other consideration received if the Taxpayer reinvests at least eighty percent of the amount of the credit claimed for the taxable year in depreciable property purchased for purposes of developing additional patents in West Virginia, or improving upon a patent developed in this state or contributing to a stipend to retain a graduate or post-doctoral student in West Virginia integral to the development of the patents or related technology during the next taxable year of the Taxpayer, and the Taxpayer has an agreement for the development of a patent.

Definitions from West Virginia Code §11-13AA-3 applicable to the incentive for developing patents in West Virginia, include the following:

“Development of a patent,” “developing patents” or “development” means the act of inventing or discovering any new and useful process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereto through significant investment of money, performance or research, or application of design or engineering expertise, which culminates in the issuance of a patent, as defined in West Virginia Code §11-13AA, et seq.

“Developer” means a person engaged in West Virginia in developing patents for direct use in a manufacturing process or product and who has an agreement, as defined in West Virginia Code §11-13AA-3, with Marshall University or West Virginia University.

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

“Agreement” means any agreement or contractual relationship entered into after the effective date of West Virginia Code §11-13AA-3 between a person developing patents in West Virginia and either:

- (A) A corporation established under the laws of this state that meet the requirements of section three, article twelve, chapter eighteen-b of the West Virginia Code; or
- (B) A center for economic development and technological advancement created pursuant to section three, article twelve-a, chapter eighteen-b of the West Virginia Code.

The Commercial Patent Incentives Tax Credit incentive for use of a patent in a manufacturing process or product in West Virginia, as summarized from West Virginia Code §11-13AA-5, pertains to the use of qualifying patents beginning on or after January 1, 2011. The amount of credit allowed is equal to:

1. Twenty percent of the net profit attributable to the patent; or
2. Thirty percent of the net profit attributable to the patent when the Taxpayer claiming the credit reinvests in capital improvements to add product lines or to increase productivity in West Virginia during the next taxable year equal to at least eighty percent of the tax credit amount used for the taxable year.

Definitions from West Virginia Code §11-13AA-3 applicable to the incentive for use of patents in West Virginia, include the following:

“Commercial use” means selling, licensing, leasing or otherwise making patents available to a third party for a price, fee, royalty, commission or other consideration called by whatever name. “Commercial use” also means, in the case of patents developed by the developer for the developer’s own commercial use, the first use of the patents in a manufacturing or other business activity of the developer. “Commercial use” does not include any selling, licensing, leasing or otherwise making patents available to a third party when done by a broker or by any person who does not own the patent sold, licensed, leased or otherwise made available.

“Directly used in a manufacturing process or product,” and “direct use in manufacturing process or product” with reference to patents means application or incorporation of a patented process, machine, article of manufacture or composition of matter, in manufacturing operations or processes, or in manufactured products, in circumstances where United States or foreign patent laws require that the specific patent for the process, machine, article of manufacture or composition of matter be owned by the manufacturer, or purchases, leased, licensed or authorized by contract to be applied or incorporated in the manufacturing operation, processes or product, and where such lawful ownership, purchase, lease licensure or contractual authorization is in effect.

“Net profits” means West Virginia taxable income as determined for purposes of West Virginia Code §11-24 et seq., before application of the Commercial Patent Incentives Tax Credit and after the application of all credits allowable under Chapter 11 of the West

Virginia Code except for the Commercial Patent Incentives Tax Credit. In the case of taxpayers that are not subject to the tax imposed by West Virginia Code §11-24 et seq., “net profits” means West Virginia taxable income as determined for purposes of West Virginia Code §11-21 et seq. before application of the Commercial Patent Incentives Tax Credit and after the application of all credits allowable under Chapter 11 of the West Virginia Code except for the Commercial Patent Incentives Tax Credit. In circumstances where net profit is not solely attributable to and the exclusive result of the direct use of a patent in a manufacturing process or product in West Virginia, the taxpayer shall determine net profit solely attributable to and the exclusive result of the direct use of a patent in a manufacturing process or product in West Virginia, and net profit for purposes of determining the amount of Commercial Patent Incentives Tax Credit allowable shall be the net profit solely attributable to and the exclusive result of the direct use of a patent in a manufacturing process or product in West Virginia.

Other statutory provisions relating to the Commercial Patent Incentives Tax Credit (both the credit for development of a patent and the credit for use of a patent) include the following:

- The Commercial Patent Incentives Tax Credit is allowed against tax imposed by W. Va. Code §11-23-1 et seq. (Business Franchise Tax), W. Va. Code §11-24-1 et seq. (Corporation Net Income Tax), and Personal Income Tax on business income (W. Va. Code §11-21-1 et seq.), but the credit may not reduce the tax below zero.
- Unused credit may be carried forward until the earlier of the tax year when the credit is used up or the ninth consecutive year after the first tax year in which the taxpayer is eligible to claim the credit.
- No Commercial Patent Incentives Tax Credit is allowed for consideration received by the developer from a person related to the developer, as defined in subsection (b), Section 267 of the Internal Revenue Code of 1986, as amended for patents developed for direct use in a manufacturing process or product.

Cost Effectiveness - Commercial Patent Incentives Tax Credit

As written in West Virginia Code §11-13AA-9(a), the State Tax Commissioner is required to submit a tax credit review and accountability report evaluating the cost effectiveness of the credits allowed under the Commercial Patent Incentives Tax Credit Act. The minimum criteria for the tax credit review and accountability report include the following:

- (1) The numbers of taxpayers claiming the credit;
- (2) The net number, type and duration of new jobs created by all taxpayers claiming the credit and the wages and benefits paid;
- (3) The cost of the credit;
- (4) The cost of the credit per new job created; and
- (5) A comparison of employment trends for the industry and for taxpayers within the industry that claim the credit or deduction.

Tax returns stored in State Tax Department databases as of March 14, 2014 contain no valid claims of the Commercial Patent Incentives Tax Credit. Therefore, there is no statistical information upon which an analysis can be made pursuant to the above enumerated tax credit review and accountability criteria. It should be noted that most new programs go through a start-up period, with participation in the program increasing over time. Other tax credit programs have required three or more years to show a significant number of claims.