WEST VIRGINIA CODE CHAPTER 11 ARTICLE 13AA

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§11-13AA-1. Short title.

This article may be cited as the "West Virginia Commercial Patent Incentives Tax Act."

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§11-13AA-2. Legislative findings and purpose.

The Legislature finds that encouraging the development and use of commercial intellectual properties in this state is in the public interest and promotes the general welfare of the people of this state. In order to encourage greater development and use in this state of commercial intellectual properties by West Virginia businesses and thereby increase economic opportunity in this state, there are hereby enacted tax incentives for developing and using patents in this state.

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§11-13AA-3. Definitions.

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

(b) Terms defined. --

(1) "Agreement" means any agreement or contractual relationship entered into after the effective date of this section between a person developing patents in this state 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 this code; or

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

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

(3) "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.

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

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

(6) "Delegate" in the phrase "or his or her delegate", when used in reference to the Tax Commissioner, means any officer or employee of the Tax Department of the Department of Revenue duly authorized by the Tax Commissioner directly, or indirectly, by one or more redelegations of authority to perform the functions mentioned or described in this article.

(7) "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

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composition of matter, or any new and useful improvement thereto through significant investment of money, performance of research, or application of design or engineering expertise, which culminates in the issuance of a patent, as defined in this article.

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

(9)"Directly used in 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 purchased, 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.

(10) "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.

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

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

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

(12) "Net profits" means West Virginia taxable income as determined for purposes of article twenty four of this chapter, before application of this credit and after application of all credits allowable under this chapter except this credit. In the case of taxpayers that are not subject to the tax imposed by article twenty-four, "net profits" means West Virginia taxable income as determined for purposes of article twenty-one of this chapter, before application of this credit and after application of all credits allowable under this chapter except this 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 this state, 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 this state, and net profit for purposes of determining the amount of credit allowable under this article 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 this state.

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

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

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

(16) "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 this state for direct use in a manufacturing process or product, or both developed for use and directly used in a manufacturing process or product in this state. For purposes of this article, patents do not include copyrights, trademarks, mask works, trade secrets or any intellectual property that is not a patent.

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

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

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

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

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

(A) Derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means, by other persons who can obtain

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economic value from its disclosure or use; and

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

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

(a) Allowance of credit. -- A person engaging in this state in developing plant patent, design patent or patents for direct use in a manufacturing process or product and who has an agreement, as defined in section three of this article, is allowed a credit, when computing the person's liability for business franchise tax imposed by article twenty-three of this chapter and corporation net income tax imposed by article twenty-four of this chapter, in the amount allowed under subsection (b) of this section. When the developer is a sole proprietor or a pass-through entity, that amount of the credit remaining after first applying it against the tax liability under article twenty-three of this chapter for the taxable year is allowed when computing the tax imposed by article twenty-one of this chapter on income from the person's business activity. No credit is allowed under this article for any activity, investment, assets, or expenditures for which any of the tax credits authorized under articles thirteen-d, thirteen-e, thirteen-q, thirteen-r, thirteen-s, or thirteen-x of this chapter, has been authorized, taken or allowed. No credit is allowed under this article for any activity, investment, assets, or expenditures for which the tax credits authorized under article thirteen, chapter eighteen-b, has been, authorized, taken or allowed.

(b) Amount of credit. -- The amount of credit allowed under this section is equal to 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 this state for direct use in a manufacturing process or product by the person in taxable years beginning on or after January 1, 2011: Provided, That the amount of credit allowed under this section is thirty percent, rather than twenty percent, when the person 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 this state in taxable years beginning on or after January 1, 2011, or improving upon a patent developed in this state or contributing to a stipend to retain a graduate or post-doctoral student in this state integral to the development of the patents or related technology in taxable years beginning on or after January 1, 2011, during the next taxable year of the person, and the person has an agreement, as defined in section three of this article, for the development of a patent.

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

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

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

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

(3) If a person receives a portion of a royalty that would be eligible for a tax credit under this section because of a business association, licensing agreement or otherwise, the person may receive the tax credit allowable to the portion of royalties that person receives provided the person has an agreement, as defined in section three of this article and otherwise meets the requirements for entitlement to this credit, as set forth in subsection (a) of this section;

(4) Unused credit may be carried forward until the earlier of the tax year when the credit is used up or the ninth consecutive tax year after the first tax year in which the taxpayer is eligible to claim the credit. When the person is an owner of a pass-through entity, credit may be taken by the owner beginning in the tax year when credit may be taken by the pass-through entity or when the pass through entity gains entitlement to the credit;

(5) No credit is allowed under this section for consideration received by the developer for patents developed for direct use in a manufacturing process or product before the taxable year beginning January 1, 2011. For purposes of this subdivision, a patent was developed for direct use in a manufacturing process or product before January 1, 2011, if it was sold, leased or licensed to a third party prior to January 1, 2011, or before that day it was reduced to practice for purely commercial purposes by the developer or a person related to the developer, as defined in subsection (b), Section 267 of the Internal Revenue Code of 1986, as amended;

(6) No credit is allowed under this section 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; and

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

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

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

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

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

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

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

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§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.

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

(b) Amount of credit. -- The amount of credit allowed under this section is equal to twenty percent of the net profit attributable to the patent: Provided, That the amount of credit allowed under this section is equal to thirty percent of the net profit attributable to the patent when the person claiming the credit reinvests in capital improvements to add product lines to or increase productivity in this state during the next taxable year an amount equal to at least eighty percent of the tax credit amount used for the taxable year.

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

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

(2) Unused credit may be carried forward until the earlier of the tax year when the credit is used up or the ninth consecutive tax year after the first tax year in which the taxpayer is eligible to claim the credit. When the person is an owner of a pass-through entity, credit may be taken by the owner beginning in the tax year when credit may be taken by the pass-through entity or when the pass through entity gains entitlement to the credit;

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

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

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

(6) No credit is allowed under this section for any patent acquired from, by or between, leased from, by or between, licensed from, by or between, or otherwise authorized to be used from, by or between related persons, as defined in subsection (b), Section 267 of the

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Internal Revenue Code of 1986, as amended.

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

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

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

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

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

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

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

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§11-13AA-6. Transfer of credit to successors.

(a) Mere change in form of business. -- A patent may not be treated as disposed of by reason of a mere change in the form of conducting the business as long as the patent is retained and directly used in a manufacturing process or product in this state and the person that developed the patent retains a controlling interest in the successor business. In this event, the successor business is allowed to claim the amount of credit still available with respect to the patent transferred to a successor.

(b) Transfer or sale to successor. -- A patent may not be treated as disposed of under this article by reason of any transfer or sale to a successor business which continues to directly use the patent in a manufacturing process or product in this state. Upon transfer or sale, the successor acquires the amount of credit or deduction that remains available under this article for each subsequent taxable year.

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

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

(1) Its identity;

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

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

(4) The amount of credit taken; and

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

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

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

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

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

(4) The date the depreciable property identified in subdivision (1) of this subsection was taken out of service or use in the person's business activity in this state and the reason why the property was taken out of service or use; and

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

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

(d) Exception. -- This section does not apply to an owner of a pass-through entity that

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develops or uses a patent for which a credit is allowed under this article.

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§11-13AA-8. Failure to keep records of a patent for which credit allowed.

A person who does not keep the records required for identification of a patent for which a credit would be allowable under this article is subject to the following rules:

(1) A person is treated as having disposed of, during the taxable year, any patent for which a credit was allowed under this article which the taxpayer cannot establish is still being directly used in the person's manufacturing process or product in this state at the end of that year;

(2) If a person cannot establish when a patent was placed in service in direct use in the person's manufacturing process or product in this state, no credit is allowed under this article.

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§11-13AA-9. Tax credit review and accountability.

(a) 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 number 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; and

(b) Taxpayers claiming the credit shall provide information that the Tax Commissioner requires to prepare the report required by this section. The information is subject to the confidentiality and disclosure provisions of sections five-d and five-s, article ten of this chapter.

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§11-13AA-10. Promulgation of rules.

The Tax Commissioner shall adopt procedural and interpretive rules or propose legislative rules for legislative approval, as appropriate, in the manner prescribed in article three, chapter twenty-nine-a of this code, that the Tax Commissioner considers necessary to administer this article.

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

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

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

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§11-13AA-12. Effective date.

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

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§11-13AA-13. Termination of credit.

The Tax Commissioner may not allow any credit for a patent developed or purchased leased or licensed after December 31, 2016, unless this credit is sooner terminated or continued by the Legislature. Termination of the credit allowed by this article, as provided in this section, does not adversely affect the ability of a taxpayer to claim the benefit of any credit accruing under this article prior to January 1, 2016.

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