June 1989

The Fiscal Responsibility Act of 1989 and Other Tax Changes Made by the 1989 West Virginia Legislature

Harry Preston Henshaw III

Follow this and additional works at: https://researchrepository.wvu.edu/wvlr

Part of the Taxation-State and Local Commons

Recommended Citation
Available at: https://researchrepository.wvu.edu/wvlr/vol91/iss4/7

This Article is brought to you for free and open access by the WVU College of Law at The Research Repository @ WVU. It has been accepted for inclusion in West Virginia Law Review by an authorized editor of The Research Repository @ WVU. For more information, please contact ian.harmon@mail.wvu.edu.
I. INTRODUCTION

The special session of the 1989 West Virginia State Legislature was faced with a large state deficit.1 Therefore, the Governor and the Legislature determined that substantial tax increases were in-

---

1. The first extraordinary session of 1989 was called by Governor Caperton immediately after taking office on January 16, 1989. Governor Caperton also appointed a Financial Condition Task Force to report on the State deficit. In its report dated January 16, 1989, the Task Force estimated the deficit at $148,000,000 as of November 30, 1988.
escapable in order to put the state on a sound fiscal basis. The result was the Fiscal Responsibility Act of 1989 ("FRA") enacted during the special session of the Legislature in January, 1989. The FRA is unprecedented in the magnitude of additional revenue it will generate through increased taxes. So that the burden would be fairly distributed, the tax increases were equally distributed between business and individuals. Therefore, the changes made by the FRA are important to all taxpayers in the state. In the regular session of the state legislature additional changes in the tax laws were made which are not as significant in terms of the revenue which they will generate but which are much more complex. A brief summary of the taxes involved and an explanation of the most significant of the tax changes made in the special and regular sessions of the Legislature follows.

II. SALES AND SERVICE TAX AND THE USE TAX

A. Summary

The West Virginia consumer sales tax was first adopted in 1933. The use tax was adopted in 1951 and generally subjects a West Virginia consumer to tax on a purchase from an out-of-state vendor where the purchaser would have paid the sales and service tax if the purchase had been made in West Virginia. These taxes were originally "consumer oriented" and provided for broad exemptions for businesses and intermediate purchasers. In 1987, the Legislature enacted the West Virginia Tax Reform Act of 1987 which substantially changed the sales and service tax and the use tax broadening the base of those taxes. In 1988, the Legislature temporarily increased until July 1, 1989 the tax rate from five percent

LEGISLATIVE TAX CHANGES

Henshaw: The Fiscal Responsibility Act of 1989 and Other Tax Changes Made

1023


8. Id.


to six percent. After July 1, 1989, the rate was to revert to the prior rate.

The sales and service tax is imposed upon the ultimate consumer, and there is a presumption that all the transactions involving tangible personal property and services are subject to the tax unless specifically exempted by statute. There are three methods of exemptions from the tax: 1) per se exemptions; 2) exemptions for which an exemption certificate is required; and 3) exemptions which require the taxpayer to pay the tax and then apply for a refund claiming the transaction was exempt.

Per se exemptions are exemptions from the sales and service tax which do not require the purchaser to present an exemption certificate or direct pay permit in order to avoid the collection of the tax by the seller. The following types of transactions are per se exempted:

1) Sales of gas, steam or water;
2) Sales of electricity;
3) Sales of public services regulated by the PSC;
4) Sales of textbooks;
5) Sales of isolated transactions;
6) Sales of delivered newspapers;
7) Sales of prescription drugs;
8) Sales of day care services;
9) Sales of lottery tickets;
10) Leases of licensed motor vehicles;
11) Sales of food;
12) Sales of items purchased with food stamps;
13) Sales of tickets for school activities;
14) Sales of advertisements;
15) Sales of personal services;
16) Sales of professional services;
17) Charges for contracting;
18) Services for an employer; and
19) Sales prohibited from taxation by law.

Certain sales of tangible personal property and services are exempt from collection of the sales and service tax if an exemption certificate is presented to and accepted by the vendor at the time of sale. The exemption of the following transactions may be asserted with an exemption certificate:

1) Sales to the state and federal governments;
2) Sales of licensed vehicles;
3) Sales to churches;
4) Sales of tangible personal property to purchasers for resale;
5) Sales of taxable services for resale;
6) Sales to schools;
7) Sales of mobile homes;
8) Sales of propane for poultry house heating;
9) Sales of property or services to be used as part of a taxable service;
10) Sales to be used in agricultural production; and
11) Sales of building material for use in a "qualified business" or "enterprise zone."

The purchaser in the following types of transactions may apply for a refund or a credit against other taxes for the sales and service tax collected by a vendor.

1) Sales to certain charitable organizations;
2) Sales to be directly used or consumed in manufacturing, contracting, transportation, transmission, communication or production of resources;
3) Sales to fraternities and social organizations;
4) Sales of firefighting equipment to volunteer fire departments;
5) Casual sales by certain charities;
6) Sales to a business subject to the business and occupation tax on utilities, the business and occupation tax on the production of electricity, the severance tax or the telecommunications tax; and
7) Sales of electronic data processing services.

The exemptions from the use tax are the same as those from the sales and service tax with several additional categories applicable only to the use tax.

---

B. Changes

1. Continuation of Six Percent Tax Rate

The one percent increase in the sales and service tax and the use tax was made permanent by the FRA instead of expiring July 1, 1989, as originally provided.\textsuperscript{15} The additional revenues generated by the one percent sales tax increase are to continue to be dedicated to the repayment of the state government's debt to the pneumoconiosis fund.\textsuperscript{16} The continuation of the one percent increase will generate or preserve $65,000,000 in state revenue.\textsuperscript{17}

2. Removal of Exemption for Sales of Food

As noted above, the sales of food by grocery-type stores (but not by other establishments such as restaurants) were per se exempt. The exemption for sales of food was removed by the FRA.\textsuperscript{18} Such removal is a crucial element of the FRA because of the large amount of revenue from individual taxpayers that it will generate. The sales tax on food will generate $144,000,000 in additional state revenue according to projections.\textsuperscript{19}

3. Limited Exemption for Sales of Food

Although the sale of food is no longer generally exempt effective March 1, 1989, effective July 1, 1989, the following specific sales of food are exempt per se unless otherwise noted:\textsuperscript{20}


\textsuperscript{17} Charleston Gazette, Feb. 1, 1989, at 1A, col. 4.

\textsuperscript{18} W. VA. CODE § 11-15-11, providing the exemption for the sales of food, was repealed by S.B. 1, c. 42, 1989 W. Va. Acts.


\textsuperscript{20} W. VA. CODE § 11-15-11, which sets forth the exemption for food, was deleted by S.B. 1, c. 42, 1989 W. Va. Acts; W. VA. CODE §§ 11-15-33(b) and 11-15A-29(b) set forth the effective dates for the changes made in the regular session of the Legislature by S.B. 303 in the first extraordinary session of the Legislature. These effective dates are different than the effective dates of the changes made by S.B. 1, which are set forth in W. VA. CODE §§ 11-15-33(a) and 11-15-29(a); W. VA. CODE §§ 11-15-9(dd) and 11-15-9(ee), as added by S.B. 303, set forth the new limited exemptions for the sale and/or purchase of food; W. VA. EMER. REG. 110 C.S.R. 15 § 9.2.11 (1989) provides that these food exemptions are per se exemptions.
1) Food purchased or sold by public or private schools or school sponsored organizations if the food is sold to students and employees during normal school hours;
2) Food purchased or sold by public or private colleges or universities or by a student organization recognized by such if the food is sold on a contract basis for a specific period at a fixed price without regard to the quantity of the food consumed;
3) Food purchased or sold by nonprofit organizations or a government agency under a program funded by the state or federal government for low income, elderly persons if the food is sold at or below cost;
4) Food sold in an occasional manner by a charitable or nonprofit organization if the sale is to obtain revenue for the activities of the organization and the revenue is so expended;
5) Food sold by religious organizations at a gathering if the purpose of selling the food is to obtain revenue for the activities of the organization and the revenue is so expended;
6) Food sold by little leagues and other youth groups to obtain revenue for their activities and the revenue is actually so expended;
7) Food purchased with food stamps pursuant to the Federal Food Stamp Program and warrants issued pursuant to the West Virginia Special Supplemental Food Program;\(^{21}\) and
8) Food purchased by charitable organizations and churches for distribution without charge, but only by certificate.\(^ {22} \)

4. Removal of Exemption for Purchases by Contractors

Sales to contractors of property or services directly used or consumed in the activity of contracting were formerly a refundable exemption. Since the charges for contracting are also exempt from a sales and service tax (a per se exemption), the Legislature believed that the additional exemption for purchases by contractors was too liberal. Consequently, the FRA removed the exemption for purchases by contractors.\(^ {23} \) Since purchases for resale are exempt (if a certificate is presented), there was concern that some purchases made by a contractor might be considered exempt as purchases for resale even after the removal of the foregoing exemption. Therefore, the Legislature further amended the law so

\(^ {23} \) W. Va. Code § 11-15-9(g) was amended by S.B. 1 to delete any reference to contracting so that only sales directly used or consumed in manufacturing, transportation, transmission, communication or in the production of natural resources are now exempt.
that property installed, fixed or incorporated into realty by a contractor is not exempt from the sales and service tax as a purchase for resale.\textsuperscript{24} Sales to persons engaged in contracting or subcontracting pursuant to a written contract with the state of West Virginia, a political subdivision thereof or a public corporation continue to be exempt from the sales and use tax if the improvement will be owned and used for a governmental purpose.\textsuperscript{25}

5. Transitional Rules for Existing Contracts

The effective date of the removal of the exemption for purchases by contractors generally is March 1, 1989. However, there are detailed transitional rules phasing out the exemption. The following transactions are not subject to the new law:\textsuperscript{26}

1) Purchases in fulfillment of a written contract that was executed and legally binding on or before February 15, 1989;
2) Purchases in fulfillment of a written contract entered into after February 15, 1989, which was based on a written bid that was binding on a contractor before that date;
3) Purchases pursuant to a written contract that was executed on or before February 15, 1989, for specified quantities of identified tangible personal property or specified services; and
4) Purchases by a contractor for consumption or use in fulfillment of a written contract for improvement to real estate entered into before September 1, 1989, which was approved by a federal or state regulatory body before February 1, 1989.

The removal of the exemption of sales to be used in contracting will generate an anticipated $18,000,000 in additional revenue.\textsuperscript{27}

6. Bond Required of Out-of-State Contractors

Since purchases out-of-state which are used in-state by non-resident contractors will now be subject to use tax, a new section has been added to facilitate the collection of the use tax.\textsuperscript{28} This

\begin{itemize}
  \item \textsuperscript{26} W. Va. Code § 11-15-8a(b), as added by S.B. 1, c. 42, 1989 W. Va. Acts 1989, p. 1899, sets forth the transition rules for the removal of the exemption for sales to be used in contracting.
  \item \textsuperscript{27} Charleston Gazette, Jan. 26, 1989, at 16A, col. 4.
\end{itemize}
new section is designed to assure that out-of-state contractors do not have a competitive advantage because they do not pay West Virginia sales or use tax on the construction materials they bring into the state. Now every nonresident contractor who will perform a contract within the state must register with the Tax Commissioner and must deposit an amount equal to six percent of the total amount the contractor will receive for performance of his contract. This amount will be held in a contractor’s use tax fund until completion of the contract and the determination of the use tax due from such foreign contractor. In lieu of a cash deposit, a contractor may provide a surety bond in the form and amount which the Tax Commissioner deems is sufficient to guarantee the payment of the use tax.

7. Definition of Contracting Changed

Contracting is defined as work on a structure or real estate. However, if the materials supplied were minimal, if the contract was truly open-ended and if the work was done on an hourly basis, the work was considered a service, not contracting. This exclusion from the definition of contracting was deleted by the Legislature in its regular session so that now all work on a structure or real estate is treated as contracting regardless of how the charges for that work are made. It should be noted that this is a pro taxpayer change since the effect is to broaden the contracting exemption from the sales and service tax. However, the definition of contracting was restricted so that if a vendor withdraws material from inventory and installs such material in a structure or other real estate and the contracting is incidental to the sale, the sale and the installation are no longer within the definition of contracting and, therefore, are no longer exempt. Under prior law, if the

contract was for a fixed sum and the material was installed in a structure, both the charges for installation and material were arguably exempt as contracting since the contracting exemption covered materials used in contracting.\textsuperscript{35} An example of this would be the installation of carpeting by the dealer who will now clearly have to charge the sales and service tax on both the carpeting he sells and the charges for its installation. It should be noted that the purchase of inventory would be exempt as a purchase for resale if a certificate is presented.\textsuperscript{36}

8. Exemption for Purchases and Sales by Certain Charities Redefined

As noted above, sales of tangible personal property and taxable services to certain charitable organizations were a refundable exemption. These charitable organizations were entities organized for religious, charitable, scientific, testing for public safety, literary, educational or international, amateur sports competition purposes exempt from federal income tax under I.R.C. section 501(c)(3) and certain civic leagues and entities organized for social welfare exempt from federal income tax under I.R.C. section 501(c)(4).\textsuperscript{37} In order to qualify for the exemption under prior law, the charitable organization could only make occasional and casual sales. This limitation has been eliminated, but now only certain section 501(c)(3) and (4) organizations will qualify for the exemption: churches, elementary and secondary schools (whether public or private), organizations receiving more than one-half of their support from the public and certain organizations formed to support charitable organizations.\textsuperscript{38} The exemption was and still is limited to property or services which are purchased for direct use or con-

\textsuperscript{35} The definition of contracting is changed effective July 1, 1989; W. VA. CODE § 11-15-33(b), as added by S.B. 303, c. 201, 1989 W. Va. Acts _____.


\textsuperscript{38} W. VA. CODE § 11-15-89(f), as amended by S.B. 303, c. 201, 1989 W. Va. Acts _____.

This subsection sets forth extensive definitions of “support,” “charitable contributions,” and “membership fees.”
sumption by the organization in its charitable activity. It should be noted that organizations which did not qualify under prior law because of the routine sale of their services (such as hospitals) will still not qualify since they are not described as a charitable organization qualifying for the exemption.39 Also exempt are casual sales to charities which are exempt on their purchases as described above.40 Both the exemptions for sales to and purchases by charities were exemptions claimed by refund under prior law. These exemptions are now asserted by certificate.41 The result of these changes should be to broaden this exemption and simplify its administration.

9. Several New Exemptions Added

Three per se exemptions have been added and are as follows:

1) Tuition charged by education summer camps;42
2) Charges for transportation of passengers in interstate commerce;43 and
3) Charges for room and board by fraternities and sororities for their members.44

Two other exemptions have also been added:

1) Sales of building materials to an organization exempt from federal income tax under I.R.C. section 501(c)(3) or (4) if such materials are to be incorporated into a building which is to be operated by a charity as permanent low income housing, transitional housing, emergency homeless shelters, domestic violence

40. W. Va. Code § 11-15-9(q), as amended by S.B. 303, c. 201, 1989 W. Va. Acts ____. Part 1 of that subsection defines "casual and occasional sales" as sales not conducted more than six times in a 12 month period and sales which do not last more than 84 hours. This is intended to cover sales at "fund raisers."
41. W. Va. Code § 11-15-9(c) and § 11-15A-3c. These sections also provide that the exemption pertaining to electronic data processing will no longer be a refundable exemption and will now be an exemption established by certificate.
shelters or emergency children or youth shelters; and
2) Services performed by corporations within a controlled group for each other ("Control" means direct or indirect ownership of stock controlling 50% or more of the total voting power of all classes of stock or stock representing 50% or more of the value of the corporation).

10. Purchaser Liable for Sales Tax Without Refusal to Pay

Under prior law, a purchaser was liable for the sales or use tax if he refused to pay the tax to the vendor. However, it was not clear that if the tax was simply not collected whether the state could go against the purchaser. The statute has now been amended so that if a purchaser refuses or otherwise does not pay the tax, the purchaser may clearly be held liable.

11. Sales Tax Due on Products Consumed by the Producer

If the taxpayer manufactures a product or produces a natural resource and consumes or uses such product or resource in performance of a contract, he must pay the use tax on the value of the product used or consumed. However, if the product or natural resource used or consumed is directly used or consumed in the taxpayer's business of manufacturing, transportation, transmission, communication or production of resources then it would be a refundable exemption. If the natural resource or product is used or consumed in the taxpayer's business which is subject to the B & O tax on utilities, the B & O tax on the production of electricity, the severance tax or the telecommunications tax, it would also be a refundable exemption.

produces rock which is used in paving a haul road, no use tax would be owed on the value of the rock. On the other hand, if the rock was used by the surface miner in the construction of a road to a warehouse which he has contracted to build, the use tax would be owed on the value of the rock.

12. Removal of Exemption of Purchases to be Used With Providing a Taxable Service

Sales of tangible personal property or service for use or consumption in conjunction with dispensing a taxable service were exempt under prior law, provided the service or property was not used in the construction upon or improvement to real estate.\[51\] This exemption has been repealed, presumably resulting in a simplification of the administration of the sales tax.\[52\] Under prior law, if a taxpayer purchased office equipment which was used in providing a taxable service and the equipment was also used in selling personal property, he would have to apportion the purchase price of the equipment attributable to providing the taxable service, and this portion would be exempt from tax.\[53\] The other portion of the purchase price would be subject to tax. The state Tax Department thought that this type of allocation was impractical and so the exemption has been removed.

13. Collection of Sales Tax from Certain Out-of-state Retailers

There has been both national and West Virginia discussion as to how a state might make out-of-state mail order houses collect a use tax if they make substantial sales in the state. Typically, such mail order houses are not "doing business" in West Virginia as under the current definition and, therefore, such retailers cannot

---

be required to collect a use tax. The Legislature in regular session amended the use tax to broaden the definition of doing business in West Virginia to its constitutional limits. Now foreign retailers are considered to be "doing business" in the state and must collect the use tax if a retailer engages in any of the following activities within West Virginia:

1) Soliciting orders by television shopping network or orders taken by mail or phone where such shopping system is broadcast by an in-state cable network;
2) Soliciting orders by television or radio broadcasts or by printed material where such broadcasts or printing is done within the state and intended primarily for residents of the state (It is presumed that advertising from radio, television and newspapers located in the state are primarily directed at in-state residents.);
3) Soliciting orders by mail if such solicitations are "substantial and reoccurring" and if the retailer benefits from any banking, financial, debt collection, telecommunication or marketing activities occurring in this state or from an authorized installation, servicing or repair facility in the state even though such facility is not operated by the retailer or a related party;
4) If an out-of-state retailer sells products in West Virginia and has a franchisee or licensee in the state under his trade name, such franchisee or licensee may be required to collect the tax; and
5) A retailer who contracts with an in-state cable television network and solicits orders by means of such cable network.

In an attempt to assure the constitutionality of the statute, all of the above activities are accompanied by the proviso that the retailer must have a "physical presence in this state in the form of employees, officers, agents, or sales outlets in this state, or any other presence that provides the necessary minimum contacts for a constitutionally sufficient nexus for a state to require such a retailer to collect and remit use taxes." It should be noted that the statute specifically indicates that this broadened definition only applies with respect to the sales and service tax and the use tax and does not affect the definition of "doing business" for other purposes.

---

III. BUSINESS FRANCHISE TAX

A. Summary

The business franchise tax was enacted in 1985 and became effective July 1, 1987.57 The business franchise tax is imposed on all corporations, associations and partnerships for the privilege of doing business in the state or owning or leasing property having a business situs within West Virginia.58 The measure of the tax is the "capital" of a taxable entity.59 Capital for purposes of the tax is a taxpayer’s balance sheet as set forth on his federal tax return, i.e., Schedule L.60 The rate of tax is .55 percent of the taxpayer’s adjusted and apportioned capital.61 Various credits are allowed against the business franchise tax including a credit for severance taxes paid; however, the credit is limited to the portion of a taxpayer’s base attributable to activities subject to the severance tax.62

B. Changes

The FRA increased the business franchise tax rate from .55 percent to .75 percent effective for taxable years beginning after December 31, 1988.63 If a taxpayer’s taxable year for federal income tax purposes is a short year, the tax base is prorated according to the ratio that the number of months in such short taxable year bears to twelve in order to determine the franchise tax for the short taxable year.64 Since the taxpayer’s balance sheet in his

62. W. Va. Code § 11-23-17 (Repl. Vol. 1987) limits the amount of the business franchise tax against which the severance tax not be credited by apportioning that tax according to gross receipts giving rise to the severance tax over the total gross receipts of such business.
federal tax return is not regulated or ordinarily subject to audit, reliance by the franchise tax on federal Schedule L might not accurately reflect capital. The statute now makes it clear that the balance sheet on the taxpayer's federal return must be prepared in accordance with generally accepted accounting principles and the Tax Commissioner may make any adjustments that he deems necessary to properly reflect "capital."

The credit against the business franchise tax for any severance tax paid was eliminated as of March 1, 1989. The increase in the business franchise tax will produce an anticipated $20,000,000 in additional revenue, and the loss of the credit for the severance tax against the business franchise tax will produce an anticipated $10,000,000 in additional revenue.

IV. SEVERANCE TAX

The severance tax replaced the former business and occupation tax imposed on persons engaging in the severance, extraction or production of natural resources within the state. The severance tax is, therefore, based on gross receipts from the production of natural resources within the state. The value added to the natural resources by certain processing and treatment activities is included in this tax base. The tax is imposed on all "producers" and processors of natural resources. There are eight natural resources classifications for determining the tax rate and the measure of taxable income.

---

65. W. VA. CODE § 11-23-3(b)(2), as amended by H.B. 2712, c. 198, 1989 W. Va. Acts 66. W. VA. CODE § 11-23-17(e), as added by S.B. 1, c. 42, 1989 W. Va. Acts ; that subsection provides for the expiration of the credit for the severance tax and states that, for taxable years straddling March 1, 1989, the credit will be pro rated as to the months before and after that date.
68. W. VA. CODE § 11-13-2a (Repl. Vol. 1987), which levied a business and occupation tax on the severance of minerals, was superseded by W. VA. CODE §§ 11-13A-1 to 24, called the Severance Tax Act, effective July 1, 1987.
71. W. VA. CODE § 11-13A-3(b) (Repl. Vol. 1987) sets forth the classifications of natural resources, the rates at which each resource is taxed and the effective dates.
cations are rock, stone, limestone, coal, shale, gravel, sand, clay, natural gas, oil, standing timbers and all other forms of minerals. The rates for each category of natural resources with the increased or adjusted tax rate as fixed by the FRA are as follows:

<table>
<thead>
<tr>
<th>Natural Resource Classification</th>
<th>Current Tax Rate</th>
<th>Increased or Adjusted Tax Rate</th>
<th>New or Revised Effective Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>3.88</td>
<td>5.00</td>
<td>March 1, 1989</td>
</tr>
<tr>
<td>Limestone or Sandstone quarried or mined</td>
<td>2.56</td>
<td>2.92</td>
<td>July 1, 1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3.28</td>
<td>July 1, 1990</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3.64</td>
<td>July 1, 1991</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4.00</td>
<td>July 1, 1992</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4.50</td>
<td>July 1, 1993</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5.00</td>
<td>July 1, 1994</td>
</tr>
<tr>
<td>Oil</td>
<td>4.272</td>
<td>5.00</td>
<td>March 1, 1989</td>
</tr>
<tr>
<td>Natural Gas (new wells drilled and placed in service on or after July 1, 1987)</td>
<td>6.00</td>
<td>5.50</td>
<td>July 1, 1989</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5.00</td>
<td>July 1, 1990</td>
</tr>
<tr>
<td>Sand, gravel or other mineral products not quarried or mined</td>
<td>4.272</td>
<td>5.00</td>
<td>March 1, 1989</td>
</tr>
<tr>
<td></td>
<td>2.50</td>
<td>3.22</td>
<td>March 1, 1989</td>
</tr>
<tr>
<td>Timber</td>
<td>3.08</td>
<td>3.316</td>
<td>July 1, 1989</td>
</tr>
<tr>
<td>Other Natural Resources</td>
<td></td>
<td>3.544</td>
<td>July 1, 1990</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3.772</td>
<td>July 1, 1991</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4.00</td>
<td>July 1, 1992</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4.50</td>
<td>July 1, 1993</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5.00</td>
<td>July 1, 1994</td>
</tr>
</tbody>
</table>
V. BUSINESS AND OCCUPATION TAX ON GENERATION OF ELECTRIC POWER

A. Summary

After the general repeal of the business and occupation tax, effective July 1, 1987, two categories of businesses remain subject to that tax: public service or utility businesses and businesses engaged in the generation of electric power. Electric power companies are generally subject to tax at a rate of four percent of their gross proceeds from the sale of electric power, although reduced rates are provided certain West Virginia businesses and under certain other circumstances. The measure of the tax is the value of all electric power generated or produced in the state for sale, profit or commercial use regardless of the place of sale or the fact that the transmission may be to points outside the state. The value of the electric power is generally determined by reference to the sales price for in-state sales and by cost of production plus a reasonable return for out-of-state sales.

B. Changes

The FRA made substantial changes in the taxation of the generation and sale of electric power in West Virginia. Effective for months beginning on or after March 1, 1989, the tax will be the greater of the tax described above or 2/10ths of one cent per kilowatt hour of net generation available for sale. The statute provides for rates lower than 2/10ths of one cent per kilowatt hour in circumstances similar to those for the alternate tax. The practical effect of the tax on kilowatt hours is to increase the tax on out-of-state users of electric power generated in West Virginia. Since the tax is on kilowatts generated rather than on the proceeds from the sale of the power, large wholesale sales to out-of-state power companies, which are at a lower price per kilowatt, pay the same per kilowatt tax as retail sales in-state, which are sold at a higher kilowatt price.

The increase in revenue generated by the alternate tax on the generation of electric power is projected to produce $50,000,000 in additional revenue.  

VI. NATURAL GAS STORAGE TAX

Effective March 1, 1989, the FRA levies a new business and occupation tax upon every taxpayer storing natural gas in reservoirs located in West Virginia. The tax is five cents per dekatherm (generally 1,000 cubic feet) of natural gas injected into or removed from a storage field in West Virginia. The dekatherms of gas withdrawn and injected are netted on a monthly basis, and the net dekatherms are subject to the tax. Gas stored in new reservoirs which are first used for storage after March 1, 1989, are exempted from the tax so that the tax will not act as a disincentive to the development of new storage reservoirs in the state. It is anticipated that the natural gas storage tax will generate $12,000,000 in additional revenue.

VII. GASOLINE AND SPECIAL FUEL EXCISE TAX

A. Summary

West Virginia first imposed the gasoline and special fuel excise tax in 1923, and the tax has remained basically the same since that date.

79. W. Va. Code §§ 11-13-1(b)(10) and (11), as added by S.B. 622, c. 194, 1989 W. Va. Acts ____, define "the net number of dekatherms" of gas injected and withdrawn which are subject to tax under section 11-13-2e.
80. W. Va. Code § 11-13-1(b)(8), as added by S.B. 622, c. 194, 1989 W. Va. Acts _____, defines "storage reservoir" in which gas is stored giving rise to the tax to include only those reservoirs in use before March 1, 1989; after some debate, the state Tax Department has taken the position that the effective date of the changes made by S.B. 622 is April 6, 1989, which creates a five week period during which the gas storage tax is effective without the amendments made by S.B. 622. Consequently, the gas storage tax will be levied on both injections and withdrawals and without regard to when the reservoir was first used during this period. W. Va. Code § 11-13-2e(b).
time. The tax is imposed upon distributors, producers, retail dealers or importers and others.\(^{83}\) If the tax has been previously paid on fuel, it is not imposed on the same fuel again.\(^{84}\) There are a number of exemptions from the gasoline and special fuel excise tax for gasoline or special fuel used for specific purposes.\(^{85}\) The rate of the gasoline and special fuel excise tax was 10.5 cents per gallon of fuel sold for use as fuel in an internal combustion engine or withdrawn from storage within the state.\(^{86}\)

B. **Changes**

Effective April 1, 1989, the special session of the Legislature in January, 1989, raised the gasoline and special fuel excise tax five cents per gallon, so that it is now 15.5 cents per gallon.\(^{87}\) Also, in order to lessen the burden of administering the tax, a new exemption was created from the gasoline and special fuel excise tax and the sales tax when sales of fuel in bulk quantities of 1,000 or more gallons are made to an interstate motor carrier having fuel storage tanks located in West Virginia.\(^{88}\) This exemption only applies if the fuel is stored *solely* for the purpose of fueling “motor carriers” who will pay the motor carriers road tax and the use tax. Since the motor carriers tax results in distributors receiving a credit against the gasoline and special fuel tax, and a credit against the sales tax for the use tax paid, this exemption should not change the revenue generated. The exemption does not apply to fuel used in two axle trucks, passenger cars or similar vehicles since they are not “motor carriers” and will not pay the motor carrier road tax.\(^{89}\)

The increase in the gasoline and special fuel excise tax and the motor carrier road tax will generate an estimated $50,000,000 in

---

additional revenue.\textsuperscript{90} Twenty-five million dollars of the revenue generated is to be used solely for bridge repair or replacement; the remaining funds are to be used for state highway bonds, the Appalachian highway system and general maintenance, reconstruction and construction.\textsuperscript{91}

\textbf{VIII. Motor Carrier Road Tax}

\textbf{A. Summary}

The motor carrier tax was first imposed in 1959 and has remained basically the same since that time.\textsuperscript{92} It is a companion tax to the gasoline and special fuel tax, and has the same rates. It is designed to tax fuel used but not purchased in the state on which the gasoline and special fuel tax has not been paid. If the gasoline and special fuel tax has been paid, it may be credited against the motor carrier tax.\textsuperscript{93} Every person who operates a "motor carrier" on a highway in the state is subject to the tax.\textsuperscript{94} A motor carrier is defined as any passenger vehicle which has seats for more than nine persons, in additional to the driver, or any road tractor, tractor truck or truck having more than two axles.\textsuperscript{95} The tax was 10.5 cents per gallon of gasoline or special fuel used in the motor carrier's operation in the state.\textsuperscript{96} The tax is based upon the number of gallons of gasoline or special fuel deemed to be used within the state.\textsuperscript{97} This is determined by a formula apportioning the total fuel used by the miles traveled within and without the state.\textsuperscript{98}

\textbf{B. Changes}

The special session of the Legislature in January, 1989, raised the motor carrier road tax effective April 1, 1989, from 10.5 cents

to 15.5 cents per gallon. Trip permits for operating a motor carrier in the state for no more than ten days may be acquired at $24 with a maximum of three such permits allowed in any year. No mileage reports are required with such trip permits since they are in lieu of the computation and payment of the motor carrier road tax. Transportation of new motor carriers between dealers requires a $15 permit per year for each such transportation of a new vehicle.

If a motor carrier is operated under a lease with a term of less than thirty days, the lessor is now primarily responsible for payment of the motor carrier road tax, and, correspondingly, if the lease is for more than thirty days, the lessee is primarily responsible for payment of the motor carrier road tax. If the lessee fails to report and pay the tax, then the lessor may be held responsible. Motor carriers which operate solely in West Virginia and purchase all their fuel within West Virginia may file an annual report in lieu of the quarterly report required by other motor carriers.

IX. CORPORATE NET INCOME

A. Summary

The West Virginia Corporate Net Income Tax Act became effective on July 1, 1967. But because the tax rates were relatively low and a credit was allowed against the corporate net income tax for the business and occupation tax, that tax was not important. Effective July 1, 1987, the business and occupation tax and the carrier income tax on most businesses were repealed, and the corporate net income tax rates were substantially increased, resulting

---


in the corporate net income tax becoming a principal tax on businesses in West Virginia.\textsuperscript{106} Any corporation which is not exempted by statute which does business in West Virginia is subject to tax.\textsuperscript{107} Taxable income for the corporate net income tax is derived from federal taxable income for West Virginia tax purposes.\textsuperscript{108} Certain nonbusiness income is directly allocated, and the remaining taxable income is apportioned by a three factor formula which includes a payroll factor, a property factor and a double weighted sales factor.\textsuperscript{109} These factors are derived by computing property, payroll or sales within and without the state.

B. \textit{Changes}

The three factor formula for apportioning taxable income to West Virginia did not accurately reflect the taxable income of motor carriers attributable to the state. Therefore, a new formula has been established apportioning motor carriers income by miles traveled within and without the state.\textsuperscript{110} A "motor carrier" means any person engaging in the transportation of passengers or property or both for compensation.\textsuperscript{111} This change is effective for taxable years beginning on or after January 1, 1989 and for all prior years still open to audit. This would apparently make the new apportionment effective retroactively for years for which returns have already been filed.\textsuperscript{112}

X. \textsc{West Virginia Capital Company}

A. \textit{Summary}

The West Virginia Capital Company Act allows a taxpayer who invests in a "qualified West Virginia capital company" a credit
against state taxes equal to fifty percent of his investment in such company.\textsuperscript{113} A qualified West Virginia capital company is a corporation or partnership which has a minimum capitalization of $1,000,000 and a maximum capitalization of $4,000,000, and which was formed to make "qualified investments" in West Virginia businesses, except for those businesses prohibited.\textsuperscript{114} Of the capital raised for the capital company, twenty-five percent can be in the form of full recourse interest bearing demand notes.\textsuperscript{115} After qualification, a capital company must make a qualified investment of at least twenty percent of its capital base within one year, forty percent of its capital base within two years and sixty percent of its capital base within three years.\textsuperscript{116} Each qualified investment of a capital company must be continued for at least five years.\textsuperscript{117} Any type of debt or equity investment could be a "qualified investment under the prior regulations." However, a capital company is required to diversify its investment in that not more than thirty percent of its total capital may be invested in any one enterprise.\textsuperscript{118}

B. Changes

Although the Legislature did not change the capital company statute, regulations have been promulgated which made significant changes in the operation of capital companies.

The new regulations restrict the qualified investments which will be made by capital companies so that insurance companies and residential housing no longer qualify as acceptable investments.\textsuperscript{119}

\begin{itemize}
\item \textsuperscript{113} W. Va. Code § 5E-1-8(c) (Repl. Vol. 1987) gives credit against West Virginia taxes to any investor in a "qualified" West Virginia capital company.
\item \textsuperscript{114} W. Va. Code § 5E-1-7 (Repl. Vol. 1987) sets a minimum level of capitalization of $1 million for a "capital company." W. Va. Code § 5E-1-8(a) (Repl. Vol. 1987) establishes a $2 million ceiling on the credits that may be extended to the investors in a single capital company; W. Va. Legis Rules 5E-1, Ser. 1, § 1.7.1.17 (1986) defines qualified investment and § 5.5 sets forth the investment restrictions.
\item \textsuperscript{115} W. Va. Legis. Rules 5E-1, Ser. 1, Sec. 2.2.5 (1986).
\item \textsuperscript{116} W. Va. Code § 5E-1-12 (Repl. Vol. 1987) sets forth the minimum qualified investment levels required of a West Virginia capital company.
\item \textsuperscript{117} W. Va. Legis. Rules 5E-1, Ser. 1, Sec. 5.8.1 (1986).
\item \textsuperscript{119} W. Va. Legis. Rules 5E-1, Ser. 1, Secs. 5.5.5 and 5.5.6 (1989).
\end{itemize}
most significant change in the regulations is that at least twenty-five percent of each capital base qualified after May 30, 1989 of a capital company must be invested in West Virginia businesses in the form of equity and/or unsecured debt investments. In other words, a capital company can no longer make its entire investment in the form of a secured loan; now twenty-five percent of its capital base must be in the form of stock or an unsecured loan. It should be noted that twenty-five percent of the capital base must be invested in stock and/or unsecured debt, not twenty-five percent of the investment which is actually made by the capital company. In other words, if the capital base is sixty percent invested, twenty-five percent must be in stock and/or unsecured debt and thirty-five percent may be in secured debt. This twenty-five percent investment in equities and/or unsecured debt must be made within five years of the date of qualification of the capital base. It is unclear how long this twenty-five percent investment must be made, but it is probably five years, the general period that investments must be maintained as previously discussed.

XI. Research and Development Project Credit

A credit is available to any taxpayer who purchases property or services for the purpose of conducting an "eligible research and development project." An eligible research and development project is one conducted in West Virginia by an "industrial business" or a producer of natural resources if the purpose of the project relates to expanding markets for or increasing sales of the state's natural resources or industrial products. The amount of the credit is ten percent of the eligible investment. Formerly, the credit could be taken against the business and occupation tax on electric generation, the sales and service tax, the use tax, the severance tax and the business franchise tax. For taxable years ending on or after

July 1, 1989, the research and development project credit may be taken against the corporate net income tax as well as the foregoing taxes. The research and development project credit may offset up to fifty percent of the corporate net income tax liability.

XII. INDIVIDUAL INCOME TAX

To arrive at adjusted gross-income which is subject to West Virginia income tax, certain decreasing modifications are made to federal adjusted gross income. One of these adjustments is that retirement income received under the West Virginia public employees retirement system, the West Virginia state teachers retirement system or any military retirement is excluded from taxable income to the extent of the first $2,000 received. There is also an unlimited exclusion from tax for West Virginia police and firemen retirement system income. In Davis v. Michigan Department of Treasury, the United States Supreme Court held that states could not exclude state pension income from state taxation and tax federal pension income since this constituted discrimination against federal retirees. In order to bring West Virginia's income tax into compliance with this decision, pension income received from any federal retirement system is now allowed a $2,000 exclusion effective for returns, including amended returns, filed after December 31, 1988. This means that taxpayers with income from a federal pension may file an amended return for open tax years and request a refund. This may make the state's treatment of retirement benefits constitutional, although certain state firemen and police pension benefits are still allowed an unlimited exclusion.

The Legislature made another change affecting pensions. Lump sum distributions from a pension plan which the recipient elects to

---


have taxed separately were not part of federal adjusted gross income. Since there was not an increasing modification adding back lump sum distributions to federal adjusted gross income to arrive at West Virginia taxable income, lump sum distributions were not subject to West Virginia income tax. There is now an increasing modification so that West Virginia can tax lump sum distributions in full as ordinary income. This modification is effective for taxable years beginning after December 31, 1987.

XIII. CONCLUSION

Although the 1989 tax increases are historically unprecedented, it is hoped that the increases will not be a disincentive for business to expand or relocate within the state. Because of the prior deficits in state government, it was obvious to business that additional revenues would have to be generated through increased taxes, and the only question was whether the burden would be equitably distributed. The fact that the increased taxes are born fifty percent by businesses should remove the fear by businesses that they would have to pay a disproportionate share of the increased taxes. A summary of the projected increased revenue follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Tax—Removal of Exemption Food</td>
<td>$144.0 million</td>
</tr>
<tr>
<td>Sales Tax—Continuation 1% Increase</td>
<td>65.0 million</td>
</tr>
<tr>
<td>Sales Tax—Taxation of Purchases by Contractors</td>
<td>18.0 million</td>
</tr>
<tr>
<td>Business Franchise Tax Increase</td>
<td>20.0 million</td>
</tr>
<tr>
<td>Loss of Severance Tax Credit</td>
<td>10.0 million</td>
</tr>
<tr>
<td>Severance Tax Increase</td>
<td>35.0 million</td>
</tr>
<tr>
<td>Alternate Electricity Tax</td>
<td>50.0 million</td>
</tr>
<tr>
<td>New Natural Gas Storage Tax</td>
<td>12.0 million</td>
</tr>
<tr>
<td>Gasoline and Motor Carrier Tax Increase</td>
<td>50.0 million</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$404.0 million</td>
</tr>
</tbody>
</table>

134. Since there was no internal effective date specified for this amendment, W VA. CODE § 11-10-5p dictates that the provision will be applicable for tax years beginning after the enactment. W VA. CODE § 11-10-5p (Repl. Vol. 1987).