

## CHAPTER 2

### BUSINESS FRANCHISE TAX

By David L. Phillips

*David L. Phillips is an executive director in charge of tax practice for the Charleston, West Virginia office of Ernst & Young. He was a special advisor to Governor Cecil H. Underwood's Commission on Fair Taxation and is a frequent lecturer and author commenting on West Virginia tax matters.*

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*Editor's Note - Senate Bill 680, enacted by the West Virginia Legislature during its 2008 Regular Session, provided for a scale back of the rate of business franchise tax imposed under Chapter 11, Article 23, of the West Virginia Code. Effective for taxable years beginning on or after January 1, 2015, no business franchise tax is imposed under this article. The contents of this Chapter 2 are provided for historic reference and context.*

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<b>Table of Contents</b>	<b>Page</b>
¶ 201 Introduction.....	2-2
¶ 202 Taxpayers Subject to Tax.....	2-2
¶ 203 Exemptions from Tax .....	2-3
¶ 204 Tax Levied on Capital.....	2-5
¶ 205 Apportionment by Three-Factor Formula .....	2-8
¶ 206 Special Apportionment for Financial Organizations .....	2-11
¶ 207 Rate of Tax.....	2-14
¶ 208 Credits Against Tax .....	2-14
¶ 209 Accounting Periods and Methods .....	2-17
¶ 210 Annual Returns.....	2-18
¶ 211 Declaration and Payment of Estimated Tax .....	2-19
¶ 212 Return Requirements .....	2-19
¶ 213 Records.....	2-20
¶ 214 Business Activities Report.....	2-20
¶ 215 General Procedure and Administration .....	2-21
¶ 216 Specimen Return – Combined Corporation Net Income/Business Franchise Tax Return – Form WV/CNF-120.....	2-21
INDEX -- CHAPTER 2 -- BUSINESS FRANCHISE TAX.....	2-22

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## ¶ 201 Introduction

*History of tax:* West Virginia's business franchise tax was enacted in 1985 to become effective for tax years beginning on or after July 1, 1987. The present law is codified at Chapter 11, Article 23, of the West Virginia Code.

The genesis for the business franchise tax can be found in the findings, conclusions, and recommendations made in March 1984 by the West Virginia Tax Study Commission. The Commission recommended that the business and occupation tax, which imposed a tax on the gross receipts of all business activities carried on within the state be replaced with a variety of taxes, including a broad-based business franchise tax. The legislative authority for the franchise tax can be found in Article X, Section 1 of the Constitution of West Virginia, which states in part that:

"... the Legislature shall have authority to tax privileges, franchises, and incomes of persons and corporations ..."

*Summary of tax:* 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. The tax is not an ad valorem property tax. The measure of the tax is the taxable "capital" of an entity, as adjusted and apportioned as provided by law.

## ¶ 202 Taxpayers Subject to Tax

*Law:* W. Va. Code §§ 11-23-3 and 11-23, *et seq.*

The business franchise tax is imposed on the privilege of doing business in West Virginia and in consideration of the benefits and protections conferred by the state on businesses. The tax is imposed upon every domestic corporation, every corporation having its commercial domicile within the state, and every foreign or domestic corporation leasing property located within West Virginia or doing business within the state. The tax is also applicable to every partnership doing business within the state or owning or leasing property located within West Virginia. The term "doing business" is broadly defined and includes any activity of a corporation or partnership that results in nexus in the state.

For years beginning after December 31, 2008, West Virginia adopted a combined system of tax reporting for businesses. Comprehensive legislative rules for the corporation net income tax were promulgated by the Tax Commissioner that took effect May 11, 2010. These rules discuss unitary groups and combined reporting for purposes of the corporation net income tax. No rules or other written guidance have been provided by the State Tax Department explaining how combined reporting concepts are applied in the context of the business franchise tax. Regulations adopted prior to migration to the combined reporting system remain in effect for business franchise tax.

As discussed in the legislative rule for the corporation net income tax, for purposes of W. Va. Code § 11-23-1 *et seq.*:

“a partnership shall be treated as conducted by its partners....to the extent of the partner’s distributive share of the partnership’s income.... A business conducted directly or indirectly by one corporation through its direct or indirect interest in a partnership will be unitary with that portion of a business conducted by one or more other corporations if there is a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts and the corporations are members of the same commonly controlled group.<sup>1</sup>”

A partnership interest that is not part of a unitary business will be treated as a discrete separate business.

### **¶ 203 Exemptions from Tax**

*Law:* W. Va. Code § 11-23-7 *et seq.*

A number of organizations and persons are specifically exempted from the imposition of the business franchise tax. Some of the exemptions completely shelter an entity from tax while other exemptions are narrow and only partially exempt an entity from the business franchise tax. The exemptions are as follows:

*Individuals doing business:* Natural persons doing business in West Virginia that are not doing business in the form of a corporation or partnership are exempt from tax. Natural persons include sole proprietors and other self-employed persons.

*Insurance companies:* Insurance companies that pay the State of West Virginia a tax on premium income and insurance companies that pay the surcharge imposed by W. Va. Code § 23-2C-3(f)(1) or (3) are exempt from tax.

*Farm credit associations:* Production credit associations organized under the provisions of the federal "Farm Credit Act of 1933" are exempt from tax. It should be noted, however, that this exemption is not applicable if the production credit association is organized under the cooperative association provisions of Chapter 19, Article 4 of the West Virginia Code.

*Credit unions:* Credit unions organized under the provisions of Chapter 31 of the West Virginia Code are exempt from tax. It should be noted, however, that this exemption is not applicable if the credit union is organized under the cooperative association provisions of Chapter 19, Article 4 of the West Virginia Code.

*State and local government corporations:* Corporations organized under West Virginia law which are political subdivisions of the State or which are an instrumentality of a political subdivision, if created pursuant to the West Virginia Code, are exempt from

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<sup>1</sup> As used here, “partnership” means any entity treated as a partnership for federal income tax purposes.

tax.

*Race tracks:* A corporation or partnership licensed under the provisions of W. Va. Code § 19-23-1 is exempt from tax. However, if the entity is not exclusively engaged in a horse or dog racing activity, its tax base is apportioned among its several activities and only that portion attributable to the horse or dog racing activity is exempt from tax.

*Certain trusts or employees:* Certain trusts established for employees under 29 U.S.C. § 186 are exempt from tax.

*Farming entities:* Corporations and partnerships whose principal activities are agricultural or farming are exempt from tax. To be exempt as an agriculture or farming entity, the activity must involve at least five acres of land and the production of at least \$1,000 of product per year. The exception of agriculture and farming from the business franchise tax extends to activities of growing and managing timberland, provided there is no direct involvement in actual timbering activity and the other statutory quantifications and qualifications are met. Syllabus point 4, *Morris v. Heartwood Forestland Fund Ltd. P'ship*, 228 W. Va. 142, 718 S.E.2d 492 (2010).

*Exempt organizations:* A limited exemption is provided to entities that are exempt from federal income tax under the provisions of IRC § 501. To the extent that a tax-exempt entity is engaged in activities generating unrelated business income, the entity is subject to the business franchise tax. Therefore, the mere generation of *gross* unrelated business income will subject an otherwise tax-exempt entity to the business franchise tax. The measure of the tax is the portion of capital utilized in the unrelated business activities and is determined by multiplying the organization's capital by a fraction, the numerator of which is the entity's total gross unrelated business income, and the denominator of which is all gross income of the entity.

$$\text{Exempt organization's capital} \times \frac{\text{Unrelated gross income}}{\text{All gross income}} = \text{Taxable capital}$$

The tax base so determined is subject to normal apportionment and adjustment for certain governmental obligations and obligations secured by residential property.

*Hunting clubs:* Corporations and partnerships who operate as hunting clubs are exempt from tax, provided the corporation or partnership distributes no dividends or income to its owners.

*Certified capital companies:* Companies certified as West Virginia capital companies are exempt from tax on that portion of their capital used in providing venture capital to West Virginia businesses. However, if the entity is not exclusively engaged providing venture capital, its tax base is apportioned among its several activities and only that portion attributable to providing venture capital is exempt from tax.

*Entities disregarded for federal tax purposes:* Single-member limited liability companies that are disregarded for federal and state income tax purposes, along with

partnerships that have elected out of partnership status under Internal Revenue Code §761 are exempt from tax. When the single member limited liability company is an individual, no business franchise tax return is filed by the disregarded limited liability company. When a disregarded single member limited liability company is owned by a corporation, the corporation must file a business franchise tax return.

## ¶ 204 Tax Levied on Capital

*Law:* W. Va. Code §§ 11-23-3 and 11-23-4 *et seq.*

*Capital:* The tax base of a taxpayer subject to the business franchise tax is the entity's average "capital" as apportioned and adjusted.

*Corporations:* Broadly speaking, capital of a corporation means the average of the beginning of the year and end of the year shareholders' equity as reflected on the corporation's federal Form 1120, Schedule L balance sheets, prepared in accordance with generally accepted accounting principles (GAAP) and filed with the Internal Revenue Service. Accordingly, capital includes all common and preferred stock, paid-in capital, capital surplus, retained earnings (whether appropriated or unappropriated) and, in the case of an S corporation, the amount of the accumulated adjustment account and any undistributed taxable income. It should be noted that, by definition, stock or shareholders' equity does not include non-voting stock that is limited and preferred as to dividends or treasury stock.

The term "corporation" includes any corporation, S corporation, joint stock company, and any association or other organization which is taxable as a corporation under federal income tax laws such as a limited liability company that elects to be treated as a corporation for federal and state income tax purposes.

*Partnerships:* For partnerships, the capital of a partnership means the average of the beginning and end of year balances of the partners' capital accounts as reflected on the partnership's federal Form 1065, Schedule L balance sheets, prepared in accordance with GAAP and filed with the Internal Revenue Service.

The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated by means of which a business is carried on and which is not a trust, estate, a corporation, or a sole proprietorship.

*Commissioner's power to increase capital:* Capital also includes any additional items or accounts of the taxpayer and any adjustments thereto that, in the opinion of the Tax Commissioner, are deemed necessary to represent equity or capital of the taxpayer under generally accepted accounting principles.

*Combined reporting:* The combined reporting rules used to apportion the unitary business income of the combined group also apply to computation of the taxable capital of members of the combined group for business franchise tax purposes. See W. Va. Code § 11-24-13a(e) and (j) and § 11-24-13f(c).

SB 386, which was passed by the Legislature on March 8, 2012, and took effect on June 6, 2012, amended and reenacted W. Va. Code § 11-24-13f relating to taxation of water's-edge corporations under the West Virginia Corporation Net Income Tax Act. It exempts from taxation certain income which is exempt from taxation under certain federal tax treaties; clarifies the entities that must be included in a water's-edge group combined report for corporation net income tax purposes; provides the Tax Commissioner with authority to require reports or make adjustments regarding combined reports; and authorizes the Tax Commissioner to promulgate legislative, procedural or emergency rules, as necessary. The provisions of SB 386 have effect as taxpayers are required to apply the water's edge reporting concepts to both income and business franchise tax computations. See W.Va. Code § 11-24-13f(c).

As discussed above, as of the end of 2014, no regulations nor other written guidance have been provided by the West Virginia State Tax Department under Article 23 on how combined reporting concepts are applied in the context of the business franchise tax. Accordingly, there are numerous issues regarding determination of taxable capital that remain uncertain or unclear at this time.

*Reliance on GAAP:* The statute and regulations clearly indicate that a taxpayer's federal income tax return balance sheet (Schedule L) should ideally be prepared in accordance with generally accepted accounting principles. In those cases where the federal tax return balance sheets and more specifically, the capital accounts appearing on the balance sheet, are not prepared in accordance with GAAP, taxpayers may be required by the Commissioner to make such adjustments to the capital accounts as are necessary to properly reflect capital on a GAAP basis. Informally, the State Tax Department has indicated that it will generally not exercise its authority to require GAAP basis computations unless the Department perceives an abusive situation. In cases where adjustments are required to reflect capital on a GAAP basis, details of the adjustments and a reconciliation from the tax return balance sheet capital accounts to GAAP basis capital accounts used for business franchise tax purposes should be prepared and filed with the return.

*Adjustments to average capital:* Once the average capital for the year has been determined, an adjustment must be made in situations where the taxpayer holds certain governmental obligations or obligations secured by residential property. A taxpayer is allowed to reduce its average capital by the proportion of capital attributable to the following assets owned by the taxpayer:

- (1) Obligations and securities of the United States or any agency, authority, commission or instrumentality of the United States;
- (2) Obligations of the State of West Virginia or any political subdivision of the state; and
- (3) Investments or loans primarily secured by mortgages or deeds of trust on residential property or mobile homes located in West Virginia and occupied

by non-transients.

The definition of federal obligations qualifying for a reduction to the tax base is rather broad and includes not only direct obligations of the federal government, but also direct obligations and securities of "any other corporation or entity created under the authority of the United States Congress for the purpose of implementing or furthering an objective of national policy." (W. Va. Code § 11-23-3(b)(2)(E)(i)(I)) However, the regulations indicate that instruments that have a government guarantee as opposed to a direct obligation will not qualify for adjustment of the tax base.

HB 2600, which was passed by the Legislature on April 13, 2013, and took effect 90 days thereafter, enacted W. Va. Code § 7-25-1 *et seq.* known as the "Resort Area District Act". This Act provides county commissions authority and guidance with respect to creation and/or expansion of resort area districts around the State of West Virginia. Pursuant to W. Va. Code § 7-25-19(c), "bonds and any income or interest thereon issued by the resort area district are exempt from taxation by the State of West Virginia and other taxing bodies of the state". Though specific guidance with respect to this claiming this exemption has not been issued, presumably it would be proper to include such resort area district bonds in the value of obligations of the State of West Virginia or any political subdivision of the State exempt from tax.

In order to determine the proportion of average capital to be included in the tax base, it is necessary for taxpayers to determine the monthly averages of the obligations noted above as well as the monthly averages of the taxpayer's total assets. Monthly averages are determined by computing an average for each month of the taxable year and dividing the sum of the monthly averages by the number of months in the taxable year. Once monthly averages have been determined, the taxable proportion of capital can be computed by the following formula:

$$\text{Average capital} \times \left(1 - \frac{\text{Average monthly balance of excluded obligations}}{\text{Average monthly total assets}}\right) = \text{Adjusted average capital}$$

For purposes of determining average monthly balances, the regulations indicate that the balances should be determined at "cost" in the same manner as the obligations, investments, and loans are reported on Schedule L of the taxpayer's federal income tax return. Presumably "cost" can be either the book or tax basis of the obligation. An example of the foregoing computation is as follows:

*Example:* Assume a corporate taxpayer has the following assets and shareholders' equity for 20xx:

$$\begin{array}{l} \text{Total shareholders' equity or capital as of:} \\ 1/01/xx \quad = \quad \$1,200,000 \\ 12/31/xx \quad = \quad \$1,450,000 \\ \\ \text{Average} \quad = \quad \frac{\$1,200,000 + 1,450,000}{2} = \$1,325,000 \end{array}$$

United States securities owned and total assets as of:

<u>Date</u>			<u>Monthly Averages</u>	
	<u>US Securities</u>	<u>Total Assets</u>	<u>US Securities</u>	<u>Total Assets</u>
1/01/xx	\$300,000	\$2,000,000	\$312,500	\$2,100,000
2/01/xx	\$325,000	\$2,200,000	\$337,500	\$2,250,000
3/01/xx	\$350,000	\$2,300,000	\$300,000	\$2,275,000
4/01/xx	\$250,000	\$2,250,000	\$175,000	\$2,275,000
5/01/xx	\$100,000	\$2,300,000	\$ 75,000	\$2,325,000
6/01/xx	\$ 50,000	\$2,350,000	\$ 25,000	\$2,325,000
7/01/xx	-0-	\$2,300,000	-0-	\$2,300,000
8/1/xx	-0-	\$2,300,000	-0-	\$2,350,000
9/01/xx	-0-	\$2,400,000	-0-	\$2,425,000
10/01/xx	-0-	\$2,450,000	\$ 25,000	\$2,425,000
11/01/xx	\$ 50,000	\$2,400,000	\$ 55,000	\$2,425,000
12/01/xx	\$ 60,000	\$2,450,000	\$ 70,000	\$2,455,000
12/31/xx	\$ 80,000	\$2,460,000		
		Total	\$1,375,000	\$27,930,000

Based upon the above, the corporation's adjusted average capital is determined to be \$1,260,075 as follows:

$$\$1,325,000 \times \left(1 - \frac{\$27,930,000 \div 12}{\$1,375,000 \div 12}\right) = \$1,260,075$$

## ¶ 205 Apportionment by Three-Factor Formula

*Law: W. Va. Code § 11-23-5 et seq.*

A taxpayer who is doing business both within and without West Virginia and, accordingly, is taxable in another state must apportion its capital base to West Virginia. Apportionment, for taxpayers other than financial organizations, is accomplished by multiplying the tax base (after adjustment for governmental and mortgage obligations) by a fraction, the numerator of which is the sum of the property factor plus the payroll factor plus two times the sales factor, and the denominator of which is four. In cases where the denominator of a factor is zero, the denominator of the apportionment formula fraction is decreased by the number of factors having zero. If the denominator of the sales factor is zero, then the apportionment fraction denominator is decreased by two.

$$\text{Adjusted average capital} \times \frac{\text{Property factor} + \text{payroll factor} + (2 \times \text{sales factor})}{4} = \text{Taxable capital}$$

*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 the taxpayer within West Virginia during the taxable year, and the denominator of which is the average-value of all real and tangible personal property owned or rented by the taxpayer.



$$\text{Property factor} = \frac{\text{Average value of real and tangible personal property in W.Va.}}{\text{Average value of all real and tangible personal property}}$$

The average value of all real and tangible personal property is taken from the taxpayer's federal income tax return, Schedule L. The average value of property is determined by averaging the values at the beginning and end of the taxable year. However, in cases where there are substantial fluctuations during the year, the Tax Commissioner may require the taxpayer to average monthly values. For purposes of determining the average value of property, original cost is to be used. Property that is not owned, but rented by the taxpayer, is valued at eight times the net annual rental rate. Rent includes all amounts payable under the lease arrangement in situations where a rental agreement obligates the lessee to pay for such items as interest, taxes, insurance, repairs, etc., as is typically found in a triple net lease. Leasehold improvements are considered property for purposes of apportionment, even if the improvements revert to the lessor upon termination of the lease.

For purposes of determining the property factor as it relates to moveable tangible personal property used within and without West Virginia, the value of the moveable property is determined by multiplying the original cost of such property by a fraction, the numerator of which is the number of days the moveable property has a physical presence in West Virginia and the denominator of which is the number of days of physical presence everywhere during the taxable year. Days of physical location can be determined by statistical methods or any other reasonable basis acceptable to the Tax Commissioner.

$$\text{Value of moveable property} = \frac{\text{Cost of moveable property in W.Va. during any part of year}}{\text{W.Va. during any part of year}} \times \frac{\text{Days within W.Va.}}{\text{Days everywhere}}$$

*Payroll factor:* The payroll factor is a fraction, the numerator of which is the total compensation paid in West Virginia during the taxable year, and the denominator of which is the total compensation paid by the taxpayer to all employees regardless of domicile as reflected on the taxpayer's federal tax forms.

$$\text{Payroll factor} = \frac{\text{Payroll in W.Va.}}{\text{Total payroll}}$$

For purposes of the payroll factor, compensation typically means all wages and other forms of remuneration paid to employees for personal services that are reportable on federal Form W-2. Payments made to independent contractors or to individuals who are not deemed employees for federal income tax purposes are not considered compensation for purposes of the payroll factor.

Compensation is deemed paid in West Virginia and shall be considered as a part of the numerator in the payroll factor if the employee's services are either:

- (1) Performed entirely within West Virginia; or
- (2) Performed both within and without the state, but the services performed

outside of West Virginia are incidental to the employee's services within the state; or

(3) Performed both within and without West Virginia and one of the following elements is present:

(a) The employee's base of operations is located within West Virginia; or

(b) The employee has no base of operations but, the employee is directed or controlled from a location within West Virginia; or

(c) There is no base of operations in any state in which some of the employee's services are performed and the employee's residence is located within West Virginia. (W. Va. Code § 11-23-5(j)).

*Sales factor.* The sales factor is a fraction, the numerator of which is the gross receipts of the taxpayer derived from normal business transactions and activities within West Virginia, net of any returns and allowances, and the denominator of which is the total gross receipts derived by the taxpayer from its normal business activities and reflected as gross income on its federal tax forms.

$$\text{Sales Factor} = \frac{\text{Gross receipts from activities within W.Va.}}{\text{Total gross receipts}}$$

Gross receipts typically means gross income and not gross profit or net income. Accordingly, no reduction for cost of goods sold or other expenses (except returns and allowances) shall be subtracted in arriving at gross receipts. In addition, if business income includes interest from governmental obligations exempt from taxation by West Virginia, such amounts shall be excluded from the numerator or denominator.

For purposes of determining the numerator in the sales factor, West Virginia has confirmed that it is a "Joyce" state. Accordingly, if the unitary member does not have nexus with West Virginia or if the unitary member is not taxable under the protections of PL 86-272, then that unitary member's gross receipts derived from transactions and activity in the regular course of its trade or business in West Virginia are **not** included in the numerator of the sales factor when the tax return is prepared, and for combined group members, when the combined report is prepared. See W. Va. CSR § 110-24-7.7.d.2.

*Sale of tangible personal property.* Sales of tangible personal property are attributable to West Virginia under either of the following conditions:

(1) The property is delivered or shipped to a purchaser, other than the United States government, who is located within West Virginia. The f.o.b, point, or other conditions of sale, are irrelevant for this purpose. West Virginia sales include delivery to a third party located in West Virginia, if the seller is so directed by an out-of-state purchaser; or

- (2) The tangible property is shipped from a West Virginia location and the purchaser is the United States government.

In situations where a taxpayer sells tangible personal property to a purchaser located within a state in which the purchaser is not taxed, then such sales shall be excluded from the denominator of the sales factor.

*Sales other than tangible property:* In cases where the taxpayer's business activities consist of sales other than sales of tangible personal property, the sales will be considered West Virginia transactions if either:

- (1) The income-producing activity is performed within West Virginia; or
- (2) The income-producing activity is performed both within and without West Virginia and a greater proportion of the income-producing activity is performed within West Virginia as compared to any other state based on the cost of the performance of the service or sale.

The term "income-producing activity" refers to each separate type or item of income or transactions that are actively carried on by the taxpayer on a regular basis for the ultimate purpose of deriving gain or profit. Such term does not encompass activities performed on behalf of a taxpayer such as those conducted by an independent contractor. "Income producing activity" includes the following:

- (1) The performance of personal services by employees utilizing tangible and intangible property of the taxpayer.
- (2) The sale, rental, leasing, licensing or other use of tangible or intangible personal property or real property. Note, however, that the mere holding of intangible personal property is not considered to be an income producing activity.

In situations where either the taxpayer or the Tax Commissioner believes the statutory apportionment formula does not fairly represent the extent of a taxpayer's business activities within West Virginia, the taxpayer may petition or the Tax Commissioner may require other methods of allocation including separate accounting, the exclusion of one of the factors, or the inclusion of one or more additional factors in order to equitably allocate or apportion the taxpayer's tax base. Taxpayers desiring approval to use an alternative method of allocation must file a petition with the Tax Commissioner no later than the due date (without regard to any extension) of the annual business franchise tax return.

## **¶ 206 Special Apportionment for Financial Organizations**

*Law:* W. Va. Code § 11-23-5a, W. Va. Code § 11-23-9a *et seq.*

*History:* The West Virginia Legislature found during its 1991 Regular Session that

the general formula set forth in W. Va. Code § 11-23-5 for apportioning the capital of corporations taxable in West Virginia as well as in another state is inappropriate for use by "financial organizations" due to the particular characteristics of those organizations and the manner in which their business is conducted. Accordingly, any organization that meets the statutory definition of a financial organization must use a special apportionment formula to determine its taxable capital.

*Financial Organization Defined:* The definition of a "financial organization" includes all bank holding companies or a subsidiary thereof, all regulated financial corporations or a subsidiary thereof, and any other entity (credit unions are exempt) so long as more than half of the entity's gross business income is derived from loans, the extension of credit, leasing and related activities, the operation of a credit card business, estate and trust services, and the acceptance of deposits.

Taxpayers that meet this definition of a financial organization are required to apportion their capital using specific apportionment rules and are not permitted to use the standard three factor formula provided in West Virginia law.

### **Apportionment of Tax Base**

A financial organization that regularly engages in business in West Virginia and which is taxable in another state is not permitted to apportion its capital base using standard three factor formula. Rather, it must apportion its capital base to West Virginia using the special single factor gross receipts formula described below.

The West Virginia Supreme Court has upheld the concept of "sufficient contact" for an out-of-state financial organization doing business in West Virginia to be subject to the business franchise tax. See *Tax Com'r of West Virginia v. MBNA America Bank, N.A.*, 220 W. Va. 163, 640 SE2d 226 (2006), petition for certiorari denied, *FIA Card Services, N.A. v. Tax Com'r of West Virginia*, 551 U.S. 1141, 168 L.Ed.2d 719, 127 S. Ct. 2997 (2007).

In this case, the Court found that an out-of-state bank whose principal business was issuing and servicing credit cards for customers throughout the United States, including customers in West Virginia, had substantial nexus with West Virginia even though it did not have a physical presence in the state. The bank's "systematic and continuous business activity in . . . [West Virginia] produced significant gross receipts attributable to its West Virginia customers which indicate a significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto*". Further, the Court found that *Quill's* physical presence requirement applies only to state sales and use taxes and not to state business franchise and corporation net income taxes.

For purposes of determining the special single factor gross receipts formula, gross receipts from certain types of property are not considered. Specifically, gross receipts from the following ownership interests (and certain related activities) are not considered in determining whether a financial organization is subject to taxation:

- (1) An interest in a real estate mortgage investment which is a conduit, such as a real estate investment trust or a regulated investment company;
- (2) An interest in security representing ownership or participation in a pool of promissory notes or certificates of interest that provide for payments in relation to payments on the notes or certificates;
- (3) An interest in a loan from which the interest is attributed to a consumer loan, a commercial loan or a secured commercial loan in which the payment obligations were solicited and entered into by a person that was independent and was not acting on behalf of the owner; or an interest in the right to service or collect income from such a loan; or
- (4) An amount held in an escrow or trust account with respect to the above interests.

If a financial organization is subject to taxation when gross receipts from the foregoing interests are not considered, such receipts must, however, be included when apportioning capital.

This single gross receipts factor is based upon the ratio of the financial organization's gross receipts derived from West Virginia as compared to total gross receipts everywhere and may be stated as follows:

$$\frac{\text{(Total Gross Receipts from WV)}}{\text{(Total Gross Receipts)}} \quad \times \quad \text{Adjusted Average Capital}$$

Excluded from both the numerator and the denominator of the gross receipts factor are interest or fees earned on obligations and securities of the United States, West Virginia, or its political subdivisions and certain investments or loans secured by real property or mobile homes located in West Virginia and occupied by non-transients.

The following types of receipts (income, not principal) which are included in both the numerator and the denominator are as follows:

- lease or rental of tangible property;
- loans secured by real or tangible property;
- consumer loans;
- commercial loans and installment obligations;
- syndication and participation loans;
- credit card service charges and fees;
- credit card merchant discount fees;
- performance of specified financial and fiduciary services;
- fees from travelers checks and money orders; and

All other types of receipts not allocable to another state where the financial

organization is taxable are attributable to West Virginia or any other state based on the laws of the taxpayer's domicile.

*Method of Filing:* The West Virginia business franchise tax law presumes that any member of a unitary group that is required to use a special apportionment method, such as the single factory gross receipts formula described above is a “special apportionment member”. In such cases, the special apportionment formula is used to apportion the unitary group capital base. In lieu of using this approach, special apportionment members may seek authorization of the Tax Commissioner to limit application of said formula to other similar members or may seek authorization to report on a separate return basis.

## **¶ 207 Rate of Tax**

*Law:* W. Va. Code § 11-23-6.

For tax years beginning on or after January 1, 2014, but before January 1, 2015, the tax is 0.10% of a taxpayer's adjusted and apportioned capital, or \$50, whichever is greater. This rate reduces to zero, and no tax is due, for tax years that begin on and after January 1, 2015.<sup>2</sup>

*Short taxable years:* If a taxpayer's taxable year for federal income tax purposes is a short taxable year, the tax determined by applying the tax rate to the taxpayer's tax base is prorated based upon the ratio which the number of months in the short year bears to 12. In circumstances where a short year arises due to the fact that it is the taxpayer's first year in which it is subject to the business franchise tax, the taxpayer's liability is determined using a proration based upon the ratio of the number of months that the taxpayer was doing business in West Virginia bears to 12. In no event can the tax be less than \$50.00.

## **¶ 208 Credits Against Tax**

*Law:* W. Va. Code § 11-23-17 *et seq.*

The statutes provide for a number of tax credits that may be utilized by qualifying taxpayers to offset their business franchise tax liability. None of the various credits are refundable nor can they be carried over to a future tax period, so they can only be used to offset a taxpayer's current year business franchise tax liability. To the extent the current year credits exceed the current year franchise tax liability, no future benefit of a credit can be obtained.

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<sup>2</sup> Senate Bill 680, enacted by the West Virginia Legislature during its 2008 Regular Session, provided for a scale back of the then current business franchise tax rate of 0.55%.

- Tax years beginning after December 31, 2008 – 0.48%
- Tax years beginning after December 31, 2009 – 0.41%
- Tax years beginning after December 31, 2010 – 0.34%
- Tax years beginning after December 31, 2011 – 0.27%
- Tax years beginning after December 21, 2012 – 0.21%

For tax years beginning on or after January 1, 2009, West Virginia has adopted a combined system of tax reporting for businesses. In general, no tax credit earned by one member of a combined group, but not fully used by or allowed to that member, may be used by another member of the combined group. Special transition rules are provided so that certain unused or unexpired economic development tax credits that were earned during a tax year in which a consolidated return was filed may be used against the taxes imposed on any member of a combined group to the extent the credits would have been allowed had the taxpayer continued to file a consolidated return. W. Va. Code § 11-23-17b.

*Credit for business and occupation tax:* Utilities, other than those engaged in telecommunication activities, that are subject to the West Virginia business and occupation tax (W. Va. Code § 11-13-1 *et seq.*) are allowed a credit for the portion of the franchise tax attributable to activities taxable under the business and occupation tax. The amount of the credit is determined by multiplying the franchise tax liability by a fraction, the numerator of which is the gross income of the business subject to the business and occupation tax, and the denominator of which is the total gross income derived by the taxpayer from activity within West Virginia.

$$\text{Franchise tax liability} \times \frac{\text{Gross income of business subject to B\&O tax}}{\text{Total gross income from W.Va. activity}} = \text{Credit}$$

*Credit for taxes paid by subsidiary:* In the case of an affiliated group of corporations filing separate West Virginia business franchise tax returns, the parent corporation will be allowed a credit for the "net amount of taxes that would have been paid" (W. Va. Code § 11-23-17(c)) by its subsidiaries without regard to the adjustments to capital of such subsidiaries for United States and West Virginia obligations and residential mortgages. In cases where a parent owns less than 100% of all classes of the subsidiary's stock, the credit is scaled back proportionately. Finally, the credit should be computed without consideration of any credits that the *subsidiary* may be entitled to for such items as severance taxes or bank shares taxes paid by the subsidiary.

The subsidiary credit is also available to a corporate partner owning an interest in a partnership that is subject to the business franchise tax and to a partnership which owns an interest in another partnership. The amount of subsidiary credit claimed by the corporate or parent partnership partner cannot exceed the amount of business franchise tax paid by the partnership multiplied by the percentage of the partner's capital accounts owned by the corporate or parent partnership partner.

*Credit for contributions to qualified neighborhood organizations:* Taxpayers who make contributions to community based non-profit organizations that establish projects to assist neighborhoods and local communities are permitted a credit equal to 50% of the eligible contribution. In order for a contribution to be eligible for the credit, it must be made to a qualified charitable organization that has received approval from the Neighborhood Investment Advisory Board and the West Virginia Development Office.

*Credit for commercially domiciled financial organizations:* Financial organizations having their commercial domicile in West Virginia are permitted a credit for taxes paid to another state. The credit is equal to the lesser of a) the taxes actually paid to another state based on or measured by the financial organization's capital or b) the portion of the tax actually paid that the financial organization would have paid if the West Virginia business franchise tax rate is applied to the tax base determined under the law of the other state. This credit is not allowed for taxable years beginning after December 31, 2008. W. Va. Code § 11-23-27(c).

*Tax credit for certain financial organizations for certain periods:* Financial organizations having their commercial domicile in West Virginia that acquire a financial organization that does not have its commercial domicile in West Virginia are permitted a credit equal to 50% of the goodwill associated with the acquisition multiplied by the tax rate applicable for the year. W. Va. Code § 11-23-5a(g).

*Tax credits for economic development:* Taxpayers who are eligible to take advantage of West Virginia's credits for economic development may, to the extent not utilized to offset other specifically enumerated taxes, use their available economic development credits to offset their annual business franchise tax liability. (For a discussion of these credits, see Chapter 3.) The credits include:

- (1) Credit for strategic research and development (W. Va. Code § 11-13R-1 *et seq.*) credit terminated for investment and expenditures made after December 31, 2013 (W. Va. Code § 11-13R-13);
- (2) Credit for investment in high-growth business projects (W. Va. Code § 11-13U-4 *et seq.*);
- (3) Credit for investments by specific industries or businesses that create new jobs (W. Va. Code § 11-13Q *et seq.*);
- (4) Credit for qualified investments for industrial expansion or revitalization (W. Va. Code § 11-13S *et seq.*);
- (5) Credit for construction or revitalization of a new or existing coal loading facility (W. Va. Code § 11-13E-1 *et seq.*);
- (6) Credit for capital investment in a qualified West Virginia capital company (W. Va. Code § 5E-1-8 *et seq.*);
- (7) Credit for hours worked by apprentices in the construction trades (W. Va. Code § 11-13W-1 *et seq.*);
- (8) Credit for certain expenditures made in West Virginia by eligible film production companies (W. Va. Code § 11-13X-1 *et seq.*);



- (9) Credit for local property taxes paid on West Virginia manufacturing inventory (W. Va. Code § 11-13Y-1 *et seq.*)

*Other tax credits:* Other tax credits that may be applied against the business franchise tax include:

- (1) Alternative-fuel tax credits for purchase of motor vehicle that runs on an alternative fuel (W. Va. Code § 11-6D-1 *et seq.* as amended effective April 13, 2013);
- (2) Alternative-fuel tax credits for cost of purchasing and installing alternative fuel refueling infrastructure, whether facility is for private or public use (W. Va. Code § 11-6D-1 *et seq.* as amended effective April 13, 2013);
- (3) Credit for developing patents in this State (W. Va. Code § 11-13AA-4);
- (4) Credit for use of patent in manufacturing (W. Va. Code § 11-13AA-5);
- (5) Credit for use of innovative mine safety technology (W. Va. Code § 11-13BB-1 *et seq.*).

These various tax credits are discussed in chapter 3 of this Guidebook.

*Repealed and expired credits:* Taxpayers who gained entitlement to certain credits prior to January 1, 2003 retain eligibility to apply those credits pursuant to the requirements and limitations of the original credit entitlement period. Included among these credits are the following:

- (1) Credit for research and development projects (W. Va. Code § 11-13D-3 *et seq.*);
- (2) Credit for business investment and jobs expansion (W. Va. Code § 11-13C *et seq.*);
- (3) Credit for industrial expansion and revitalization (W. Va. Code § 11-13D *et seq.*);
- (4) Credit for residential housing development projects (W. Va. Code § 11-13D *et seq.*);
- (5) Credit for qualified investment in an aerospace industrial facility (W. Va. Code § 11-13D-3 *et seq.*).

## ¶ 209 Accounting Periods and Methods

*Law:* W. Va. Code § 11-23-8 *et seq.*

A taxpayer's accounting period for purposes of the business franchise tax must be the same as that used for federal income tax reporting purposes. If a taxpayer changes his taxable year for federal income tax purposes, the taxpayer must conform for purposes of the business franchise tax and provide a copy of the Internal Revenue Service authorization for change with its business franchise tax return.

The taxpayer's method of accounting for the business franchise tax return must be the same as the accounting methods employed for federal income tax purposes. Similarly, as with changes in accounting periods, if the taxpayer's method of accounting is changed for federal income tax purposes, a conforming change must be made for the business franchise tax with a copy of the Internal Revenue Service's approval of the accounting change filed with the business franchise tax return.

## **¶ 210 Annual Returns**

*Law:* W. Va. Code § 11-23-9 *et seq.*, W. Va. Code § 11-23-9a *et seq.*

*Due dates:* The return due dates for the business franchise tax conform to the federal rules for corporations and partnerships. As such, annual business franchise tax returns for corporations are due on the 15th day of the third month after the close of the taxable year. In the case of a partnership, the franchise return is due on or before the 15th day of the fourth month following the close of the tax year. The filing of a return is required whether or not any tax is due.

The corporation net income tax and business franchise tax annual returns have been combined. Corporations file Form CNF-120 Corporation Net Income/Business Franchise Tax Return. The income tax and business franchise tax returns of partnerships and S corporations have also been combined. Pass-through entities file Form SPF 100 West Virginia Income/Business Franchise Tax Return – S Corporations and Partnership (Pass-Through Entity).

*Extension of time to file:* An extension of time for filing a taxpayer's federal tax return will automatically extend the time for filing the West Virginia business franchise tax return for the same period as the federal extension. However, similar to the federal income tax provisions, an extension of time will not extend the time for payment of the business franchise tax. To avoid interest and late payment penalties, full payment of the business franchise tax must be made on or before the unextended due date of the return. Copies of the federal extension must be attached to the completed business franchise tax return when it is filed. A state extension of time to file may be obtained, even if a federal extension has not been requested, by providing a written request to the West Virginia State Tax Department prior to the due date of the West Virginia return.

*Consolidated returns: Not allowed.* For tax years beginning before January 1, 2009, members of an affiliated group filing a consolidated federal income tax return were required to file a separate business franchise tax return unless they elected to file a consolidated West Virginia's corporate net income tax return. If the consolidated

group elected to file a consolidated West Virginia corporate net income tax return, a consolidated business franchise tax return was also required. Additionally, special rules were provided for an affiliated group that includes one or more financial organizations electing to file a consolidated return. These rules were repealed for tax years beginning on or after January 1, 2009.

*Combined reports:* For tax years beginning on or after January 1, 2009, members of a combined group engaged in a unitary business activity must combine their taxable capital and apportion the combined amount to West Virginia in the same manner as required for apportionment of combined business income. However, the combined report includes only group members that use the same apportionment formula. To date, no guidance has been issued by the Tax Commissioner on how the group's taxable capital is to be divided when only a portion of a group member's taxable capital is from activity that is unitary business activity.

*Combined returns:* Members of a combined group engaged in unitary business activity that have taxable nexus with West Virginia may designate one of their members as surety to file a combined return on behalf of the nexus members of the combined group. See W. Va. Code § 11-24-13e.

#### **¶ 211 Declaration and Payment of Estimated Tax**

*Law:* W. Va. Code § 11-23-13 *et seq.*

If a taxpayer can reasonably expect its business franchise tax liability for the taxable year to exceed \$12,000, estimated tax declarations and payments are required. The due dates for filing declarations and payment of estimated taxes conform to federal income tax provisions for corporations in that one-fourth of the total estimated tax shall be due on the fifteenth of the fourth, sixth, ninth, and twelfth months of the taxable year.

#### **¶ 212 Return Requirements**

*Law:* W. Va. Code §§ 11-23-14, 11-23-15, 11-23-16 *et seq.*

As part of a full and complete West Virginia business franchise tax return, taxpayers must attach a signed copy of their federal corporation income tax return or federal partnership return as filed with the Internal Revenue Service (Form 1120, 1120A, 1120S, 990T, or 1065) to their business franchise tax return.

If a consolidated federal income tax return is filed, taxpayers must include supporting consolidating schedules as well as federal Form 851, which details the members of the affiliated group. To the extent that there are differences between the balance sheet reported for federal consolidated filing purposes and the balance sheet reported for business franchise tax purposes, a signed statement explaining the differences must also be provided.

If filing as a member of an affiliated group for federal income tax purposes, but separately for West Virginia, the federal return requirement is satisfied with the attachment of a pro-forma federal document.

Franchise tax returns must be signed and dated by an officer or partner duly authorized to so act.

### **¶ 213 Records**

*Law:* W. Va. Code § 11-23-19 *et seq.*

All taxpayers must maintain appropriate records relating to the business franchise tax and its computation. These records must be maintained for a period of at least three years subsequent to the return filing. In cases where the time for making an assessment has been extended, the record retention period is automatically extended.

### **¶ 214 Business Activities Report**

*Law:* W. Va. Code § 11-23-28 *et seq.*

*Introduction:* Unless specifically exempted, every corporation or partnership that carries on any business activity or owns or maintains property in West Virginia must file an annual Business Activities Report with the Tax Commissioner. This report must be filed on or before the 15th day of the 4th month after the end of a corporation's or partnership's taxable year. There are no taxes or fees associated with the filing of this report.

While the filing of a Business Activities Report is not to be used in considering whether or not a corporation or partnership is subject to taxation by West Virginia, there are adverse consequences to taxpayers that do not file the report. The statute specifically prohibits, until such a Business Activity Report is filed, any taxpayer from utilizing the West Virginia court system to pursue any claim not related to a tax liability. For example, a taxpayer will be prevented, until such time as current and past due Business Activity Reports have been filed, from pursuing in a West Virginia court a contractual dispute that is governed by West Virginia law.

*Exemptions from Filing:* A corporation or partnership will be exempt from filing a Business Activities Report if any of the following conditions are satisfied:

- (1) During the taxable year for which a report is due, the corporation or partnership is registered to engage in business in West Virginia in accordance with W. Va. Code § 11-12-1 *et seq.*
- (2) A tax return was filed for the taxable year in question covering any of the taxes subject to the provisions of the West Virginia Tax Procedures and Administration Act. See W. Va. Code § 11-10-1 *et seq.*

- (3) The corporation or partnership is a type of organization expressly exempted from taxation by West Virginia or Federal statute or regulation; or its activities are similarly exempted.

*Business Activity:* Unless exempted as noted above, all taxpayers that engage in any business activity or own or maintain property in West Virginia are required to file an annual Business Activities Report. The following activities, unless specifically exempted, will require the filing of a Business Activities Report:

- (1) Maintaining an office or other place of business in West Virginia.
- (2) The presence of employees, agents, representatives, or independent contractors within the state if they are conducting business on behalf of the corporation or partnership, regardless of whether the individual or person is residing or regularly stationed in West Virginia.
- (3) Owning or maintaining any real, tangible or intangible property within West Virginia.
- (4) Any activity carried on by a financial organization that would be includible in the numerator of the special apportionment formula to be used by financial organizations (see ¶ 206).

#### **¶ 215 General Procedure and Administration**

*Law:* W. Va. Code §§ 11-9-1 *et seq.*, §§ 11-10-1 *et seq.*, 11-23-20, and 11-23-21 *et seq.*

As with other West Virginia taxes, the business franchise tax incorporates by reference the provisions of the West Virginia Tax Procedure and Administration Act discussed in chapter 9 of this Guidebook. This Act provides for uniform procedures for the assessment and collection of most West Virginia taxes. In addition, the Act provides for uniform provisions dealing with interest, additions to tax, and penalties. The business franchise tax also adopts the provisions of the West Virginia Tax Crimes and Penalties Act which provides criminal penalties for such matters as failure to file a return or pay tax, failure to maintain records, filing a false or fraudulent tax return, or otherwise attempting to evade tax.

#### **¶ 216 Specimen Return – Combined Corporation Net Income/Business Franchise Tax Return – Form WV/CNF-120**

The forms are available at the State Tax Department's website: . Click on the **Forms** icon located in the left column on that page. On the next page that appears under the heading **Business Taxes**, click on **Corporate Net/Business Franchise Tax**.

## INDEX -- CHAPTER 2 -- BUSINESS FRANCHISE TAX

accounting periods and methods [¶ 209](#)

apportionment of capital

    general rule [¶ 205](#)

    special rule – financial organizations [¶ 206](#)

basis of tax

    apportionment [¶ 205](#); [206](#)

    capital [¶ 204](#)

business activities report [¶ 214](#)

credits against tax [¶ 208](#)

    commercially domiciled financial organizations [¶ 208](#)

    credit for payment of business and occupation tax [¶ 208](#)

    credit for contributions to qualified neighborhood organizations [¶ 208](#)

    credit for taxes paid by subsidiary [¶ 208](#)

    economic development tax credits [¶ 208](#)

        coal loading facilities tax credit [¶ 208](#); 326

        economic opportunity tax credit [¶ 208](#)

        investment in high-growth business projects tax credit [¶ 208](#)

        manufacturing investment tax credits [¶ 208](#)

        strategic research and development tax credit [¶ 208](#)

        apprenticeship training credit [¶ 208](#); 313

        film industry credit [¶ 208](#); 314

        manufacturing property tax adjustment credit [¶ 208](#); 303

    tax credits repealed or expired

        credit for research and development projects [¶ 208](#)

        credit for business investment and jobs expansion [¶ 208](#)

        credit for industrial expansion and revitalization [¶ 208](#); 326

        credit for residential housing development projects [¶ 208](#); 317

        credit for qualified investment in aerospace industrial facility [¶ 208](#)

        credit for investment in West Virginia capital company [¶ 208](#); 344

        strategic research and development tax credit [¶ 208](#)

estimated tax

    declaration of tax of estimated tax [¶ 211](#)

exemptions from tax [¶ 203](#)

financial organizations

    apportionment of tax base [¶ 206](#)

    “financial organization” defined [¶ 206](#)

    method of filing returns [¶ 206](#)

history of tax [¶ 201](#)

- measure of tax
  - taxable capital [¶ 204](#)
  
- payment of tax
  - estimated tax [¶ 211](#)
  - procedure and administration [¶ 215](#)
  
- rate of tax [¶ 207](#)
  
- records
  - record retention period [¶ 213](#)
  
- returns and reports
  - annual return [¶ 210](#)
  - authority to sign [¶ 212](#)
  - business activities report [¶ 214](#)
  - consolidated federal income tax returns [¶ 212](#)
  - consolidated returns [¶ 210](#)
  - due dates [¶ 210](#)
  - extensions of time to file [¶ 210](#)
  - federal income tax return attached [¶ 212](#)
  - specimen return [¶ 216](#)
  
- taxpayers subject to tax [¶ 202](#)