

**Questions for Meeting with State Tax Department and WVSCPAs
June 1, 2010**

General

1. Please provide a written summary and give a discussion of tax changes since January 1, 2009.

A tabular summary of Tax related enactments is attached to the back of this handout.

We would point out the following legislation from 2010:

- Senate Bills 214 and 216 are update bills updating the corporate net income tax, personal income tax respectively, to conform with the Internal Revenue Code's definition of adjusted gross income.
- Senate Bill 461 updates the Streamlined Sales and Use Tax code to conform with Streamlined Sales and Use Tax Agreement amendments and changes.
- Senate Bill 345 requires a study to produce recommendations as to how to modernize the West Virginia telecommunications tax and make the tax effective and efficient.
- Senate Bill 401 mandates certain changes relating to property tax assessment and hearings procedures.
- Senate Bill 577 makes raffle machines illegal in West Virginia.
- House Bill 4035 makes certain changes relating to electronic filing thresholds and requirements. Beginning January 1, 2011: (a) Employers with 50 or more employees must file/pay withholding tax electronically; (b) tax preparers that prepare 25 or more personal income tax returns, those returns must be filed electronically; and (c) any person or entity that has an annual remittance of \$10,000 or more for any single tax type must electronically file and pay for all tax types.
- House Bill 4335 authorizes West Virginia State agencies to collect debts through a United States Treasury Offset program. Federal payments otherwise payable to vendors, contractors and taxpayers, are offset and redirected to the State agency to which the vendor, contractor or taxpayer owes a debt.

Also, some examples of tax legislation passed during the 2009 legislative session include:

- Effective January 1, 2010, the state's alternative minimum tax was repealed.
- Legislation was passed to ensure that taxpayers subject to the federal AMT are not entitled to certain credits aimed at low income persons.
- WV now allows for withholding of state income tax from unemployment benefits, as is done at the federal level.
- Purchases of prescription drugs and durable medical goods are now a per se exemption for sales tax purposes and an exemption certificate is not required.

2. What audit initiatives are being pursued by the State?

The Department conducts a required number of motor carrier audits to meet the IFTA and IRP Agreements. We also conduct cigarette audits to comply with the tobacco settlement.

3. What is the status of the study of our tax system and what particular aspects are being studied? How may we help you?

The Governor's Tax Modernization Project is an ongoing initiative. The Legislature has enacted a significant number of the recommendations made thus far with further study and recommendations in the very near future.

The Governor has sent a letter to the Governor's Tax Modernization Project members asking that the Governor's Tax Modernization committee pay particular attention to local taxation issues. Also, the telecommunications tax study mandated by Senate Bill 345 will be pursued at the same time.

The Governor's Tax Modernization Project and the telecommunications study team will call upon you as work progresses for help and input.

4. What tax changes would the State like to make?

Reform the telecommunications tax. Simplify the senior citizens' property tax-based income tax credits and deferral provisions. Give local governments more options to raise revenue locally as instructed by the Governor in his above-mentioned letter.

5. What is the status of a tax practitioner "hot line?"

The Tax Department is committed to providing quality service to all of its customers. The recently implemented integrated tax system has provided benefits to both customers and the Department. We recognize that other Department systems also need enhanced.

The Department expects that in the very near future it will acquire a more modern communications solution that will provide the potential for a wide array of specialized customer service options. One enhancement is expected to be the establishment of a tax practitioner hot line. Additional information will be provided when the Department has implemented the necessary communication software.

6. What data can a practitioner get as a form of transcript from State Tax database on each of the various personal and business tax filings and for what periods of time is it available? What are the requirements to obtain a transcript?

None, because of the internal document privilege under the Freedom of Information Act.

Individual Taxes

7. Why are estimated payment vouchers being mailed each quarter to individual taxpayers with two large zeros printed in the amount due space? I have had several clients call and tell me we made a mistake on their estimate payments because they received something from the state indicating they owe zero. The preprinted vouchers have confused numerous clients.

Instead of sending coupon booklets, the Tax Department has generated the quarterly estimated returns from the new system. Unfortunately, we failed to give instructions that were clear as to what was changing. The two large zeros are meant to indicate that they should pay whole dollars (just like on their personal income tax returns). We are taking steps to put some instruction on that line to help clarify.

8. If a valid Federal extension is filed, is the personal extension Schedule L required to be filed if there is a balance due, but it is not paid?

To avoid penalty and interest any tax due should be paid with the Schedule L. However, if the tax is not going to be paid with the Schedule L, then it does not need to be filed for an extension to be granted. When the return is received with the extension date field completed, the appropriate penalty and interest will be assessed using the post mark date of the return.

Electronic Filing and Payment

9. Please discuss the new e-filing requirements. Please discuss implementation plans for required (expanded) electronic filing as required by 2010 legislation. Will there be any opportunities for taxpayers to “opt out.” (e.g. elderly, disabled, vision impaired, those not having access to the internet, etc.)

Tax preparers filing more than 25 returns in any tax year are required to file electronically. No “opt out” option available in the West Virginia Code. However, the Tax Commissioner may prescribe rules if necessary to provide specified “opt out” language, if necessary.

The Legislature changed the threshold in HB 4035 from \$100,000 to \$10,000. For tax years beginning on or after January 1, 2011, any person required to file a return for a tax administered under the provisions of the Tax Procedure and Administration Act and who had total annual remittance for any single tax equal to or greater than \$10,000 during the immediately preceding tax year is required to all returns for all taxes administered under the Tax Procedure and Administration Act electronically.

For any tax period beginning on or after January 1, 2011, any employer with 50 or more employees must file its withholding tax return using electronic filing.

Exceptions:

The Tax Commissioner has the authority to prescribe exceptions to the electronic filing requirements by regulation. No regulations have been issued on exceptions to e-filing because the thresholds have thus far been sufficiently high as to exclude many of the persons enumerated in the question.

Title 110 Code of State Rules series 10F contains rules for waiver of penalties if failure was due to reasonable cause and not due to willful neglect. Certainly we can fine tune that rule if it appears that a change is needed.

10. Which items are required to be faxed when Form IT-140 is efiled? When will the State eliminate this burdensome requirement? (No doubt the State knows that this discourages e-filing.)

Supporting schedules/documentation for the credits taken on the Tax Credit Recap Schedule H (for first year filers only). Any form or schedule not supported by the software you are using (WV8379, etc).

Once Modernized e-file is implemented, the need for separate faxing/emailing can be eliminated by including the information within the e-file. Until that time the information is required whether filing by paper or electronically.

11. Is it okay to file electronically & then submit such attachments separately by postal mail?

Yes attachments may be mailed...but the preferred method is via email to: TaxWVefile@wv.gov or by fax to 304.558.1150.

12. Considerable confusion and erroneous computer generated notices continue to surround individual taxpayers claiming the Neighborhood Investment Credit and Taxes Paid to Other States for e-filed returns. Can the process be simplified?

This issue usually stems from the supporting documentation not being submitted prior to the return being processed. When this occurs, a notice is generated requesting the supporting documentation. This documentation is necessary to substantiate the credit(s) being claimed. To avoid the confusion, it is necessary to submit the supporting documentation by fax or preferably by e-mail.

Send the supporting documentation to TaxWVefile@wv.gov immediately after e-filing the return. This will help ensure that the documentation is received timely to avoid the notices.

Modernized e-file (which should be available for the 2010 filing season) will permit PDF attachments and lessen the need for supporting paper documents.

13. There is considerable confusion and a wide spectrum of variation as to how practitioners deal with “opt out” of e-filing forms. Can the State Tax Department suggest best practices? While taxpayers are requested to return “opt out” forms to the accounting

firm, often taxpayers fail to do so. At least one accounting firms (while requesting the taxpayer to return a signed copy of the form) also attaches a copy of the form to the filing copy of the actual tax return. In that case, the client/taxpayer is encouraged to sign the form that accompanies the original filing.

HB 4035 §11-21-54 repealed “opt out” language. All preparers who file 25 returns in any tax year are required to file electronically. However, the Tax Commissioner may prescribe rules if necessary to provide specified “opt out” language, if necessary.

Business Taxes

14. The 2009 Form WV/CNF-120 does not appear to align well with the combined reporting statute and regulations. For example, the CNF-120 appears to imply that all income of affiliated groups is unitary. Further, many of us assumed that there would be various documents filed in a unitary setting, including a “combined report” accompanied by individual “returns.” The revised CNF-120 appears more suited to the optional combined reporting prior to introduction of unitary filing.

Does the State Tax Department agree with this perception? If so, what changes are anticipated for future years? How are unitary filers to present information through a Form CNF-120, when their income includes unitary business income, non-unitary business income as well as non-business income?

The Tax Department agrees that the form needs revision and fine tuning. The Tax Department has had meetings with and input from many people in the tax practitioner and business community on this very issue.

The basic revisions cover unitary and non-unitary income, as well as business and non-business income of the same Taxpayer. The form will be revised to deal with allocation and apportionment in the context of unitary and non-unitary income reportable by the same Taxpayer.

The change to combined report is a substantial undertaking. Everyone expects some initial learning curve issues and “bumps in the road” in trying to implement the concept. We expect the forms to improve.

15. The WV/CNF-120 does not incorporate some of the other changes in the laws that affect tax liability, e.g.:
 - The form still uses the old definition of business income and that definition was changed several years ago.

The definitions in both places appear to be the same:

§11-24-3a. Specific terms defined.

(a) For purposes of this article:

(2) *Business income.*—The term “business income” means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property or the rendering of services in connection therewith constitute integral parts of the taxpayer’s regular trade or business operations and includes all income which is apportionable under the Constitution of the United States.

The booklet states: Business income arises from transaction and activities in the regular course of the corporation’s trade or business, and includes income from tangible and intangible property if the acquisition, management or disposition of the property constitutes integral parts of the corporation’s trade or business. (Page 9, WV/CNF-120).

- The form still has partnership distributive share sourced to WV reported as income allocated to WV.

The 2010 forms are being updated and will address this issue.

- The form does not have lines to report the new add-backs for certain interest expense and intangibles expenses or place to assert why add-back is not required.

The 2010 forms are being updates and will address this issue.

16. When the Department audits the returns, either desk audit or field audit, will the Department audit for compliance with the forms (WV/CNF-120) and instructions or for compliance with the Green books (WV Code)?

Desk audits are conducted for compliance with the forms and compliance with the West Virginia Code. The forms are designed incorporating instructions from the law.

We audit for compliance with the Green books (W.Va. Code). The instructions have a codicil: Use the forms in this booklet for calendar year 2009 and for fiscal years beginning in 2009 and ending in 2010. The information in this book is intended to help you complete your return and is not a substitute for tax law and regulations.

17. If the audit will be for compliance with the Green books, what steps has the Department taken or will the Department take to inform taxpayers that have already filed their annual return (WV/CNF-120) that the return as filed should comply with the Green books and not the form itself? Will the Department advise taxpayers that have not yet filed (because they have a federal extension of time) what they need to do to file a correct return (WV/CNF-120)?

If a situation exists that the form is contrary to the West Virginia Code, we will be glad to work with the taxpayer and/or accountant to guide them through how to file. With

combined reporting we realize that the form for 2009 is not designed to conform to every situation that may arise, therefore if assistance is needed, we are available.

18. We assume that the Department will take appropriate steps to correct the problems with the current return and instructions. Will we have an opportunity to see the draft return and instruction before they are finalized and sent to the printer?

We are working on the 2010 return and instructions and we will be glad to share those with you if possible to get your input prior to submission to the printer.

19. Will the Department be providing (by regulation, TSD, instructions or other written guidance instructions to corporations filing a combined report) guidance on how to compute business franchise tax liability when members of the group have unitary business income, other business income and non-business income? The apportionment formula methodology for corporate net income tax purposes applies only to unitary business income. It does not apply to other business income of a corporation or to nonbusiness income. Simply using the apportionment factor for apportioning unitary business income to apportion capital will likely understate or overstate taxable capital depending upon the facts and circumstances.

Yes, the Tax Department may issue guidance regarding the business franchise tax.

The combined reporting methodology is very much intended to be an income tax concept. Combined reporting is less suited to a net equity tax concept. However, the basic procedure is conceptually as follows:

- Determine the taxable capital of the unitary businesses in the combined reporting group.
- For each filer take the 11-23-17 tax credit to eliminate any duplications of capital.
- Apportion the filer's capital based on the property factor, payroll factor and double weighted sales factor.
- Apply the rate.

B&O Taxes

20. Guidance for the municipal business and occupation tax is found in regulations in large part pre-dating the State's repeal of its own B&O tax as of July 1, 1987. Since that time the business activities of CPAs and other professionals have grown. CPAs are more frequently associated with work performed for their clients within and outside city limits, as well as within and outside of the State of West Virginia. While there are old B&O Regs (C.S.R. 110-26), navigating them is complicated. There appears to be very little guidance in terms of whether municipality-based CPAs should be taxed on work performed outside of the municipality and, if taxed, whether that tax should be apportioned. What guidance, if any, does the State Tax Department have on this matter? Will the State Tax Department consider issuing clarifying guidance such as regulations or an administrative notice?

Under West Virginia Code §8-13-5(e), whenever the business of a taxpayer is carried on in two or more municipalities, the amount of gross income, taxable by each municipality shall be determined in accordance with such legislative regulations as the Tax Commissioner may prescribe.

The Tax Commissioner has prescribed regulations for general administration of municipal business and occupation tax. The Tax Department has otherwise traditionally limited Tax Department participation in municipal business and occupation tax administration to non-binding advisory opinions, typically issued at the request of municipal authorities.

The municipal business and occupation tax rules, 110 Code of State Rules Series 26 were filed and effective on April 15, 1992. You can find those rules at the Secretary of State's web site at <http://www.wvsos.com/csrdocs/worddocs/110-26.doc>.

Municipalities are granted authority to impose a municipal business and occupation tax pursuant to W. Va. Code §8-13-5. Section 8-13-5(e) reads as follows:

(e) Activity in two or more municipalities.

Whenever the business activity or occupation of the taxpayer is engaged in or carried on in two or more municipalities of this state, the amount of gross income, or gross proceeds of sales, taxable by each municipality shall be determined in accordance with such legislative regulations as the Tax Commissioner may prescribe. It being the intent of the Legislature that multiple taxation of the same gross income, or gross proceeds of sale, under the same classification by two or more municipalities shall not be allowed, and that gross income, or gross proceeds of sales, derived from activity engaged in or carried on within this state, that is presently subject to state tax under section two-c or two-h, article thirteen, chapter eleven of this code, which is not taxed or taxable by any other municipality of this state, may be included in the measure of tax for any municipality in this state, from which the activity was directed, or in the absence thereof, the municipality in this state in which the principal office of the taxpayer is located. Nothing in this subsection shall be construed as permitting any municipality to tax gross income or gross proceeds of sales in violation of the Constitution and laws of this state or the United States, or as permitting a municipality to tax any activity that has a definite situs outside its taxing jurisdiction.

Emphasis added.

West Virginia Code §8-13-5(e) permits a municipality to tax sales of tangible personal property or the provision of services which actually occur outside of the municipality, provided the sale or service is not subject to municipal business and occupation tax in the municipality in which they occur. A municipality may impose its municipal business and occupation tax upon such sales **only** if the activity was directed from that municipality, or where the principal office of the Taxpayer is located, if the sale or service is not directed from another municipality with a municipal business and occupation tax. Sales or services provided outside the State of West Virginia are not subject to the business and occupation tax because such sales are in the stream of interstate commerce. *See, United Fuel Gas Co. v. Hallanan*, 257 U.S. 277, 42 S.Ct. 105, 66 L.Ed. 234 (1921). Furthermore, sales outside of West Virginia are not to be included in fixing gross proceeds of sale subject to business and occupation tax. *See, Bluefield Produce & Provision Co. v. City of Bluefield*, 120 W. Va. 111, 196 S.E. 568 (1938).

Therefore,

(1A) If a business is directed from the municipality, **or**

(1B) The business has its principal office located in the municipality,

and

(2) The business is engaged in making sales of tangible personal property (formerly taxed under the sales classification under W. Va. Code §11-13-2c) or providing a service (formerly taxed under the service classification under W. Va. Code §11-13-2h),

Then the municipality may impose its municipal business and occupation tax on the proceeds from those activities engaged in within this State, except where the sale or service provided is subject to another municipality's business and occupation tax.

The municipal business and occupation tax rules (Title 110 Code of State Rules series 26) relating to municipal jurisdiction to impose the municipal business and occupation tax on services with a destination **outside** of the municipality, where the principal office of the Taxpayer is located **inside** of the municipality read in part as follows:

12.3.6. **In those instances where a service business or calling is primarily engaged in within a municipality that municipality may impose its municipal business and occupation tax pursuant to W. Va. Code '8-13-5(e), if the provision of the service has its principal office in the municipality and the provision of the service was not directed from another business location.** In no instance shall the taxing authority extended under W. Va. Code '8-13-5(e) apply to sales of services

performed in another municipality which imposes a municipal business and occupation tax or performed outside of West Virginia unless such services are incidental to the basic provision of a service as indicated under Sections 11.3.3 and 11.3.4 of these regulations.

...

Emphasis added.

Absent a statutory change mandating a different disposition, the municipal business and occupation tax applies as outlined above.

21. Various municipalities have been conducting audits of law firms and assessing B&O taxes on what would be considered (for federal income tax purposes) as repayment of advanced client costs. What guidance, if any, does the State Tax Department have on this matter? Will that State Tax Department consider issuing clarifying guidance?

The municipal business and occupation tax is a gross receipts tax.

The law and the basic presumption for municipal business and occupation tax purposes is that the gross receipts tax base **includes** repayments, expense reimbursements, and cost reimbursements of any character.

Municipalities are expressly authorized to tax those businesses and occupations taxable under the West Virginia State business and occupation tax Code as it existed on July 1, 1987. West Virginia Code §8-13-5(a)(1). The West Virginia Legislature amended the State business and occupation tax Code in 1971 in response to the *Bethlehem Mines* decision of the West Virginia Supreme Court, to expressly **include** reimbursed expenses as gross income subject to the State business and occupation tax. See, *Dailey v. Bachtel Corp.*, 157 W. Va. 1023, 207 S.E.2d 169, 1974 W. Va. LEXIS 248 (1974), in which the court discusses the legislative response to *Bethlehem Mines Corporation v. Haden*, 153 W.Va. 721, 172 S.E.2d 126, 1969 W. Va. LEXIS 205 (1969).

Reimbursed costs are taxable under Code of State Rules Section 110-26-1a.2.11, the municipal business and occupation tax rules:

“Gross income” means the gross receipts of the taxpayer, received as compensation for personal services and the gross receipts of the taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property (real or personal), or service, or both, and all receipts by reason of the investment of the capital of the business engaged in, including rentals, royalties, fees, **reimbursed costs** or expenses or other emoluments.

Emphasis added.

During our panel session on June 1, 2010, the focus of this question was refined to encompass the treatment of money or property received or held in trust by a professional person for the benefit of a client, as described in section 110-26-1a.20.10 of the Code of State Rules. That section reads as follows:

1a.20.10. The terms "Gross Income" or "Gross Proceeds of Sales" shall not include money or other property received or held by a professional person for the sole use and benefit of a client or another person or money received by the taxpayer on behalf of a bank or other financial institution for the repayment of a debt of another. The manner in which the attorney keeps his books and records must clearly and properly reflect this situation. Money or property received for the benefit of a client should be credited to a trustee or escrow account so that the State's tax examiners do not credit and include said funds in the trustee's gross income. For example, X, an attorney, institutes suit on behalf of a client and receives a favorable verdict. As a result therefore, the defendant, rather than making restitution directly to the plaintiff, pays the amount of the verdict to X. Therefore, X has received money for the benefit of a client and said amount shall not constitute gross income to X. X, the attorney, will include in gross income for municipal business and occupation tax purposes only his fee.

This is a comparatively narrow exception applicable in accordance with the terms set forth in section 1a.20 *et seq.*

Outside of the narrow exception for section 110-26-1a.20.10, the universally applicable rule for reimbursements of advanced costs are treated the same as any other taxable gross receipt for purposes of the municipal business and occupation tax. They are taxable.

Property Taxes

22. SB401 makes significant reforms to property tax administration in West Virginia. Does the State Tax Department plan to issue additional guidance in the form of regulations or notices to assist taxpayers and, if so, when?

Yes, the State Tax Department intends to issue a procedural rule to provide guidance on the implementation of Senate Bill 401.

Estate Taxes

23. In 2011, the federal estate tax returns to the pre-2001 rules, which include a credit for state death taxes. What will the effect be on WV estates? Will the estate tax be imposed on WV decedents in 2011?

Under the West Virginia Code, it will be necessary to affirmatively reestablish the tax by statute. The statute does not automatically revive if the federal estate tax reverts to the pre-2001 rules. We anticipate that, if the federal estate tax is revived with a credit for State death taxes, then the Legislature will revive the West Virginia statute to take advantage of the provision. If a state “pick-up tax,” based on the federal credit for state taxes paid, is not enacted, then the tax would go to the federal government instead of to the State of West Virginia. We understand that any new legislation would NOT include a “pick up tax” provision. If the estate tax merely reverts to pre-2001 rules, the pick up tax will be revived as well.

Offers in Compromise

24. How does the Department process offers in compromise? How is the offer reviewed? How do you determine acceptable offers or calculate the amounts?

WV Code §11-10-5q authorizes the Tax Commissioner to enter into offers in compromise agreements with respect to any tax debt administered under article 10 for reasons of doubt as to liability or doubt as to collectibility.

The Tax Commissioner has delegated to the Compliance Division of the Tax Department the authority to initiate, negotiate, reject, or recommend acceptance of a proposed offer. Final approval of any offer in compromise rests with the Tax Commissioner.

Any offer in compromise proposal for reason of doubt as to liability must be submitted with appropriate proof to substantiate the claim. While finalized liability is not subject to any administrative or judicial review, the Tax Commissioner may approve an offer in compromise where through a preponderance of the evidence it can be determined that a finalized tax debt should be reduced.

Any offer in compromise proposal for reason of doubt as to collectability must be submitted with the appropriate financial information in support the proposed settlement amount. The Department requires the completion of forms 433-A and/or 433-B depending upon the type of tax included in the proposal. Depending upon the specific facts associated with a proposal the Department may require additional information, such the most recent set of audited financials, and proof of loan applications and or rejections.

Acceptable offers for reason of doubt as to collectability are determined after close evaluation of all relevant financial information of the debtor. The Department will quantify the benefit of acceptance of the offer by determining the collectible assets and future income potential of the debtor. The Department may also consider its past history with the debtor in its evaluation. Since the Department recognizes that proposals may contain unique situations and information, we will not disclose the exact formulas used internally to determine acceptable offer amounts.

Offer in Compromise proposals may be submitted to the nearest Compliance Division office. Office location and the appropriate offer forms are available on the State Tax

Department website, <http://www.wva.state.wv.us/wvtax/default.aspx>. Should you require additional information you may contact Jeff Oakes, Compliance Division Director, at (304) 558-8751.

Conclusion

25. What would you like to share with us that we have not asked about?

Nothing further at this time.