

WEST VIRGINIA
TAX EXPENDITURE
STUDY

Expenditures

for

Special Business Taxes,

Business License Taxes

Excise Taxes

and Property Taxes

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EXECUTIVE SUMMARY

This report covers special business taxes imposed on certain West Virginia businesses, along with business license taxes, excise taxes and property taxes. The report analyzes various expenditures for these taxes. Some of these provisions constitute government expenditure programs while others are an integral part of the basic tax structure. The following summaries provide information on the taxes covered in this study.

SPECIAL BUSINESS TAXES

This section of the report analyzes the expenditures provided for the Business and Occupation Tax, Severance Tax, Telecommunications Tax, and Health Care Provider Taxes. Unlike other taxes in this study, which affect nearly all West Virginia businesses and individuals, these taxes are levied on small groups of taxpayers.

Less than 120 businesses are subject to the State Business and Occupation Tax, a tax levied on public utilities, electric power companies, gas storage operators and manufacturers that produce synthetic fuel from coal. Gas storage operators and synthetic fuel producers pay a per unit tax. Electric power producers pay a per unit tax on taxable capacity while electric utilities pay a per unit tax on kilowatt hours of electricity sold. Other public utilities pay a tax based on gross income. Through statute or regulation, thirty-two expenditures are available for application against the Business and Occupation Tax. These expenditures encompass businesses excluded from the tax, tax base exemptions, reduced rates, alternate tax calculations and credits against tax liability.

The Severance Tax is levied on the gross receipts of businesses that engage in the severance, extraction, or production of depletable natural resources. The tax base also includes the processing and treatment of certain natural resource products as part of the production process. A person who purchases raw coal and processes it into a commercially usable product only pays tax on the value added in the processing activity and not on the total value of the product. In that sense, the West Virginia Severance Tax differs from a usual severance tax, for which the tax base is determined at the point of extraction.

The Minimum Severance Tax on Coal, a tax of 75 cents per ton, is imposed on every business severing, extracting or producing coal in the State for sale, profit or commercial use. The Minimum Severance Tax on coal is only applicable to coal production subject to the 5.0 percent Severance Tax rate. A credit is allowed against Severance Tax imposed on coal production for payment of the Minimum Severance Tax on Coal. However, no other credits can be used to offset the Minimum Severance Tax on Coal.

The Telecommunications Tax is levied on the gross income of businesses engaged in selling or furnishing telegraph, telephone or other telecommunications services. Gross income does not include commodities or services that are determined by the Public Service Commission to be subject to competition. Gross income from the provision of network access billing or similar services

provided to end users, other telephone companies or communications carriers is also not included in the tax base. The Telecommunications Tax has two groups of expenditures.

Health Care Provider Taxes represent a variety of taxes imposed on gross receipts of selected health care service providers within West Virginia. The proceeds from these taxes fund roughly 35 percent of the State's share of the Medicaid Program. The Medicaid Program is a jointly funded cooperative venture between the federal and state government to assist states in providing medical care to eligible low-income persons. In West Virginia, federal funds are matched with State funds at a ratio of roughly three to one.

BUSINESS LICENSE TAXES

For purposes of this report, Business License Taxes include the Business Registration Tax and Corporate License Tax.

The Business Registration Tax affects most businesses in West Virginia. By statute, each location of a business subject to the tax must obtain a business registration certificate from the State Tax Department before beginning business in the State. The tax is assessed biennially at a set fee of \$30 per business location. Business Registration Tax expenditures include activities excluded from the definition of business, activities exempt from registration, activities not required to obtain a registration certificate and activities exempt from payment of the tax.

All corporations that engage in business activity in West Virginia must file a Corporate License Tax return. The filing requirements apply to both domestic corporations and foreign corporations. For purposes of the Corporate License Tax, a domestic corporation is defined in the West Virginia Code as ". . . a corporation incorporated under the laws of this state and corporations organized under the laws of the state of Virginia before the twentieth day of June, one thousand eight hundred and sixty-three, which have its principal place of business and chief works (if it has chief works) in this state." All other corporations are classified as foreign corporations. This report examines three tax expenditures provided by statute that apply to the Corporate License Tax. The Corporate License Tax is commonly referred to as the Charter Tax.

EXCISE TAXES

Excise taxes are generally levied on units of consumption of certain commodities in order to generate revenue for the taxing authority. In West Virginia, excise taxes are imposed on the privilege of manufacturing, producing, distributing or selling certain items within the State. These items include gasoline and special fuel, non-intoxicating beer, wine, tobacco products and soft drinks. In addition to the excise tax, suppliers of gasoline and special fuel are also subject to the Consumers Sales Tax and Use Tax based on the average wholesale price of gasoline. Also, the excise tax on gasoline and special fuel is levied on motor carriers operating within the State.

On January 1, 1996, West Virginia became a member of the International Fuel Tax Agreement (IFTA). IFTA is a fuel tax reciprocity agreement among states of the United States and provinces of Canada. The agreement is intended to simplify the reporting and payment of all fuel use taxes by interstate motor carriers. All West Virginia-based motor carriers who travel in at least one other IFTA jurisdiction and operate one or more qualified vehicles must obtain an IFTA license. All West Virginia-based IFTA licensees must file a single tax return with the State Tax Department. West Virginia then distributes both the tax and the carrier information to the other IFTA jurisdictions on behalf of the carrier. West Virginia receives its portion of gasoline taxes due from motor carriers based in other IFTA jurisdictions from the carrier's home jurisdiction.

Revenue collected from the Motor Fuel Excise Tax is deposited into the State Road Fund. All amounts collected under IFTA are deposited into the International Fuel Tax Agreement Clearing Fund for distribution of funds owed to other member jurisdictions as provided in the agreement and for payment of any refunds owed to West Virginia-based taxpayers. After refund payments and distributions to other jurisdictions, all remaining IFTA funds are deposited into the State Road Fund. Revenue collected from the excise taxes on non-intoxicating beer, wine and tobacco products is deposited into the General Revenue Fund of the State. Revenue collected from the Soft Drinks Tax is deposited into a special medical school fund. This fund shall be used solely for the construction, maintenance, and operation of a four-year school of medicine, dentistry, and nursing of West Virginia University.

There are many possible exemptions and refunds available for the excise taxes. However, most of the expenditures pertain to the taxes on gasoline and special fuel for off-highway uses of such products. In addition to refunds and credits, discounts are available for the excise taxes on tobacco products and soft drinks.

PROPERTY TAXES

The Property Tax and the Property Transfer Tax are collected at the county level, but the revenue from these taxes benefits both State and local governments. While the Property Tax is an annual levy on property, the Property Transfer Tax is levied on property only when it is transferred.

The Property Tax is levied on all real and personal property in West Virginia, except property specifically exempted in the West Virginia Code. Revenues from the Property Tax benefit the State, counties, county boards of education and municipalities. Each county and municipality can impose its own rates of property taxation. These rates can vary within counties depending upon the classification of the property. The West Virginia Legislature sets the regular rate of tax for county boards of education. This rate is used by all county boards of education Statewide. However, the total tax rate for county boards of education may differ from county to county due to excess levies and/or bond levies.

Property is assessed based on its use, location and value as of July 1 of each year. The amount of tax paid on property depends upon the assessed valuation of the property and the rate of tax. Each county assessor is required to maintain current values on all real and personal property, except operating public utility property, in that county. The State Tax Commissioner is required to determine the market value of all industrial and natural resource properties in the State. The State Tax Commissioner also is responsible for the valuation of public utility property and all types of property that are to be included in the operating property of a public utility.

Although all property is presumed to be taxable until its owner proves otherwise, there are many possible exemptions from the Property Tax. Some of these exemptions are based on the ownership of the property while others are based on the use of the property.

The Property Transfer Tax consists of an excise tax on the privilege of transferring real estate to be paid to the State and an excise tax to be paid to the county where the transfer is recorded. Both the State and county excise tax are paid to the county clerk. There are many exemptions to the tax, which can be categorized as follows:

1. those principally for the benefit of individuals;
2. those principally for the benefit of corporations;
3. transfers by gift, dedication, deed or condemnation proceeding to or from the United States government or the West Virginia government, including agencies, instrumentalities or political subdivisions;
4. gifts to or transfers from or between certain voluntary charitable or educational organizations, and
5. certain miscellaneous transfers.

INTRODUCTION

West Virginia Code §11-10-5s(c) requires a tax expenditure report to be submitted to the Legislature by January 15 of each year. In three-year cycles, these reports are intended to analyze tax expenditures for most major State taxes. The law defines the term "tax expenditure" as a provision in the tax laws designed to encourage certain kinds of activities or to aid taxpayers in special circumstances. Such provisions generally include exclusions, exemptions, deductions, adjustments, credits and deferrals from tax.

The State Tax Commissioner has promulgated rules setting forth a timetable for such reports. This report covers **special business taxes, business license taxes, excise taxes and property taxes.** Special business taxes include the Business and Occupation Tax, Severance Tax, Telecommunications Tax and Health Care Provider Taxes. Business license taxes analyzed in this report are the Business Registration Tax and the Corporate License Tax. Excise taxes include the Motor Fuel Excise Tax, Motor Carrier Road Tax, International Fuel Tax, Tobacco Products Excise Tax, Soft Drinks Tax, Beer Barrel Tax and Wine Liter Tax. Property taxes include both the Property Tax and the Property Transfer Tax. Other reports cover taxes administered by the State Tax Department that are not analyzed within this report.

OVERVIEW

The special business taxes, business license taxes, excise taxes and property taxes combined to account for roughly \$2.15 billion in State and local revenue in Fiscal Year 2005. These revenues were distributed as follows:

<u>Fund</u>	<u>Revenue</u>
State General Revenue Fund	\$ 576 million
State Road Fund	\$ 312 million
State Medicaid Fund	\$ 159 million
State Infrastructure Fund	\$ 24 million
West Virginia Medical School Fund	\$ 15 million
Division of Forestry Fund	\$ 4 million
Local Government Funds	\$1,055 million

The local share included over \$20 million in Additional Severance Tax on Coal, \$5 million in oil and gas severance tax revenues, \$4 million from the tax on synthetic fuel produced from coal, roughly \$170,000 from the Severance Tax on waste coal and more than \$1 billion in property and property transfer taxes for Fiscal Year 2005.

In Fiscal Year 2005, special business taxes and business license taxes totaled roughly \$667 million. Approximately 67 percent of these tax collections was deposited into the State's General Revenue Fund. The remainder was distributed to special revenue funds (29 percent) and to local governments (3 percent). These collections represented nearly 13 percent of total State General Revenue Fund receipts.

WV GENERAL REVENUE FUND PERCENTAGE YIELD

<u>REVENUE SOURCE</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>FY 2004</u>	<u>FY 2005</u>
Business & Occupation Tax	6.2%	6.1%	5.8%	5.2%
Severance Tax	5.9	5.6	6.0	7.1
Telecommunications Tax	0.5	0.4	0.4	0.2
Corporate License Tax	0.2	0.2	0.2	0.2
Business Registration Tax	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>
Total	12.9%	12.4%	12.5%	12.8%

More than 70 percent of all excise tax collections are deposited into the State Road Fund while roughly 25 percent of collections are deposited into the State General Revenue Fund. The remaining collections (i.e., Soft Drinks Tax collections) are deposited into a special medical school fund for West Virginia University. Excise taxes accounted for \$439.3 million in Fiscal Year 2005.

As a percentage of total revenue, excise tax collections tend to decline in importance over time unless there is a tax rate increase because such taxes are based upon units of consumption and are not responsive to inflation. For example, collections from the tax on cigarettes increased from 1.2 percent to 2.9 percent of total State General Fund revenue between Fiscal Year 2002 and Fiscal Year 2005 due to the tax rate increase of 38 cents per pack in 2003. Excise taxes are often imposed upon products in an effort to discourage consumption (e.g., tax on tobacco products and beer).

Nearly 99.6 percent of total Property Tax collections go to local governments. More than 66.5 percent of these collections directly benefit primary and secondary public schools. Over 25.5 percent of total Property Tax collections go to county governments while municipalities receive approximately 7.5 percent of total collections. The State generally receives roughly 0.4 percent of total property tax receipts.

Property taxes account for nearly one-third of the total state and local tax receipts in the United States. However, in West Virginia, the Property Tax accounts for less than 20 percent of total State and local tax collections. The lower ratio of Property Tax to all State and local tax collections in West Virginia is largely attributable to both lower than average housing values and low effective tax rates. According to the Census Bureau, the median value of housing in West Virginia in 2003 (i.e., \$78,201) was just 56 percent of the median value for the United States (i.e., \$139,759). In addition, the average effective tax rate on owner-occupied residential housing is less than 0.75 percent in the State. This is substantially lower than the national average. As a result, residential property taxes account for more than half of all property taxes in the United States, but approximately 25 percent of all property taxes in West Virginia.

Owner-occupied housing receives preferential tax treatment in West Virginia. The rate of tax on residential housing is roughly one-half the rate of tax on most other types of property. There are additional valuation preferences and exemptions that can reduce the property tax on certain residences even further.

This study will concentrate on the effect of tax expenditures upon tax yields. Most exclusions, exemptions, deductions and credits associated with these taxes may be viewed as tax expenditures. Tax expenditures tend to escape the usual legislative scrutiny afforded other expenditures in the annual budget approval process because provisions in the tax law often remain intact indefinitely. Programs funded through tax expenditures, in effect, receive priority funding over all other programs. The goal of this report is to facilitate an examination of special business tax, miscellaneous business tax, excise tax and property tax expenditures using available resources.

Tax expenditures are deviations from a model tax structure. A model tax structure typically contains a minimal allowance for exclusions, exemptions, deductions and credits. A minimal allowance for tax expenditures is necessary to maximize tax equity and tax efficiency.

The distribution of tax burdens should be equitable. There are two types of equity, horizontal and vertical. Horizontal equity occurs when those with equal capacity (e.g., equal income) pay the same amount of tax. The achievement of vertical equity occurs whenever those with a greater income or tax base pay more than those with a lesser income or tax base. Tax expenditure provisions often reduce the horizontal equity of a tax structure through an allowance of special benefits to some at the expense of others.

Economic efficiency, a requirement of a model tax structure, occurs whenever tax interference in the economy is kept to a minimum. Tax expenditures tend to reduce economic efficiency through the promotion of some economic activities over others. For example, federal depreciation and passive loss rules of the 1980's led to a significant increase in office building construction and eventually to a glut of office space.

A low-rate, broad-based tax structure often results in optimal tax competitiveness between states, another requirement of a model tax structure. However, many states tend to use tax

expenditures, such as investment tax credits, to gain a competitive advantage over other states with respect to a particular taxpayer or industry. The value of these expenditures should be minimized because their cost is distributed among other taxpayers.

A model tax structure produces stable and sufficient revenue for basic public services. Tax expenditures decrease revenue, which may result in fiscal instability.

Understandability and simplicity are also important requirements for a model tax structure. Tax expenditures may complicate the tax structure, resulting in high administration and compliance costs for both the taxpayer and the taxing authority.

A model tax structure would tax nearly all expenditures in West Virginia to the extent within the Legislature's power. Deductions or exclusions required by federal law would **not** be tax expenditures because such modifications could not be effectively repealed by the Legislature.

ESTIMATING COSTS OF TAX EXPENDITURES

This study provides estimates of the value of special business tax, miscellaneous business tax, excise tax and property tax expenditures and certain provisions considered necessary to define a model tax structure. Except where otherwise noted, each expenditure within the study is examined independently from all other expenditures. Following the establishment of a value in isolation, the influence of outside factors (i.e., other expenditures and taxpayer behavior) is discussed, where applicable. Expenditure values less than \$10,000 are reported as "minimal".

Several sources of information were used in the construction of expenditure valuations. These include, among others:

1. the Department's tax return data;
2. surveys of various organizations;
3. publications from the U.S. Department of Energy;
4. publications from the U.S. Bureau of the Census, and
5. information from other West Virginia agencies.

In most cases, the revenue impact attributable to the repeal of a tax expenditure is less than the value of that expenditure. This occurs because tax expenditures tend to overlap one another and taxpayers tend to alter their behavior whenever items of income or consumption become taxed for the first time.

SPECIAL BUSINESS TAXES

BUSINESS AND OCCUPATION TAX

OVERVIEW

The Business and Occupation Tax, known throughout most of its history as the "Gross Sales Tax", was originally enacted in 1921. As enacted, the Gross Sales Tax had as its intent to tax every individual, firm, partnership, association and corporation conducting business for profit in West Virginia.

Enactment of the "Tax Reform Act of 1985" altered the scope of the Business and Occupation Tax to a tax on public utilities and electric power producers only, effective July 1, 1987. As of 1989, natural gas storage facility operators are subject to a per unit tax under the Business and Occupation Tax statutes. Additionally, legislation in 1989 provided that electric power producers and distributors would be subject to the greater of the gross sales tax or a new per unit tax on kilowatt-hours of electricity generated or distributed. Beginning in June 1995, electric power producers whose tax liability for every month in 1994 was based on kilowatt-hours of electricity generated were to determine their tax liability based upon "taxable generating capacity". The legislation enacted in 1995 defined "taxable generating capacity" as the "capacity factor" times the official capability of a generating unit. "Capacity factor" was defined as the fraction of the average four-year generation for the 1991 to 1994 period divided by the "maximum possible annual generation" of a unit. The official capability of a unit times 8,760 (the number of hours in a year) was defined as the "maximum possible annual generation". In 2001, the Business and Occupation Tax statute was revised to subject the manufacturing or production of synthetic fuel from coal to tax at a rate of \$0.50 per ton.

Applicable tax rates for the Business and Occupation Tax, as of July 1, 2005, are shown on the following pages.

BUSINESS AND OCCUPATION TAX RATES¹

<u>Taxpayer Type</u>	<u>Activity and West Virginia Code Citation</u>	<u>Tax Base</u>	<u>Tax Rate</u>
Electric power company	Generating or producing electricity for sale, profit or commercial use (§11-13-2o(b)(1))	Generating capacity	\$22.78 per KW ²
Electric power company	Generating or producing electricity for sale, profit or commercial use by a unit which has installed a flue gas desulfurization system (§11-13-2o(b)(1))	Generating capacity	\$20.70 per KW ²
Electric power company	Selling electricity that is not generated or produced in West Virginia by the taxpayer (§11-13-2o(b)(2))	Electricity sold	\$0.0019 per KWH ³
Electric power company	Selling electricity that is not generated or produced in West Virginia by the taxpayer and sale is to a plant location of a customer engaged in a manufacturing activity, if the contract demand at such plant location exceeds 200,000 kilowatts per hour per year (§11-13-2o(b)(2))	Electricity sold	\$0.0005 per KWH ³

1. Rates as of July 1, 2005

2. Kilowatt

3. Kilowatt-hour

BUSINESS AND OCCUPATION TAX RATES (continued)

<u>Taxpayer Type</u>	<u>Activity and West Virginia Code Citation</u>	<u>Tax Base</u>	<u>Tax Rate</u>
Natural gas storage operator	Withdrawal and/or injection of natural gas from/into storage reservoirs (§11-13-2e)	Net dekatherms ¹	\$0.05 per dekatherm
Natural gas utility	Public service or utility business (§11-13-2d(a)(4))	Gross income	4.29 percent
Water utility	Public service or utility business (§11-13-2d(a)(2))	Gross income	4.40 percent
Street and interurban and electric railways	Public service or utility business (§11-13-2d(a)(1))	Gross income	1.40 percent
Toll bridge companies	Public service or utility business (§11-13-2d(a)(5))	Gross income	4.29 percent
All other public service or utility business	Public service or utility business (§11-13-2d(a)(6))	Gross income	2.86 percent
Manufacturer or producer of synthetic fuel from coal	Producing synthetic fuel from coal (§11-13-2f)	Tons produced	\$0.50 per ton

1. Dekatherm means the thermal energy unit equal to 1,000,000 British thermal units (BTU's) or the equivalent of 1,000 cubic feet of gas having a heating content of 1,000 BTU's per cubic foot.

ESTIMATING COSTS OF TAX EXPENDITURES

The values of the expenditures contained within this report have been determined from several sources. Where available, information from 2003 and 2004 Business and Occupation Tax returns was used. Also, other State Tax Department files, Public Service Commission reports and U. S. Department of Energy publications were used.

ORGANIZATION AND ANALYSIS

This study separates the Business and Occupation Tax expenditures into five groups. The groups are based on the type of expenditure or on the organization or activity involved. The five groups are as follows:

- Expenditures Relating to the "Old" Business and Occupation Tax
- Income or Other Measurable Quantities Exempt from Tax
- Activities Subject to Reduced Rates
- Alternate Tax Calculations
- Credits

Each expenditure listed in this report contains a brief rationale for its existence. In many cases, legislative documentation on why a particular tax expenditure was enacted was not available; thus, the rationales herein are based solely on the experience or inference of the State Tax Department.

EXPENDITURES RELATING TO THE "OLD" BUSINESS AND OCCUPATION TAX

The "Tax Reform Act of 1985", effective July 1, 1987, significantly narrowed the application of the Business and Occupation Tax. The repeal of some sections of the Business and Occupation Tax statute in 1985 provided an implicit exemption for many businesses since the scope of the tax was narrowed to public utilities and electric power producers. In addition to this implicit exemption, the Business and Occupation Tax statute, in its present form, also contains explicit exemptions, exclusions and credits that apply to the tax in its prior form. The expenditures (and the appropriate West Virginia Code citations) that are remnants of the "old" Business and Occupation Tax are as follows:

- Exemption for West Virginia Business Development Corporations (W. Va. Code §31-14-13)
- Exemption for Transportation and Communications Businesses (W. Va. Code §11-13-2d(a))
- Exemption for Selected Insurance, Nonprofit, Religious, and Finance Businesses (W. Va. Code §11-13-3(b))
- Gross Income Exclusion for Selected Advertising Service in Radio and Television Broadcasting (W. Va. Code §11-13-3(b)(6))
- Exclusion for Contributions to an Employee Stock Ownership Plan by a Manufacturer (W. Va. Code §11-13-3a)
- Residential Housing Development Project Credit¹ (W. Va. Code §11-13D-3)

Since these expenditures apply to the "old" Business and Occupation Tax and are not apt to be claimed by current taxpayers, the repeal of these exemptions would not lead to any increase in State revenue.

¹ New qualifying Residential Housing Development Credit applications were terminated through tax credit reform legislation enacted in 2002.

INCOME OR OTHER MEASURABLE QUANTITIES EXEMPT FROM TAX

The Business and Occupation Tax statutes provide several exemptions that exclude gross income or units of activity from the base of the tax. The following items are excluded from the appropriate tax base prior to the calculation of the tax due:

- Municipally-Owned Water, Sewer or Electric Plants
- Electric Power or Natural Gas Related to Selected Manufacturing Processes
- Gross Income from Interstate Commerce
- Gas Consumed and/or Recycled in a Gas Storage Operation
- Electric Generation by a Manufacturer
- Net Generation Excluded from Taxable Generating Capacity
- Capacity Related to Retired/Inactive Reserve Electric Generating Units
- Capacity Exemptions for New Electric Generating Units
- Non-Utility Natural Gas Sales
- New Natural Gas Storage Reservoirs
- Community Service Assessment Income of Nonprofit Homeowners' Associations

Expenditure calculations for these excluded items follow.

MUNICIPALLY-OWNED WATER, SEWER OR ELECTRIC PLANTS

STATUTE: West Virginia Code §§11-13-2d(a)(2), 11-13-2o(a)(10)(C), 11-13-2o(b)(2),
11-13-2o(c)(2) and 11-13-2o(c)(3)
West Virginia Legislative Regulation §110-13-3.2

EXEMPTION: Tax is not imposed on income received by municipally-owned water plants (§11-13-2d(a)(2))
"Net generation" for a period means the kilowatt-hours of net generation available for sale generated or produced by the generating unit in this state during such period less ... the total kilowatt hours of electricity generated ... by a municipally owned plant (§11-13-2o(a)(10)(C))
Upon every person ... in the business of selling electricity to consumers ... tax imposed ... provisions ... shall not apply to ... kilowatt hours of electricity generated and sold, or purchased and resold, by a municipally-owned plant (§11-13-2o(b)(2))
New generating units ... the taxable generating capacity of a county or municipally-owned generating unit shall equal zero percent of the official capability of the unit (§11-13-2o(c)(2))
Peaking units ... the taxable generating capacity of a county or municipally-owned generating unit shall equal zero percent of the official capability of the unit (§11-13-2o(c)(3))
Public service districts for water and sewage services, municipal waterworks, municipal combined waterworks and sewage systems and municipal and sanitary district sewage works are exempt from payment of the tax (§110-13-3.2)

VALUE: **\$11.5 million per year**

Rationale

Municipalities provide clean, safe drinking water and sewage treatment more as a service to the residents than as a revenue-generating venture. Many municipalities have rate structures that produce revenue below that necessary to cover the cost of service and capital expenditures, including the debt service on bonds issued. Thus, the provision of drinking water is funded in part from other revenue sources of the municipality, including taxes and fees. Although municipalities are incorporated, the statutes permitting their incorporation are distinct from the statutes governing the incorporation of businesses. The exemption for municipally-owned water or sewage plants exists in recognition that municipalities and public service districts are not in the business of providing water or sewage services for profit.

While municipal water or sewage service plants often operate at a loss, several West Virginia municipalities have entered into electric power production and/or distribution activity to generate revenue for governmental operations. This exemption exists in recognition that municipalities are not businesses although the generation and distribution activities produce income in excess of costs. For tax equity purposes, this exemption can only be justified if the service does not compete with services available from non-government utilities.

**ELECTRIC POWER OR NATURAL GAS RELATED
TO SELECTED MANUFACTURING PROCESSES**

STATUTE: West Virginia Code §§11-13-2d(a)(4) and 11-13-2o(a)(10)(C)

EXEMPTION: Sale of natural gas ... exempt ... to the extent that the natural gas is separately metered and is gas from which the purchaser derives hydrogen and carbon monoxide for use in the manufacture of chemicals (§11-13-2d(a)(4))
"Net generation" for a period means the kilowatt-hours of net generation available for sale generated or produced by the generating unit in this state during such period less ... the total kilowatt hours of electricity generated ... that are separately metered and consumed in an electrolytic process for the manufacture of chlorine ... that are separately metered and consumed in the manufacture of ferroalloy (§11-13-2o(a)(10)(C))

VALUE: **Cannot be disclosed¹**

Rationale

The exemptions provided for electricity used in the manufacture of chlorine or a ferroalloy and for natural gas from which hydrogen and carbon monoxide are derived for use in the manufacture of chemicals are similar in nature. The West Virginia Code requires that the rate reduction or economic benefit derived from the exemption must be passed on to the manufacturer purchasing the electricity or natural gas. These exemptions exist to reduce production costs of manufacturing businesses in West Virginia.

¹ Due to taxpayer confidentiality

GROSS INCOME FROM INTERSTATE COMMERCE

STATUTE: West Virginia Code §11-13-2d(b)

EXEMPTION: The measure of this tax shall not include gross income derived from commerce between this State and other states of the United States or between this State and foreign countries

VALUE: Not available

Rationale

Federal law restricts the taxation of interstate commerce by the states. This exemption reaffirms the constraints cited in the Commerce Clause of the United States Constitution and thus does **not** constitute a tax expenditure since state law makers have no authority to tax the cited activity.

GAS CONSUMED AND/OR RECYCLED IN A GAS STORAGE OPERATION

STATUTE: West Virginia Legislative Regulation §§110-13-1a.2.5.1.a and 110-13-1a.2.5.1.b

EXEMPTION: The number of dekatherms of gas injected into or withdrawn from a gas storage reservoir shall not include any gas consumed by a gas storage operation as fuel for compressors used to pump gas into or out of storage (§110-13-1a.2.5.1.a)

The number of dekatherms of gas injected into or withdrawn from a gas storage reservoir shall not include any gas used in a recycling operation of the storage reservoir (§110-13-1a.2.5.1.b)

VALUE: Not available

Rationale

The exemption for gas consumed as fuel in a gas storage activity presumably exists in recognition that such gas is not part of the gas storage economic activity.

"Recycling operation" is defined in the Business and Occupation Tax Regulations as "the withdrawal of gas from a storage reservoir and the subsequent re-injection of gas into the same reservoir solely for the purpose of regulating the pressure of the storage reservoir or a portion

thereof." Since the base of the tax is the net number of dekatherms injected into storage or the net number of dekatherms withdrawn from storage, this exemption presumably exists to avoid double taxation of recycled gas.

ELECTRIC GENERATION BY A MANUFACTURER

STATUTE: West Virginia Code §11-13-2o(c)(6)

EXEMPTION: When electricity used in a manufacturing activity is generated in this state by the person who owns the manufacturing facility in which the electricity is used and the electricity generating units or units producing the electricity so used are owned by such manufacturer, or by a member of the manufacturer's controlled group, as defined in section 267 of the Internal Revenue Code of 1986, as amended, the generation of the electricity shall not be taxable under this article

VALUE: **\$3.5 million per year**

Rationale

This exemption exists because the eligible companies are not regularly involved in an activity subject to the Business and Occupation Tax.

**NET GENERATION EXCLUDED FROM
TAXABLE GENERATING CAPACITY**

STATUTE: West Virginia Code §§11-13-2o(a)(10)(A) and 11-13-2o(a)(10)(B)

EXCLUSION: "Net generation" for a period means the kilowatt-hours of net generation available for sale generated or produced by the generating unit in this state during such period less the following: twenty-one twenty-sixths of the kilowatt-hours of electricity generated at the generating unit and sold during such period to a plant location of a customer engaged in manufacturing activity if the contract demand at such plant location exceeds two hundred thousand kilowatts per hour in a year or where the usage at such plant location exceeds two hundred thousand kilowatts per hour in a year (§11-13-2o(a)(10)(A))
"Net generation" for a period means the kilowatt-hours of net generation available for sale generated or produced by the generating unit in this state during such period less the following: twenty-one twenty-sixths of the kilowatt-hours of electricity produced or generated at the generating unit during such period by any person producing electric power and an alternative form of energy at a facility located in this state substantially from gob or other mine refuse (§11-13-2o(a)(10)(B))

VALUE: **Cannot be disclosed¹**

Rationale

In 1995, the Business and Occupation Tax on electric power producers shifted from a tax largely based on kilowatt hours of electricity generated to a tax on the capacity of the generating units. Prior to the change in 1995, the large volume sales to manufacturers and the generation from gob or other mine refuse were taxed at a reduced rate that was 5/26ths of the general rate on net generation. The exclusion cited above extended the preferential treatment into the revised tax base (i.e., taxable generating capacity).

Prior to June 1995, the reduced rate for large quantities of electric power delivered to a manufacturer presumably existed to provide reduced rates to the power provider. There was an understanding that the reduction in tax rates would, in turn, be passed on to the large user through lower charges. The reduced rate existed to lower production costs for manufacturers consuming large quantities of electric power.

¹ Due to taxpayer confidentiality

Go piles and mine refuse are both environmental hazards and aesthetic eyesores. The reduced rate (prior to June 1995) for electricity produced or generated from such sites presumably existed to reduce the number and size of mine waste piles.

Other exclusions from the definition of net generation exist for the following:

Generation from municipally owned power plants,
Electric power separately metered and consumed in an electrolytic process for the manufacture of chlorine, and
Electric power separately metered and consumed in an electrolytic process for the manufacture of ferroalloy.

Further information on these three exclusions can be found in the first two expenditures of this section. An additional expenditure related to large volume sales to manufacturers may be found in a following group of expenditures entitled "Alternate Tax Calculations".

CAPACITY RELATED TO RETIRED/INACTIVE RESERVE ELECTRIC GENERATING UNITS

STATUTE: West Virginia Code §11-13-2o(c)(1)

EXEMPTION: If a generating unit is retired from service or placed in inactive reserve, a taxpayer shall not be liable for tax computed with respect to the taxable generating capacity of the unit for the period that the unit is inactive or retired

VALUE: **Cannot be disclosed¹**

Rationale

Prior to 1995, the tax base for electric power producers was based upon ongoing economic activity either in the form of gross income or in the form of kilowatt hours of electricity generated. Under West Virginia Code §11-13-2o et. seq., the measure of the tax (i.e., taxable capacity) was based, in part, upon net generation. This exemption presumably exists in recognition that retired and/or inactive generating units are not producing net electric power generation.

¹ Due to taxpayer confidentiality

**CAPACITY EXEMPTIONS FOR
NEW ELECTRIC GENERATING UNITS**

STATUTE: West Virginia Code §§11-13-2o(c)(2) and 11-13-2o(c)(3)

EXEMPTION: If a new generating unit, other than a peaking unit, is placed in initial service on or after the effective date of this section, the generating unit's taxable generating capacity shall equal forty percent of the official capability of the unit: Provided, that the taxable generating capacity of a county or municipally-owned generating unit shall equal zero percent of the official capability of the unit and the taxable generating capacity of a generating unit utilizing a turbine powered by wind shall equal five percent of the official capability of the unit (§11-13-2o(c)(2))

If a peaking unit is placed in initial service on or after the effective date of this section, the generating unit's taxable generating capacity shall equal five percent of the official capability of the unit: Provided, that the taxable generating capacity of a county or municipally-owned plant shall equal zero percent of the official capability of the unit (§11-13-2o(c)(3))

VALUE: **Cannot be disclosed¹**

Rationale

These exemptions presumably exist to encourage the construction and operation of new generating plants.

¹ Due to taxpayer confidentiality

NON-UTILITY NATURAL GAS SALES

STATUTE: West Virginia Code §11-13-2d(a)

EXEMPTION: Upon any person engaging or continuing within this state in any public service or utility business ... the tax imposed by section two of this article shall be equal to the gross income of the business derived from such activity or activities

VALUE: **\$13.8 million per year**

Rationale

Although the statute cited above was originally enacted in 1935, non-utility natural gas sales did not become exempt from tax under the Business and Occupation Tax until the "Tax Reform Act of 1985". Prior to July 1, 1987, non-utility sales of natural gas were subject to tax under the wholesale or retail classes of the Business and Occupation Tax. As previously stated, the 1985 legislation reduced the scope of the Business and Occupation Tax to a tax upon public utilities. The Public Service Commission issues companies a "Certificate of Public Convenience and Necessity" to operate as utilities in designated areas. As stated in United Fuel Gas Co. v. Battle, 153 W. Va. 222, 167 S.E. 2d 890, sales by utilities outside their designated service area are not classified as utility sales. In addition, non-utilities may make sales in areas in competition with utilities. With recent deregulation of the natural gas industry, non-utility sales of natural gas have become more significant in relation to all natural gas sales. This exemption exists in part due to the conversion of the Business and Occupation Tax to a tax upon utilities.

NEW NATURAL GAS STORAGE RESERVOIRS

STATUTE: West Virginia Code §11-13-1(b)(8)

EXEMPTION: "Storage reservoir" means that portion of any subterranean sand or rock stratum or strata into which gas has been injected for the purpose of storage prior to the first day of March, one thousand nine hundred eighty-nine

VALUE: **Cannot be disclosed¹**

¹ Due to taxpayer confidentiality

Rationale

The inclusion of a date in the definition of storage reservoir created an exemption for storage reservoirs developed after February 28, 1989. This exemption presumably exists to encourage the development of new natural gas storage reservoir capacity in West Virginia.

COMMUNITY SERVICE ASSESSMENT INCOME OF NONPROFIT HOMEOWNERS' ASSOCIATION

STATUTE: West Virginia Code §11-13-3(b)(7)

EXEMPTION: The provisions of this article shall not apply to : ... (7) Gross income of a nonprofit homeowners' association received from assessments on its member for community services such as road maintenance, common area maintenance, water service, sewage service and security service.

VALUE: **Minimal**

Rationale

As stated previously, legislation in 1985 reduced the scope of the Business and Occupation Tax to a tax upon public utilities. The test to determine status as a public utility, as stated in United Fuel Gas Co. v. Battle, 153 W. Va. 222, 167 S.E. 2d 890, "is that to be such there must be a dedication or holding out either express or implied that such person, firm, or corporation is engaged in the business of supplying his or its product or services to the public as a class or any part thereof as distinguished from the serving of only particular individuals ..." Generally, a homeowners association only provides service to particular individuals (i.e., members of the association). This expenditure was enacted in 2005 in recognition that a homeowners association is not a public utility for purposes of the Business and Occupation Tax.

ACTIVITIES SUBJECT TO REDUCED RATES

Reduced tax rates are provided presumably in recognition of the cost or benefit associated with the particular activity or quantity. In some cases, only one or two taxpayers are eligible for the reduced tax rate. The following activities are eligible for reduced tax rates under the Business and Occupation Tax Statute:

Sales of Electric Power Exceeding 200,000 Kilowatts Per Hour Per Year
Capacity of Units with a Flue Gas Desulfurization System

Expenditure calculations for the items subject to reduced rates follow.

SALES OF ELECTRIC POWER EXCEEDING 200,000 KILOWATTS PER HOUR PER YEAR

STATUTE: West Virginia Code §11-13-2o(b)(2)

TAX RATE: For taxpayers who sell electricity to consumers in this state that is not generated or produced in this state by the taxpayer ... the rate shall be five hundredths of one cent times the kilowatthours of electricity ... sold to a plant location in this state of a customer engaged in manufacturing activity if the contract demand at such plant location exceeds two hundred thousand kilowatts per hour per year or if the usage at such plant location exceeds two hundred thousand kilowatts per hour in a year

VALUE: **Cannot be disclosed¹**

Rationale

The reduced rate for large quantities of electric power delivered to a manufacturer presumably exists to provide reduced rates to the power provider. There is an understanding that the reduction in tax rates would, in turn, be passed on to the large user through lower charges. This exemption exists to lower production costs for manufacturers consuming large quantities of electric power.

¹ Due to taxpayer confidentiality

**CAPACITY OF UNITS WITH A
FLUE GAS DESULFURIZATION SYSTEM**

STATUTE: West Virginia Code §11-13-2o(b)(1)

TAX RATE: Upon every person engaging or continuing within this state in the business of generating or producing electricity for sale, profit or commercial use, either directly or indirectly through the activity of others, in whole or part, ... the tax imposed by section two of this article shall be equal to: ... the product of twenty-two dollars and seventy-eight cents multiplied by the taxable generating capacity of each generating unit in this state owned or leased by the taxpayer, ... Provided, that with respect to each generating unit in this state which has installed a flue gas desulfurization system, the tax imposed by section two of this article shall, on and after the thirty-first day of January, one thousand nine hundred ninety-six, be equal to the product twenty dollars and seventy cents multiplied by the taxable generating capacity of the units

VALUE: **Cannot be disclosed¹**

Rationale

Flue gas desulfurization systems are intended to remove sulfur compounds from the exhaust gases of electric generating units fired by fossil fuel. The removal of sulfur compounds (e.g., sulfur dioxide) reduces the amount of acid rain formed when the exhaust gases combine with moisture in the air. This reduced tax rate presumably exists to encourage the installation of flue gas desulfurization systems at electric generating plants and, in turn, reduce the acid rain produced from the exhaust gases. The reduced tax rate also presumably promotes a market for high-sulfur coal.

¹ Due to taxpayer confidentiality

ALTERNATE TAX CALCULATIONS

Provisions that limit tax liability to the minimum of two alternate calculations are present for the following:

Gas Storage
Large Volume Electricity Sales to Manufacturers

Expenditure calculations for these alternate tax methods follow.

GAS STORAGE

STATUTE: West Virginia Code §11-13-2e(a)

ALTERNATE CALCULATION: Effective the first day of July, one-thousand nine hundred ninety-five, the net number of dekatherms of gas injected or the net number of dekatherms withdrawn shall not exceed the storage utilization index ... “storage utilization index” means the utilization of storage reservoir, through the operation of existing and functional facilities available for storage use during the five year base period ending the thirty-first day of December, one thousand nine hundred ninety-four, and the storage utilization index shall be the five-year average of taxable dekatherms as determined for each taxable period of the stated base period

VALUE: **\$5.9 million per year**

Rationale

This expenditure was enacted in order to cap the tax liability of natural gas storage operators at the average monthly level experienced by such taxpayers between 1990 and 1994.

LARGE VOLUME ELECTRICITY SALES TO MANUFACTURERS

STATUTE: West Virginia Code §11-13-2o(b)(1)

ALTERNATE

CALCULATION: Upon every person engaging or continuing within this state in the business of generating or producing electricity for sale, profit or commercial use, either directly or indirectly through the activity of others, in whole or part, ... the tax imposed by section two of this article shall be equal to: ... the product of twenty-two dollars and seventy-eight cents multiplied by the taxable generating capacity of each generating unit in this state owned or leased by the taxpayer, ... Provided, however, that with respect to kilowatt hours sold to or used by a plant location engaged in manufacturing activity in which the contract demand at such plant location exceeds two hundred thousand kilowatts per hour per year or if the usage at such plant location exceeds two hundred thousand kilowatts per hour in a year, in no event shall the tax imposed by this article with respect to the sale or use of such electricity exceed five hundredths of one cent times the kilowatt hours sold to or used by a plant engaged in such a manufacturing activity

VALUE: **Cannot be disclosed¹**

Rationale

As indicated in prior sections concerning reduced tax rates for the provision of large quantities of electricity to manufacturers, it was understood that the rate reduction would be passed on to the user. This alternate calculation of tax presumably exists to ensure that under the revised tax structure enacted in 1995 the tax on the capacity dedicated to producing the electricity for the manufacturer is the same or less than the tax under prior statutes. This alternate tax calculation ensures that the pass-through of reduced-price electric power will not be affected by the change in the tax structure. If the qualified pass-through manufacturer consumes less electricity than was consumed during the base period, the alternative kilowatt-hour tax applies.

¹ Due to taxpayer confidentiality

CREDITS

The West Virginia Code provides for the application of various tax credits against the Business and Occupation Tax. Some credits provide qualifying businesses with an investment incentive. Others provide relief from double taxation or provide relief to utilities providing aid to low-income households. Some credits are carry-overs from an old tax base in place prior to 1995. Three of these old tax base credits, the Tax Credit for Increased Generation of Electricity from Coal, Credit for Electric Power Generation Taxes Paid to Another State and the Coal Loading Facilities Credit, no longer apply to the current tax base and are not subject to further discussion within this section. The following credits apply against current Business and Occupation Tax liability:

- Business Investment and Jobs Expansion Credit¹
- Industrial Expansion and Revitalization Credit
- Research and Development Projects Credit²
- Natural Gas Industry Jobs Retention Credit
- West Virginia Capital Company Credit
- Credit for Reducing Utility Charges to Low-Income Families
- Consumers Sales and Service Tax and Use Tax Overpayment Credit
- Annual Credit

Many of the credits listed above may also be applied against other business and personal taxes. Expenditure values presented in this section represent the amounts applied against **only** Business and Occupation Tax. In most cases, the priority order specified by statute or regulation specifies that the initial claim of the credit be applied against the Business and Occupation Tax. However, in some cases, the credits may be applied to other taxes first; thus, the credit amounts claimed against the Business and Occupation Tax may be negligible compared to the total cost of the credit. An analysis of these expenditures follows.

¹ For investment placed in use or service on or after January 1, 2003, the Economic Opportunity Tax Credit essentially replaces the Business Investment and Jobs Expansion Credit. However, the Economic Opportunity Tax Credit may not be used to offset or reduce Business and Occupation Tax liability. Taxpayers with Business Investment and Jobs Expansion Credit entitlement may continue to use the credit to offset or reduce Business and Occupation Tax liability until the credit allocation or credit time period expires, whichever comes first.

² For investment placed in use or service on or after January 1, 2003, the Strategic Research and Development Tax Credit essentially replaces the Research and Development Projects Credit. However, the Strategic Research and Development Tax Credit may not be used to offset or reduce Business and Occupation Tax liability. Taxpayers with Research and Development Projects entitlement may continue to use the credit to offset or reduce Business and Occupation Tax liability until the credit allocation or credit time period expires, whichever comes first.

BUSINESS INVESTMENT AND JOBS EXPANSION CREDIT

STATUTE: West Virginia Code §§11-13C-5 and 11-13-3c

CREDIT: Credit, attributable to qualified investment in tangible and real property and the creation of new jobs in West Virginia, may be used to offset up to eighty percent of Business and Occupation Tax liability attributable to the qualified investment activity for the first ten years of a qualified project, and up to one hundred percent in years eleven through thirteen

VALUE: **Cannot be disclosed¹**

Rationale

The Business Investment and Jobs Expansion Credit program also included the Corporate Headquarters Relocation Credit and Small Business Credit. This credit program was intended as an incentive for businesses to increase investment and employment levels in West Virginia. The basis of the program was largely attributable to capital investment, not direct employment growth.

Due to rising costs and a poor correlation with employment, this credit program was amended several times and then replaced with the Economic Opportunity Tax Credit for investment placed in service on or after January 1, 2003 by qualified businesses. However, the Economic Opportunity Tax Credit may not be used to offset or reduce Business and Occupation Tax liability.

Although no new Business Investment and Jobs Expansion Credit may be earned, taxpayers that gained entitlement to the credit prior to the termination date of December 31, 2002 retained that entitlement and may apply the credit until the original multi-year entitlement (i.e., up to thirteen years) has been exhausted. Thus, this credit will remain a tax expenditure for several years.

¹ Due to taxpayer confidentiality

INDUSTRIAL EXPANSION AND REVITALIZATION CREDIT

STATUTE: West Virginia Code §§11-13D-3a and 11-13-3d

CREDIT: Credit, attributable to qualified investment by electric power producers in tangible and real property, may be used to offset up to fifty percent of Business and Occupation Tax liability for a period of ten years

VALUE: **\$23.7 million per year**

Rationale

The Industrial Expansion and Revitalization Credit exists as an incentive for manufacturers of electricity to increase their property investment levels in West Virginia. The credit is available for nearly all purchases of real property and tangible personal property. Also, investment in replacement property is valued equally with investment in expansion property.

Revenue Analysis

The value of the Industrial Expansion and Revitalization Credit has grown significantly since 1992 when it was roughly \$4.6 million. The increase in recent years is the result of increased investment by the electric power industry in the areas of plant revitalization and pollution control abatement.

RESEARCH AND DEVELOPMENT PROJECTS CREDIT

STATUTE: West Virginia Code §§11-13D-3a and 11-13-3d

CREDIT: Credit, attributable to qualified research expenditures by manufacturers, may be used to offset up to fifty percent of Business and Occupation Tax liability for a period of ten years

VALUE: **\$0 per year**

Rationale

The Research and Development Projects Credit was intended as an incentive for manufacturers to increase their research and development activity within West Virginia.

The Research and Development Projects Credit was essentially replaced by the Strategic Research and Development Credit. However, the Strategic Research and Development Credit may not be used to offset or reduce Business and Occupation Tax liability. Although no new Research and Development Projects Credit may be earned, taxpayers that gained entitlement to the credit prior to the termination date of December 31, 2002 retained that entitlement and may apply the credit until the original multi-year entitlement (i.e., up to ten years) has been exhausted. Thus, this credit will remain a tax expenditure for several years.

Revenue Analysis

For the period of this study, no Business and Occupation taxpayer claimed this credit.

NATURAL GAS INDUSTRY JOBS RETENTION CREDIT

STATUTE: West Virginia Code §11-13L

CREDIT: Credit, attributable to the number of qualified employees employed by a natural gas storage taxpayer during the taxable year multiplied by \$1,000, may annually offset up to one hundred percent of Business and Occupation Tax liability attributable to the natural gas storage tax for tax years beginning on or after October 1, 1996

VALUE: **Cannot be disclosed¹**

Rationale

The Natural Gas Industry Jobs Retention Credit exists as an incentive for natural gas storage companies to maintain their current employment levels within West Virginia.

¹ Due to taxpayer confidentiality

WEST VIRGINIA CAPITAL COMPANY CREDIT

- STATUTE:** West Virginia Code §5E-1-8
- CREDIT:** Credit, attributable to capital investments in a qualified West Virginia venture capital company, may be used to offset up to one hundred percent of Business and Occupation Tax liability
- VALUE:** **\$0 per year**

Rationale

The purpose of the West Virginia Capital Company Credit is to encourage the creation of additional venture capital for high risk business investment.

Revenue Analysis

For the period of this study, no Business and Occupation taxpayer has invested in a qualifying capital company.

CREDIT FOR REDUCING UTILITY CHARGES TO LOW-INCOME FAMILIES

- STATUTE:** West Virginia Code §§11-13F-3 and 11-13-3f
- CREDIT:** Credit, attributable to the provision of electric or natural gas service to qualified low-income residential customers at special reduced rates, may be used to offset up to one hundred percent of Business and Occupation Tax liability
- VALUE:** **\$4.1 million per year**

Rationale

This credit is a form of government assistance to qualified low-income households. Public utilities are compensated for the value of rate reductions to low-income customers through the tax credit program.

**CONSUMERS SALES AND SERVICE TAX
AND USE TAX OVERPAYMENT CREDIT**

STATUTE: West Virginia Code §11-13-31

CREDIT: Overpayments of sales and use tax may be claimed as a credit against the Business and Occupation Tax

VALUE: **Minimal**

Rationale

This credit is a mechanism for taxpayers to claim a refund for the overpayment of Consumers Sales Tax or Use Tax without the need for filing a refund request with the State Tax Department. This credit is **not** a tax expenditure because it simply provides an additional mechanism for expeditious return of funds never due the State.

ANNUAL CREDIT

STATUTE: West Virginia Code §11-13-3

CREDIT: An annual credit of \$500 is permitted for each taxpayer subject to the Business and Occupation Tax

VALUE: **\$40,000 per year**

Rationale

The purpose of this credit may be to provide some measure of tax relief to small businesses. However, the credit applies to all Business and Occupation taxpayers, regardless of size. This provision is a carryover from the old broad-based Business and Occupation Tax structure in place prior to July 1, 1987.

SEVERANCE TAX

OVERVIEW

The Severance Tax is imposed on the gross value of the severed natural resource. The gross value of the severed natural resource is the market value of the resource in the immediate vicinity where severed. Transportation costs to the customer are not included. The rate of taxation varies among the resources taxed as follows:

<u>Natural Resource</u> ¹	<u>Tax Rate</u>
Coal mined and produced, average seam thickness in excess of 45 inches	5.00%
Coal mined and produced from new underground mines, average seam thickness of 37 inches to 45 inches	2.00%
Coal mined and produced from new underground mines, average seam thickness less than 37 inches	1.00%
Waste coal	2.50%
Limestone or sandstone quarried or mined	5.00%
Oil	5.00%
Natural gas	5.00%
Blast furnace slag	5.00%
Sand, gravel and other mineral products not quarried or mined	5.00%
Timber	3.22%
Other natural resource products.	5.00%

Also, raw coal purchased and further processed into a commercially useable product is assessed tax on the value added in the processing. A Minimum Severance Tax of 75 cents per ton of coal produced by a taxpayer for sale, profit or commercial use applies to coal subject to the 5.0 percent rate.

The Workers' Compensation Debt Reduction Act of 2005 created three new taxes to provide funding to reduce the unfunded liability of the current Workers' Compensation system, pay debt service on revenue bonds issued to provide the funding, or any combination of the two. These new taxes apply as of December 1, 2005. The three new taxes are as follows:

¹ Reduced severance tax rates for "th in-seam" production apply only to new underground coal mines (mines first opened on or after April 11, 1997) with average seam thickness of less than 45 inches.

1. a 56 cents per ton additional Severance Tax on persons for the privilege of engaging in West Virginia in the business of severing, extracting, reducing to possession and producing coal for sale, profit or commercial use;
2. a 4.7 cents per mcf additional Severance Tax on persons for the privilege of engaging in West Virginia in the business of severing natural gas for sale, profit or commercial use, and
3. an additional Severance Tax imposed at the rate of 2.78 percent on persons for the privilege of engaging in West Virginia in the business of severing timber for sale, profit or commercial use (the measure of the tax is the gross value of the timber at the point where the production privilege ends).

The Severance and Business Privilege Tax is imposed at the rate of 5.0 percent on persons providing behavioral health. Because the tax is similar to the Health Care Provider Taxes for other health care providers, all further discussion of this tax in this publication can be found under the Health Care Provider Taxes section.

ESTIMATING COSTS OF TAX EXPENDITURES

Several sources were used to estimate the costs of Severance Tax expenditures. However, taxpayer returns and other records of the State Tax Department were used primarily for the estimates.

ORGANIZATION AND ANALYSIS

The Severance Tax expenditures discussed in this report are divided into two groups as follows:

Exclusions and Other Tax Preferences
Credits

The analysis provided for each tax expenditure includes the item's cost to the State and a possible rationale.

EXCLUSIONS AND OTHER TAX PREFERENCES

Several types of activities are excluded from the Severance Tax due to the nature of the business activity or the level of that activity. In addition, certain coal mining activities are subject to preferential tax rates. The following is a list of these exclusions and other tax preferences:

- Treatment Processes Not Considered as Mining
- Gob or Coal Refuse
- Treatment Processes Not Included in Extraction of Oil and Gas
- Low-Volume Oil and Gas Well Exclusions
- Ending of Severance Activity for Timber
- Ending of Severance Activity for Limestone and Sandstone
- Coalbed Methane
- Reduced Tax Rates for Thin-Seamed Coal from New Underground Mines
- Reduced Tax Rate for Extracting Coal from Refuse and Gob Piles

An analysis of these exclusions and other tax preferences follows.

TREATMENT PROCESSES NOT CONSIDERED AS MINING

STATUTE: West Virginia Code §11-13A-4(b)

EXCLUSION: Unless such processes are otherwise provided for, or are necessary or incidental to processes provided for, the following treatment processes shall not be considered as "mining": Electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action and molding or shaping

VALUE: Not available

Rationale

That portion of income derived from value added by treatment processes after severance is by definition not part of the severance process and, therefore, is exempt from tax. These processes consist of electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other minerals, treatment effecting a chemical change, thermal action

and molding or shaping. These processes generally occur after the resource is removed from the earth, the point at which severance occurs.

GOB OR COAL REFUSE

STATUTE: West Virginia Code §§11-13A-2c(5) and 11-13A-3e(e)

EXCLUSION: "Extraction of ores or minerals from the ground" includes extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining only when such extraction is sold (§11-13A-2c(5))

The tax imposed in West Virginia Code §11-13A-3e(b) shall not apply to any electrical power co-generation plant burning material from its wholly owned refuse or gob pile (§11-13A-3e(e))

VALUE: Not available

Rationale

Gob that is severed but not sold by producers before use is excluded from the Severance Tax. Gob is considered to be "coal mine refuse".

As a result of technological developments and other factors, the material in some refuse or gob piles can be recovered and used as clean coal. The exemption for electric power co-generation plants using material from their own refuse or gob piles presumably exists to provide an incentive to reduce or eliminate the refuse or gob piles.

TREATMENT PROCESSES NOT INCLUDED IN EXTRACTION OF OIL AND GAS

STATUTE: West Virginia Code §11-13A-4(c)

EXCLUSION: The privileges of severing and producing oil and natural gas shall not include any conversion or refining process

VALUE: Not available

Rationale

The conversion or refining of oil and natural gas is excluded from the Severance Tax. These processes are not considered part of the severance of the natural resource and, thus, are excluded from taxation.

LOW-VOLUME OIL AND GAS WELL EXCLUSIONS

STATUTE: West Virginia Code §11-13A-3a(a)

EXCLUSION: As of January 1, 2000, there are exclusions of receipts attributable to free natural gas provided to a surface owner, natural gas from wells with prior year production of less than five thousand cubic feet per day, oil from wells with prior year production of less than one-half barrel per day and, for a period of ten years, natural gas from wells with no marketable production for a prior five year period

VALUE: **\$5.0 million per year**

Rationale

The exclusion of receipts from low-volume wells presumably exists to reduce tax paperwork associated with such wells. In addition, the ten-year exemption for inactive wells presumably promotes additional development and marketing of natural gas wells in West Virginia.

Revenue Analysis

Four separate exclusions are discussed in this section: natural gas produced from wells identified as low-volume, oil produced from wells identified as low-volume, receipts attributable to free natural gas provided to a surface owner, and natural gas produced from wells with no marketable production for a prior five-year period. Each taxpayer subject to severance taxes may claim an annual tax credit of up to \$500. The annual tax credit effectively shields many producing wells from taxation.

The expenditure value attributable for low-volume natural gas wells is the \$5.0 million value listed above. The expenditure value attributable for low-volume oil wells is unavailable. The expenditure value attributable to the free natural gas exclusion is minimal due to the effect of the annual tax credit.

The expenditure value attributable to the ten-year exclusion of receipts from gas wells not in production over a prior five-year period is not available, but could be significant. If current market

prices are low, the new expenditure may encourage operators to immediately cap all of their newly drilled productive wells for the minimum five-year exclusion qualification period. Such an incentive could result in a significant reduction in natural gas severance tax receipts over a period of five to ten years.

ENDING OF SEVERANCE ACTIVITY FOR TIMBER

STATUTE: West Virginia Code §11-13A-4(d)

EXCLUSION: The privilege of severing and producing timber shall end once the tree is severed and delimbed

VALUE: \$4.7 million per year

Rationale

Severance activity ends when the tree is severed and delimbed. Any processing past this point is considered manufacturing activity and is not taxed under the Severance Tax law.

ENDING OF SEVERANCE ACTIVITY FOR LIMESTONE AND SANDSTONE

STATUTE: West Virginia Code §11-13A-4(e)

EXCLUSION: The privilege of severing and producing limestone and sandstone by quarrying or mining shall end once the limestone or sandstone is severed from the earth

VALUE: \$2.8 million per year

Rationale

Once limestone or sandstone has been removed from the seam and is on the quarry floor, the act of severance is completed. Taxation is levied only on the severance activity; therefore, further processing (e.g., crushing or sizing) is not considered part of the severance activity and is not taxable under the law.

COALBED METHANE

STATUTE: West Virginia Code §11-13A-3d(b)

EXCLUSION: Effective for taxable years beginning on or after the first day of January, two thousand one, there is an exemption from the imposition of the tax provided by West Virginia Code §11-13A-3d for a maximum period of five years for all coalbed methane produced from any coalbed methane well placed in service after the first day of January, two thousand

VALUE: **\$3.5 million per year**

Rationale

This exemption presumably exists to encourage the capture and use of coalbed methane. The advance removal of coalbed methane provides a safer working environment for coal miners. Additionally, the U. S. Environmental Protection Agency through their coalbed methane outreach program encourages the removal and use of methane that is otherwise vented during mining operations.

REDUCED TAX RATES FOR THIN-SEAMED COAL FROM NEW UNDERGROUND MINES

STATUTE: West Virginia Code §11-13A-3(f)

TAX RATE: For tax years beginning after April 10, 1997, any new underground mine producing coal from seams of less than forty-five inches in average thickness or any existing underground mine that had not produced coal from seams of less than forty-five inches in thickness between October 12, 1996 and April 10, 1997 may qualify for reduced severance tax rates. The tax rate is two percent for coal mined from seams with an average thickness of thirty-seven inches to forty-five inches and one percent for coal mined from seams with an average thickness of less than thirty-seven inches

VALUE: **\$23.5 million per year**

Rationale

The application of reduced coal severance tax rates for “new” thin-seamed underground mines presumably exists to encourage greater coal production from thin-seamed underground mines. The application of the reduced tax rates to just “new” mines represents an effort to minimize the initial cost of this expenditure.

REDUCED TAX RATE FOR EXTRACTING COAL FROM REFUSE AND GOB PILES

STATUTE: West Virginia Code §11-13A-3e(c)

TAX RATE: The tax imposed in West Virginia Code § 11-13A-3e(b) shall be two and one-half percent of the gross value of the coal so produced

VALUE: **\$250,000 per year**

Rationale

The application of a reduced coal severance tax rate for the extracting and recovering material from refuse, gob piles or other sources of waste coal presumably exists to reduce the volume and number of coal refuse and gob piles

CREDITS

The West Virginia Code provides for the application of various tax credits against the Severance Tax. Some credits provide qualifying businesses with an investment incentive while others provide relief from double taxation. Although there are various credits provided by statute that can be applied against Severance Tax liability, this report analyzes only those tax credit applications subject to potential utilization by Severance taxpayers. For example, the Housing Development Projects Credit is not subject to further discussion within this section, even though it may technically apply against the Severance Tax. Since those in the business of mineral extraction are not in the business of residential housing construction, the Housing Development Projects Credit is not used by taxpayers against the Severance Tax. The following credits apply against Severance Tax liability:

- Business Investment and Jobs Expansion Credit¹
- Industrial Expansion and Revitalization Credit²
- Manufacturing Investment Tax Credit
- Research and Development Projects Credit³
- Coal Loading Facilities Credit
- West Virginia Capital Company Credit
- Credit for Payment of Minimum Severance Tax on Coal Annual Credit

Many of the credits listed above may also be applied against other business and personal taxes. Expenditure values presented in this section represent the amounts applied against only the Severance Tax. An analysis of these expenditures follows.

¹ For investment placed in use or service on or after January 1, 2003, the Economic Opportunity Tax Credit essentially replaces the Business Investment and Jobs Expansion Credit. However, the Economic Opportunity Tax Credit may not be used to offset or reduce Severance Tax liability. Taxpayers with Business Investment and Jobs Expansion Credit entitlement may continue to use the credit to offset or reduce Severance Tax liability until the credit allocation or credit time period expires, whichever comes first.

² For investment placed in use or service on or after January 1, 2003, the Manufacturing Investment Tax Credit essentially replaces the Industrial Expansion and Revitalization Credit for businesses other than those engaged in the manufacture or production of electric power. Taxpayers with Industrial Expansion and Revitalization Credit entitlement may continue to use the credit until the credit allocation or credit time period expires, whichever comes first.

³ For investment placed in use or service on or after January 1, 2003, the Strategic Research and Development Tax Credit essentially replaces the Research and Development Projects Credit. However, the Strategic Research and Development Tax Credit may not be used to offset or reduce Severance Tax liability. Taxpayers with Research and Development Projects entitlement may continue to use the credit to offset or reduce Severance Tax liability until the credit allocation or credit time period expires, whichever comes first.

BUSINESS INVESTMENT AND JOBS EXPANSION CREDIT

STATUTE: West Virginia Code §§11-13C-5 and 11-13A-10a(1)

CREDIT: Credit, attributable to qualified investment in tangible and real property and the creation of new jobs in West Virginia, may be used to offset up to eighty percent of Severance Tax liability attributable to the qualified investment activity for the first ten years of a qualified project, and up to one hundred percent in years eleven through thirteen

VALUE: **\$15.0 million per year**

Rationale

The Business Investment and Jobs Expansion Credit program also included the Corporate Headquarters Relocation Credit and Small Business Credit. This credit program was intended as an incentive for businesses to increase investment and employment levels in West Virginia. The basis of the program was largely attributable to capital investment, not direct employment growth.

Due to rising costs and a poor correlation with employment, this credit program was amended several times in recent years. Most of these amendments (e.g., elimination of new credit applications against Severance Tax) were designed to control program costs. Credit applications were restricted to businesses engaged in manufacturing, information processing, warehousing, goods distribution and destination-oriented recreation and tourism.

Revenue Analysis

The value of this expenditure peaked at roughly \$67 million in 1991 and has gradually decreased since then due to a sunset provision enacted in 1990 to preclude new credit applications against the Severance Tax. As old credits expire, the expenditure value will continue to decline toward zero by 2006.

INDUSTRIAL EXPANSION AND REVITALIZATION CREDIT

- STATUTE:** West Virginia Code §§11-13D-3a and 11-13A-10a(2)
- CREDIT:** Credit, attributable to qualified investment by manufacturers in tangible and real property, may be used to offset up to fifty percent of Severance Tax liability for a period of ten years
- VALUE:** **\$920,000 per year**

Rationale

The Industrial Expansion and Revitalization Credit, as applied against the Severance Tax, was intended as an incentive for manufacturers to increase their property investment levels in West Virginia. Only businesses classified as manufacturers (e.g., timber cutters with sawmills) were permitted to reduce their Severance Tax liability with the Industrial Expansion and Revitalization Credit. The basis for the credit included nearly all purchases of real property and tangible personal property. Also, investment in replacement property was valued equally with investment in expansion property.

The Industrial Expansion and Revitalization Credit, for manufacturers, was essentially replaced by the Manufacturing Investment Tax Credit for qualified investment on or after January 1, 2003. Although no new Industrial Expansion and Revitalization Credit may be earned, taxpayers that gained entitlement to the credit prior to the termination date of December 31, 2002 retained that entitlement and may apply the credit until the original multi-year entitlement (i.e., up to ten years) has been exhausted. Thus, this credit will remain a tax expenditure for several years.

MANUFACTURING INVESTMENT TAX CREDIT

- STATUTE:** West Virginia Code §11-13S-4(b)(2)
- CREDIT:** Credit, attributable to qualified investment by manufacturers in tangible and real property, may be used to offset up to fifty percent of Severance Tax liability for a period of ten years
- VALUE:** **Minimal¹**

¹ As the Industrial Expansion and Revitalization Credit that was earned prior to January 1, 2002 expires, the Manufacturing Investment Tax Credit will become more significant.

Rationale

The Manufacturing Investment Tax Credit was enacted to encourage the location of new industry in West Virginia and to encourage the expansion, growth and revitalization of existing industrial facilities in West Virginia. Qualified investment placed in service or use on or after January 1, 2003 may qualify for the credit. Eligible taxpayers include those with business activity classified as having a sector identifier, consisting of the first two digits of the six-digit North American Industry Classification System code number, of thirty-one, thirty-two or thirty-three.

RESEARCH AND DEVELOPMENT PROJECTS CREDIT

STATUTE: West Virginia Code §§11-13D-3a and 11-13A-10a(2)

CREDIT: Credit, attributable to qualified research expenditures by manufacturers or natural resource producers, may be used to offset up to fifty percent of Severance Tax liability for a period of ten years

VALUE: **Cannot be disclosed¹**

Rationale

The Research and Development Projects Credit exists was intended as an incentive for manufacturers or natural resource producers to increase their research and development activity within West Virginia.

The Research and Development Projects Credit was essentially replaced by the Strategic Research and Development Credit. However, the Strategic Research and Development Credit may not be used to offset or reduce Severance Tax liability. Although no new Research and Development Projects Credit may be earned, taxpayers that gained entitlement to the credit prior to the termination date of December 31, 2002 retained that entitlement and may apply the credit until the original multi-year entitlement (i.e., up to ten years) has been exhausted. Thus, this credit will remain a tax expenditure for several years.

¹ Due to taxpayer confidentiality

COAL LOADING FACILITIES CREDIT

STATUTE: West Virginia Code §§11-13E-3a and 11-13A-10a(3)

CREDIT: Credit, attributable to qualified investment in tangible and real property for use in a coal loading facility, may be used to offset up to fifty percent of Severance Tax liability for a period of ten years

VALUE: **Cannot be disclosed¹**

Rationale

The Coal Loading Facilities Credit exists as an incentive to encourage the construction and maintenance of coal loading facilities in West Virginia. Under this credit program, investment in replacement property is valued equally with investment in expansion property.

WEST VIRGINIA CAPITAL COMPANY CREDIT

STATUTE: West Virginia Code §5E-1-8

CREDIT: Credit, attributable to investments in a qualified West Virginia venture capital company, may be used to offset up to one hundred percent of Severance Tax liability

VALUE: **Cannot be disclosed¹**

Rationale

The purpose of the West Virginia Capital Company Credit is to encourage the creation of additional venture capital for high risk business investment.

¹ Due to taxpayer confidentiality

**CREDIT FOR PAYMENT OF
MINIMUM SEVERANCE TAX ON COAL**

STATUTE: West Virginia Code §11-12B-3(b)

CREDIT: A person who pays the Minimum Severance Tax shall be allowed a credit against the Severance Tax, but not including the Additional Severance Tax on Coal

VALUE: **\$105.0 million per year**

Rationale

A business that pays the Minimum Severance Tax on Coal is allowed a credit against the net State Severance Tax, (i.e., the gross receipts tax rate less the 0.35 percent designated for local governments). The credit amount is equal to the liability for the Minimum Severance Tax on Coal for the taxable year. The amount of the credit may not exceed the Severance Tax liability of the taxpayer. This credit is **not** a true tax expenditure. It is part of a mechanism to ensure that a minimum amount of tax per ton of mined coal is paid.

ANNUAL CREDIT

STATUTE: West Virginia Code §11-13A-10

CREDIT: An annual credit of \$500 is permitted for each taxpayer subject to the Severance Tax

VALUE: **\$2.5 million per year**

Rationale

The purpose of this credit may be to provide some measure of tax relief to small businesses. However, the credit applies to all Severance taxpayers, regardless of size.

TELECOMMUNICATIONS TAX

OVERVIEW

The Telecommunications Tax is imposed upon every telecommunications business selling or furnishing telegraph, telephone or other telecommunications services. The tax is levied on the gross income received from the provision of local exchange or long-distance voice or data communications services. The gross income from the provision of network access billing or similar services provided to end users, other telephone companies or communications carriers is not part of the tax base. In addition, the tax is not levied upon the telecommunications services provided by municipalities or any other political subdivisions of this State.

Gross income was redefined on July 1, 1988 to exclude the provision of commodities or services determined by the Public Service Commission of West Virginia to be subject to competition. By the end of each calendar year, the Public Service Commission determines which commodities or services are subject to competition. This decision serves as a conclusive determination for the purposes of defining gross income. The competitive services exclusion was added at the request of telephone companies to avoid placing them at a competitive disadvantage compared to non-utility companies. Since 1987, implementation of this exclusion has significantly eroded the tax base.

The Telecommunications Tax generated approximately 1.3 percent of the total General Revenue Fund in Fiscal Year 1988. After passage of the competitive services exemption beginning in Fiscal Year 1989, the tax generated just slightly more than 0.5 percent of the total General Revenue Fund in each subsequent year until declining to 0.2 percent in 2005.

The Public Service Commission does not limit its definition of "competition" to commodities or services that can be obtained from either a utility or a non-utility. It also includes within its definition any commodity or service a customer can obtain from two or more regulated telephone companies, although the commodity or service is unavailable from an unregulated company. For example, interLATA long distance telephone service is considered a service subject to competition and is therefore exempt from the Telecommunications Tax. However, such service is available **only** from a few companies, each of which is regulated by the Federal Communications Commission and the Public Service Commission. None of these providers would be placed at a competitive disadvantage if interLATA telephone service was subject to the Telecommunications Tax.

The current tax base for application of the Telecommunications Tax is restricted to local telephone service. The federal Telecommunications Act of 1996 opened local telephone service to immediate competition, subject to state regulatory action. Certain regulatory issues concerning competitive local telephone service have yet to be resolved. The Public Service Commission has determined a majority of local telephone service subject to competition as discussed below. Local competition will ultimately reduce the Telecommunications Tax yield to \$0 per year due to the competitive services exemption.

ESTIMATING COSTS OF TAX EXPENDITURES

Many sources were used to estimate the costs of the Telecommunications Tax expenditures. However, information supplied by the West Virginia Public Service Commission and the records of the State Tax Department were the primary sources.

ORGANIZATION AND ANALYSIS

The Telecommunications Tax study separates the expenditures into two groups. The groups are as follows:

Activities Excluded from Definition of Business Activity
Credits

The rationale supporting each tax expenditure attempts to briefly explain the existence and the theory behind each expenditure.

**ACTIVITIES EXCLUDED FROM DEFINITION
OF BUSINESS ACTIVITY**

The following activities are excluded from the definition of business activity associated with the telecommunications industry and are exempt from the Telecommunication Tax:

Telecommunications Services Provided by Governmental Units
Exclusion of Commercial Broadcast Radio or Television, Cable Television or
Amateur or Citizen's Band Radio
Network Access Billing or Similar Services Provided to End Users or Other
Telephone Companies
Commodities or Services Determined to Be Subject to Competition

An analysis of these exclusions follows.

**TELECOMMUNICATIONS SERVICES
PROVIDED BY GOVERNMENTAL UNITS**

STATUTE: West Virginia Code §11-13B-3(c)

EXCLUSION: No tax applies to telecommunications services provided by municipalities or by any other political subdivisions of the State

VALUE: \$0 per year

Rationale

The Telecommunications Tax is not levied on any telecommunications services provided by municipalities or by any other political subdivisions of the State. The exclusion presumably exists to lower the costs to local governments providing telecommunications services for residents.

Revenue Analysis

At this time, regulated public utility businesses provide telecommunications services to most State residents. No municipalities or other political subdivisions of the State are currently providing telecommunications services.

**EXCLUSION OF COMMERCIAL BROADCAST RADIO OR TELEVISION,
CABLE TELEVISION OR AMATEUR OR CITIZEN'S BAND RADIO**

STATUTE: West Virginia Code §11-13B-2(11)

EXCLUSION: Telecommunications shall not include commercial broadcast radio or television, cable television or amateur or citizen's band radio

VALUE: Not available

Rationale

The definition of telecommunications specifically excludes commercial broadcast radio or television, cable television or amateur or citizen's band radio. However, in July 1992, the Federal Communications Commission adopted a rule allowing local telephone companies to transmit television programming to homes over their telephone lines. Some of these activities were excluded by the Legislature as taxable telecommunications services because such services are generally not provided by regulated public utilities.

**NETWORK ACCESS BILLING OR SIMILAR SERVICES PROVIDED
TO END USERS OR OTHER TELEPHONE COMPANIES**

STATUTE: West Virginia Code §11-13B-2(b)(5)

EXCLUSION: Gross income from the provision of network access billing or similar services provided to end users or other telephone companies

VALUE: \$3.3 million per year

Rationale

Gross income from the provision of network access billing or similar services provided to end users or other telephone companies is not taxable under the Telecommunications Tax. Access charges are the fees that long distance telephone companies pay to local telephone companies for the service of providing access to the local exchange network. Before divestiture, Bell Telephone operating companies were required by the Federal Communications Commission to provide equal access to all long distance carriers. With divestiture, the existing system was replaced by generalized tariffed access charges applicable to all long distance service on the same basis and at the same rates. The

appropriate treatment of access charges under a state gross receipts tax has produced a variety of legal controversies.

The argument against taxation is that access charges represent a sale for resale and that businesses subject to a gross receipts tax were being treated differently than those covered by consumer sales tax. Utility deregulation has tended to blur the distinctions between utilities and other businesses. The argument for taxation is that the structure of gross receipts taxes does not generally preclude the taxation of sales for resale. The resolution in a growing number of states is to tax telecommunications sales under a consumer sales tax.

**COMMODITIES OR SERVICES DETERMINED
TO BE SUBJECT TO COMPETITION**

STATUTE: West Virginia Code §11-13B-2(b)(5)

EXCLUSION: Commodities or services which have been determined to be subject to competition by the Public Service Commission

VALUE: **\$29.8 million per year**

Rationale

On December 31 of each year, the Public Service Commission of West Virginia must submit to the State Tax Commissioner a list of telecommunications commodities or services that it determines to be subject to competition. These competitive commodities or services are excluded by law from the gross income of telecommunications businesses. As of December 31, 2004, the Public Service Commission has determined the following commodities or services to be subject to competition:

1. single or multi-line speed calling;
2. multi-line conference calling;
3. multi-line call waiting;
4. multi-line call forwarding;
5. time and temperature;
6. directory advertising;
7. inside wiring services;
8. customer premises equipment;
9. alarm couplers;
10. apartment door answering service;
11. paging services;

12. telephone booths;
13. 911 equipment;
14. jacks and network interface devices other than demarcation point devices;
15. mobile and portable telephone service (including all services provided by cellular and personal communications service (PCS) carriers (also known as commercial mobile radio service (CMRS) carriers) as such carriers are defined by the Federal Communications Commission (FCC));
16. power station protection equipment;
17. billing and collecting;
18. select-a-station service;
19. telemetry alarm bridge services;
20. interLATA toll services, including interLATA call completion/operator services;
21. intraLATA toll services including message toll, operator assistance, private line, LD conference, 800 service, toll-free INWATS, special reverse charge, OUTWATS and channel conditioning;
22. residence service variety package;
23. interstate, intraLATA toll services;
24. CENTREX services (excluding Access);
25. coin telephone services (excluding access-related revenues);
26. repeat call;
27. multi-line three-way calling;
28. frame relay service;
29. prepaid calling service;
30. "Call54" Service ("reverse directory assistance");
31. connect request service;
32. IntelliLinQ PRI;
33. directory assistance (intrastate only)
34. national directory assistance ("NDA" or National "411");
35. PBX Trunks (including associated local usage and features);
36. digital data services and high capacity services (DS1, DS2, DS3 and T-1);
37. CENTREX service (including access);
38. Private Line Local Service, including dedicated loop or transportation facilities running between points determined by the customer, including electronics necessary to digitize signals transmitted over the digital channels;
39. Asynchronous Transfer Mode (ATM) Service;
40. Internet Protocol Routing Service (IPRS);
41. Big Deal;
42. Bonus Discount Plan;
43. Business Link Rewards;
44. Call Gate;
45. Conference Service (Local);
46. Direct Inward Dialing (DID);
47. Easy Voice Dialing (Speech Recognition);

48. Home Intercom;
49. Intercom Extra;
50. ISDN BRI;
51. Residential ISDN;
52. Rewarding Connections;
53. Special Billing Number Service;
54. Switched Multi-megabit Data Service (SMDS);
55. Switched Redirect Service;
56. Uniform Call Distribution Services;
57. Usage Charges associated with PTNL Lines;
58. Virtual Private Network Service (VPN);
59. Wired Music;
60. WorkSmart;
61. List Service;
62. Three-Way Call Transfer;
63. Local Business Service, including associated vertical services;
64. Packaged services offered in response to competition;
65. Local residential service where a competitive local exchange carrier uses its own switching facilities and loops, or leases switching facilities and loops, and
66. Local residential and business service where at least one telecommunications carrier, in addition to the incumbent, has been designated an eligible telecommunications carrier.

CREDITS

The West Virginia Code provides for the application of various tax credits against the Telecommunications Tax. Some credits provide qualifying businesses with an investment incentive while others provide relief from double taxation. Although there are various credits provided by statute that can be applied against Telecommunications Tax liability, this report analyzes only those tax credit applications subject to potential utilization by Telecommunications taxpayers. For example, the Research and Development Projects Credit is not subject to further discussion within this section even though it may technically apply against the Telecommunications Tax. Since those in the business of providing local telephone service are not in the business of manufacturing, the Research and Development Projects Credit is not used by taxpayers against the Telecommunications Tax. The following credits apply against Telecommunications Tax liability:

Business Investment and Jobs Expansion Credit¹
West Virginia Capital Company Credit
Credit for Reducing Telephone Utility Charges to Low-Income Families
Consumers Sales and Service Tax and Use Tax Overpayment Credit

Many of the credits listed above may also be applied against other business and personal taxes. Expenditure values presented in this section represent the amounts applied against **only** the Telecommunications Tax. An analysis of these expenditures follows.

BUSINESS INVESTMENT AND JOBS EXPANSION CREDIT

STATUTE: West Virginia Code §§11-13C-5 and 11-13B-10a(1)

CREDIT: Credit, attributable to qualified investment in tangible and real property and the creation of new jobs in West Virginia, may be used to offset up to eighty percent of Telecommunications Tax liability attributable to the qualified investment activity for the first ten years of a qualified project, and up to one hundred percent in years eleven through thirteen

VALUE: **Cannot be disclosed**²

¹ For investment placed in use or service on or after January 1, 2003, the Economic Opportunity Tax Credit essentially replaces the Business Investment and Jobs Expansion Credit. However, the Economic Opportunity Tax Credit may not be used to offset or reduce Telecommunications Tax liability. Taxpayers with Business Investment and Jobs Expansion Credit entitlement may continue to use the credit to offset or reduce Telecommunications Tax liability until the credit allocation or credit time period expires, whichever comes first.

² Due to taxpayer confidentiality

Rationale

The Business Investment and Jobs Expansion Credit program also included the Corporate Headquarters Relocation Credit and Small Business Credit. This credit program was intended as an incentive for businesses to increase investment and employment levels in West Virginia. The basis of the program was largely attributable to capital investment, not direct employment growth.

Due to rising costs and a poor correlation with employment, this credit program was amended several times and then replaced with the Economic Opportunity Tax Credit for investment placed in service on or after January 1, 2003 by qualified businesses. However, the Economic Opportunity Tax Credit may not be used to offset or reduce Telecommunications Tax liability.

Although no new Business Investment and Jobs Expansion Credit may be earned, taxpayers that gained entitlement to the credit prior to the termination date of December 31, 2002 retained that entitlement and may apply the credit until the original multi-year entitlement (i.e., up to thirteen years) has been exhausted. Thus, this credit will remain a tax expenditure for several years.

WEST VIRGINIA CAPITAL COMPANY CREDIT

- STATUTE:** West Virginia Code §5E-1-8
- CREDIT:** Credit, attributable to investments in a qualified West Virginia venture capital company, may be used to offset up to one hundred percent of the Telecommunications Tax liability
- VALUE:** **Cannot be disclosed¹**

Rationale

The purpose of the West Virginia Capital Company Credit is to encourage the creation of additional venture capital for high risk business investment.

¹ Due to taxpayer confidentiality

**CREDIT FOR REDUCING TELEPHONE UTILITY CHARGES
TO LOW-INCOME FAMILIES**

- STATUTE:** West Virginia Code §§11-13G and 11-13B-10a(4)
- CREDIT:** Credit, attributable to the provision of telephone service to qualified low-income residential customers at special reduced rates, may be used to offset up to one hundred percent of Telecommunications Tax liability
- VALUE:** **Cannot be disclosed¹**

Rationale

This credit is a form of government assistance to qualified low-income households. Local telephone utilities are compensated for the value of rate reductions to low-income customers through the tax credit program.

Revenue Analysis

Any unused portion of the credit can be taken as a credit against Corporation Net Income Tax.

**CONSUMERS SALES AND SERVICE TAX
AND USE TAX OVERPAYMENT CREDIT**

- STATUTE:** West Virginia Code §11-13B-18
- CREDIT:** Overpayments of sales and use tax may be claimed as a credit against the Telecommunications Tax
- VALUE:** **\$0 per year**

¹ Due to taxpayer confidentiality

Rationale

This credit is a mechanism for taxpayers to claim a refund for the overpayment of Consumers Sales Tax or Use Tax without the need for filing a refund request with the State Tax Department. This credit is **not** a tax expenditure because it simply provides an additional mechanism for expeditious return of funds never due the State.

Revenue Analysis

No taxpayer claimed this credit against the Telecommunications Tax during this time period.

HEALTH CARE PROVIDER TAXES

OVERVIEW

Prior to 1992, West Virginia was under pressure from both the Federal Health Care Finance Administration (HCFA) and the Courts to:

1. assure reasonable reimbursement rates to providers;
2. assure the same access to care for Medicaid clients as for the general population, and
3. meet escalating costs brought on by federal mandates to increase both the range of covered services and the eligible population covered by the Medicaid Program.

The State's solution to these pressures was the implementation of its Medicaid Enhancement Tax in January 1992.

The Medicaid Enhancement Tax was equal to the State share of the Medicaid Program (i.e., a 23 percent tax on Medicaid reimbursements). This tax allowed the State to effectively recycle its initial matching funds through a tax on Medicaid service providers. This tax had a "hold harmless" effect because the resultant higher Medicaid reimbursement levels more than offset the Medicaid Enhancement Tax impact on each provider. As a result, the federal government picked up most of the cost of this enhancement. Due to the Medicaid Enhancement Tax, the Medicaid Program grew from roughly \$400 million in Fiscal Year 1990 to roughly \$1.2 billion by Fiscal Year 1993.

In an atmosphere of escalating Medicaid outlays, Congress enacted legislation and HCFA instituted regulations to bar the use of taxes with a "hold harmless" effect to finance state Medicaid programs. The new rules required states to use broad-based taxes to finance their share of Medicaid. In response to these changes in federal law and regulation, West Virginia enacted the Health Care Provider Taxes to replace its Medicaid Enhancement Tax as of June 1, 1993.

Eighteen separate Health Care Provider Taxes were enacted in 1993. In each case, the tax base includes gross receipts attributable to health care service activity. These taxes include the following:

<u>Health Care Provider Tax</u>	<u>Tax Rate July 1, 2000 (Percent)</u>	<u>Tax Rate July 1, 2005 (Percent)</u>
Ambulatory Surgical Centers	1.75	1.75
Chiropractors	1.75	0.875
Dentists	1.75	0.875
Emergency Ambulance Services	5.50	2.75
Independent Labs & X-ray Facilities	5.00	5.00
Inpatient Hospitals	2.50	2.50
Intermediate Care Facilities for Mentally Retarded	5.50	5.50
Nursing Homes	5.50	5.50
Nurses	1.75	0.875
Opticians	1.75	0.875
Optometrists	1.75	0.875
Outpatient Hospitals	2.50	2.50
Physicians	2.00	1.00
Podiatrists	1.75	0.875
Psychologists	1.75	0.875
Therapists	1.75	0.875
Behavioral Health Services-Severance	5.00	5.00
Community Care Services–Severance	5.00	-----

Effective July 1, 2001 and on each succeeding first day of July, the tax rates for chiropractors, dentists, nurses, opticians, optometrists, podiatrists, psychologists and therapists will be reduced by 0.175 percentage points until the rate is eliminated on July 1, 2010. Similarly, the tax rates for physicians and emergency ambulance services will be reduced on each first day of July, beginning with July 1, 2001, by 0.20 and 0.55 percentage points, respectively.

As enacted in 1993, Behavioral Health Services and Community Care Services were part of the State's Severance Tax statute. This combination occurred because federal regulations required taxes on such services to be part of a broad-based tax on both health and non-health business activities. Effective June 5, 2002, the definition of "certain health care services" subject to the Severance Tax was limited to behavioral health services.

In recognition that expenses for the State's Medicaid program are increasing at a faster rate than the dedicated Health Care Provider Taxes and the State's General Revenue Fund, a contingent tax rate increase on selected health care providers was enacted in 2004. The increased tax rates do not apply unless all of the following have occurred:

1. the Governor determines that both general revenue fund collections and funds available to finance this state's Medicaid program will be less next fiscal year than those funds are estimated to be in the current fiscal year due to changes or anticipated changes in the Medicaid program at the federal level or a result of a federal administrative action;
2. the Governor notifies the President of the Senate and the Speaker of the House of Delegates of this determination;
3. the Governor issues an executive order to convene a panel to study and examine possible alternative means of addressing the budget shortfall;
4. the panel is afforded not less than seventy-five days in which to conduct the study, with the findings to be provided to the Governor, the President of the Senate and the Speaker of the House, and
5. the Legislature adopts a resolution authorizing the rate increase.

If no other solution is reached, then the tax rates below will become effective on the date specified by the legislature:

Ambulatory Surgical Center	2.36%
Inpatient Hospital Services	3.38%
Intermediate Care Facility	5.95%
Outpatient Hospital Services	3.38%

ESTIMATING COSTS OF TAX EXPENDITURES

Tax return information was used to estimate expenditure valuations. Estimates were calculated using the various tax rates and include the aggregate of all Health Care Provider Taxes.

ORGANIZATION AND ANALYSIS

There are only two possible deductions from the Health Care Provider Tax bases, contractual allowances and bad debts. In addition, certain tax credits apply to selected provider activities. The analysis provided for each deduction or credit includes the item's value and a rationale.

DEDUCTIONS

The two possible deductions from the gross receipts tax base of the various Health Care Provider Taxes are as follows:

Contractual Allowances
Bad Debts

An analysis of these deductions follows.

Rationale

The deductions for contractual allowances and bad debts exist to prevent taxation of gross receipts never received by accrual basis taxpayers. Contractual allowances represent the difference between gross receipts at established rates and amounts realizable from third-party payers under contractual agreements. Bad debts are deducted to the extent such amounts were previously included in the measure of gross receipts upon which tax was paid. These deductions are **not** tax expenditures.

CONTRACTUAL ALLOWANCES

STATUTE: West Virginia Code §11-27

DEDUCTION: Accrual basis providers shall be allowed to reduce gross receipts by their contractual allowances, to the extent such allowances are included therein

VALUE: **\$7.0 million per year**

BAD DEBTS

STATUTE: West Virginia Code §11-27

DEDUCTION: Accrual basis providers shall be allowed to reduce gross receipts by bad debts, to the extent the amount of such bad debts was previously included in gross receipts upon which the tax imposed by this section was paid

VALUE: **\$680,000 per year**

CREDITS

The possible tax credit applications for selected provider activities are as follows:

West Virginia Capital Company Credit

Annual Credit

Tax Credit for Medical Liability Insurance Premiums

Tax Credit for Combined Claims Made Medical Malpractice Premiums and Medical Malpractice Liability Tail Insurance Premiums Paid

The West Virginia Capital Company Credit and the Annual Credit may be applied against the Severance Tax on Behavioral Health Services, while the Tax Credit for Medical Liability Insurance Premiums may only be applied against Health Care Provider Tax liability attributable to physician services.

An analysis of these credits follows.

Rationale

The West Virginia Capital Company Credit and the Annual Credit are part of the regular Severance Tax base. The federal regulations on state Medicaid funding require similar tax treatment for all taxpayers subject to an eligible broad-based tax. These tax credits are available to Behavioral Health Services providers because they are available to all other Severance taxpayers.

The Tax Credit for Medical Liability Insurance Premiums was presumably enacted to effectively decrease the cost of medical liability insurance premiums paid on physicians' services.

The Tax Credit for Combined Claims Made Medical Malpractice Premiums and Medical Malpractice Liability Tail Insurance Premiums Paid was presumably enacted to promote stable and affordable insurance rates that will induce retention of physicians practicing in this state.

Revenue Analysis

While behavioral health service providers use the annual credit, they do not use the West Virginia Capital Company Credit. To date, these health care providers have not invested in a West Virginia venture capital company. Therefore, there is no expenditure value associated with an application of the West Virginia Capital Company Credit to the Behavioral Health Service Severance Tax.

WEST VIRGINIA CAPITAL COMPANY CREDIT

STATUTE: West Virginia Code §5E-1-8

CREDIT: Credit, attributable to capital investments in a qualified West Virginia venture capital company, may be used to offset up to 100 percent of the Severance Tax liability of Behavioral Health Service Providers

VALUE: **\$0 per year**

ANNUAL CREDIT

STATUTE: West Virginia Code §11-13A-10

CREDIT: An annual credit of \$500 is permitted for each taxpayer subject to the Severance Tax

VALUE: **\$40,000 per year**

TAX CREDIT FOR MEDICAL LIABILITY INSURANCE PREMIUMS

STATUTE: West Virginia Code §11-13P-4

CREDIT: The amount of annual credit allowable to an eligible taxpayer shall be equal to ten percent of the adjusted annual medical liability insurance premium for the taxpayer's specialty or subspecialty group or ten percent of the taxpayer's actual annual medical liability insurance premium, whichever is less

VALUE:

Fiscal Year 2005

Succeeding Years

\$5.6 million

Minimal

Revenue Analysis

The tax credit was terminated, by 2003 legislation for any taxable year after December 31, 2004.

TAX CREDIT FOR COMBINED CLAIMS MADE MEDICAL MALPRACTICE PREMIUMS AND MEDICAL MALPRACTICE LIABILITY TAIL INSURANCE PREMIUMS PAID

STATUTE: West Virginia Code §11-13T-4

CREDIT: The amount of annual credit allowable to an eligible taxpayer shall be equal to ten percent of the combined annual medical liability insurance premium paid in excess of thirty thousand dollars, or twenty percent of the combined annual medical liability insurance premium paid in excess of seventy thousand dollars

VALUE: **\$2.7 million**

BUSINESS LICENSE TAXES

BUSINESS REGISTRATION TAX

OVERVIEW

The Business Registration Tax is a biennial license fee required prior to starting business operations in West Virginia. The tax was originally enacted in 1970 as the "Business Franchise Registration Tax" to replace both the General License Tax and the Store Tax. In 1986, the name was changed to the Business Registration Tax to avoid confusion with the Business Franchise Tax, a tax on the net worth of businesses. In Fiscal Year 2005, Business Registration Tax collections totaled \$1.9 million.

ESTIMATING COSTS OF TAX EXPENDITURES

The values of the expenditures contained within this section were determined from a variety of sources. In many cases, internal State Tax Department data was used to calculate a value for the expenditure. In other cases, the information to calculate an expenditure value was not readily available to the Department.

ORGANIZATION AND ANALYSIS

This study separates the Business Registration Tax expenditures into four groups based on statutory language. The expenditure groups are listed below:

- Activities Excluded from Definition of Business Activity
- Activities Exempt from Registration
- Activities not Requiring Business Registration Certificate
- Activities Exempt from Payment of Tax

In requiring the periodic tax expenditure studies, West Virginia Code §11-10-5s(c) defines a tax expenditure as "a provision in the tax laws ... designed to encourage certain kinds of activities or to aid taxpayers in special circumstances". Underlying the definition is an assumption that the expenditure could be repealed or altered by the State Legislature. While this report includes all activities where specific code citations provided for an exclusion, exemption, deduction or credit, some provisions identified as expenditures are not "true" expenditures but instead are an integral part of the tax structure.

Each expenditure listed in this section contains a brief rationale for the existence of the expenditure. Legislative documentation on why a particular tax expenditure was enacted is generally

not available. Thus, the rationales herein are based solely on the experience of the State Tax Department.

**ACTIVITIES EXCLUDED FROM DEFINITION
OF BUSINESS ACTIVITY**

The following activities are excluded from the definition of business activity and are thus excluded from taxation under Business Registration Tax statutes:

Sales of Property Directed by or Conducted by Governmental Agencies
The Conduct of Charitable Bingo or Raffle
Horse or Dog Race Meeting Activities and Associated Services
Occasional or Casual Sales of Property or Services

An analysis of these exclusions follows.

**SALES OF PROPERTY DIRECTED BY OR CONDUCTED BY
GOVERNMENTAL AGENCIES**

STATUTE: West Virginia Code §§11-12-2(b)(2)(A) and 11-12-2(b)(2)(B)

EXCLUSION: “Business Activity” shall not include:
Judicial sales directed by law or court order (§11-12-2(b)(2)(A))
Sales for delinquent taxes of real or personal property (§11-12-2(b)(2)(B))

VALUE: \$170,000 per year¹

Rationale

Judicial sales directed by law or court order are predominantly of two types. The first type involves the sale of property owned by persons claiming bankruptcy while the second type involves the sale of confiscated property. The confiscated property generally results from its use in criminal activities or due to outstanding tax liabilities, not including outstanding property tax liabilities. While one could construe these sales as satisfying the "revenue-generating" and "gain or economic benefit" clauses in the definition of "business activity", the intent of the sales is generally otherwise. These sales are presumably excluded since the purpose of the sale is generally not for economic gain by the entity conducting the sale. The proceeds of sales resulting from bankruptcy proceedings are, in part, distributed to the creditors of the company claiming bankruptcy protection. However, the revenue received by the creditors from these sales is usually only a fraction of the amount due. In these cases,

¹ In Fiscal Year 2006 this number could be larger due to The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and then smaller in proceeding years

the sales reduce the "economic loss" of the creditors. Sales of property seized due to outstanding tax liabilities are generally applied to reduce the amount due. The sale of property seized due to criminal activity is made to reduce the economic gain of the criminal activity.

The sales of real or personal property for delinquent taxes are generally made by county sheriffs and the State. This exclusion exists in recognition that the entities making the sales are not businesses.

THE CONDUCT OF CHARITABLE BINGO OR RAFFLE

STATUTE: West Virginia Code §§11-12-2(b)(2)(C) and 11-12-2(b)(2)(D)

EXCLUSION: "Business Activity" shall not include:
The conduct of charitable bingo by any person licensed under West Virginia Code §47-20-1 et seq. (§11-12-2(b)(2)(C))
The conduct of a charitable raffle by any person (§11-12-2(b)(2)(D))

VALUE: **\$10,000 per year**

Rationale

Tax-exempt charitable and public service organizations conducting bingo games are required to complete a separate application to obtain a license to conduct bingo games. Similarly, charitable and public service organizations, including the West Virginia State Fair Board, qualified to conduct raffles are required to file for a raffle license. Organizations conducting charitable bingo and/or raffles are excluded from the Business Registration Tax due to their filing and paying a separate license fee.

Revenue Analysis

While some organizations conduct bingo games or raffles on a fairly regular basis, there are licenses available for limited occasion use. The organizations conducting bingo or raffles on a limited occasion license could presumably qualify for the exclusion provided for occasional or casual sales of property or services. Additionally, most charitable organizations are exempt from payment of the tax due to their nonprofit status.

HORSE OR DOG RACE MEETING ACTIVITIES AND ASSOCIATED SERVICES

STATUTE: West Virginia Code §§11-12-2(b)(2)(E), 11-12-2(b)(2)(F), 11-12-2(b)(2)(G) and 11-12-2(b)(2)(H)

EXCLUSION: “Business Activity” shall not include:

- The conduct of a horse or dog race meeting by any racing association licensed under West Virginia Code §19-23-1 et seq. (§11-12-2(b)(2)(E))
- The operation or maintenance of the pari-mutuel system of wagering during the conduct of a licensed horse or dog race meeting (§11-12-2(b)(2)(F))
- The sale of any commodity during the conduct of a licensed horse or dog meeting (§11-12-2(b)(2)(G))
- The services of owners, trainers or jockeys which are essential to the effective conduct a licensed horse or dog meeting (§11-12-2(b)(2)(H))

VALUE: **\$100,000 per year**

Rationale

West Virginia Code §19-23-1 requires all associations conducting horse or dog race meetings for any purse to possess a license from the West Virginia Racing Commission. The exclusion for the conduct of a horse or dog race meeting that involves a purse exists in recognition of the separate licensing requirements for such activities.

The exclusion concerning the operation or maintenance of the pari-mutuel wagering system presumably exists due to an interpretation that this activity requires a separate license from the West Virginia Racing Commission. The interpretation that a separate license is required may be the result of the language in the West Virginia Code pertaining to horse or dog racing. The heading for West Virginia Code §19-23-1 begins "License required for horse and dog racing and pari-mutuel wagering in connection therewith; ..." Although the quoted segment implies that a separate license is required, West Virginia Code §19-23-9 only permits the pari-mutuel system of wagering to be conducted by the licensee of the horse or dog race meeting.

A segment of West Virginia Code §19-23-12 reads in part "nor shall there be, hereafter, any imposition of tax pursuant to articles twelve, thirteen or fifteen of chapter eleven of this code on the income or receipts of owners, trainers or jockeys directly arising from their services which are essential to the effective conduct of a horse or dog race meeting." Additionally, West Virginia Code §19-23-12 precludes the taxation of the sale of any commodities during a horse or dog race meeting.

Revenue Analysis

Repeal of the exclusions relating to horse and dog racing meetings would result in no revenue gain for the State. West Virginia Code §19-23-12 reads in part "The license tax imposed in section ten [West Virginia Code § 19-23-10] of this article shall be in lieu of all other license, income, excise, special or franchise taxes of this State, and no county or municipality or other political subdivision of this State shall be empowered to levy or impose any license, income, pari-mutuel, excise, special or franchise tax on any racing association engaged in the business of conducting a horse or dog race meeting at which horse or dog races are run for purses under the jurisdiction of and being licensed by the racing commission, or on the operation or maintenance of the pari-mutuel system of wagering, or on the sale of any commodity during a horse or dog race meeting at which horse or dog races are run, or at any such horse or dog racetrack...." While the removal of this expenditure might subject activities coincidental to the conduct of horse or dog race meetings to the registration requirements of the Business Registration Tax, the above statement precludes the assessment of any tax.

In some cases, a business that conducts horse or dog race meetings may also be engaged in other business activity at the same location. This other business activity would be subject to the Business Registration Tax. Since the tax is based on the location of the business and not the activities, businesses already paying the tax would continue to pay if the exclusion stated above is repealed. In this case, State revenue would not change due to the repeal of the exclusion.

While the repeal of this expenditure may subject the owners, trainers and jockeys to the registration requirements of West Virginia Code §11-12-1 et seq., the imposition of the tax is precluded as stated above.

OCCASIONAL OR CASUAL SALES OF PROPERTY OR SERVICES

STATUTE: West Virginia Code §11-12-2(b)(2)(I)

EXCLUSION: "Business Activity" shall not include:
Occasional or casual sales of property or services

VALUE: \$3.0 million per year

Rationale

Regulations specify occasional or casual sales as those occurring not more than four times a year. The sale of outgrown or unneeded items by individuals through yard sales, bulletin boards or classified advertisements is often undertaken less than five times in a year. This expenditure exists because of the administrative difficulties of registering every individual conducting occasional or casual sales.

ACTIVITIES EXEMPT FROM REGISTRATION

The only businesses exempt from registering for the Business Registration Tax are those persons not required to collect or withhold a tax administered under West Virginia Code §11-10-1 et seq. An analysis of this exemption follows.

PERSONS NOT REQUIRED TO COLLECT OR WITHHOLD TAX

STATUTE: West Virginia Code §11-12-3(c)

EXEMPTION: Persons engaging in business activity in West Virginia who are not required by law to collect or withhold a tax administered under West Virginia Code §11-10-1 et seq. and who does not claim exemption from payment of taxes imposed by articles fifteen and fifteen-a of the West Virginia Code shall be exempt from both registration and payment of the tax imposed by article twelve if such person had gross income from business activity of \$4,000 or less during that person's tax year for income tax purposes immediately preceding the registration year for which a registration certificate is otherwise required

VALUE: Not Available

Rationale

The restrictions stated in this exemption applying to persons not required to collect or withhold a tax administered by West Virginia Code §11-10-1 et seq. severely limits the application of the exemption. Since Article 10, relating to tax procedure and administration, of the West Virginia Code applies to the Consumers Sales Tax and the Personal Income Tax, the exemption is limited to persons with no sales or only exempt sales and no employees. Additionally, the limit on gross income from business activity of \$4,000 or less would limit application of the exemption.

This exemption presumably exists in recognition that persons satisfying the above-cited restrictions do not meet the "purposeful revenue-generating activity" clause in the definition of "business activity" stated in West Virginia Code §11-12-2(b)(2).

ACTIVITIES NOT REQUIRING BUSINESS REGISTRATION CERTIFICATE

The Business Registration Tax statutes provide several activities with an exemption from obtaining the Business Registration Certificate required of most other businesses. The following exempted activities are discussed in this section:

Individual Coin-Operated Machines
Employment Agencies, Collection Agencies and Drug Paraphernalia Businesses

Expenditure calculations for these exempt business activities follow.

INDIVIDUAL COIN-OPERATED MACHINES

STATUTE: West Virginia Code §11-12-3(b)(2)

EXEMPTION: A separate business registration certificate is not required for each coin-operated machine. A separate certificate is required for each location from which making coin-operated machines available to the public is itself a business activity

VALUE: **\$870,000 per year**

Rationale

The coin-operated machine exemption exists to recognize that the activity of making coin-operated machines available, rather than operating the individual machines, is the "business activity" subject to the Business Registration Tax.

**EMPLOYMENT AGENCIES, COLLECTION AGENCIES
AND DRUG PARAPHERNALIA BUSINESSES**

STATUTE: West Virginia Code §11-12-3(b)(4)

EXEMPTION: Persons engaging in purposeful revenue generating activity for which an employment agency license or collection agency license or a license to sell drug paraphernalia is required and no other business activity is conducted by that person at each business location for which the employment agency license or collection agency license or license to sell drug paraphernalia is issued, then only that license is required for each such activity conducted by the licensee at each business location

VALUE: **Minimal**

Rationale

Employment agencies, collection agencies and businesses selling drug paraphernalia each have their own licensing requirements. The exemption exists to avoid the duplication of licensing and registration under the Business Registration Tax and the licensing and registration required in other parts of the West Virginia Code.

Revenue Analysis

The repeal of this exemption would provide minimal revenue gain. As noted in the statement of the expenditure, the portion of the exemption available to employment agencies, collection agencies or drug paraphernalia businesses can be used if the listed activity is the **only** business activity conducted at each location. However, most of these businesses are also engaged in other activities in addition to the exempt activity. These other activities are subject to the Business Registration Tax.

ACTIVITIES EXEMPT FROM PAYMENT OF TAX

Several groups of taxpayers who are required by law to collect or withhold taxes administered by West Virginia Code §11-10-1 et seq., or who claim exemption from payment of Consumers Sales and Service Tax and Use Tax are exempt from payment of the biennial \$30 Business Registration Tax. However, these taxpayers **are required** to obtain a business registration certificate. The groups exempt from payment of the Business Registration Tax are as follows:

Persons with Limited Business Activity or Nexus
Governmental Agencies or Instrumentalities
Persons Engaged in Agriculture and Farming

An analysis of these expenditures follows.

PERSONS WITH LIMITED BUSINESS ACTIVITY OR NEXUS

STATUTE: West Virginia Code §§11-12-3(d)(1), 11-12-3(d)(2) and 11-12-3(d)(6)

EXEMPTION: A person who had gross income from business activity of \$4,000 or less during that person's tax year for State income tax purposes immediately preceding the registration year for which a registration certificate is required is exempt from payment of the tax (§11-12-3(d)(1))
An organization which qualifies, or would qualify, for exemption from federal income taxes under section 501 of the Internal Revenue Code of 1986 are exempt from payment of the tax (§11-12-3(d)(2))
A foreign retailer who is not a "retailer engaging in business in West Virginia" as defined in West Virginia Code §11-15A-1 who enters into an agreement with the State Tax Commissioner to voluntarily collect and remit Use Tax on sales to West Virginia customers is exempt from payment of the tax (§11-12-3(d)(6))

VALUE: \$750,000 per year

Rationale

For persons with business gross income of \$4,000 or less, the exemption presumably exists to reduce the cost of operating a business. The "purposeful revenue-generating activity" of these businesses is a marginal activity.

Prior to 1986, the occasional sales by societies acting for charitable, religious or benevolent purposes were excluded from the definition of "business" and therefore were exempt from registration. Under current law, these organizations must obtain a license but are exempt from payment. These businesses, which include charitable and religious organizations, are usually exempt from taxes, presumably in recognition of the benevolent services provided by these groups.

While engaging in "business activity", foreign retailers are not always engaged in such activity within the borders of West Virginia. This expenditure exists in recognition of the lack of "West Virginia tax nexus" for these businesses. In addition, Use Tax collections by foreign retailers are voluntary.

GOVERNMENTAL AGENCIES OR INSTRUMENTALITIES

STATUTE: West Virginia Code §§11-12-3(d)(3) and 11-12-3(d)(4)

EXEMPTION: The State of West Virginia, or a political subdivision thereof, selling tangible personal property, admissions or services, when those activities compete with or may compete with the activities of another person are exempt from payment of the tax (§11-12-3(d)(3))
The United States, or an agency or instrumentality thereof, which is exempt from taxation by the states is exempt from payment of the tax (§11-12-3(d)(4))

VALUE: **\$20,000 per year**

Rationale

The payment of the Business Registration Tax by the State and its political subdivisions would increase the cost of governmental services and the taxes and fees used to fund the services. Payment of the tax would generally result in a transfer of local government revenue to the State. The exemption thus exists to reduce the cost of governmental services and the transfer of local revenue to the State.

The exemption from payment of the Business Registration Tax by the United States and its agencies and instrumentalities is required by the federal supremacy clause in the United States Constitution. This exemption from payment of the tax is **not** an expenditure since states are prohibited from levying direct taxes upon the United States government.

PERSONS ENGAGED IN AGRICULTURE AND FARMING

STATUTE: West Virginia Code §11-12-3(d)(5)

EXEMPTION: A person engaged in the business of agriculture and farming is exempt from payment of the tax

VALUE: **\$190,000 per year**

Rationale

This exemption presumably exists to promote agriculture and farming. Prior to 1986, sales of products from farms, gardens, or dairies by the producers or growers were excluded from the definition of "business" and therefore were exempt from registration. Under current law, these organizations must obtain a license but are exempt from payment of the tax.

CORPORATE LICENSE TAX

OVERVIEW

The Corporate License Tax, commonly known as the Charter Tax, is an annual license fee assessed on corporations engaging in any business activity in West Virginia. Even though the Corporate License Tax was enacted in 1939, some form of license tax on corporations may have been in effect since statehood. As enacted in 1939, the tax was codified in Sections 79 to 86, inclusive, Article 12, Chapter 11 of the West Virginia Code. In 1992, legislation revised and reenacted the Corporate License Tax under West Virginia Code §11-12C et. al.

All corporations, domestic and foreign, with the exception of nonprofit corporations are required to pay the tax. Domestic corporations are defined in the West Virginia Code as "a corporation incorporated under the laws of this state and corporations organized under the laws of the state of Virginia before the twentieth day of June, one thousand eight hundred and sixty-three, which have its principal place of business and chief works (if it has chief works) in this state." Foreign corporations are all other corporations that are not domestic corporations.

The tax is an annual tax with the license year beginning on July 1 of each year and ending June 30 of the following year. Domestic corporations pay tax on their charter based on authorized capital stock as follows:

<u>Capital Stock</u>	<u>Tax</u>
\$5,000 or less	\$20
More than \$5,000, but not more than \$10,000	\$30
More than \$10,000, but not more than \$25,000	\$40
More than \$25,000, but not more than \$50,000	\$50
More than \$50,000, but not more than \$75,000	\$80
More than \$75,000, but not more than \$100,000	\$100
More than \$100,000, but not more than \$125,000	\$110
More than \$125,000, but not more than \$150,000	\$120
More than \$150,000, but not more than \$175,000	\$140
More than \$175,000, but not more than \$200,000	\$150
More than \$200,000, but not more than \$1,000,000	\$180

and an additional 20 cents on each \$1,000, or fraction thereof, in excess of \$200,000

More than \$1,000,000, but not more than \$15,000,000	\$340	and an additional 15 cents on each \$1,000, or fraction thereof, in excess of \$1,000,000
More than \$15,000,000	\$2,500	

Foreign corporations pay the tax based upon a proportion of their issued capital stock. The proportion is determined from the ratio of property owned and used in West Virginia to all property owned and used. For foreign corporations, the rate of tax is as follows:

<u>Proportion of Stock Represented by Property Owned and Used in West Virginia</u>	<u>Tax</u>	
\$175,000 or less	\$250	
More than \$200,000, but less than \$1,000,000	\$315	and an additional 35 cents on each \$1,000, or fraction thereof, in excess of \$200,000
More than \$1,000,000, but less than \$15,000,000	\$595	and an additional 26.25 cents on each \$1,000, or fraction thereof, in excess of \$1,000,000
More than \$15,000,000	\$4,375	

For both domestic and foreign corporations, the license tax described above is in addition to the statutory Attorney-in-Fact Fee.

ESTIMATING COSTS OF TAX EXPENDITURES

The values of the expenditures contained within this section have been determined from Corporate License Tax returns and internal State Tax Department data.

ORGANIZATION AND ANALYSIS

Although the Corporate License Tax expenditures fall into distinct categories, there is no more than one expenditure within each category. Since there are only three Corporate License Tax expenditures, the usual grouping of expenditures into categories, as present in other sections of this report, has been eliminated. The three expenditures are as follows:

Activities of Foreign Corporations Not Considered Business Activity
Reduced Tax on Domestic Corporations
Corporations Exempt from Payment of the Tax

Each expenditure listed in this section contains a brief rationale for its existence. In many cases, legislative documentation on why a particular tax expenditure was enacted was not available; thus, the rationales herein are based solely on the experience of the State Tax Department.

ACTIVITIES OF FOREIGN CORPORATIONS
NOT CONSIDERED BUSINESS ACTIVITY

STATUTE: West Virginia Code §11-12C-1(1)

EXEMPTION: "Business Activity" means all activities engaged in or caused to be engaged in with the object of gain or economic benefit, direct or indirect, but does not mean any of the activities of foreign corporations enumerated in subsections (b), (c) and (d), section forty-nine [§ 31-1-49, repealed], article one, chapter thirty-one of the West Virginia Code

VALUE: Not available

Rationale

This exemption presumably exists in recognition that certain activities of corporations, without a physical presence in West Virginia, are negligible in scope. Additionally, the states are prohibited from taxing interstate commerce.

The activities enumerated in West Virginia Code §31-1-49(b)¹ are as follows:

- "(1) Maintaining or defending any legal action or proceeding or any administrative or arbitration proceeding, or effecting the settlement thereof or the settlement of claims or disputes;
- (2) Holding meetings of its directors, shareholders or members or carrying on other activities concerning its internal affairs;
- (3) Maintaining bank accounts;
- (4) Creating evidences of debt, mortgages or liens on real or personal property;
- (5) Securing or collecting debts or enforcing any rights in property securing the same;
- (6) Conducting its affairs or doing or transacting business in interstate commerce;
- (7) Granting funds or other gifts;
- (8) Distributing information to its shareholders or members; or
- (9) Conducting an isolated transaction completed within a period of thirty days and not in the course of a number of repeated transactions of like nature."

¹ Repealed and replaced by §31D-15-1501 and §31E-14-1401 of the West Virginia Code

Similarly, the activities enumerated in West Virginia Code §31-1-49(c)¹ are as follows:

- "(1) Maintaining offices or agencies for the transfer, exchange and registration of its securities, or appointing and maintaining trustees or depositories with relation to its securities;
- (2) Effecting sales through independent contractors;
- (3) Soliciting or procuring orders, whether by mail or through employees or agents or otherwise, where such orders require acceptance without this State before becoming binding contracts."

And finally, the activities enumerated in West Virginia Code §31-1-49(d)¹ are as follows:

- "(1) The acquisition by purchase of loans secured by mortgage or deeds of trust, drawn and executed in compliance with section two, article one, chapter thirty-eight of the West Virginia Code on real or personal property situated in West Virginia pursuant to commitment agreements or arrangements made prior to or following the origination or creation of said loans;
- (2) The ownership, modification, renewal, extension, transfer or foreclosure of such loans, or the acceptance of substitute or additional obligers thereon;
- (3) The maintaining or defending of any actions or suits relative to such loans, mortgages or deeds of trust;
- (4) The maintenance of bank accounts in West Virginia banks in connection or servicing of such loans;
- (5) The making, collection and servicing of such loans through a resident person, firm or corporation, or a foreign corporation qualified to do business in West Virginia, engaged in the business of servicing loans for investors;
- (6) The taking of deeds to the mortgaged property either in lieu of foreclosure or for the purpose of transferring title either to the federal housing administration or to the veterans administration as the insurer or guarantor;
- (7) The acquisition of title to property under foreclosure sale or from the owner in lieu of foreclosure;
- (8) The management, rental, maintenance and sale, or the operating, maintaining, renting, or otherwise dealing with, selling or disposing of property acquired under foreclosure sale or by agreement in lieu thereof;
- (9) Physical inspection and appraisal of property in West Virginia as security for deeds of trust or mortgages and negotiations for the purchase of such loans;

¹ Repealed and replaced by §31D-15-1501 and §31E-14-1401 of the West Virginia Code

- (10) Any other transaction directly related to the activities above described:
Provided, That if property acquired in or by reason of any of the activities defined in the provisions of subdivisions (6), (7), and (8) of this subsection shall be held longer than a period of five years, the provisions of this section shall thereafter be inapplicable."

REDUCED TAX ON DOMESTIC CORPORATIONS

STATUTE: West Virginia Code §11-12C-2(b)(2)

TAX RATE: It shall be the duty of the tax commissioner to assess and fix the license tax of each foreign corporation ... which license tax shall at the rate prescribed in West Virginia Code §11-12C-2(b)(1), plus seventy-five percent of such tax.

VALUE: **\$4.6 million per year**

Rationale

Corporations are generally subject to tax since they enjoy certain statutory benefits and services. Domestic corporations presumably are assessed the tax at a lower rate in consideration of their overall contribution to the West Virginia economy.

CORPORATIONS EXEMPT FROM PAYMENT OF THE TAX

STATUTE: West Virginia Code §11-12C-2(c)

EXEMPTION: Nonprofit corporations are exempt from payment of the Corporate License Tax.

VALUE: **\$290,000 per year**

Rationale

Nonprofit corporations generally exist to provide a service that is of a charitable, benevolent, educational, social or related nature. The definition of nonprofit corporations for the Corporate License Tax refers to the definition in West Virginia Code §31E-1-150 (17), which in turn provides that “‘nonprofit corporation’ means a corporation which may not make distributions to its members, directors or officers”. This exemption presumably exists so as not to reduce the amount of revenue available to provide the service for which the nonprofit corporation was established.

EXCISE TAXES

MOTOR FUEL EXCISE TAX

OVERVIEW

Effective January 1, 2004, the Gasoline and Special Fuels Excise Tax was repealed, and the Motor Fuel Excise Tax was imposed on motor fuel. The Motor Fuel Excise Tax is a combination of the following:

1. a flat rate of 20.5 cents per invoiced gallon, and
2. a variable sales and use tax rate of 6.5 cents per invoiced gallon as of January 1, 2005.

The variable component of the tax is the Consumers Sales and Service Tax and Use Tax, which is based on the average wholesale price of gasoline and special fuel as determined by the State Tax Commissioner. Each January 1, the State Tax Commissioner will determine the average wholesale price for the annual period based on sales data gathered for the preceding period of July 1 through October 31. However, the average wholesale price will never be deemed to be less than 97 cents per gallon.

The Use Tax is based on the percentage of carrier operations in West Virginia. The relevant percentage is the proportion of West Virginia miles compared with the total miles traveled within and without West Virginia. Consumers Sales and Service Tax will be included in the price of fuel purchased in West Virginia and can offset the Use Tax.

The Motor Fuel Excise Tax is imposed at the time motor fuel is imported into West Virginia, other than by a bulk transfer and is measured by invoiced gallons received outside this State at a refinery, terminal or bulk plant for delivery to a destination in West Virginia. The tax is payable by the person importing the motor fuel. The tax is also imposed on invoiced gallons of motor fuel removed, other than by bulk transfer,

1. from the bulk transfer/terminal system in West Virginia,
2. from the bulk transfer/terminal system outside West Virginia for delivery to a location in West Virginia as represented on the shipping papers, or
3. upon sale or transfer in a terminal or refinery in West Virginia to any person not holding a supplier's license.

The tax does not apply to motor fuel imported into West Virginia in the motor fuel supply tank or tanks of a motor vehicle, but the Motor Carrier Road Tax may still apply. Tax applies to fuel blended in West Virginia and is calculated on the difference between the total quantity blended and the quantity used for blending but previously taxed.

There are several exemptions from the excise tax on gasoline and special fuel. Certain exemptions are an integral part of the "normal" tax base and are not considered true expenditures.

These include gasoline or special fuel used for off-highway purposes and gasoline or special fuel exported out of the State. Also included in the "normal" tax base are federally mandated exemptions. These include sales to the United States government and interstate motor carriers.

ORGANIZATION AND ANALYSIS

Motor Fuel Excise Tax expenditures are divided into three groups:

Exemptions

Refunds

Deductions and Discounts

The analysis provided for each tax expenditure includes a rationale for each item and the item's cost to the State.

EXEMPTIONS

Exemptions from the Motor Fuel Excise Tax are allowed depending upon the use of the fuel. The following exemptions are discussed in this section:

- Gasoline or Special Fuel Exported Out-of-State
- Sales of Aviation Fuel
- Sales of Dyed Special Fuel
- Sales of Propane
- Sales to the United States Government
- Sales to County Boards of Education
- Sales to Municipalities, Urban Mass Transportation Authorities and Units of County Government
- Sales to Licensed Exporters
- Sales to Urban and Suburban Bus Lines
- Sales of Propane to Consumers for Poultry House Heating Purposes
- Certain Off-Highway Uses
 - Stationary Off-Highway Turbine Engines
 - Special Fuel Used for Heating Purposes
 - Special Fuel Used for Boilers
 - Gasoline or Special Fuel Used as a Dry Cleaning, Commercial or Industrial Solvent
 - Gasoline or Special Fuel Used as Part of a Manufactured Product
 - Gasoline or Special Fuel Sold as Fuel for Commercial Watercraft
 - Special Fuel Consumed in Railroad Diesel Locomotives

An analysis of these exemptions follows.

GASOLINE OR SPECIAL FUEL EXPORTED OUT-OF-STATE

STATUTE: West Virginia Code §§11-14C-9(a)(1) and 11-14C-9(b)

EXEMPTION: All motor fuel exported from this State to any other state or nation

VALUE: **Not Available**

Rationale

The purpose of this per se exemption from both the flat rate component and the variable rate component is to exclude from taxation motor fuel not sold or used within this State. This is **not** a true tax expenditure. It is inherent in the structure of the Motor Fuel Excise Tax that only fuel sold and used on the highways of West Virginia is taxable.

SALES OF AVIATION FUEL

STATUTE: West Virginia Code §11-14C-9(a)(2)

EXEMPTION: All sales of aviation fuel

VALUE: **\$1.9 million per year**

Rationale

This per se exemption from the flat rate component of tax is **not** considered a tax expenditure. As part of the "normal" tax base, certain off-highway uses of motor fuel are exempt from taxation. It is inherent in the structure of the Motor Fuel Excise Tax that only fuel used on the highways of West Virginia is taxable.

SALES OF DYED SPECIAL FUEL

STATUTE: West Virginia Code §11-14C-9(a)(3)

EXEMPTION: All sales of dyed special fuel

VALUE: **\$50.0 million per year**

Rationale

This per se exemption from the flat rate component of tax is **not** considered a tax expenditure. As part of the "normal" tax base, certain off-highway uses of motor fuel are exempt from taxation. It is inherent in the structure of the Motor Fuel Excise Tax that only fuel used on the highways of West Virginia is taxable. "Dyed diesel fuel" is defined in the West Virginia Code §11-14C-2(31) as follows:

"...diesel fuel that meets the dyeing and marking requirements of section 4082, Title 26, United States Code, regardless of how the diesel fuel was dyed."

SALES OF PROPANE

STATUTE: West Virginia Code §11-14C-9(a)(4)

EXEMPTION: All sales of propane

VALUE: **\$13.4 million per year**

Rationale

This per se exemption from the flat rate component of tax is **not** considered a tax expenditure. As part of the "normal" tax base, certain off-highway uses of motor fuel are exempt from taxation. It is inherent in the structure of the Motor Fuel Excise Tax that only fuel used on the highways of West Virginia is taxable.

SALES TO THE UNITED STATES GOVERNMENT

STATUTE: West Virginia Code §§11-14C-9(c)(1) and 11-14C-9(d)(1)

EXEMPTION: All gallons of motor fuel sold to and purchased by the United States or any agency thereof

VALUE: **Minimal**

Rationale

This refundable exemption from both the flat rate component and the variable rate component of tax is mandated by federal law and, therefore, is **not** considered a tax expenditure.

SALES TO COUNTY BOARDS OF EDUCATION

STATUTE: West Virginia Code §§11-14C-9(c)(4) and 11-14C-9(d)(5)

EXEMPTION: All gallons of motor fuel sold to and purchased by any county boards of education

VALUE: **\$10.9 million per year**

Rationale

This refundable exemption from both the flat rate component and the variable rate component presumably exists to benefit West Virginia public school children and to reduce costs to public school systems in the State.

Revenue Analysis

The value presented for this expenditure is based on the amount of fuel used in school buses operated on behalf of county boards of education. Fuel used in public school buses is also exempt from the Motor Carrier Road Tax.

SALES TO MUNICIPALITIES, URBAN MASS TRANSPORTATION AUTHORITIES, UNITS OF COUNTY GOVERNMENT AND VOLUNTEER FIRE DEPARTMENTS

STATUTE: West Virginia Code §§11-14C-9(c)(2) & (d)(3), 11-14C-9(c)(3) & (d)(4), 11-14C-9(c)(5) & (d)(6), 11-14C-9(c)(6) & (d)(7) and 11-14C-9(c)(18) & (d)(8)

EXEMPTION: All gallons of motor fuel sold any county government or agency thereof (§§11-14C-9(c)(2) and 11-14C-9(d)(2))
All gallons of motor fuel sold to any municipal government or agency thereof (§§11-14C-9(c)(2) and 11-14C-9(d)(3))
All gallons of motor fuel sold to any urban mass transportation authority, created pursuant to the provisions of article twenty-seven [§8-27-1 et seq.], chapter eight of this code (§§11-14C-9(c)(5) and 11-14C-9(d)(6))
All gallons of motor fuel sold to and purchased by any municipal, county, state, or federal civil defense or emergency service program pursuant to a government contract for use in conjunction therewith (§§11-14C-9(c)(6) and 11-14C-9(d)(7))
All gallons of motor fuel sold to and purchased by any bona fide volunteer fire department, nonprofit ambulance service or emergency rescue service (§§11-14C-9(c)(18) and 11-14C-9(d)(8))

VALUE: Not Available

Rationale

This refundable exemption from both the flat rate component and the variable rate component of the tax for sales to any municipal, county, State or federal civil defense or emergency service program or urban mass transportation system exists because these items are made available for the convenience and welfare of the citizens of West Virginia. The refundable exemptions for sales of fuel

to municipalities and units of county governments presumably exist to reduce costs to these entities, thereby benefitting the citizens of West Virginia.

SALES TO LICENSED EXPORTERS

STATUTE: West Virginia Code §§11-14C-9(c)(7) and 11-14C-9(d)(9)

EXEMPTION: All invoiced gallons of motor fuel purchased by a licensed exporter and subsequently exported from this state to any other state or nation: Provided, that the exporter has paid the applicable motor fuel tax to the destination state or nation prior to claiming this refund

VALUE: **Not Available**

Rationale

The purpose of this refundable exemption from both the flat rate component and the variable rate component is to exclude from taxation motor fuel not sold or used within this State. This is **not** a true tax expenditure. It is inherent in the structure of the Motor Fuel Excise Tax that only fuel sold and used on the highways of West Virginia is taxable.

SALES TO URBAN AND SUBURBAN BUS LINES

STATUTE: West Virginia Code §11-14C-9(c)(17)

EXEMPTION: All gallons of motor fuel sold to any person regularly operating any vehicle under a certificate of public convenience and necessity or under a contract carrier permit for transportation of persons when purchased in an amount of twenty-five gallons or more; Provided, that the amount refunded is equal to six cents per gallon; Provided, however, that the gallons of motor fuel have been consumed in the operation of urban and suburban bus lines and the majority of passengers use the bus for traveling a distance not exceeding forty miles, measured one way, on the same day between their places of abode and their places of work, shopping areas or schools

VALUE: **Minimal**

Rationale

This refundable exemption from the flat rate component of the tax is made available for the convenience and welfare of the citizens of West Virginia.

SALES OF PROPANE TO CONSUMERS FOR POULTRY HOUSE HEATING PURPOSES

STATUTE: West Virginia Code §11-15-9(18)

EXEMPTION: Sales of propane to consumers for poultry house heating purposes

VALUE: **\$130,000 per year**

Rationale

This refundable exemption from the variable rate component of tax for sales of propane to consumers to heat poultry houses presumably exists to promote the poultry industry in West Virginia.

CERTAIN OFF-HIGHWAY USES

- STATUTE:** West Virginia Code §§11-14C-9(c)(8), 11-14C-9(c)(9), 11-14C-9(c)(10), 11-14C-9(c)(11), 11-14C-9(c)(12), 11-14C-9(c)(13), 11-14C-9(c)(14), 11-14C-9(c)(15), and 11-14C-9(c)(16)
- EXEMPTION:** All gallons of gasoline or special fuel used and consumed in stationary off-highway turbine engines (§11-14C-9(c)(8))
All gallons of special fuel for heating any public or private dwelling, building or other premises (§11-14C-9(c)(9))
All gallons of special fuel for boilers (§11-14C-9(c)(10))
All gallons of gasoline or special fuel used as a dry cleaning solvent or commercial or industrial solvent (§11-14C-9(c)(11))
All gallons of gasoline or special fuel used as lubricants, ingredients or components of any manufactured product or component (§11-14C-9(c)(12))
All gallons of gasoline or special fuel sold for use or used as a fuel for commercial watercraft (§11-14C-9(c)(13))
All gallons of special fuel sold for use or consumed in railroad diesel locomotives (§11-14C-9(c)(14))
All gallons of motor fuel purchased in quantities of twenty-five gallons or more for use as a motor fuel for internal combustion engines not operated upon highways of this state (§11-14C-9(c)(15))
All gallons of motor fuel purchased in quantities of twenty-five gallons or more and used to power a power take-off unit on a motor vehicle (§11-14C-9(c)(16))
- VALUE:** **\$65.4 million per year**

Rationale

As part of the "normal" tax base, certain off-highway uses of motor fuel are exempt from taxation. It is inherent in the structure of the Motor Fuel Excise Tax that only fuel used on the highways of West Virginia is taxable. Fuel purchased for use in any of the above circumstances is entitled to a refundable exemption from the flat rate component of the Motor Fuel Excise Tax.

REFUNDS

A refund for Motor Fuel Excise Tax paid is allowed for the following reasons:

Erroneously Collected Taxes

Gasoline or Special Fuel Lost through Fire, Lightning, Breakage, Flood, or Other Casualty

Gasoline or Special Fuel Lost through Evaporation

Tax Rate Decrease

An analysis of these refunds follows.

ERRONEOUSLY COLLECTED TAXES

STATUTE: West Virginia Code §11-14C-30(a)

REFUND: Refund of motor fuel taxes erroneously collected from any person, including any tax, interest, additions to tax, or penalties

VALUE: Not Available

Rationale

This refund exists to protect the taxpayer and to enable the taxpayer to reclaim taxes that should not have been paid.

Revenue Analysis

The refund for erroneous payments has declined in recent years, in part, due to the dyed diesel fuel exemption. The exemption reduces the amount of paperwork needed by both the taxpayer and the State Tax Department, resulting in fewer errors.

**MOTOR FUEL LOST THROUGH FIRE, LIGHTNING,
BREAKAGE, FLOOD, OR OTHER CASUALTY**

STATUTE: West Virginia Code §11-14C-30(b)

REFUND: Refund of any invoiced gallons of motor fuel lost through fire, lightning, breakage, flood or other casualty by any supplier, distributor, producer, retail dealer, exporter or importer equal to the amount of the flat rate component of the tax

VALUE: **Minimal**

Rationale

A refund for the flat rate of tax paid on invoiced gallons of motor lost through fire, lightning, breakage, flood or other casualty exists as part of the "normal" tax base. Tax should not be paid on motor fuel that is destroyed and cannot be sold or used.

Revenue Analysis

The amount of this refund has been minimal in recent years due to technological improvements in the equipment used to store and haul motor fuel. There have also been improvements in preventing and managing accidents or other casualties involving the handling of motor fuel.

MOTOR FUEL LOST THROUGH EVAPORATION

STATUTE: West Virginia Code §11-14C-30(c)

REFUND: Annual refund of the flat rate component of tax to retail dealers, and any bulk plant, for invoiced gallons of motor fuel lost through evaporation, not exceeding one-half of one percent of adjusted total accountable gallons

VALUE: **Minimal**

Rationale

A refund for motor fuel lost through evaporation exists as part of the "normal" tax base because tax should not be paid on gasoline or special fuel that is lost and cannot be sold or used.

TAX RATE DECREASE

STATUTE: West Virginia Code §11-14C-30(d)

REFUND: Refund of the flat rate component of tax paid resulting from a change of rate decreasing the tax on motor fuel, which is on hand and in inventory on the effective date of the rate change

VALUE: \$0 per year

Rationale

This refund of the flat rate component of tax exists to protect the taxpayer and to enable the taxpayer to reclaim an overpayment of taxes.

Revenue Analysis

There have been no refunds because the tax rate has not changed since enactment of the Motor Fuel Excise Tax Act in 2003.

DEDUCTIONS AND DISCOUNTS

Deductions and discounts from the Motor Fuel Excise Tax are allowed for the following reasons:

- Default Payments
- Administrative Discount for Suppliers
- Deduction for Sales to Distributors

An analysis of these discounts and deductions follows.

DEFAULT PAYMENTS

STATUTE: West Virginia Code §11-14C-23(a)

DEDUCTION: Deduction for motor fuel taxes not remitted by any licensed distributor or importer to a supplier

VALUE: **\$0 per year**

Rationale

This deduction exists to protect suppliers from distributors who default on payments owed to the supplier.

Revenue Analysis

Since enactment of the Motor Fuel Excise Tax, no taxpayers have taken this deduction.

ADMINISTRATIVE DISCOUNT FOR SUPPLIERS

STATUTE: West Virginia Code §11-14C-23(b)

DISCOUNT: A supplier or permissive supplier who timely files a return with the payment may deduct an administrative discount of one tenth of one percent of the amount of tax payable to this state, not to exceed five thousand dollars per month

VALUE: **\$280,000 per year**

Rationale

This discount presumably exists as an incentive to suppliers to timely file their tax-due returns.

DEDUCTION FOR SALES TO DISTRIBUTORS

STATUTE: West Virginia Code §11-14C-23(c)

DEDUCTION: For sales to licensed distributors, a supplier or permissive supplier shall deduct three fourths of one percent of the tax due from the licensed distributor as a discount to the licensed distributor

VALUE: \$1.4 million per year

Rationale

This deduction exists to provide a discount to licensed distributors. It does not apply to any other transactions, including, but not limited to, licensed distributor to licensed distributor transactions. Additionally, if the permissive supplier and/or supplier is also a licensed distributor, this discount does not apply.

MOTOR CARRIER ROAD TAX

OVERVIEW

The Motor Carrier Road Tax is a tax on every person or firm who operates any passenger vehicle that has seats for more than nine passengers, in addition to the driver, and any road tractor, tractor truck or truck that has more than two axles. The tax is closely related to the Motor Fuel Excise Tax. The rate of tax for motor carriers is the same as the flat rate component of the Motor Fuel Excise Tax (i.e., 20.5 cents per gallon). When motor carriers operate in interstate commerce, tax computation is accomplished by basing Motor Carrier Road Tax liability on the fraction of the total amount of motor fuel that is the same fraction that the miles traveled by the carrier on West Virginia highways is of the total number of miles traveled by the carrier in all states.

As of January 1, 1996, interstate motor carriers must obtain an International Fuel Tax Agreement (IFTA) license. All West Virginia-based motor carriers who travel in at least one other IFTA jurisdiction and operate one or more qualified vehicles must obtain an IFTA license. All West Virginia-based IFTA licensees must file a single tax return with the West Virginia State Tax Department. This tax return will contain detailed information about vehicle operations in each IFTA member jurisdiction. West Virginia then distributes both the tax and the carrier information to the other IFTA jurisdictions on behalf of the carrier. West Virginia receives its portion of gasoline taxes due from motor carriers based in other IFTA jurisdictions from the carrier's home jurisdiction. If a motor carrier does not operate in any other IFTA jurisdiction, the motor carrier must file the Motor Carrier Road Tax return for tax due to West Virginia and file returns as required by other non-IFTA jurisdictions in which the carrier traveled. More specific information can be found in the separate International Fuel Tax Agreement section.

The Motor Carrier Road Tax was created as a tax on motor carriers operating upon the highways of West Virginia. Collections of the Motor Carrier Road Tax are deposited into the State Road Fund and used **only** for the following purposes: construction, reconstruction, maintenance and repair of highways; matching of federal funds available for highway purposes, and payment of the interest and sinking fund obligations on State bonds issued for highway purposes. Unless necessary for bond requirements, five-fourteenths of the tax shall be used for feeder and State-local service highway purposes.

Certain exemptions are an integral part of the "normal" tax base for motor carriers and are **not** considered true tax expenditures. These include an exemption for gasoline or special fuel purchased in this State but consumed out of the State and a credit for the Gasoline Excise Tax paid to avoid double taxation. Also included in the "normal" tax structure are federally mandated exemptions. The federally mandated exemptions are **not** considered expenditures in this study since they are excluded from state taxation by federal law.

ORGANIZATION AND ANALYSIS

Motor Carrier Road Tax expenditures are divided into three groups:

Exemptions

Refunds

Credits

The analysis provided for each tax expenditure includes a rationale for each item and the item's cost to the State.

EXEMPTIONS

Exemptions from the Motor Carrier Road Tax are allowed depending upon the use of the fuel. The following exemptions are discussed in this section:

Motor Carriers Operated on Behalf of the Federal Government or any State Government
Private and State School Buses

An analysis of these exemptions follows.

MOTOR CARRIERS OPERATED ON BEHALF OF THE FEDERAL GOVERNMENT OR ANY STATE GOVERNMENT

STATUTE: West Virginia Code §11-14A-8

EXEMPTION: Motor carriers operated on behalf of any agency of the federal government, any state government or political subdivision of any state

VALUE: Not available

Rationale

States are prohibited from taxing purchases of motor fuel for use in vehicles operated on behalf of the federal government. Therefore, this portion of the exemption is **not** considered a true tax expenditure. Motor carriers operated on behalf of any state government are also exempt from taxation to avoid increased costs for those entities.

PRIVATE AND STATE SCHOOL BUSES

STATUTE: West Virginia Code §11-14A-8

EXEMPTION: School buses operated on behalf of any private school and operated on behalf of this State or any of its political subdivisions

VALUE: \$11.0 million per year

Rationale

This exemption exists to benefit all West Virginia school children by reducing the operating costs of elementary and secondary schools in the State.

REFUNDS

A refund of the Motor Carrier Road Tax is only available for fuel consumed outside of this State. An analysis of this refund follows.

FUEL CONSUMED OUTSIDE OF THIS STATE

STATUTE: West Virginia Code §11-14A-11

REFUND: Refund for gallons of motor fuel purchased in this State but consumed outside of this State

VALUE: **Minimal**

Rationale

Tax on fuel consumed outside of this State is refundable because it is not used upon the highways of West Virginia.

Revenue Analysis

The value for refunds is minimal due to the enactment of IFTA, which began on January 1, 1996. Since IFTA involves a reciprocity agreement among member jurisdictions, the need for refunds for fuel consumed outside of the State has become negligible. The West Virginia State Tax Department distributes both the tax and the carrier information to the other IFTA jurisdictions on behalf of the carrier. West Virginia receives its portion of motor fuel taxes due from motor carriers based in other IFTA jurisdictions from the carrier's home jurisdiction.

CREDITS

A credit against Motor Carrier Road Tax is allowed for an amount equal to the amount of Motor Fuel Excise Tax paid. An analysis of this credit follows.

CREDIT AGAINST MOTOR CARRIER ROAD TAX EQUAL TO AMOUNT OF MOTOR FUEL EXCISE TAX PAID

STATUTE: West Virginia Code §11-14A-9

CREDIT: Credit for amount of Motor Fuel Excise tax paid, if no other refund was given

VALUE: Not available

Rationale

This credit exists to avoid double taxation on gasoline or special fuel.

INTERNATIONAL FUEL TAX AGREEMENT

OVERVIEW

The International Fuel Tax Agreement (IFTA) is a fuel tax reciprocity agreement among states of the United States and provinces of Canada. The agreement is intended to simplify the reporting and payment of all fuel use taxes by interstate motor carriers for all qualified vehicles. Qualified vehicles are only those taxed under IFTA and used, designed or maintained for transportation of persons or property having two or more axles and gross vehicle weight of more than 26,000 pounds. The rate of tax is the same as the Motor Carrier Road Tax.

All West Virginia-based motor carriers who travel in at least one other IFTA jurisdiction and operate one or more qualified vehicles must obtain an IFTA license. All IFTA licensees must file a single quarterly tax return with the West Virginia State Tax Department. This tax return will contain detailed information about vehicle operations in each IFTA member jurisdiction. West Virginia then distributes both the tax and the carrier information to the other IFTA jurisdictions on behalf of the carrier. West Virginia receives its portion of gasoline taxes due from motor carriers based in other IFTA jurisdictions from the carrier's home jurisdiction. If a motor carrier does not operate in any other IFTA jurisdiction, the motor carrier must file the Motor Carrier Road Tax return for tax due to West Virginia and file returns as required by other non-IFTA jurisdictions in which the carrier traveled.

All amounts collected under IFTA are deposited into the International Fuel Tax Agreement Clearing Fund for distribution of funds owed to other member jurisdictions as provided in the agreement and for payment of any refunds owed to West Virginia-based taxpayers. After all payments and distributions, the remaining funds are deposited into the State Road Fund and used **only** for the following purposes: construction, reconstruction, maintenance and repair of highways; matching of federal funds available for highway purposes, and payment of the interest and sinking fund obligations on State bonds issued for highway purposes.

The same expenditures available under the Motor Carrier Road Tax also apply under IFTA. These include vehicles owned and operated by the federal government or any State government agency and school buses. Refunds help define and should be considered as part of the "normal" tax base. A refund is also allowed for any overpayment of motor fuel taxes paid by a West Virginia-based interstate motor carrier. Since this expenditure is part of the "normal" tax base, it is **not** considered a true expenditure for purposes of this study. In this section, only the refund for overpayment of taxes is discussed. A specific discussion of the other expenditures can be found in the Motor Carrier Road Tax section. Also, as part of the "normal" tax base, non-highway uses of gasoline or special fuel are exempt from taxation under IFTA. It is inherent in the structure of the Gasoline and Special Fuel Excise Tax, and the related Motor Carrier Road Tax, that only fuel used on the highways of West Virginia is taxable. Therefore, any private or non-highway use of fuel by motor carriers is not required to be reported on the IFTA tax return. Information on specific expenditures relating to the sale of gasoline and special fuel for non-highway purposes can be found in the Gasoline and Special Fuel Excise Tax section.

ORGANIZATION AND ANALYSIS

Refunds will be the only IFTA expenditures discussed in this section. The analysis for the overpayment of motor fuel taxes includes a rationale and the cost to the State.

REFUNDS

A refund for overpayment of any motor fuel tax paid by a West Virginia-based interstate motor carrier is available under IFTA. An analysis of this refund follows.

OVERPAYMENT OF MOTOR FUEL TAXES

STATUTE: West Virginia Code §11-14B-11(b)(2)

REFUND: Refund for overpayment of motor fuel taxes by a West Virginia-based interstate motor carrier

VALUE: **\$160,000 per year**

Rationale

Overpayment of motor fuel taxes by a West Virginia-based interstate motor carrier is refundable since the taxes were never due to the State. This refund is **not** a tax expenditure because it simply provides for a return of funds never owed to West Virginia. Overpayment of taxes may also be recovered through a credit for use against future motor fuel taxes owed.

TOBACCO PRODUCTS EXCISE TAX

OVERVIEW

The Tobacco Products Excise Tax Act was passed in 2001 and replaced the Cigarette Excise Tax with a tax on both cigarettes and tobacco products other than cigarettes. Effective May 1, 2003, the tax on cigarettes was raised to the rate of 55 cents on each pack of twenty cigarettes. The tax is imposed on every wholesaler, subjobber, subjobber dealer, retail dealer and vending machine operator by the purchase of stamps to be affixed to or impressed upon each package of cigarettes to be sold. Stamps or meter impressions are purchased from the State Tax Commissioner and are evidence of payment of the tax.

Effective January 1, 2002, an excise tax is levied on the sale of tobacco products other than cigarettes at a rate of 7 percent of the wholesale price of each item or article sold. Tobacco products to be taxed include cigars, snuff, chewing tobacco, and other non-cigarette tobacco products.

The excise tax on cigarettes and other tobacco products was created to provide revenue for the General Revenue Fund of the State. There are two types of expenditures that apply to the Tobacco Products Excise Tax, discounts and refunds. Discounts are allowed on all tax due on cigarettes for affixing stamps and collecting and paying the tax as required by law. Wholesalers of other tobacco products are also allowed a discount for collecting and remitting the tax. Discounts are not considered to be a part of the "normal" tax base. However, refunds in this case help define, and should be considered as part of, the "normal" tax base. Since the tax is on cigarettes meant for retail sale, a refund is allowed on any unsalable merchandise returned to the manufacturer. Refunds are also allowed on any unused or mutilated stamps.

ORGANIZATION AND ANALYSIS

Tobacco Products Excise Tax expenditures are divided into two groups as follows:

Discounts

Refunds

The analysis provided for each tax expenditure includes a rationale for each item and the item's cost to the State.

DISCOUNTS

Discounts are allowed on all tax due for affixing stamps and collecting and paying the tax. Discounts that apply are as follows:

Four Percent Discount on Stamp Purchases and for Collecting and Remitting the Tax
Commission for Banks Authorized to Set Meters or Sell Stamps

An analysis of these discounts follows.

FOUR PERCENT DISCOUNT ON STAMP PURCHASES AND FOR COLLECTING AND REMITTING THE TAX

STATUTE: West Virginia Code §§11-17-4(b) and 11-17-9

DISCOUNT: A discount of four percent on all tax due for persons affixing stamps, collecting and paying of tax as required and prescribed by this article

VALUE: **\$4.3 million per year**

Rationale

The 4 percent discount allowed on purchases of stamps is granted to taxpayers for providing the service of affixing stamps and collecting and remitting the tax on cigarettes and for collecting and remitting the tax on other tobacco products.

COMMISSION FOR BANKS AUTHORIZED TO SET METERS OR SELL STAMPS

STATUTE: West Virginia Code §11-17-1

DISCOUNT: The Tax Commissioner may appoint any bank or trust company authorized to do business in the State, as his/her deputy for the purpose of selling stamps or checking, setting and sealing meters; such deputy is allowed a fee of one eighth of one percent of the face value of all stamps sold

VALUE: **Minimal**

Rationale

The commission for banks authorized to set meters or sell stamps exists as an incentive for their assistance in providing the service of selling such stamps and collecting and remitting the tax.

REFUNDS

A refund of the tax on cigarettes is available for any unused or mutilated stamps or for any unsalable merchandise returned to the manufacturer with stamps affixed. An analysis of this refund follows.

UNUSED OR MUTILATED STAMPS OR UNALABLE MERCHANDISE RETURNED TO MANUFACTURER

STATUTE: West Virginia Code §11-17-10

REFUND: Unused or mutilated stamps and stamps destroyed by fire or flood, or stamps or meter impressions on cigarettes returned to manufacturer may be redeemed for a refund of ninety-five percent of the face value of the stamps, less any discount allowed on the purchase of the stamps

VALUE: \$440,000 per year

Rationale

A refund for unused or mutilated stamps or unsalable merchandise returned to the manufacturer exists as part of the "normal" tax base. Tax should not be paid on cigarette tax stamps that are destroyed or on cigarettes that cannot be sold or used.

SOFT DRINKS TAX

OVERVIEW

The Soft Drinks Tax is an excise tax levied on all bottled soft drinks, all soft drink syrups, and dry mixtures as defined by regulation, whether manufactured within or without this State. The rates of tax are as follows:

1. on each bottled soft drink, a tax of one cent on each sixteen and nine-tenths fluid ounces or on each one-half liter, or portion thereof;
2. on each gallon of soft drink syrup, a tax of eighty cents, or on each four liters of soft drink syrup a tax of eighty-four cents, or portion thereof, and
3. on each ounce by weight of dry mixture, a tax of one cent, or on each 28.35 grams, a tax of one cent, or portion thereof.

The tax is imposed on any West Virginia manufacturer or producer of bottled soft drinks or soft drink syrup for sale within this State. The tax also applies to distributors and wholesale or retail dealers who are the original consignees of any bottled soft drink or soft drink syrup brought into the State that was manufactured or produced outside of this State. In addition, the tax is imposed on any out-of-state bottler who puts indicia on a product to be sold in West Virginia.

The excise tax on soft drinks was created for the sole purpose of providing revenue for the construction, maintenance and operation of a four-year school of medicine, dentistry and nursing of West Virginia University. The revenue collected is deposited into a special medical school fund.

There are only two types of expenditures that apply to the Soft Drinks Tax, discounts and refunds. Discounts are not considered to be a part of the "normal" tax base. However, refunds in this case help define, and should be considered as part of, the "normal" tax base. Since the tax is on soft drinks meant for retail sale, a refund is allowed on any stamps, crowns or soft drinks, soft drink powders or soft drink syrups that are destroyed by fire, lightning or flood. Refunds are also allowed on soft drinks, syrups or powders exported from West Virginia or destroyed pursuant to a federal or State order. Because of the discounts on stamps and crowns, refunds are not allowed on tax paid stamps or crowns in the case of breakage or destruction of containers stamped or crowned. This also applies to the spoilage of soft drinks or syrups, or the loss or destruction of tax stamps or crowns.

In addition to the refunds mentioned above, several items specifically exempt from the Soft Drinks Tax base help define, and are considered part of, the "normal" tax base. Although the term "soft drinks" is interpreted quite liberally, it does **not** apply to fluid milk to which no flavoring has been added or to natural undiluted fruit or vegetable juices that may not be sweetened. Also, the tax does not apply to 100 percent pure juice with sweetener added. These exempt items are **not** considered expenditures for the purposes of this report and therefore will not be discussed further in this section.

ORGANIZATION AND ANALYSIS

Soft Drinks Tax expenditures are divided into two groups as follows:

Discounts

Refunds

The analysis provided for each tax expenditure includes a rationale for each item and the item's cost to the State.

DISCOUNTS

Discounts are allowed on the sale of both tax stamps and crowns for soft drinks. The following discounts apply:

<u>Sale</u>	<u>Discount</u>
Stamp sales of less than \$25	No discount
Stamp sales of \$25 or over and less than \$50	5%
Stamp sales of \$50 or more	10%
Crown sales	12.5%

Due to the small number of tax stamp discounts, they will be combined for the purposes of this study. The following discounts are discussed:

Discount on Stamp Sales
Twelve and One-half Percent Discount on Crowns

An analysis of these discounts follows.

DISCOUNT ON STAMP SALES

STATUTE: West Virginia Code §11-19-5

DISCOUNT: Stamp sales of twenty-five dollars or over and less than fifty dollars, a discount of five percent of the face value of all stamps sold; and on stamp sales of fifty dollars or more, a discount of ten percent of the face value of all stamps sold

VALUE: **\$130,000 per year**

Rationale

The discounts allowed on purchases of stamps exist for providing the service of affixing stamps and collecting and remitting the tax.

TWELVE AND ONE-HALF PERCENT DISCOUNT ON CROWNS

STATUTE: West Virginia Code §11-19-5

DISCOUNT: On the purchase of tax crowns, a discount of twelve and one-half percent on the value of the crowns

VALUE: **\$1.2 million per year**

Rationale

The 12.5 percent discount allowed on purchases of crowns exists for providing the service of affixing the crowns and collecting and remitting the tax, and to allow for crowns lost through breakage and spoilage.

REFUNDS

A refund of the Soft Drinks Tax is available when the tax stamps or crowns or soft drinks, soft drink powders or soft drink syrups are destroyed by fire, lightning or flood or must be destroyed pursuant to federal or State order. A refund is also available when the soft drinks, syrups or powders are exported out of this State. The following refunds are discussed in this section:

Destruction of Soft Drink Tax Stamps, Crowns or Soft Drinks
Soft Drinks, Syrups or Powders Exported Out-of-State

Analysis of these refunds follows.

DESTRUCTION OF SOFT DRINK TAX STAMPS, CROWNS OR SOFT DRINKS

STATUTE: West Virginia Code §11-19-5

REFUND: Refunds are allowed when tax stamps or crowns or soft drinks, soft drink powders or soft drink syrups, upon which tax has been paid, are destroyed by fire, lightning or flood; or are required to be destroyed pursuant to federal or State order

VALUE: \$0 per year

Rationale

The refund for stamps, crowns or soft drink products that are destroyed by fire, lightning or flood exists as part of the "normal" tax base. Tax should not be paid on stamps or crowns or soft drinks that are destroyed and cannot be sold or used.

Revenue Analysis

The refund for tax stamps, crowns or soft drink products that have been destroyed has not been claimed in recent years. No accidents have been reported in the last few years involving soft drink manufacturers or distributors. Technological improvements are another reason for the lack of refund requests. Soft drink product containers have become more durable in recent years as manufacturers switched from glass bottles to cans and plastic containers. Since these soft drink product containers are more durable, the products with tax stamps and crowns already attached are not as easily destroyed.

**SOFT DRINKS, SYRUPS OR POWDERS
EXPORTED OUT-OF-STATE**

STATUTE: West Virginia Code §11-19-5

REFUND: Refunds are allowed when soft drinks, syrups or powders upon which tax has been paid are exported from this State

VALUE: **\$70,000 per year**

Rationale

The purpose of this refund is to exclude from taxation soft drinks, syrups or powders not sold or used within this State.

BEER BARREL TAX

OVERVIEW

The Beer Barrel Tax is levied at the rate of \$5.50 per barrel of thirty-one gallons of "non-intoxicating beer" manufactured and sold in this State, whether contained or sold in barrels, bottles or other containers. The tax also applies to distributors who are the original consignees of non-intoxicating beer manufactured outside this State and brought into the State for sale. The Beer Barrel Tax does not apply to non-intoxicating beer manufactured by a brewpub.

The term "non-intoxicating beer" refers to the following products of the brewing industry: cereal malt beverages, beer, lager beer, ale, malt coolers and other similar items. A product that contains at least 0.5 percent alcohol by volume, but not more than 4.2 percent alcohol by weight or 6 percent by volume, whichever is greater, is considered "non-intoxicating beer."

Except for the exemption of brewpubs, there are no tax expenditures that apply to the Beer Barrel Tax. Unlike the other excise taxes in this study, there are no refunds or discounts that pertain to the Beer Barrel Tax.

ORGANIZATION AND ANALYSIS

The brewpub exemption from the Beer Barrel Tax is discussed in this section. The analysis includes a rationale for the item and the item's cost to the State.

EXEMPTIONS

The only item exempted from the Beer Barrel Tax is non-intoxicating beer manufactured by a brewpub. An analysis of this exemption follows.

BREW PUBS

STATUTE: West Virginia Code §11-16-13(a)

EXEMPTION: The barrel tax shall not apply to non-intoxicating beer manufactured by a brewpub

VALUE: **Cannot be disclosed¹**

Rationale

The exemption for brewpubs exists in order to promote small-scale manufacturing within the State.

¹ Due to taxpayer confidentiality

WINE LITER TAX

OVERVIEW

The Wine Liter Tax is levied on all wine sold by suppliers to distributors, except wine sold to the Alcohol Beverage Control Commissioner. As of April 30, 1983, the tax is levied at a rate of 26 cents per liter. Collections of the Wine Liter Tax are deposited into the General Revenue Fund.

Refunds are the only types of expenditures that apply to the Wine Liter Tax. Refunds help define, and should be considered as part of, the "normal" tax base. Since the tax is meant to be imposed on wine that will eventually sell at the retail level, a refund is allowed on wine lost through fire or casualty. A refund or credit is also allowed on tax erroneously or illegally collected. Since these refunds are part of the "normal" tax base, they are **not** considered true expenditures for purposes of this study.

ORGANIZATION AND ANALYSIS

Although **not** a true tax expenditure, refunds are analyzed in this section. The analysis provided for each tax refund includes a rationale for each item and the item's cost to the State.

REFUNDS

As part of the "normal" tax base, refunds of tax paid on liters of wine are allowed for the following reasons:

Erroneously or Illegally Collected Taxes
Wine Lost through Fire or Casualty

An analysis of these items follows.

ERRONEOUSLY OR ILLEGALLY COLLECTED TAXES

STATUTE: West Virginia Code §60-8-5
REFUND: Refund or credit will be granted for any tax erroneously or illegally collected
VALUE: **Minimal**

Rationale

This refund exists to protect the taxpayer and to enable the taxpayer to reclaim taxes that should not have been paid.

WINE LOST THROUGH FIRE OR CASUALTY

STATUTE: West Virginia Code §60-8-5
REFUND: Refund of wine lost through fire or casualty, other than breakage, when the amount of tax paid exceeds \$50
VALUE: **\$0 per year**

Rationale

A refund for taxes of over \$50 paid on wine lost through fire or casualty, other than breakage, exists as part of the "normal" tax base. Tax should not be paid on wine that is lost and cannot be sold or used.

Revenue Analysis

The refund for wine lost through fire or casualty when taxes of over \$50 have been paid has not been taken in recent years. This may be because the refund excludes breakage of products, which is probably the most likely accident to occur on a daily basis. There have been no reported fires or other casualties by suppliers in recent years.

PROPERTY TAXES

PROPERTY TAX

OVERVIEW

The Property Tax, which was enacted in 1863, is one of the oldest forms of taxation in West Virginia. This tax is administered by county officials and officials of several State government agencies. For the purposes of taxation, property can be divided into two categories: real and personal. Real property is land and anything permanently attached to land and owned by the owner of the land. Personal property is all other objects or rights that can be owned. Personal property can also be categorized as tangible and intangible. Generally, intangible property consists of rights to, or claims against, other property or services. In West Virginia, the Property Tax is levied on all real and personal property, except that which is specifically exempt in the West Virginia Code. Most of the exemptions discussed in this study have been in effect since the Property Tax laws were first enacted.

Less than 0.5 percent of all the Property Taxes collected in West Virginia goes to State government. The other beneficiaries of the Property Tax are county boards of education, county commissions and municipalities. For the fiscal year ending June 30, 2005, \$1.0 billion in Property Taxes was levied by the State, county boards of education, county commissions and municipalities. The following list shows the amount of Property Taxes levied by each levying body for the fiscal year ending June 30, 2005 (Tax Year 2004).

<u>Levying Body</u>	<u>Taxes Levied</u>
State	\$ 4,091,846
County	259,730,081
School Boards	677,790,889
Municipalities	<u>76,104,651</u>
Total	\$1,017,717,467

The Property Tax is levied at different tax rates depending on the class of property. The State rate is set in the West Virginia Constitution. Each county and municipality can impose its own rates of property taxation. The West Virginia Legislature sets the rate of tax for county boards of education. This rate is used by all county boards of education Statewide. The following classes of property are used for tax purposes:

- Class I¹ a. All tangible personal property used exclusively in agriculture, including horticulture and grazing, and

¹ Beginning with the 2003 tax year, all notes, bonds, bills, stocks, accounts receivable, and any other intangible personal property will be exempt from property taxation.

- b. all products of agriculture, including livestock, while owned by the producer
- Class II
- a. All property owned, used and occupied by the owner exclusively for residential purposes, and
 - b. all farms including land used for horticulture and grazing, which are occupied and cultivated by their owners or bona fide tenants.
- Class III All real and personal property situated outside municipalities, exclusive of Classes I and II.
- Class IV All real and personal property situated inside municipalities, exclusive of Classes I and II.

The maximum current tax rates shown in the table below for each local taxing authority are given in terms of class of property.

MAXIMUM PROPERTY TAX RATES
Rates in dollars per \$100

Taxing Authority	Class I	Class II	Class III	Class IV
State	\$.0025	\$.0050	\$.0100	\$.0100
County	.1430	.2860	.5720	.5720
School Boards	.2295	.4590	.9180	.9180
Municipalities	<u>.1250</u>	<u>.2500</u>	<u>--</u>	<u>.5000</u>
	\$1.5000	\$3.0000	\$4.5000	\$7.0000

Amendments to the State Constitution provide that these maximum rates can be temporarily exceeded by all the taxing authorities except State government. The voters of each taxing authority must approve any excess levy of tax proposed for their municipality, school board or county by a prescribed majority. The average actual tax rates per \$100 of assessed valuation for the 2004 tax year, expressed in rounded dollars, are shown in the following table.

ACTUAL TAX YEAR 2004 PROPERTY TAX RATES¹

Rates in dollars per \$100 of **assessed** valuation

	<u>Average</u>
Class I	\$.48
Class II	1.24
Class III	2.26
Class IV	2.95

Statewide, the average rate for all property is \$2.00 per \$100 of assessed valuation.

ESTIMATING COSTS OF TAX EXPENDITURES

Several sources of information were used to determine the expenditure valuations. These include publications from the United States Bureau of the Census and the West Virginia Public Service Commission and surveys conducted by the Research Division. Estimates were calculated using tax levy rates provided by the Chief Inspector Division of the State Auditor's Office and include all regular, special and excess levy rates. The estimates were based on an assumed equalization rate of 60 percent.

ORGANIZATION AND ANALYSIS

Although all property is presumed to be taxable until its owner proves otherwise, there are many possible exemptions from the Property Tax. The exemptions can be divided into seven distinct groups. The following is the list of groups used in this study:

- Government Exemptions
- Educational Exemptions
- Exemptions for Church Property
- Exemptions for Property Owned by Nonprofit Organizations
- Miscellaneous Exemptions
- Property Valuation Preferences
- Homestead Exemption

An analysis provided for each tax expenditure includes a rationale for each item and the item's cost to the State and local governments.

¹ Rates include excess levy rates.

GOVERNMENT EXEMPTIONS

Exemptions from Property Tax are granted to several different government entities. The exemptions included in this section are as follows:

- United States Government Property
- State Government Property
- Local Government Property
- Property Belonging to Another State
- Government-Owned Waterworks and Electrical Power Systems

Rationale

The exemption for property of the United States is required by the federal supremacy clause in the United States Constitution. Since state and local governments are prohibited from levying direct taxes upon the United States government, this exemption is **not** a true tax expenditure.

Unlike the exemption for property belonging to the United States government and its agencies, taxation of State property and local government property used for public purposes is not prohibited by constitutional restrictions. However, if the State imposed a Property Tax on State property and local government property used for public purposes, this would result in increased costs to those entities. An increase in costs to State and local governments would possibly result in an unintended transfer of funds from one government entity to another.

UNITED STATES GOVERNMENT PROPERTY

STATUTE: West Virginia Code §11-3-9(a)(1)

EXEMPTION: Property that belongs to the United States government, other than property permitted by the United States to be taxed under state law

VALUE:	State	\$ 30,000
	County	\$1,600,000
	School Boards	\$3,840,000
	Municipalities	\$ 420,000

Revenue Analysis

All real and personal property belonging to the United States government is exempt from Property Tax in West Virginia. This includes all public corporations and other agencies created by the federal government for national purposes. This exemption does **not** include private corporations hired by the United States government.

STATE GOVERNMENT PROPERTY

STATUTE: West Virginia Code §11-3-9(a)(2)

EXEMPTION: Property that belongs exclusively to the State

VALUE:	State	\$ 260,000
	County	\$16,680,000
	School Boards	\$40,010,000
	Municipalities	\$ 4,360,000

Revenue Analysis

All real and personal property belonging exclusively to the State of West Virginia is exempt from Property Tax in this State. This estimate does **not** include property belonging to State colleges and universities because such property is included in the exemption for educational institutions presented later in this report.

LOCAL GOVERNMENT PROPERTY

STATUTE: West Virginia Code §11-3-9(a)(3)

EXEMPTION: Property that belongs exclusively to any county, district, city, village or town in this State and used for public purposes

VALUE:	State	\$ 290,000
	County	\$18,020,000
	School Boards	\$43,230,000
	Municipalities	\$ 4,710,000

Revenue Analysis

This exemption includes property owned by counties and municipalities, including the property of any parks and recreation commissions or county development authorities created by a county commission. Property used for municipal and county waterworks is **not** included in the calculations for this exemption. Also **not** included is property owned by county boards of education, which is included in the exemption for educational institutions discussed later in this section.

PROPERTY BELONGING TO ANOTHER STATE

STATUTE: West Virginia Code §11-3-9(a)(4)

EXEMPTION: Property, located in this State, belonging to any city, town, village, county or other political subdivision of any other state when it is used for public purposes

VALUE: Negligible

Revenue Analysis

Property located in West Virginia that belongs to any municipality, county or other political subdivision of another state is exempt from Property Tax in West Virginia if the property is used for public purposes. The value of this exemption is negligible since there is little property of this type within West Virginia.

**GOVERNMENT-OWNED WATERWORKS
AND ELECTRICAL POWER SYSTEMS**

STATUTE: West Virginia Code §8-19-4

EXEMPTION: Personal and real property of a municipality or a county which was acquired and constructed for the purposes of a waterworks system or electrical power system and any leasehold interest in such systems which are held by other persons

VALUE:	State	\$ 110,000
	County	\$ 6,860,000
	School Boards	\$18,250,000
	Municipalities	\$ 1,980,000

Revenue Analysis

Property used for a municipal or county waterworks is exempt from Property Tax in West Virginia. Additionally, the property used for municipal and county electrical power systems is exempt. An exemption for this type of property is justified for tax equity purposes only if the service does not compete with a similar service available from a non-government utility.

EDUCATIONAL EXEMPTIONS

Certain types of property related to education are exempt from Property Tax in West Virginia. These exemptions include the following:

Property Used for Educational Purposes
Property Whose Income Supports Institutions of Higher Education
Dormitories, Literary Halls and Clubrooms

Rationale

These exemptions presumably exist to maximize funding of education since a tax on school property would result in the net transfers of some funds from the schools to the State, county commissions, and municipalities.

PROPERTY USED FOR EDUCATIONAL PURPOSES

STATUTE: West Virginia Code §11-3-9(a)(9)

EXEMPTION: Property belonging to, or held in trust for, colleges, seminaries, academies and free schools when it is used for educational, literary or scientific purposes including books, apparatus, annuities and furniture

VALUE:	State	\$ 420,000
	County	\$26,080,000
	School Boards	\$70,540,000
	Municipalities	\$10,210,000

Revenue Analysis

This exemption applies to property directly used for education, literary or scientific purposes by colleges, seminaries, and public and private elementary and secondary schools. However, colleges must have approval from the Board of Trustees of the University System of West Virginia or the Board of Directors of the State College System of West Virginia to grant degrees of higher education to qualify for this exemption. The educational, literary or scientific use of the property must be the primary use of the property.

**PROPERTY WHOSE INCOME SUPPORTS
INSTITUTIONS OF HIGHER EDUCATION**

STATUTE: West Virginia Code §11-3-9(a)(10)

EXEMPTION: Property belonging to, or held in trust for, colleges and universities located in West Virginia, or any public or private nonprofit foundation or corporation which receives contributions exclusively for such college or university, if the property or dividends, interest, rents or royalties derived therefrom are used or devoted to educational purposes of such college or university

VALUE:	State	Minimal
	County	\$180,000
	School Boards	\$420,000
	Municipalities	\$150,000

Revenue Analysis

To qualify for this exemption, the property must meet several conditions. The property must belong to or be held in trust by a West Virginia college or university or a public or private nonprofit foundation that receives contributions exclusively for an institution of higher education in West Virginia. In addition, the property, or the dividends, interest, rents and royalties derived from the property, must be used for the educational purposes of the college or university. The property must belong exclusively to the college, university or foundation.

DORMITORIES, LITERARY HALLS AND CLUBROOMS

STATUTE: West Virginia Code §11-3-9(a)(15)

EXEMPTION: All real estate, not exceeding one-half acre in extent, and the buildings thereon, used exclusively by any college or university society as a literary hall, dormitory or clubroom, if not used with a view to profit, including, but not limited to, property owned by a fraternity or sorority organization affiliated with a university or college, or property owned by a nonprofit housing corporation or similar entity on behalf of a fraternity or sorority organization affiliated with a university or college, when the property is used as residential accommodations, or as a dormitory, for members of the organization

VALUE:	State	\$ 20,000
	County	\$1,320,000
	School Boards	\$3,740,000
	Municipalities	\$ 990,000

Revenue Analysis

All real estate not exceeding one-half acre and any building on that property used by a college or university organization as a literary hall, dormitory or clubroom is exempt from Property Tax in West Virginia. This includes property used as residential accommodations for sorority or fraternity members and property owned by a nonprofit housing corporation and used as dormitories for students. In order for the property to be exempt, any revenue generated from that property must not exceed the cost of maintaining that property and the reasonable operating costs of the organization.

EXEMPTIONS FOR CHURCH PROPERTY

Several exemptions exist for churches and religious organizations. These include the following:

Property Used Exclusively for Divine Worship
Parsonages
Securities Sold by Churches and Religious Organizations

Rationale

The exemptions for churches were presumably enacted to avoid State interference with church activities.

PROPERTY USED EXCLUSIVELY FOR DIVINE WORSHIP

STATUTE: West Virginia Code §11-3-9(a)(5)

EXEMPTION: Property used exclusively for divine worship

VALUE:	State	\$ 110,000
	County	\$ 7,070,000
	School Boards	\$19,210,000
	Municipalities	\$ 2,030,000

Revenue Analysis

This exemption applies only to property used exclusively for divine worship. Property considered to be used for "divine worship" includes property used for religious services, for educational activities, such as Sunday School or Hebrew School classes, and for meetings and other activities held to further the religious activities of the organization. Property used for divine worship usually qualifies for the exemption for property used for charitable purposes as well.

PARSONAGES

STATUTE: West Virginia Code §11-3-9(a)(6)

EXEMPTION: Parsonages and the household goods and furniture pertaining thereto

VALUE:	State	Minimal
	County	\$ 520,000
	School Boards	\$1,350,000
	Municipalities	\$ 140,000

Revenue Analysis

Parsonages and the household goods of these residences are exempt from Property Tax in West Virginia. In order for the property to qualify for this exemption, the parsonage must be owned by the trustees of the church and must be used as a home by the pastor, priest, bishop or other similar leader of that church. The household goods excluded from taxation by this exemption are those owned by the church and do not include those goods owned by the pastor or other leader. However, household goods owned by the resident of the parsonage would be exempt under the exemption for all household goods and personal effects.

SECURITIES SOLD BY CHURCHES AND RELIGIOUS ORGANIZATIONS

STATUTE: West Virginia Code §11-3-9(a)(7)

EXEMPTION: Mortgages, bonds and other debt securities in the hands of bona fide owners and holders when the securities are issued and sold by churches and religious societies for the purposes of gaining money to be used in the erection of church buildings to be used exclusively for divine worship or for the purpose of paying indebtedness thereon

VALUE: **Minimal**

Revenue Analysis

Mortgages, bonds and other types of debt securities sold by churches and religious societies to secure money to be used in the erection of church buildings used exclusively for divine worship are exempt from Property Tax in West Virginia. Although this exemption is church-related, the taxpayers who are exempt from Property Tax in West Virginia on these types of debt instruments are the owners and holders of the securities, not the churches.

EXEMPTIONS FOR PROPERTY OWNED BY NONPROFIT ORGANIZATIONS

The property of various nonprofit organizations is exempt in West Virginia. The organizations whose property is partially or completely exempt from Property Taxes are as follows:

Libraries
Charitable and Benevolent Organizations
Nonprofit Corporations Distributing Water or Natural Gas or Providing Sewer Services
Public Institutions for the Deaf, Mute and Blind
Nonprofit Hospitals
Houses of Refuge, Lunatic or Orphan Asylums, and Homes for Those in Need
Fire Departments

Rationale

These exemptions generally involve organizations providing socially desirable services, often for low-income individuals. These exemptions exist to promote the social welfare and public service activities of these organizations.

LIBRARIES

STATUTE: West Virginia Code §11-3-9(a)(11)

EXEMPTION: Public and family libraries

VALUE:	State	\$ 10,000
	County	\$ 890,000
	School Boards	\$2,240,000
	Municipalities	\$ 650,000

Revenue Analysis

Both real and personal property owned by public and family libraries are exempt under this expenditure. Family libraries only qualify for this exemption if the materials kept in the library are available for use by the public. All books, manuscripts, musical scores and other literary, scientific or artistic writings or materials owned by the library are exempt. In addition, personal property, such as desks and audiovisual equipment, necessary for the operation of the library and the building that houses the materials is exempt.

CHARITABLE AND BENEVOLENT ORGANIZATIONS

STATUTE: West Virginia Code §§11-3-9(a)(12) and 11-3-9(a)(16)

EXEMPTION: Property used for charitable purposes and not held or leased out for profit
(W. Va. Code §11-3-9(a)(12))
Property used by benevolent associations, not conducted for private profit
(W. Va. Code §11-3-9(a)(16))

VALUE:	State	\$ 20,000
	County	\$1,550,000
	School Boards	\$4,140,000
	Municipalities	\$ 490,000

Revenue Analysis

Charities are eligible for an exemption from Property Tax in West Virginia under certain conditions. The charity must be operated on a nonprofit basis, must directly benefit society and must be exempt from federal income tax as a 501(c)(3) or (4) organization. In addition, the primary and immediate use of the property must be for one or more charitable purposes in order for the property to be exempt.

Some property belonging to a fraternal, benevolent or relief society or association is exempt from the Property Tax in West Virginia. In order for the property to be exempt, it must be used primarily for charitable purposes. Lodges, meeting halls, clubhouses, and other buildings, which are used mainly for social purposes for the enjoyment of the members, are not exempt.

NONPROFIT CORPORATIONS DISTRIBUTING WATER OR NATURAL GAS OR PROVIDING SEWER SERVICES

STATUTE: West Virginia Code §11-3-9(a)(13)

EXEMPTION: Property used for public purposes of distributing water or natural gas or providing sewer services by a duly chartered nonprofit corporation when such property is not held, leased or used for profit

VALUE:	State	\$ 90,000
	County	\$ 5,510,000
	School Boards	\$14,540,000
	Municipalities	\$ 1,310,000

Revenue Analysis

Property held by a duly chartered nonprofit corporation that distributes water or natural gas or provides sewer services for public purposes is exempt. To qualify for this exemption the property must not be used for profit.

PUBLIC INSTITUTIONS FOR THE DEAF, MUTE AND BLIND

STATUTE: West Virginia Code §11-3-9(a)(17)

EXEMPTION: Property belonging to any public institution for the education of the deaf, mute or blind

VALUE: **Minimal**

Revenue Analysis

This exemption applies to any public institution for the education of the deaf, mute and blind. Since there are very few of these types of institutions in West Virginia, the value of this exemption is minimal if considered in isolation from other exemptions. However, repeal of this exemption would not affect Property Tax revenue since these types of institutions would qualify for another exemption, such as that for charitable purposes.

NONPROFIT HOSPITALS

STATUTE: West Virginia Code §11-3-9(a)(17)

EXEMPTION: Property belonging to any hospital not held or leased out for profit

VALUE: **Not available**

Revenue Analysis

Nonprofit hospitals qualify for an exemption only if the primary and immediate use of the property is for charitable purposes. Any health care organization or hospital operated for the private gain of physicians, officers or members of the board of the institutions does not qualify for this exemption.

**HOUSES OF REFUGE, LUNATIC OR ORPHAN ASYLUMS
AND HOMES FOR THOSE IN NEED**

STATUTE: West Virginia Code §§11-3-9(a)(18) and 11-3-9(a)(19)

EXEMPTION: House of refuge, lunatic or orphan asylums (W. Va. Code §11-3-9(a)(18))
Homes for children or for the aged, friendless or infirm, not conducted for private profit (W. Va. Code §11-3-9(a)(19))

VALUE: **Minimal**

Revenue Analysis

The following types of property are specifically exempted from West Virginia Property Tax:

1. houses of refuge, such as a community shelter for battered women;
2. lunatic asylums;
3. orphan asylums;
4. homes for children, and
5. homes for the aged, the friendless or the infirm.

To qualify for an exemption from Property Tax, the property must be used for charitable purposes. A home for the aged, friendless, or infirm or for children does not qualify if, to gain admittance to the home, a person must deposit a substantial amount of money that could be equated as prepayment of rent. Homes also do not qualify if they require an application fee, damage deposit, or room charge unless the charge is substantially less than market value.

Although there is a specific exemption for these asylums and homes, the institutions would qualify for an exemption either as a charitable organization, an educational institution, or a government entity. Therefore, repeal of this exemption would have no impact on Property Tax revenue.

FIRE DEPARTMENTS

STATUTE: West Virginia Code §11-3-9(a)(20)

EXEMPTION: Fire engines and implements for extinguishing fires, and property used exclusively for the safekeeping thereof, and for the meeting of fire companies

VALUE:	State	\$ 10,000
	County	\$ 880,000
	School Boards	\$2,270,000
	Municipalities	\$ 200,000

Revenue Analysis

All fire engines, equipment used to extinguish fires and all other equipment used by firefighters and the building and land used by the fire department to store those items are exempt from Property Tax in West Virginia. Since fire equipment owned by State, county and municipal fire departments is exempt under the exemption for State and local governments, the value of that equipment was not included in the calculations of the value of this exemption. The exemption value is based **only** on the value of equipment and real property owned by volunteer fire departments.

MISCELLANEOUS EXEMPTIONS

The West Virginia Code provides for several miscellaneous exemptions that cannot be classified in the above-listed groups. The following is a list of the exemptions not previously discussed:

- Property Used for Area Economic Development Purposes
- Inventory Property Stored While in Transit
- Cemeteries
- Property Used in the Subsistence of Livestock
- Household Goods and Personal Effects
- Bank Deposits and Money
- Capital Stock
- Class I Intangible Property

An analysis of these exemptions follows.

PROPERTY USED FOR AREA ECONOMIC DEVELOPMENT PURPOSES

STATUTE: West Virginia Legislative Regulation §11-3-20.1

EXEMPTION: Property used for area economic development purposes by nonprofit corporations when such property is not leased for profit whose purpose is to develop special programs to improve the quality of social participation in community life, contribute to the elimination of poverty and establish permanent economic and social benefits in urban or rural low-income areas

VALUE: Not available

Rationale

This exemption presumably exists to encourage economic development in the State. The exemption applies to property owned by community development corporations or property used by certain nonprofit corporations.

INVENTORY PROPERTY STORED WHILE IN TRANSIT

STATUTE: West Virginia Code §11-5-13

EXEMPTION: Tangible personal property which is moving in interstate commerce through West Virginia, or which was consigned from a point of origin outside the State to a warehouse within the State for storage in transit to a final destination outside the State

VALUE: **\$9.4 million per year**

Rationale

This exemption, also known as the "Freeport Exemption", was approved by the voters in a Constitutional Amendment to encourage the development and maintenance of goods distribution centers in the State.

CEMETERIES

STATUTE: West Virginia Code §11-3-9(a)(8)

EXEMPTION: Cemeteries, except for certain personal property of commercial cemeteries, including any sites of unmarked graves which have been certified as such by the Division of Culture and History

VALUE: **Not available**

Rationale

This exemption relates specifically to burial plots at cemeteries and unmarked graves certified by the Division of Culture and History. This exemption presumably exists because of the use of the property as a burial site. Such property cannot readily be used for other purposes.

For purposes of this exemption, property classified as cemetery property includes property where remains are buried or interred, tombstones, and access roads to service the property. Family-owned cemeteries are exempt only if the immediate use of the entire parcel of land is as a cemetery. Property owned by a cemetery company, such as office furniture, office buildings and chapels, is **not** exempt from Property Tax.

Revenue Analysis

An accurate estimate of the value of this exemption could not be made since the property actually belongs to the individuals who own the burial lots, not the cemetery companies who operate the cemeteries.

PROPERTY USED IN THE SUBSISTENCE OF LIVESTOCK

STATUTE: West Virginia Code §11-3-9(a)(21)

EXEMPTION: All property to be used in the subsistence of livestock on hand at the commencement of the assessment year

VALUE:	State	Minimal
	County	\$110,000
	School Boards	\$210,000
	Municipalities	Not applicable

Rationale

This exemption aids farmers by exempting all feed and other items intended to be used to feed livestock owned or kept by the farmer. This exemption is for the personal property a farmer uses in the subsistence of livestock the farmer owns.

HOUSEHOLD GOODS AND PERSONAL EFFECTS

STATUTE: West Virginia Code §§11-3-9(a)(22) and 11-3-9(a)(24) et. seq.

EXEMPTION: Household goods (personal property and goods commonly found within the house and items used to care for the house and its surrounding property) when not held or used for profit (W. Va. Code §11-3-9(a)(22))
Personal effects (articles and items of personal property commonly worn on or about the body or carried by a person and normally associated with the person) when not held or used for profit, and dead victuals laid away for family use (W. Va. Code §11-3-9(a)(24) et. seq.)

VALUE: Not available

Rationale

This exemption benefits taxpayers by exempting their household goods and personal effects. These items were exempted to limit invasion of privacy. Also, there would be administrative and compliance difficulties associated with the collection of Property Tax on these items.

BANK DEPOSITS AND MONEY

STATUTE: West Virginia Code §11-3-9(a)(23)

EXEMPTION: Bank deposits and money

VALUE:	State	\$ 360,000
	County	\$22,800,000
	School Boards	\$54,710,000
	Municipalities	\$ 5,980,000

Rationale

This exemption presumably exists in recognition of the difficulty in administering a tax on intangible assets. However, the exemption was limited to bank deposits and money.

Revenue Analysis

The exemption values listed are based on bank deposits and do not include cash on hand. These values also do not include coin collections, which are treated as cash and are therefore exempt, unless the collections are being maintained for the purposes of future profit.

CAPITAL STOCK

STATUTE: West Virginia Code §11-5-6

EXEMPTION: Shares in companies whose stock is assessed

VALUE: Not available

Rationale

This exemption exists to avoid double taxation since the exemption only applies to shares in companies that have already been assessed Property Tax on their assets. This exemption only applies to shares owned by taxpayers in West Virginia.

CLASS I INTANGIBLE PROPERTY

STATUTE: West Virginia Code §11-1C-1b

EXEMPTION: Intangible personal property with tax situs in this state shall be exempt from ad valorem property tax beginning tax year one thousand nine hundred ninety-eight: Provided, That such property shall be subject to ad valorem property tax and taxed at fifty percent of assessed value for tax year one thousand nine hundred ninety-eight; at forty percent of assessed value for the tax year one thousand nine hundred ninety-nine; at thirty percent of assessed value for the tax year two thousand; at twenty percent of assessed value for the tax year two thousand one; at ten percent of assessed value for the tax year two thousand two and eliminated completely for the tax year two thousand three and thereafter

VALUE: **\$16.5 million per year**

Rationale

This exemption was approved by the voters in a Constitutional Amendment and presumably exists in recognition of the difficulty in administering a tax on intangible assets.

PROPERTY VALUATION PREFERENCES

The West Virginia Code provides special valuation procedures for certain types of property. In the determination of tax appraisals, these valuation procedures generally place a greater weight upon actual economic use rather than market valuation based on the highest and best use of the property. The following types of property are subject to special valuation procedures which result in a partial exclusion from taxation:

- Farm Real Estate Property
- Managed Timberland
- Pollution Control Facilities
- Specialized Manufacturing Production Property
- Qualified Capital Additions to Manufacturing Facilities

An analysis of these preferences follows.

FARM REAL ESTATE PROPERTY

STATUTE: West Virginia Code §11-1A-10

PREFERENCE: With respect to farm property, the tax commissioner shall appraise such property so as to ascertain its fair and reasonable value for farming purposes regardless of what the value of the property would be if used for some other purpose, and the value shall be arrived at by giving consideration to the fair and reasonable income which the property might be expected to earn in the locality wherein situated, if rented

VALUE: **\$10.4 million per year**

Rationale

This preference presumably exists to encourage the preservation of farming activities within the State. If such property is actually used for viable farming activity, then the preference exists to discourage the conversion of such property over to alternative uses. This preference applies to real property designated for farm use.

MANAGED TIMBERLAND

STATUTE:	West Virginia Code §11-1C-11b(a)
PREFERENCE:	Property certified by the Division of Forestry as managed timberland shall be valued based upon the land's potential to produce future income according to its use and productive potential as managed timberland
VALUE:	\$4.4 million per year

Rationale

This preferential valuation treatment was approved by the voters in a constitutional amendment to encourage the development and maintenance of managed timberland in the State. The preference arose out of concern that excessive property taxation encourages the clear-cutting of forest land. Managed timberland is defined by legislative regulation to include surface real property of at least ten contiguous acres which is devoted to forest use, has sufficient numbers of commercially valuable trees and is managed pursuant to a State-approved plan.

POLLUTION CONTROL FACILITIES

STATUTE:	West Virginia Code §11-6A
PREFERENCE:	The value of a pollution control facility first placed into operation subsequent to July 1, 1973, shall ... be deemed to be its salvage value.
VALUE:	\$28.7 million per year

Rationale

This preferential treatment recognizes the limited economic benefits associated with pollution control facilities. Pollution control facilities are appraised at 5 percent of original cost.

SPECIALIZED MANUFACTURING PRODUCTION PROPERTY

STATUTE:	West Virginia Code §11-6E
PREFERENCE:	The value of specialized manufacturing production property shall ... be its salvage value.
VALUE:	\$2.7 million per year

Rationale

Specialized manufacturing production property includes molds, jigs, dies, forms, patterns and templates directly used in manufacturing. This preferential treatment recognizes the limited uses or useful life of this type of property. Such property is appraised at 5 percent of original cost.

QUALIFIED CAPITAL ADDITIONS TO MANUFACTURING FACILITIES

STATUTE:	West Virginia Code §11-6F
PREFERENCE:	The value of a certified capital addition which exceeds \$50 million added to an existing manufacturing facility with an original cost valuation of \$100 million or more first placed into operation for tax years beginning on or after July 1, 1997, shall ... be deemed to be appraised at five percent of its original cost.
VALUE:	Cannot be disclosed¹

Rationale

This preferential treatment presumably exists to encourage manufacturing companies with huge existing facilities within the State to undertake major expansions within the State. The new qualifying investment would be appraised at 5 percent of original cost.

¹ Due to taxpayer confidentiality

HOMESTEAD EXEMPTION

This program provides for a \$20,000 exemption against the total assessed value of single-family dwellings, including mobile or manufactured homes, owned and occupied as a residence by any person who is at least sixty-five years old or totally and permanently disabled and has legally resided in and paid taxes on a homestead in this State for two consecutive taxable years before filing for this exemption. In general, this represents an exclusion of the first \$33,333 of the appraised residential property value. However, the exclusion can exceed \$33,333 in cases of additional tax preferential treatment.

STATUTE: West Virginia Code §11-6B-3

EXEMPTION: An exemption ... shall be allowed for the first twenty thousand dollars of assessed value of a homestead that is used and occupied by the owner thereof exclusively for residential purposes when such owner is sixty-five years of age or older or is certified as being permanently and totally disabled

VALUE:	State	\$ 180,000
	County	\$11,360,000
	School Boards	\$29,640,000
	Municipalities	\$ 3,330,000

Rationale

This exemption provides a measure of tax relief for some elderly and permanently and totally disabled taxpayers. The exemption applies to these taxpayers regardless of income level or ability to pay.

PROPERTY TRANSFER TAX

OVERVIEW

The Property Transfer Tax was enacted as a State tax in 1959. The tax is imposed on the privilege of transferring real property. The State tax rate is \$1.10 per each \$500 dollars of value transferred, or fraction thereof. The proceeds of the State tax are deposited in the General Revenue Fund.

In 1968, an additional county tax was imposed at a rate of 55 cents per each \$500 of value, or fraction thereof. In 1989, county commissions were given the option of increasing their tax rate by an additional 55 cents per each \$500 of value, upon a majority vote of the county commission. The proceeds of the county tax are deposited into the general fund of the county in which the property is located.

The Property Transfer Tax represents less than 0.5 percent of all funds paid annually into the General Revenue Fund. The following table shows the amounts received by the General Revenue Fund in Property Transfer Tax receipts for the last three fiscal years. Since all counties except Mingo County have increased their tax by the optional 55 cents per \$500 of value tax, an almost identical amount has been received by the fifty-five county commissions during each year.

<u>Fiscal Year</u>	<u>Tax Receipts</u>
2003	\$8,365,472
2004	\$10,128,603
2005	\$12,171,339

Each deed or other instrument presented to the county clerk for recordation is to be accompanied by a sales listing form. The form includes, among other information, the actual consideration for the property (i.e., the value on which the tax is calculated). Payment of the tax is shown by affixing documentary stamps, or other evidence of payment, to the instrument presented for recordation.

ESTIMATING COSTS OF TAX EXPENDITURES

Tax data provided to the State Tax Department by county clerks was the primary means in determining the value of each tax expenditure.

ORGANIZATION AND ANALYSIS

The Property Transfer Tax expenditures discussed in this report are divided into three groups:

Transfers to or from Governmental Bodies

Transfers between Related Parties

Certain Miscellaneous Transfers

The analysis provided for each tax expenditure includes the item's cost to the State and a rationale.

TRANSFERS TO OR FROM GOVERNMENTAL BODIES

Certain transfers of property are excluded from the Property Transfer Tax if the transferor or transferee is a governmental entity. These exclusions may be divided into two categories:

Transfers to or from the United States Government
Transfers to or from West Virginia Governmental Entities

An analysis of these expenditures follows.

TRANSFERS TO OR FROM THE UNITED STATES GOVERNMENT

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... transfers to or from the United States.

VALUE:	State	\$70,000
	County	\$70,000

Rationale

States are prohibited from imposing ad valorem or any other form of taxation on the value of real property owned by the federal government unless the federal government chooses to subject itself to this form of taxation. Therefore, this exclusion is **not** a true tax expenditure.

TRANSFERS TO OR FROM WEST VIRGINIA GOVERNMENTAL ENTITIES

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... transfers to or from ... the State of West Virginia, or to or from any of their ... political subdivisions.

VALUE:	State	\$180,000
	County	\$180,000

Rationale

The purpose of this expenditure is presumably to reduce the cost of acquiring property for the State of West Virginia and local governments. An exclusion from the Property Transfer Tax reduces the cost of purchasing property.

TRANSFERS BETWEEN RELATED PARTIES

Property transfers excluded from the Property Transfer Tax due to the relationship of the transferor and transferee parties may be divided into three categories:

- Transfers between Related Business Entities
- Transfers between Related Individuals
- Transfers between a Principal and a Straw Party

An analysis of these expenditures follows.

TRANSFERS BETWEEN RELATED BUSINESS ENTITIES

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... deeds made pursuant to mergers of corporations or limited liability companies, partnerships, or limited partnerships, deeds made by a subsidiary corporation to its parent corporation for no consideration other than the cancellation or surrender of the subsidiary's stock and deeds made due to the conversions of corporations or other business organizations into limited liability companies

VALUE:	State	\$120,000
	County	\$120,000

Rationale

The purpose of this expenditure is to exclude various types of property transfers between related business entities when no financial gain is realized by the business entity transferring the property.

TRANSFERS BETWEEN RELATED INDIVIDUALS

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... transfers between husband and wife, transfers between parent and child, transfers between parent and child and his or her spouse, transfers between grandparent and grandchild and his or her spouse, without consideration.

VALUE:	State	\$320,000
	County	\$320,000

Rationale

The purpose of this expenditure is to exclude various types of property transfers between related persons when no financial gain is realized by the person transferring the property.

TRANSFERS BETWEEN A PRINCIPAL AND A STRAW PARTY

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... transfers between a principal and straw party for any reason.

VALUE: **Minimal**

Rationale

The purpose of this expenditure is to exclude various types of property transfers where no financial gain is realized by the party transferring the property. A straw party is defined by Black's Law Dictionary as " ... a third party who is put up in name only to take part in a transaction. Nominal party to a transaction; one who acts as an agent for another for the purpose to taking title to real property and executing whatever documents and instruments the principal may direct respecting the property. Person who purchases property for another to conceal identity of real purchaser, or to accomplish some purpose otherwise not allowed."

CERTAIN MISCELLANEOUS TRANSFERS

Other property transfers excluded from the Property Transfer Tax may be divided into four categories:

Transfers Where the Value of Property is \$100 or Less
Quitclaim or Corrective Deeds
Transfers to or from Voluntary Charitable or Educational Associations
Other Miscellaneous Transfers

An analysis of these expenditures follows.

TRANSFERS WHERE THE VALUE OF PROPERTY IS \$100 OR LESS

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... transfer of real property where the value of the property transferred is one hundred dollars or less

VALUE: **Minimal**

Rationale

The presumed purpose of this expenditure is ease of administration.

QUITCLAIM OR CORRECTIVE DEEDS

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... quitclaim or corrective deeds without consideration.

VALUE: **Minimal**

Rationale

The purpose of this expenditure is to exclude quitclaim or corrective deeds from Property Transfer Tax. Quitclaim deeds are defined by Black's Law Dictionary as, "A deed of conveyance operating by way of release; that is, intended to pass any title, interest, or claim which the grantor may have in the premises, but not professing that such title is valid, nor containing any warranty or covenants for title..."

TRANSFERS TO OR FROM VOLUNTARY CHARITABLE OR EDUCATIONAL ASSOCIATIONS

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... gifts to or transfers from or between voluntary charitable or educational associations or trustees thereof and like nonprofit corporations having the same or similar purposes.

VALUE: **Minimal**

Rationale

The purpose of this expenditure is to exclude property transfers to or from charitable or educational associations from the Property Transfer Tax. Presumably, this exclusion exists in recognition of the public good rendered by these organizations.

OTHER MISCELLANEOUS TRANSFERS

STATUTE: West Virginia Code §11-22-1

EXCLUSION: "Document" ... does not include ... wills ... testamentary or inter vivos trusts, deeds of partition

VALUE: **Minimal**

Rationale

The purpose of this expenditure is to exclude various types of property transfers where no financial gain is realized by the party transferring the property.