

REDACTED DECISION – DK# 15-104 RP-C

**BY: CRYSTAL S. FLANIGAN , ADMINISTRATIVE LAW JUDGE
SUBMITTED FOR DECISION ON DECEMBER 19, 2016
ISSUED ON FEBRUARY 20, 2018**

BEFORE THE OFFICE OF TAX APPEALS

FINAL DECISION

On February 12, 2015, the Tax Accounting Administration of the West Virginia State Tax Commissioner's Office (hereinafter "Tax Department" or "Respondent") issued a refund denial letter (Letter Id #____) to the Petitioners in Personal Income Account Number _____. This refund denial was issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 10 *et seq*, of the West Virginia Code. The refund denial stated that the Respondent was unable to accept the amendments to the Petitioners' 2012 and 2013 returns due to them having West Virginia source income.

The Petitioners timely filed their Petition for Refund with this Tribunal on March 30, 2015. Subsequently, notice of a hearing on the petition was sent to the parties and in accordance with the provisions of West Virginia Code Section 11-10A-10, a hearing was held on September 29, 2015, in Clarksburg, West Virginia, and the matter became ripe for decision at the conclusion of the same.

FINDINGS OF FACT

1. Petitioners are the sole shareholders and employees of Company A (Tran. 12, Respondent's Ex. 4).

2. Company A., is a West Virginia corporation with its principal place of business in a West Virginia location, which primarily handled repossession work for bank-leased commercial assets between 1996-2010 (Respondent's Ex. 4 & 5).

3. In 2010, a portion of Company A., the repossession business, was sold as an owner financed sale, and the installment payments from that sale make up part of Company A's current income¹ (Tran. 13-14, 22).

4. Upon the sale of the repossession business, the Petitioners structured the remaining portion of Company A, so that they could be considered employees receiving an annual salary for income and withholding purposes (Tran. 35).

5. The revenues currently received by Company A., consist of installment payments from the repossession sale, and the purchase and sale of real estate² (Tran. 12-14).

6. The Petitioners received W-2s for their salaries from their employer Company A, for tax years 2012 and 2013 (Petitioners' Ex. 1).

7. On January 9, 2015, the Petitioners filed amended West Virginia personal income tax returns for tax years 2012 and 2013 based on their belief that they are entitled to a refund due to being nonresidents. The returns reported no West Virginia income and the Petitioners are seeking a refund for the 2012 tax year in the amount of \$_____, and for 2013 tax year in the amount of \$_____ (Petitioners' Ex. 1).

¹ Although not elicited during the Evidentiary Hearing, the Petitioners state in their Memorandum of Law that they sold their repossession business to Company B., and later converted this sale into an installment purchase agreement secured by a Deed of Trust dated December 12, 2014, recorded in the Office of the Clerk office of a West Virginia County Commission.

² The Petitioners' Memorandum of Law further describes deed of trust payments received from two tracts of land sold and secured by deeds of trust dated November 2, 2009, and September 13, 2013, in the original principal amounts of \$_____ and \$_____.

8. On February 12, 2015, the Respondent denied the Petitioners' refund regardless of their residency status for tax years 2012 and 2013 due to their West Virginia source income (Respondent's Ex. 1).

9. The State of Florida imposes no personal state income tax, and judicial notice was taken of this fact during the Evidentiary Hearing with the agreement of the parties (Tran. 46).

DISCUSSION

The Petitioners are the sole owners and employees of Company A, a West Virginia corporation with its principal place of business in a West Virginia location. Company A's income is derived from installment payments from the sale of the repossession business of Company A, the installment payments from the sale of two tracts of land, and the sale of real estate, in West Virginia.

In 2012, the Petitioners each received W-2's for salaried income from Company A, in the amount of \$_____. In 2013, the Petitioners each received W-2's for salaried income from Company A., in the amount of \$_____. These amounts are accurately reflected on their 2012 and 2013 West Virginia State Income Tax Returns. It is undisputed that the Petitioners received income from Company A, a West Virginia corporation, for wages earned.³ Furthermore, the Petitioners strongly argue that they are residents of Florida and nonresidents of West Virginia.⁴

West Virginia source income of a nonresident is discussed in West Virginia Code § 11-21-32 and states "[T]he West Virginia source income of a nonresident individual shall be the sum of the net amount of income, gain, loss and deduction entering into his or her federal adjusted gross

³ The Petitioners relied on the advice of their accountant to have the lease payments paid to them in the form of wages, instead of capital gains (Trans. 35).

⁴ This Tribunal recognizes that the parties spent a good deal of time litigating the issue of residency during the pendency of this case. However, the determinative issue in this matter concerns West Virginia source income.

income....derived or connected with West Virginia sources.” W. Va. Code Ann. § 11-21-32(a) (West 2010). This section further defines income and deductions from West Virginia sources in subsection (b):

- (1) Items of income, gain, loss, and deduction derived from or connected with West Virginia sources shall be those items attributed to:
 - (A) The ownership of any interest in real or tangible personal property in this state; or
 - (B) A business, trade, profession, or occupation carried on in this state; or
 - (C) In the case of a shareholder of an S corporation, the ownership of shares issued by such corporation, to the extent determined under section thirty-seven.
- (2) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property, shall constitute income derived from West Virginia sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in this state.

W.Va. Code Ann. § 11-21-32 (b) (West 2010).

Under W.Va. Code § 11-21-32(b)(1)(A), income attributed to... “[t]he ownership of any interest in real or tangible personal property in this state” is defined as West Virginia source income. Additionally, Legislative Rule 32.2.1.1 defines rental, installment sales, and other income derived from ownership interests in real property in West Virginia as follows:

The West Virginia adjusted gross income of a nonresident individual includes items of income, gain, loss and deduction entering into his or her federal adjusted gross income which are attributable to the ownership interest in real or tangible personal property in this State. Thus, West Virginia adjusted gross income includes rental income from real or tangible personal property in this State after deducting ordinary and necessary expenses attributable to the ownership, operation or maintenance of such property. Income and deductions available to a lease-hold interest in property in this State are included, as well as income and deductions attributable to ownership in fee.

West Virginia Code R. §110-21-32.

The Petitioners contend that they do not derive income from typical business activities such as, the sale of goods or rendering of personal activities. Furthermore, the Petitioners argue

they do not earn wages or income for services and work performed in West Virginia., but instead are realizing income from a prior owner-financed sale of both personal property and real estate.

Income derived from or connected with West Virginia sources shall be those items attributed to “[a] business, trade, profession, or occupation carried on in this state.” The Petitioners seek to narrow the definition of income when the statute is devoid of any requirement of a sale of goods or personal services. Furthermore, the Petitioners contend that they do not earn wage income for services or work performed, although they have W-2s for this very reason. This Tribunal finds that the Petitioners’ characterization of income and their wages earned are without merit.

The Petitioners’ ownership in real estate installment payments and real estate ownership specifically meets the statutory language in West Virginia Code § 11-21-32(b)(1)(A) and Legislative Rule 32.2.1.1 for West Virginia source income. Company A, receives installment payments from an asset sale of the previous repossession business which is recorded in the a West Virginia county courthouse. Company A, also receives installment payments from the sale of two tracts of land, and from other various real estate income. Therefore, Petitioners’ nonresident income is subject to West Virginia State income tax under West Virginia. Code § 11-21-32(b)(1)(A) as it is attributable to West Virginia sources. Under West Virginia Code § 11-21-32(b)(1)(B), income attributed to a “[b]usiness, trade, profession, or occupation carried on in this state” is also defined as source income to Company A., because it is 1) a West Virginia corporation; and 2) the business derives its income from a business carried on in West Virginia. As the statute is clear and unambiguous, the Petitioners’ income meets the requirements of nonresident West Virginia sourced income. Therefore, Petitioners’ income is subject to West Virginia income tax, and the Petitioners have failed to meet their burden on this issue.

The Petitioners finally argue that any West Virginia income tax applicable to them violates the “internal consistency” test of the Dormant Commerce Clause.

The Commerce Clause of the United States Constitution gives Congress the power to regulate commerce. However, the courts, in particular the United States Supreme Court, have created a body of law regarding the flip side of Congress’ power to regulate commerce, namely the limitations on the individual states ability to regulate/hamper interstate commerce. This body of law is referred to as the dormant Commerce Clause. One of the standard bearer cases on the dormant Commerce Clause is *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). The *Complete Auto* Court created a four part test to ascertain if a state taxing scheme violates the Clause. The Court ruled that a tax that: (1) applies to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) is not discriminatory towards interstate or foreign commerce; and (4) is fairly related to the services provided by the State, will pass muster under the dormant Commerce Clause. *Id.*, at 279.

The Petitioners allege that if the internal consistency test is applied to the Petitioners, then they are suffering from the double taxation of the same income from the State of West Virginia and in the State of Florida, violating their Due Process and Dormant Commerce Clause of the Constitution.⁵

The Tax Commissioner contends that the Petitioners’ internal consistency argument fails as Florida does not impose a state income tax and because West Virginia both apportions the

⁵ A “[c]omponent of fairness in an apportionment formula is what might be called internal consistency—that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business’s income being taxed” as discussed in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 103 S.Ct. 2933, 77 L.Ed.2d 545 (1983). Internal consistency has further been described in that it “[h]elps courts identify tax schemes that discriminate against interstate commerce, assumes that every State has the same tax structure. *Comptroller of Treasury of Maryland v. Wynne*, 135 S.Ct. 177, 191 L.Ed2d 813, 83 USLW 4309 (2015). The internal consistency test appears to be an offshoot of prongs two and three of the four part test in *Complete Auto Transit Inc., v. Brady*, 430 U.S. 274, 97 S. Ct 1076, 51 LEd2d 326 (1977), which assists courts in ascertaining whether a tax is discriminatory towards interstate or foreign commerce.

income of nonresidents so that it only taxes income attributable to West Virginia sources and provides a credit for income taxes paid to other states under West Virginia Code § 11-21-30 (2005)⁶ and West Virginia Code § 11-21-30 (2005).⁷

The Petitioners are complaining that they are somehow being double taxed on their personal income taxes because they are paying taxes in both West Virginia and Florida under a discriminatory tax scheme. However, upon close inspection, this Tribunal finds that the State of Florida does not even impose a state personal income tax,⁸ and we cannot see how the risk of double taxation can even exist, much less cause a double taxation to the Petitioners. This Tribunal finds the Petitioners' argument less than availing, and further finds that they have clearly failed to meet their burden of proof on this issue.

CONCLUSIONS OF LAW

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).

2. In a hearing before the West Virginia Office of Tax Appeals on a petition for refund, the burden of proof is upon the Petitioner to show that he is entitled to the refund claimed by him. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010); W. Va. Code. R. §§ 121-1-63.1 and 69.2 (2003).

⁶ “[A] taxpayer shall first calculate tax liability...as if it were a resident of the state whether an individual, estate, or trust for an entire taxable year.”

⁷ “[A]nonresident shall be allowed a credit against the tax otherwise due under this article for any income tax imposed for the taxable year by another state of the United States or by District of Columbia, of which the taxpayer is a resident.”

⁸ During the evidentiary hearing held in this matter, Administrative Law Judge Piper took judicial notice of Florida not having a state income tax (Tran. 46).

3. Each year a tax is imposed, based upon a rate set by the legislature, on the West Virginia taxable income of every individual, estate and trust. *See* W. Va. Code Ann. § 11-21-3 (West 2010).

4. The West Virginia source income of a nonresident individual shall be the sum of the net income, gain, loss, and deduction entering into his or her federal adjusted gross income, as defined by the laws of the United States and section nine of this article, for the taxable year, deprived from or connected with West Virginia sources. *See* W.Va. Code Ann. § 11-21-32(a) (West 2010).

5. Items of income, gain, loss, and deduction derived from or connected with West Virginia sources shall be those items attributable to (A) the ownership of any interest in real or tangible personal property in this state; or (B) a business, trade, profession, or occupation carried on in this state; or (C) in the case of a shareholder of an S corporation, the ownership of shares issued by such corporation, to the extent determined under section thirty-seven. *See* W.Va. Code § 11-21-32(b) (West 2010).

6. The United States Supreme Court has created a four part test to ascertain if a state taxing scheme violates the dormant Commerce Clause. The Court ruled that a tax that: (1) applies to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) is not discriminatory towards interstate or foreign commerce; (4) is fairly related to the services provided by the State, will pass muster. *Complete Auto Transit, Inc., v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L.Ed.2d 326 (1977).

7. A taxpayer shall first calculate tax liability...as if it were a resident of the state whether an individual, estate, or trust for an entire taxable year. The taxpayer shall receive the

same deductions, exemptions, and credits that would be allowable if he were a resident individual, estate, or trust for the entire taxable year. W.Va. Code § 11-21-30.

8. A nonresident shall be allowed a credit against the tax otherwise due for income due for any income tax imposed for the taxable year by another state. *See* W.Va. Code § 11-11-40.

9. The Petitioners have not carried their burden of proving that they do not owe West Virginia State Income Tax for 2012 and 2013. Therefore, the February 12, 2015, refund denial of their 2012 and 2013 amended West Virginia Personal Income Tax Returns was proper.

10. The refund denial does not violate the internal consistency test of the Dormant Commerce Clause under *Container Corp. of American v. Franchise Tax Board*, 463 U.S. 169, 103 S.Ct. 2933, 77 L.Ed.2d 545 (1983).

11. Based upon the above, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the personal income refund denial issued against the Petitioners on February 12, 2015, for a refund in the amount of \$_____ for 2012, and a refund on the amount of \$_____ for tax year 2013, is hereby **AFFIRMED**.⁹

WEST VIRGINIA OFFICE OF TAX APPEALS

By: _____
Crystal S. Flanigan
Administrative Law Judge

Date Entered

⁹ This decision is being authored by Administrative Law Judge Flanigan although the Evidentiary Hearing was held by Administrative Law Judge Piper on September 29, 2015.