

## SYNOPSIS

**CORPORATE NET INCOME TAX -- CONSOLIDATED RETURN OF AFFILIATED FINANCIAL ORGANIZATIONS HAVING COMMERCIAL DOMICILES ONLY IN THIS STATE -- STATUTORY DECREASING ADJUSTMENT MADE TO *PRO FORMA* TAXABLE INCOME OF MEMBER OF AFFILIATED GROUP, NOT TO CONSOLIDATED TAXABLE INCOME OF AFFILIATED GROUP** -- Under W. Va. Code § 11-24-13a(c)(3)(A) [1996], it is clear that the adjustment decreasing federal taxable income which is provided by W. Va. Code § 11-24-6(f) [1998] for certain governmental obligations and obligations secured by residential property is made to the *pro forma* West Virginia taxable income of each member of the affiliated group having such obligations, not to the consolidated taxable income of the affiliated group, even when all of the members of the affiliated group have their respective commercial domiciles in the State of West Virginia.

## FINAL DECISION

On an unspecified date during the year 2003, the Petitioner filed a claim for refund (actually, a claim for a credit carryforward, for an alleged overpayment) of West Virginia corporate net income tax for the tax and calendar year 2002. After an office audit of this claim, the Corporate & Franchise Tax Unit of the Internal Auditing Division of the West Virginia State Tax Commissioner's Office, by a letter dated March 05, 2003, and received by the Petitioner on March 07, 2003, denied part of the carryforward credit claim, specifically. While the Respondent's March 05, 2003 letter listed which lines in the consolidated corporate net income tax return (the claim) had been changed and by what amounts, that letter did not explain why the changes had been made.

Thereafter, by mail postmarked May 05, 2003, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for refund. See W. Va. Code § 11-10A-8(2) [2002].

Subsequently, pursuant to the provisions of 121 C.S.R. 1, § 53.1 (Apr. 20, 2003) (Rules of Practice and Procedure before the West Virginia Office of Tax Appeals), the parties submitted the matter for a decision by this tribunal on stipulated facts and memoranda of law. This matter was submitted in this manner for decision on October 23, 2003 (by verbal agreement, parts of the briefing schedule had been extended for a few days).

### **FINDINGS OF FACT**

The material and relevant portions of the stipulated facts (Joint Exhibit # 1) are as follows:

1. The Petitioner is a single-bank holding company having its *commercial domicile* in the State of *West Virginia*. Stipulation No. 1.

2. The Petitioner's sole subsidiary is a *West Virginia*-chartered operating banking corporation having its main office in another town and county in West Virginia. Stipulation No. 2.

3. For the year 2002, the Petitioner and the Operating Bank filed a consolidated return for federal and West Virginia corporate net income tax purposes. Stipulation No. 3.

4. The Petitioner and the Operating Bank attached to the consolidated 2002 West Virginia corporate net income tax return their respective *pro forma* West Virginia corporate net income tax returns for that year showing what their respective taxable incomes would have been if they each had filed separately. Stipulation No. 4.

5. In their respective *pro forma* returns the Petitioner and the Operating Bank showed adjustments decreasing federal taxable income for, among other things, interest expense on state obligations not allowed as a deduction on their consolidated federal corporate income tax return, respectively. Stipulation No. 10.

6. In their respective *pro forma* returns the Petitioner and the Operating Bank also showed decreasing allowances for certain governmental obligations and obligations secured by residential property ("AGORP"), respectively. Stipulation No. 11.

7. The decreasing allowance for AGORP shown by the Operating Bank on its *pro forma* return was based on the average of its beginning and ending monthly balances during the year 2002 for federal obligations and securities, for obligations issued by the State of West Virginia or its political subdivisions, for investments or loans primarily secured by mortgages or deeds of trust on residential property in West Virginia and for loans primarily secured by a lien or a security agreement on mobile homes, etc., in West Virginia. Stipulation No. 12.

8. In their respective *pro forma* returns the Petitioner and the Operating Bank determined their respective *pro forma* West Virginia taxable income for West Virginia corporate net income tax purposes by subtracting the amount of their respective AGORP and other decreasing adjustments, if any, from their respective total West Virginia taxable income before decreasing adjustments, resulting in the amounts of a *pro forma* net loss for the Petitioner and a *pro forma* net income for the Operating Bank. Stipulation No. 14.

9. To determine their consolidated West Virginia taxable income in their 2002 consolidated West Virginia corporate net income tax return, the Petitioner and the Operating Bank added their respective *pro forma* West Virginia taxable incomes (after making their respective increasing and decreasing adjustments), which resulted in a consolidated taxable income. Stipulation No. 15.

10. Based on consolidated West Virginia corporate taxable income, the Petitioner and the Operating Bank showed in their 2002 consolidated West Virginia corporate net income tax return an overpayment of tax for the year 2002 and requested that such amount be applied as a credit to their 2003 West Virginia corporate net income tax liability. Stipulation No. 16.

11. Upon an office audit of the Petitioner's 2002 consolidated West Virginia corporate net income tax return, the Respondent reduced the amount of the claimed overpayment of West Virginia corporate net income tax for that year. Although the Respondent's letter reducing the claimed overpayment did not state so, the Respondent now states that this reduction was based upon: (1) calculating the decreasing adjustment for the Operating Bank's AGORP only after consolidating the Petitioner's and the Operating Bank's separate *pro forma* taxable incomes; and (2) calculating the decreasing adjustment for the AGORP by utilizing the average of the beginning and ending *annual* balances of the relevant assets, instead of utilizing the average of the beginning and ending *monthly* balances for those assets. Stipulations Nos. 22 & 23.

12. In her memoranda of law (at pages 5-6) the Respondent now concedes that the second change just mentioned was invalid and that the Petitioner's use of the average *monthly* balances for the relevant assets was proper and correct as filed.

## DISCUSSION

The only issue is whether the Petitioner, in the consolidated West Virginia corporate net income tax return, properly calculated the W. Va. Code § 11-24-6(f) [1998] adjustment decreasing federal taxable income for the AGORP, by making that adjustment to the respective incomes of each of the members of the affiliated group, rather than to the consolidated income of the affiliated group.

W. Va. Code § 11-24-13a(c) [1996] provides the following with respect to the filing of a consolidated West Virginia corporate net income tax return for an affiliated group of financial organizations:

An affiliated group that includes one or more financial organizations may elect under this section to file a consolidated return when that affiliated group complies with all of the following rules:

(1) The affiliated group of which the financial organization is a member must file a federal consolidated income tax return for the taxable year.

(2) All members of the affiliated group included in the federal consolidated return must consent to being included in the consolidated return filed under this article. The filing of a consolidated return under this article is conclusive proof of such consent.

(3) The West Virginia taxable income of the affiliated group shall be the sum of:

(A) The pro forma West Virginia taxable income of all financial organizations having their commercial domicile in this state that are included in the federal consolidated return, as shown on a combined pro forma West Virginia return prepared for such financial organizations; plus

(B) The pro forma West Virginia taxable income of all financial organizations not having their commercial domicile in this state that are included in the federal consolidated return, as shown on a combined pro forma West Virginia return prepared for such financial organizations; plus

(C) The pro forma West Virginia taxable income of all other members included in the federal consolidated income tax return, as shown on a combined pro forma West Virginia return prepared for all such nonfinancial organization members, except that income, income adjustments and

exclusions, apportionment factors and other items considered when determining tax liability shall not be included in the pro forma return prepared under this paragraph for a member that is totally exempt from tax under section five of this article, or for a member that is subject to a different special industry apportionment rule provided for in this article. When a different special industry apportionment rule applies, the West Virginia taxable income of a member(s) subject to that special industry apportionment rule shall be determined on a separate pro forma West Virginia return for the member(s) subject to that special industry rule and the West Virginia taxable income so determined shall be included in the consolidated return.

(4) The West Virginia consolidated return is prepared in accordance with regulations of the tax commissioner promulgated as provided in article three, chapter twenty-nine of this code.

(5) The filing of a consolidated return does not distort taxable income. In any proceeding, the burden of proof that taxpayer's method of filing does not distort taxable income shall be upon the taxpayer.

In 1996, the Legislature enacted the above quoted subsection (c) of W. Va. Code § 11-24-13a at the same time that the Legislature amended the provisions of W. Va. Code § 11-24-7b by repealing former subsection (c) of § 11-24-7b. That former provision had allowed an affiliated group of financial organizations to file a consolidated return only if all of the group's members had their commercial domiciles in the State of West Virginia.

The Respondent argues in her brief that the provisions of W. Va. Code § 11-24-13a(c)(3) [1996] does not apply here because it applies only if at least one of the members of the affiliated group of financial organizations filing the consolidated West Virginia corporate net income tax return has a commercial domicile within this State and at least one member of that affiliated group has a commercial domicile without this State.

## CONCLUSIONS OF LAW

It is **DETERMINED** that:

1. The obvious legislative intent in making the changes in the year 1996 to W. Va. Code §§ 11-24-7b and 11-24-13a was to eliminate the distinction between financial organizations domiciled within West Virginia and such organizations domiciled without West Virginia concerning the requirements and procedures for the filing of consolidated West Virginia corporate net income tax returns.
2. In light of Conclusion of Law No. 1, it is clear that, under W. Va. Code § 11-24-13a(c)(3)(A) [1996], the adjustment decreasing federal taxable income which is provided by W. Va. Code § 11-24-6(f) [1998] for certain governmental obligations and obligations secured by residential property is made to the *pro forma* West Virginia taxable income of each member of the affiliated group having such obligations, not to the consolidated taxable income of the affiliated group, even when all of the members of the affiliated group have their respective commercial domiciles in the State of West Virginia.
3. The Petitioner's method of calculating the adjustment decreasing federal taxable income for certain governmental obligations and obligations secured by residential property appropriately matches the assets that give rise to the adjustment with the entity that holds the assets, that is, the Operating Bank, instead of the Petitioner, a bank holding company not having any such obligations.
4. The Petitioner's consolidated West Virginia corporate net income tax return in question complies with all five of the requirements of W. Va. Code § 11-24-13a(c)(1)-(5) [1996], including the fifth requirement of non-distortion of taxable income.
5. In a hearing before the West Virginia Office of Tax Appeals on a petition for refund, the burden of proof is upon the petitioner-taxpayer, to show that the petitioner-taxpayer is entitled to the refund. See W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, §§ 63.1 and 53.2 (Apr. 20, 2003).
6. In light of Conclusions of Law Nos. 1 through 4, the Petitioner-taxpayer in this matter has carried the burden of proof with respect to the issue of whether it was entitled to the portion of the refund claim that was denied by the Respondent.\*

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\*Having ruled in favor of the Petitioner on the main issue of the applicability of the statute in question, this tribunal need not address the issue of whether the Respondent's partial denial of the claimed credit carryforward was so vague as to constitute a denial of procedural due process, thereby voiding the denial for that constitutional reason.

## **DISPOSITION**

**WHEREFORE**, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the Petitioner's petition for refund of West Virginia corporate net income tax, for the tax and calendar year 2002, is hereby **AUTHORIZED**.

As set forth in W. Va. Code § 11-10A-18 [2002], the West Virginia State Tax Commissioner's Office is to see that the payment of the refund is issued promptly (or, here, the overpayment credit carryforward is applied to next year's return).