# Impact of Case Regarding Taxes Paid to Localities in Other States

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In the recent case of *Matkovich v. CSX Transportation Inc.*,[1] the West Virginia Supreme Court of Appeals held that West Virginia's use tax credit for sales taxes paid on motor fuel purchases made in other states must extend to motor fuel sales taxes imposed by cities, counties, and municipalities in those states.[2]

The court applied the four-prong dormant commerce clause test in *Complete Auto* in rendering its decision.[3] Under that test, a state tax or credit will not be sustained unless it "(1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate; and (4) is fairly related to the services provided by the State."[4] The court held that West Virginia's use tax on motor fuel and its corresponding sales tax credit satisfied prongs one and four of *Complete Auto*. However, because the sales tax credit did not extend to sales taxes imposed by cities, counties, or other taxing jurisdictions in other states, the credit was not fairly apportioned and discriminated against interstate commerce in violation of the dormant commerce clause.

In analyzing the fairly apportioned prong, the court held that the refusal of the West Virginia State Tax Department to apply the credit to subjurisdictional sales taxes paid to other states violated the U.S. Supreme Court's internal consistency analysis in that it produced a "total tax burden on interstate commerce [that] is higher" than a purely intrastate transaction.[5] The court further held that not applying the credit to city, county, and other sales taxes discriminated against interstate commerce in that it provided "a direct commercial advantage to local business.[6]

*CSX* followed on the heels of Comptroller of *Maryland v. Wynne*,[7] wherein the U.S. Supreme Court held that Maryland violated the dormant commerce clause by not allowing a credit against Maryland's county income taxes for income taxes paid to other states.


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While *CSX*'s focus was on the application of West Virginia's use tax credit to motor fuel purchases,[8] its precedential effect is perhaps more relevant in the context of the credit against purchases of all types of tangible personal property, custom software, and services that are taxable under West Virginia's broad-based consumer sales and use tax. Further, West Virginia's approach to granting credits or entering into reciprocal agreements for personal income tax purposes paid to other states arguably violates the dormant commerce clause.

### Sales and Use Tax Credits

The statutory use tax credit that was analyzed in *CSX* applies to all tangible personal property, custom software, and services that are used in West Virginia when sales tax was initially paid to another state. Under the statute, the amount of credit allowed may not exceed the amount of tax imposed on the use of the property in West Virginia.[9] *CSX* potentially exposes West Virginia to sales and use tax refund claims for other tangible personal property and services that were purchased elsewhere and later brought into West Virginia. However, because of various exemptions available under the West Virginia Code, it is unlikely that the decision will result in an influx of amended returns to claim credits for sales and use tax paid to localities in other states.

One exemption that is likely to reduce the impact of *CSX* is for tangible personal property, custom software, or services purchased outside West Virginia for use outside the state by a business or nonresident person who later brings the property or software into West Virginia in connection with establishing a permanent residence or business in the state.[10] This exemption only applies if the property was purchased more than six months before the date it was first brought into West Virginia, or six months before the establishment of the residence or business, whichever occurs first. Thus, for residents or businesses that move to West Virginia permanently, there is only a six-month window for taxability. Also, any credit claim would arise only after the taxpayer filed a use tax return with the tax department, which, presumably, is rarely done in these circumstances.


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Also, not all sales of tangible personal property, custom software, or services are taxable in the state[11] One exemption available to many West Virginia businesses is the direct use exemption. This exemption is a refundable exemption available for sales of services, machinery, supplies, and materials that are directly used or consumed in the activities of manufacturing; transportation; transmission; communication; production of natural resources; gas storage; the generation, production, or sale of electric power; the provision of a public utility service; or the operation of a utility business.[12]

However, the direct use exemption is not applicable to purchases of gasoline or special fuel. Otherwise, *CSX* could have relied on this exemption as a transportation company, and the applicability of the use tax credit for sales taxes paid to other states and localities in other states would have been moot.

The direct use exemption has typically been broadly applied by the tax department, and the exemption applies to a large swath of industries. Most businesses that may bring tangible personal property into West Virginia would be able to claim this exemption, negating any need to apply the use tax credit for sales taxes paid in other states or their local jurisdictions.

### Income Tax: Credits and Reciprocal Agreements

West Virginia residents, estates, and trusts are allowed a credit against personal income tax for any tax imposed by another state for income derived from sources in the other state, which is also subject to West Virginia personal income tax[13] Through regulation, the tax department allows no credit for personal income taxes imposed by a county, municipality, borough, township, or any other political subdivision of another state.[14]

West Virginia has reciprocal agreements with its surrounding states of Kentucky, Maryland, Ohio, Pennsylvania, and Virginia, and no credit is allowed against a West Virginia resident's personal income tax for taxes levied by those jurisdictions if the tax is based on wage, salary, or unemployment compensation income.[15] Rather, for West Virginia residents to receive a refund for taxes withheld by Kentucky, Maryland, and Ohio, a return must be filed in the state


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where withholding occurred. For Pennsylvania and Virginia, the same procedure applies if the West Virginia resident spent 183 or fewer days working in those states.[16] If the West Virginia resident spent more than 183 days working in Pennsylvania or Virginia, that person is considered a resident of those states and is entitled to the credit on his West Virginia return.[17] West Virginia's personal income tax booklet lists 36 states and the District of Columbia for which the credit may be claimed by West Virginia residents for income tax paid to those jurisdictions. Nonresidents are not entitled to claim the credit under any circumstances, and part-year residents may only claim the credit for taxes paid to another state during their period of West Virginia residency.

It is unclear whether West Virginia's use of credits and reciprocal agreements with surrounding states for personal income tax purposes runs afoul of either *Wynne* or *CSX*. *Wynne* was based on Maryland's refusal to allow a credit against county taxes imposed in Maryland for personal income taxes paid in other states. West Virginia, unlike Maryland, does not impose city, county, or other municipal income taxes; thus, *Wynne* is distinguishable. *CSX*, while based on sales and use taxes, is perhaps a better case for analyzing West Virginia's method for granting personal income tax credits. As was the case for the sales and use tax paid to other states, in *CSX* the tax department allows a dollar-for-dollar credit (up to the amount of West Virginia tax) for personal income tax paid to other states. As in *CSX*, West Virginia does not allow for a credit for personal income taxes imposed by a political subdivision of another state. In fact, while sales and use tax statutes and regulations are silent on this point, West Virginia includes this limitation in its legislative regulation for personal income taxes. As noted by the court in *CSX*, "Disallowance of the sales tax credit for sales taxes imposed by the subdivisions of other states would produce a 'total tax burden on interstate commerce [that] is higher' than a purely intrastate transaction."[18]

I am aware of no direct challenges to West Virginia's personal income tax structure regarding denial of a credit for income taxes imposed by cities, counties, or other municipalities in other states, but the decisions in *CSX* and *Wynne* could potentially lead to refund claims being filed.


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[1] *Matkovich v. CSX Transportation Inc.*, 793 S.E.2d 888 (W. Va. 2016). *Certiorari denied by Stenger v. CSX*, Docket No. 16-1251, (U.S. Sup. Ct. 2017).

[2] W. Va. Code section 11-15A-10a(a). See also W. Va. Code R. section 110-15-43 and West Virginia State Taxability Matrix (Aug. 1, 2017).

[3] *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

[4] *See generally Arizona Department of Revenue v. Arizona Public Service Co.*, 934 P.2d 796 (Ariz. Ct. App. 1997); and *General Motors Corp. v. City & County of Denver*, 990 P.2d 59 (Colo. 1999) (*en banc* ).

[5] Citing *Comptroller of Maryland v. Wynne*, 135 S. Ct. 1787 (2015).

[6] Citing *Oklahoma Tax Commission v. Jefferson Lines Inc.*, 514 U.S. 175 (1995).

[7] *Wynne*, 135 S. Ct. at 1787.

[8] *CSX* only sought refunds for sales tax paid to localities in Alabama and Georgia, because many states where *CSX* purchases its motor fuel, and localities in those states, do not impose a sales tax on motor fuel.

[9] W. Va. Code section 11-15A-10a(a).

[10] 10W. Va. Code section 11-15A-3a.

[11] W. Va. Code section 1l-15A-3(a)(2), (4).

[12] W. Va. Code section 11-15-9(b)(2). *See also* W. Va. Code section 11-15-2(b)(4); W. Va. Code R. section 110-15-2.27; W. Va. Code R. section 110-15-23; and West Virginia State Tax Department, TSD Publication 358 (revised July 2008). Taxpayers in the listed industries may also apply for a direct pay permit, Form CST-250, in


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lieu of paying the tax and seek a refund.

[13] W. Va. Code section 11-21-20(a).

[14] W. Va. Code R. section 110-21-20.1.

[15] W. Va. Code R. 110-21-20.3.

[16] Alternatively, a West Virginia resident working in a reciprocal state may provide her employer with a statement of residency in a reciprocal state and request that no income tax withholding occur for a reciprocal state in which the employee receives salary or wages.

[17] The West Virginia Code does not address municipal or county income taxes regarding reciprocal agreement states. All of West Virginia's surrounding states, except for Virginia, impose local-level income taxes.

[18] Citing *Wynne*, 135 S. Ct. at 1787.

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