

No. 031725

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

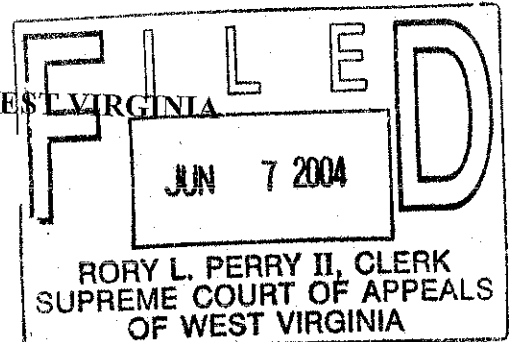
PRITCHARD MINING COMPANY,

Petitioner,

v.

RONALD C. STONE,  
State Tax Commissioner,

Respondent.



TAX COMMISSIONER'S BRIEF

REBECCA MELTON CRAIG,  
STATE TAX COMMISSIONER OF  
THE STATE OF WEST VIRGINIA

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No. 31725

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PRITCHARD MINING COMPANY, INC.,

Appellant,

v.

RONALD C. STONE,  
State Tax Commissioner,

Appellee.

**TAX COMMISSIONER'S BRIEF**

Rebecca Melton Craig, State Tax Commissioner of the State of West Virginia ("Tax Commissioner") and successor in that position to Ronald C. Stone, files this brief in response to the brief previously filed by Pritchard Mining Company, Inc. ("Taxpayer").

**KIND OF PROCEEDING AND NATURE OF THE RULING BELOW**

This case began as Taxpayer's appeal from an assessment of severance tax. The Tax Commissioner's Office of Hearings and Appeals upheld the assessment, and Taxpayer appealed to the Circuit Court of Kanawha County pursuant to W. Va. Code § 11-10-10. The Circuit Court of Kanawha County (Judge King) affirmed the Tax Commissioner's administrative decision on 15 July 2003, and Taxpayer has brought this appeal from that Order of the Circuit Court.

## FACTS

The severance tax assessment at issue in this case involves the period from 1 January 1996 through 31 December 1998, during which Taxpayer mined coal in Kanawha County, West Virginia. Tr. 4-5, 39. Taxpayer pays an independent trucking company to transport the coal it mines either directly to a customer or to a docking facility on the Kanawha River where it would be loaded onto a barge for transport to the customer. Tr. 41, 53, 61-63. The most common destination for Taxpayer's coal during the years at issue was a facility owned by the Coalburg Corporation at Coalburg, West Virginia. Tr. 53, 55. Taxpayer's sole shareholder owns fifty percent of the Coalburg Corporation, and the other fifty percent is owned by employees of Taxpayer. Tr. 53, 87.

As recognized by Taxpayer, the sole remaining issue in this case is whether Taxpayer may calculate the gross value of the coal it severs by deducting trucking and tipping fees paid with regard to 642,862 tons of coal that were transported by truck to a loading facility where it was loaded aboard a barge where the customer took title to it.

## ARGUMENT

### STATUTES AND REGULATIONS

The coal severance tax at issue in this case is set forth in W. Va. Code § 11-13A-3, the relevant portion of which provides:

(a) *Imposition of tax.* – Upon every person exercising the privilege of engaging or continuing within this state in the business of severing, extracting, reducing to possession and producing for sale, profit or commercial use coal, . . . there is hereby levied and shall be collected from every person exercising such privilege an annual privilege tax.

(b) *Rate and measure of tax.* – The tax imposed in subsection (a) of this section shall be five percent of the gross value of the natural resource produced . . .

as shown by the gross income derived from the sale or furnishing thereof by the producer . . . .

Certain treatment processes are statutorily considered part of production, as set forth in W.

Va. Code § 11-13A-4, the relevant portion of which provides:

(a) *Treatment processes considered as mining.* – The following treatment processes (and the treatment processes necessary or incident thereto) when applied by the mine owner or operator to natural resources mined in this state shall be considered as mining and part of the privilege taxed under this article.

(1) *Coal.* – In the case of coal: Cleaning, breaking, sizing, dust allaying, treating to prevent freezing and loading for shipment. [Emphasis added]

\* \* \*

(5) *Other.* – Any other treatment process provided for in a legislative rule prescribed by the tax commissioner which, with respect to the particular ore or mineral, is not inconsistent with the preceding subdivisions of this subsection (a).

(b) *Treatment processes not considered as mining.* – Unless such processes are otherwise provided for in subsection (a), or are necessary or incidental to processes provided for in subsection (a), 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.

The legislative regulations referenced in W. Va. Code § 11-13A-4(a)(5) are included in

Series 13A of Title 110 of the Code of State Regulations, relevant portions of which provide:

2.7. **Gross Value.** – The term “gross value” in the case of natural resources means the market value of the natural resource product, in the immediate vicinity, where severed, determined after application of post production processing generally applied by the industry to obtain commercially marketable or usable natural resource products. The value of natural resource products produced shall be determined by the gross proceeds of sales in every instance in which a *bona fide* sale of such products is made at the point where production ends, and whether sold at wholesale or retail. In determining the value of natural resource products delivered to purchasers there may be deducted from gross proceeds of sales so much thereof as the taxpayer can prove to be actual outgoing freight charges (paid by him) from the point at which shipment originates in this State to the point of delivery. However, no deduction is permitted for expenses incurred by him through the use of his own equipment in transporting items produced. No deduction is permitted for expenses incurred to transport items from the point of severance to the processing plant (or

loading facilities), when treatment processes are considered part of the production or mining taxable as such pursuant to W. Va. Code § 11-13A-4. Further, no deduction will be allowed for sales commissions, royalties, or other costs, expenses or fees incurred by a producer and ultimately paid to third parties. For a discussion of “gross value” see Section 3 of these regulations. [Emphasis added]

\* \* \*

**4.1. Treatment Processes Constituting Mining.** – The following treatment processes listed in Subsections 4.1.1 through 4.1.4 (and the treatment processes necessary or incidental thereto) when applied by the mine owner or operator to natural resources mined in this State shall be considered as mining and part of the privilege taxed.:

**4.1.1. Coal.** – In the case of coal, the term “production of coal” shall include all activities and values arising from the severance or extraction of coal and/or the ordinary processing activities including crushing, working, cleaning, drying, sorting, sizing, dust allaying, loading for shipment and freeze treatment. When any of the activities are performed, the value added to the coal shall be considered gross value attributable to the owner of the coal taxable under the severance tax. [Emphasis added]

110 C.S.R. 13A, §§ 2.7, 4.1, 4.1.1.

#### TAXPAYER CANNOT DEDUCT THE EXPENSE OF TRANSPORTING ITS COAL TO ITSELF.

This case involves certain deductions claimed by Taxpayer in calculating its severance tax liability. Deductions are matters of legislative grace, and must be strictly construed against the person claiming them. INDOPCO, Inc. v. Commissioner of Internal Revenue, 503 U.S. 79, 84, 112 S. Ct. 1039, 1043, 117 L.Ed.2d 226 (1992).

Taxpayer argues that trucking and tipping fees it pays to get its coal from the mine into the barges should be deducted when calculating the “gross value” to which the severance tax applies. The applicable statutes and regulations do not support Taxpayer’s position.

The provisions of W. Va. Code § 11-13A-4 clearly identify “loading for shipment” as a process to be included in the base of the severance tax. “Loading for shipment” is exactly what occurs at the Coalburg facility, where title to the coal changes hands when it is loaded into the

barges. The applicable regulations expressly provide that “[n]o deduction is permitted for expenses incurred to transport items from the point of severance to the processing plant (or loading facilities), when treatment processes are considered part of the production or mining taxable as such pursuant to W. Va. Code § 11-13A-4.” 110 C.S.R. 13A, § 2.7 (emphasis added). In this case, the transport charges Taxpayer seeks to deduct are “expenses incurred to transport items from the point of severance to . . . loading facilities”, and thus are not deductible pursuant to the clear language of the regulation. The tipping fee Taxpayer seeks to deduct is nothing more than a fee charged to load the coal for shipment, and “loading for shipment” is clearly identified as a process subject to the tax.

Taxpayer’s reliance on Administrative Decision 91-500 SV is misplaced. The transportation at issue in Administrative Decision 91-500 SV was from the taxpayer’s processing facility to an unrelated coal loading facility, where it was delivered to the customer. In this case, the loading facility the coal is delivered to (Coalburg) is related to Taxpayer, in that Taxpayer’s sole shareholder owns half of the Coalburg facility and the other half is owned by two employees of Taxpayer. Tr. 87. Thus, the loading facility and Taxpayer are related parties,<sup>1</sup> in contrast to the facts in Administrative Decision 91-500 SV. The loading done by Coalburg is legitimately considered as loading done by Taxpayer itself, and the statutes and regulations both specifically identify “loading for shipment” as a treatment process equivalent to mining and subject to the severance tax. W. Va. Code § 11-13A-4(a)(1), 110 C.S.R. 13A, § 4.1.1.

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<sup>1</sup>The term “related parties” is statutorily defined as:  
... two or more persons, organizations or businesses owned or controlled directly or indirectly by the same interests. . . . In the case of related parties, the tax commissioner may apportion or allocate the receipts between or among such persons, organizations or businesses if he determines that such apportionment or allocation is necessary to more clearly reflect gross value.  
W. Va. Code § 11-13A-2(c)(10).

Nor does Publication TSD-210 support Taxpayer's argument, inasmuch as it states:

Freight expenses related to the transporting of coal from a mine to a processing area are not deductible. Only outgoing freight charges incurred in shipping coal to a customer are exempt. [Emphasis added]

The transportation fees Taxpayer seeks to deduct in this case were incurred to transport the coal to a related loading facility, rather than to a customer, and thus are not deductible. Essentially, when Taxpayer pays a trucking company to haul the coal to the Coalburg dock, it is paying to transport the coal to itself, rather than to a customer. Transporting goods to oneself does not constitute "freight expenses".

#### THE CIRCUIT COURT'S DECISION IS NOT INCONSISTENT WITH CONSTITUTIONAL REQUIREMENTS.

Taxpayer argues that the Tax Commissioner's application of the severance taxes violates the Commerce Clause and the Import-Export Clause of the United States Constitution. This argument is based on the faulty premise that the Tax Commissioner's interpretation requires that the severance taxes are imposed on the coal after it has entered the stream of commerce. This premise is itself based on the faulty premise that the stream of commerce starts when the coal is loaded into the trucks that take it to the loading facility, rather than when it is loaded onto barges and the title transfers to the customer.

First, the transport of the coal from the mine to the related loading facility, inasmuch as it is merely Taxpayer transporting the coal to itself, is not the stream of commerce any more than if the means of transport was by conveyor belt. Second, the United States Supreme Court has already considered the constitutionality of a coal severance tax and found that the coal does not enter the

stream of commerce until it is loaded for shipment. Commonwealth Edison Company v. Montana, 453 U.S. 609, 101 S. Ct. 2946, 69 L.Ed.2d 884 (1981). Again, Taxpayer would have the point where the coal is "loaded for shipment" being the loading of the coal into the trucks that take it to the related loading facility; but the Tax Commissioner has held, and the Circuit Court affirmed, that "loading for shipment" does not occur until the coal is loaded into the barges.

#### THE TAX COMMISSIONER'S POSITION IS CONSISTENT WITH OTHER CASES.

Taxpayer argues that the Tax Commissioner's position in this case is inconsistent with the position the Tax Commissioner has taken in several cases involving challenges to the severance taxes based on the Import-Export Clause of the United States Constitution. In those cases, which the Tax Commissioner expects will soon be before this Court on appeal,<sup>2</sup> the loading for shipment occurred when the coal was loaded into rail cars and title passed. As in this case, any transportation to get the coal to that point was included in the severance tax base. The key difference in this case is that the transportation Taxpayer seeks to deduct is transportation to itself, and therefore prior to the coal being loaded for shipment to a customer.

#### CONCLUSION

Taxpayer is attempting to deduct costs of transportation incurred in getting the coal to the place where shipment takes place. This transportation to itself is fundamentally different from the sort of transportation contemplated by statutes and regulations, which allows a deduction for freight

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<sup>2</sup>By an Order entered 27 May 2004 in the case of U. S. Steel Mining Company, et al. v. Craig, Civil Action No. 03-AA-74 (Kanawha County), Judge Kaufman upheld the severance taxes against a claim that they violate the Import-Export Clause as applied to exported coal.

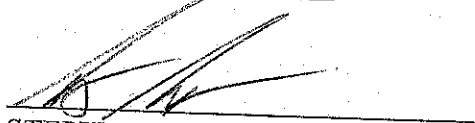
charges incurred in shipping coal to a customer. The decision of the Circuit Court, affirming the assessment, should be upheld.

Respectfully submitted,

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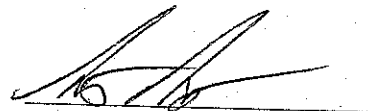
RONALD C. STONE,  
State Tax Commissioner,

Respondent.

CERTIFICATE OF SERVICE

I, Stephen Stockton, Senior Assistant Attorney General, do hereby certify that a true and exact copy of the foregoing "*Tax Commissioner's Brief*" was served by depositing the same, postage prepaid, via United States Mail, this 7th day of June, 2004 to the following:

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