

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

CHARLESTON

No. 03-2705

PRITCHARD MINING COMPANY, INC.,

Petitioner,

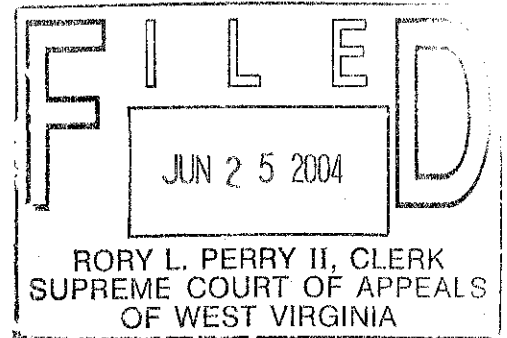
v.

**RONALD C. STONE,
State Tax Commissioner,**

Respondent.

**FROM THE CIRCUIT COURT OF KANAWHA COUNTY,
WEST VIRGINIA**

REPLY BRIEF OF PRITCHARD MINING COMPANY, INC.



Respectfully submitted

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PRITCHARD MINING COMPANY, INC.

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REPLY BRIEF OF PRITCHARD MINING COMPANY, INC.

The issue before the Court is where is the value of coal measured for severance tax purposes. The Respondent's Brief appears to be designed to obfuscate, rather than clarify this issue. *W. Va. Code* § 11-13A-2(c)(6), plainly states that: "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" (emphasis added). In this case, the value of Petitioner's coal should have been determined at the mine after all ordinary processing required to produce a commercially marketable product was complete, after the coal was loaded for shipment, but before transportation commenced.

I. Respondent Fails to Discuss Prior West Virginia Supreme Court Decisions Addressing the Valuation Issue.

As set forth in detail in Petitioner's initial Brief, West Virginia has imposed a severance tax on production of natural resources in the state since 1921. The West Virginia Supreme Court of Appeals, on three occasions, has specifically addressed the issue of where coal is valued for production tax purposes. In *Hope Natural Gas Co. v. Hall*, 102 W.Va. 272, 135 S.E. 582 (1926), the Court held that in enacting the West Virginia B&O tax: "the Legislature did not mean to include, as an element of value, so much of the gross proceeds of a sale of an article in interstate commerce as is represented by the cost of transportation and we restrain the operation of the statute accordingly".

Twenty-five years later, when the Tax Commissioner attempted to expand the scope of the B&O tax, the Court again addressed the issue of where natural resources are valued in *Soto v. Hope Natural Gas Co.* 142 W.Va. 373, 95 S.E.2d 769 (1953). In *Soto*, the Court stated:

In *Hope Natural Gas Co. v. Hall*, this Court held that the measure of the tax on gas sold in interstate commerce was the value of the product "within this state", and the Supreme Court of the United States found that the tax "must be computed on the value of the gas at the well, and not otherwise". In view of that construction as to gas sold by producers in interstate commerce, we find that it was the intention of the legislature to impose a tax upon the privilege "of producing gas, and that the tax upon all gas produced, whether sold in interstate or interstate commerce is to be measured by the value at the well, the place where production ends".

Most recently, the Court addressed the issue of where the production privilege ends, in *Gilbert Imported Hardwoods v. Dailey* 167 W.Va. 587, 280 S.E.2d 260 (1981). In *Gilbert Hardwoods* the Court held that the production of coal, for purposes of *W. Va. Code*

§ 11-13-2a (1971), ends when the coal reduced to possession on the surface. These cases stand on four squares opposed Respondent's position in the instant case, yet none were addressed in Respondent's Brief.

II. The Term "Loading for Shipment" Encompasses Only the Activity of Initially Loading Coal into Vessels at the Place Where Production Ends. It Does Not Include the Activity of Transferring the Coal from Trucks to Barges after the Coal's Journey to Market Has Begun.

In its Brief, Respondent correctly points out that "loading for shipment", as that term is used in *W. Va. Code* § 11-13A-4(a)(1), is a process included in the base of the severance tax. However, Respondent then erroneously asserts that the activity of transferring coal from trucks into barges during the course of its journey to market constitutes loading for shipment.

The intention of the Legislature in including "loading for shipment" as part of the treatment processes enumerated in *W. Va. Code* § 11-13A-4(a)(1) was to set the point at which the coal is valued for severance tax purposes, after all ordinary processing required to produce a commercially marketable product are complete but before the start of transportation. The use of the prepositional phrase "for shipment" as part of the term "loading for shipment" limits the loading activity considered part of processing, to coal that has not yet begun its journey to market. Once the coal has started its journey it can never again be "loaded for shipment". In the present case, the coal was loaded for shipment is when it was loaded into trucks at Petitioner's mine. After that point, the fact that the coal changed vessels during the course of its delivery did not constitute "loading for shipment", but merely loading, or to be more precise, changing modality of transportation during shipment.

Respondent fails to acknowledge that all loading does not constitute loading for shipment and, more fundamentally, that the Severance Tax Code and prior decisions of the West Virginia Supreme Court of Appeals require that coal be valued in the immediate vicinity where it is severed before transportation begins.

Respondent asserts that W. Va. Leg. Reg. § 110-13A-2.7, (which provides in part: "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.") supports its argument that the cost of transportation to a facility where the coal changes vessels is not deductible. The specific language of the regulation makes it clear that it only applies where the coal is being hauled to a facility where treatment processes are performed.

To the extent that this regulation contradicts prior decisions of this Court and the severance tax statute itself, it is invalid. However, the Court is not required to invalidate the regulation in order to find in favor of Petitioner in this matter. By simply interpreting the term "loading for shipment" as including only the initial loading of the natural resource product into a vessel for delivery to customer after post-production processing is complete, the regulation is in complete accord with the statute.

III. The Fact That Coal Was Transferred from Truck to Barge by a Separate Corporation, Owned Partly by Petitioner's Owner Does Not Change the Fact That Transportation to Market Originated at the Mine.

Respondent attempts to further muddy the waters by proffering the purely semantic argument that the coal at issue was not being shipped to taxpayer's customers because

Petitioner was delivering the coal to itself. According to Respondent's theory, because the coal was transferred from trucks to barges at the Coalburg Dock, a separate corporation owned fifty percent by the shareholder of Petitioner, the coal had not yet begun its journey to market. This theory clearly ignores the reality of the transaction, which is that production and processing were complete at the mine and that transportation began when the coal was loaded for shipment into the independent hauler's trucks. It is interesting that neither the Office of Hearings and Appeals nor the Circuit Court below attached any relevance to the fact that the Coalburg Dock was partially owned by Petitioner's shareholder.

The first problem with Respondent's reasoning is that it is asking the Court to ignore the separate legal existences of Petitioner and Coalburg Dock. The Supreme Court has never accepted this type of reasoning. Just two years ago, the Court rejected an attempt by CB&T Operations Company, Inc. and CB&T Financial Corp. to avoid the sales tax on transactions between a parent and its wholly owned subsidiary by asserting that the related party transactions be ignored. In finding for the Tax Commissioner in that case the Supreme Court held that the parties to the transactions were each established as separate legal entities and the Appellants will not be permitted to disregard their chosen corporate structures merely to suit the occasion. *CB&T Operations Company, Inc. and CB&T Financial Corp. v. Tax Commissioner*, 564 S.E.2d 408 (W.Va. 2002).

Similarly, in *Southern States Cooperative, Inc. v. Dailey*, 167 W.Va. 920, 280 S.E.2d 821 (1981), this Court rejected the argument by Southern States Cooperative, Inc., that it should not be subject to the West Virginia Business and Occupation Tax on sales made at cost to its local affiliates. In *Southern States*, the Court ruled that Southern States and its local cooperatives are separate legal entities and fall individually into categories of businesses

defined as persons for business and occupation tax purposes and that consequently such entities are separately and individually subject to the B&O Tax. The facts in the instant case are identical to the facts in *CB&T* and the *Southern States* cases with the exception that in the present case, it is the Tax Commissioner asking the Court to ignore the separate existence of Petitioner and Coalburg Dock. The Respondent cannot choose to recognize or disregard the separate existence of related corporation, based simply on whether it increases tax liability.

Second, even if the Court chose not to recognize the separate existence of Petitioner and the Coalburg Dock, that does not change the point where the value of the coal is measured in this case. Respondent cites Publication TSD-210 in support of the argument that the river dock constituted a loading facility owned by taxpayer. Contrary to Respondent's assertions, Publication TSD-210 makes it clear that unless processing activities such as cleaning, crushing, blending or screening take place at the river dock, that mere transfer of the coal from one vessel into another does not constitute post-production processing for severance tax purposes. With regard to the coal at issue, the dock was not a processing facility. When the coal left the mine, no further processing was required to produce a marketable product. The production privilege ended at the mine when the coal began its journey to market.

Finally, the Respondent's assertion that gross value in the present case should include transportation specifically because Petitioner's shareholder is a part owner of the Coalburg Dock, is troubling because for the second time in this case Respondent is proffering arguments to this Court which are inconsistent with the position the Tax Department is taking in other cases. Specifically, on May 5, 2004, the Respondent made a severance tax assessment against Kingston Resources, Inc., TIN # 61-1093577-002, for tax years 2001-2003 in the

approximate amount of \$65,000. A copy of the Kingston, Notice of Assessment is attached. The sole adjustment proposed by the Respondent in that audit is described in the audit workpapers as follows:

1. Deductions for transportation of coal to river docks and loaded into barges disallowed. Loading fees at docks were also disallowed.

Kingston Resources, Inc. produces coal from a deep mine located near Mossey, in Fayette County, West Virginia. The coal produced by Kingston is washed at a preparation plant located near the mine. The coal is loaded for shipment to Kingston's customers into trucks owned by independent, third party haulers. The coal is then transported fifteen to twenty miles to river loading facilities located on the Kanawha River, where for a fee, the coal is then transferred from trucks into barges to continue its journey to Kingston's customers. In that case, the river docks are completely independent of Kingston, yet the Tax Department has disallowed transportation from the preparation plant to the river dock.

Respondent cannot, in the present case, assert that transportation should be taxed simply because Petitioner's shareholder owns fifty percent of the dock which transloaded the coal, when in other cases, transportation to unrelated river terminals is being taxed. Apparently, in practice, the Tax Department's position is that ownership of the river dock is irrelevant. This type of argument creates the same nonuniformity issue that the Respondent has created by imposing the severance tax on transportation in the present case, while arguing in the import/export clause refund cases that gross value for severance tax purposes is determined before transportation begins.

IV. Respondent Failed to Support its Assertion That a Severance Tax Which Measures the Value of Coal after Transportation Commences Is Consistent with Constitutional Requirements.

Respondent cites that *Commonwealth Edison Company v. Montana*, 453 US 609, 101 Sup. Ct. 2946, 69 L. Ed.2d 884 (1981) in support of its argument that coal does not enter the stream of commerce until after it has been transloaded at the Coalburg Dock. In fact, the *Commonwealth Edison* case supports Petitioner's position.

The severance tax at issue in *Commonwealth Edison* was determined based on the "contract sales price" of the coal. "Under *Mont. Code Ann. § 15-35-103* (1979), the "contract sales price" is defined as "the price of coal extracted and prepared for shipment, f.o.b. mine, excluding the amount charged by the seller to pay taxes paid on production..." (Emphasis added) 69 L.Ed.2d 891 fn1. In ruling in favor of the constitutionality of the severance tax, the United States Supreme Court stated that:

Montana may constitutionally raise general revenue by imposing a severance tax on coal mined in the state. The entire value of the coal, before transportation, originates in the state, and mining of the coal depletes the resource base and wealth of the state, thereby diminishing a future source of taxes and economic activity (Emphasis added).

Clearly the severance tax at issue in *Commonwealth Edison* was imposed "f.o.b. mine," prior to the commencement of any transportation. Petitioner's research has not revealed any case where the federal courts have sustained a state severance tax measured after the coal began its journey to market. Apparently neither has Respondent's. If the United States Supreme Court had the present case before it, where the Respondent is attempting to impose the tax on value added by transportation, the result would likely have been different. Petitioner asserts that the *Commonwealth Edison* case supports the argument that the West Virginia

severance tax is constitutional, provided: that, it is imposed prior to the time transportation commences.

V. In the Present Case, the Respondent Is Attempting to Expand the Scope of the Severance Tax to Include Transportation. Therefore, the law must Be Construed in Favor of Petitioner.

Finally, Respondent urges the Court to strictly construe the law against Petitioner because deductions are matters of Legislative grace and must be strictly construed against the person claiming them. Actually, this case is not an exemption case at all. Respondent is attempting to broaden the scope of the severance tax by taxing value added by transportation which has historically been exempt from the tax. In such cases, the rules of statutory construction support construing the statute in a manner that is favorable to the taxpayer when there is doubt as to the meaning of such laws. *Coordinating Counsel for Independent Living, Inc. v. Palmer*, 209 W.Va. 274, 546 S.E.2d 454 (2001).

Prior to the present case, the severance tax statutes in this state have consistently been interpreted as valuing natural resources in the immediate vicinity where severed prior to transportation. Petitioner believes that to the extent that there is ambiguity in this interpretation that it should be resolved in its favor, absent legislation specifically manifesting an intent to subject transportation to tax.

VI. Conclusion

The value of coal for West Virginia Severance Tax purposes is required to be determined: 1) in the immediate vicinity where the coal is severed; 2) after all production processes required to obtain a commercially, marketable natural resource product have been completed; 3) after the coal has been loaded for shipment; and, 4) before it begins its journey to market. The value of coal which is transported to point distant from where production ends

prior to being sold is required to be determined by reducing the sale price by the cost of transportation incurred after the production privilege ended.

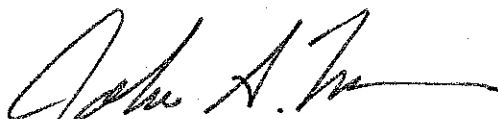
The Court below has held that Petitioner is not entitled to deduct the cost of transportation from the point where production ended to a distant point where the coal is transloaded from truck to barge. The ruling below is inconsistent with the language of the severance tax statute, the applicable regulations, and prior decisions of the West Virginia Supreme Court, all of which require that coal be valued for severance tax purposes prior to the commencement of transportation. The position asserted by the Respondent is also inconsistent with the positions the Respondent is actively asserting in current assessments and in various Import/Export Clause refund cases.

For the above stated reasons, Petitioner respectfully requests the West Virginia Supreme Court of Appeals reverse the Circuit Court below.

Respectfully Submitted,

PRITCHARD MINING COMPANY, INC.

By Counsel



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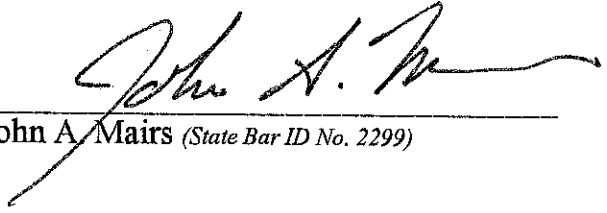
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CERTIFICATE OF SERVICE

I, John A. Mairs, do hereby certify that service of the attached *Reply Brief of Pritchard Mining Company, Inc.* was made upon the parties by forwarding a true and exact copy thereof in a properly stamped and addressed envelope deposited in the regular course of United States Mail this 24th day of June, 2004, to the individual listed below:

Steven Stockton
Senior Assistant Attorney General
Attorney General's Office
Tax and Revenue Division
Building 1, Room W-435
1900 Kanawha Boulevard, East
Charleston, WV 25303



John A. Mairs (State Bar ID No. 2299)

Notice of Assessment

I, Dan Taylor, Director of the Auditing Division, pursuant to the lawful authorization of the Tax Commissioner of the State of West Virginia, do hereby make the following assessment of tax, interest and additions to tax under the provisions of Article 10 and 13A, and 12B Chapter 11, Code of West Virginia of 1931, as amended, and do hereby certify that the assessment is based upon the best information available:

File No. : 611093577002

Audit Period : 1/1/2001 through 12/31/2003

Taxpayer : KINGSTON RESOURCES INC

Type of Tax : Severance Tax

Date : 03-May-04

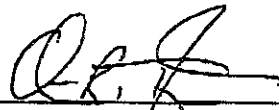
Tax Code : 92

Address : 400 PATTERSON LANE
CHARLESTON WV 25311

Year	Tax	Interest	Additions to Tax	Total Due
1/1/2001 to 12/31/2001	\$11,921	\$2,469	\$0	\$14,390
1/1/2002 to 12/31/2002	\$25,326	\$2,997	\$0	\$28,323
1/1/2003 to 12/31/2003	\$24,225	\$567	\$0	\$24,792
Totals	\$61,472	\$6,033	\$0	\$67,505

Interest will continue to accrue until date of payment.

Given under my hand this 5th day of May, 2004.



Director, Auditing Division

You are hereby served with notice that if you have any objections to this assessment of tax and interest, or to any part thereof, you must file a duly verified petition for reassessment within sixty (60) days from assessment. Administrative hearings, if necessary, are held in the Charleston, Wheeling, Clarksburg, and Martin West Virginia areas. If you have a preference for the location of your hearing, please indicate in your petition for reassessment. If you fail to file the aforesaid petition within the time prescribed by law, the assessment shall become conclusive and payable.

If you do not object to this assessment, please attach your remittance in the sum of \$67,505 within fifteen (15) days to the enclosed copy of the Assessment of Tax Liability and forward the same to this office. In accordance with W.Va. Code 11-10-17, interest will continue to accrue until the tax liability is satisfied. For your convenience, I have enclosed a self-addressed envelope.

File No. : 611093577002

Taxpayer: KINGSTON RESOURCES INC

Auditor: M Evans

Tax: SEV

Period: 01/01/01 - 12/31/01

Explanation of Items

Increasing Adjustments	(Decreasing Adjustments)	Description
\$1,192,096.00		TAXABLE INCOME (COAL SALES) INCREASED PER AUDIT DUE TO THE FOLLOWING FACTOR: 1. DEDUCTIONS FOR TRANSPORTATION OF COAL TO RIVER DOCKS AND LOADED INTO BARGES DISSALLOWED. LOADING FEES AT DOCK WERE ALSO DISALLOWED.

01/01/01 - 12/31/01