

Nos. 31725 and 31791

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

Pritchard Mining Company, Petitioner, Below,
Appellant

vs.) No. 31725

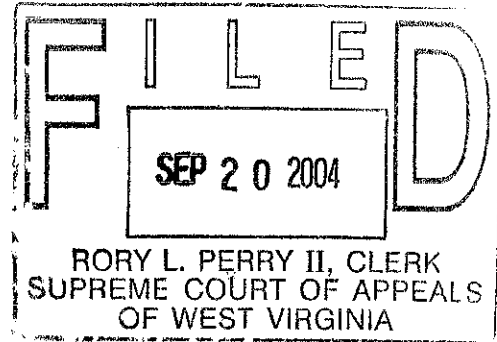
Ronald C. Stone, State Tax Commissioner,
Respondent Below, Appellee

AND

Kanawha Eagle Coal, LLC,
Plaintiff Below, Appellant

vs.) No. 31791

Tax Commissioner of the State of West
Virginia, Defendant Below, Appellee



FROM THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

REPLY BRIEF OF KANAWHA EAGLE COAL, LLC

Respectfully submitted,

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KANAWHA EAGLE COAL, LLC

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I. INTRODUCTION

The Tax Commissioner's Brief makes three main points. First, the Tax Commissioner contends it may disregard precedent establishing the standard used for valuing coal (in the immediate vicinity where severed) for West Virginia natural resource production tax purposes in formulating a new administrative policy outside a rulemaking proceeding. Second, the new policy formulated for purposes of these contested cases is: dumping coal from a railcar into a barge at a remote river dock is considered a separate treatment process applied to coal, but only if there is common ownership among the coal producer and the river dock owner/operator. Third, the Tax Commissioner's failure to adhere to express due process protections for taxpayers does

not affect the Tax Commissioner's efforts to extend additional taxes through the new policy. The Petitioner urges this Court to reject the Tax Commissioner's *ad hoc* policy making in this case.

II. ARGUMENT

A. The "gross value" tax base.

The Tax Commissioner argues that costs paid to third parties to transport coal by truck or train to a remote river dock should be treated like an itemized "deduction," citing a federal income tax case to support its proposition that deductions are a matter of legislative grace to be strictly construed against a taxpayer. This argument supposes that the West Virginia Severance Tax is a gross sales tax and that post production transportation costs are deductions that *may* be allowed in some cases and disallowed in others. This is incorrect.

As discussed in detail in the Appellant's Brief, West Virginia's natural resource privilege taxation—since the 1920s—has been imposed on the *gross value* of natural resources produced in the State. At issue in this case is the point of valuation. Excluding post-production transportation costs from the Severance Tax base is *not* a deduction, but instead is recognition of the tax base—gross value. The Tax Commissioner cannot simply dismiss as "irrelevant" longstanding jurisprudence and tax administration practices *requiring exclusion of transportation costs* from the gross value of natural resources for West Virginia privilege tax purposes.

If this Court accepts the Tax Commissioner's new conception of the Severance Tax (as a gross sales tax against which narrowly construed deductions *may* be allowed as a matter of legislative grace), the State's fisc will suffer the consequences because so many *sales* of coal and other West Virginia-produced natural resources are closed outside West Virginia—in interstate or foreign commerce. The State of West Virginia simply cannot tax *sales* that are closed outside the State. The West Virginia Severance Tax (and its direct ancestor, the former State Business and Occupation Tax on natural resource producers) is *not* a gross sales tax.

B. Where production ends.

The Severance Tax is imposed upon persons for the privilege of producing natural resources within this State. In the case of coal, the privilege of production includes post-production processing activities, so the tax base includes value added at preparation plants and the like.

The Tax Commissioner argues, without any supporting authority, that “loading for shipment”¹ a second time—after third party shippers have already transported coal a considerable distance at considerable expense—extends the place at which production ends (and valuation is determined), *but only in some circumstances*. The Tax Commissioner now concedes that third-party costs incurred to transport coal to a West Virginia river dock at which coal is placed in barges is generally not included in the tax base. However, in this case, the Tax Commissioner argues that transportation costs are not excludable if the coal producer shares some common ownership with the river dock company at which coal changes its mode of transportation.² The *ad hoc* policy to draw this distinction is not supported by any statute or rule.

Indeed, West Virginia tax cases do not allow parties to simply ignore the existence of separate legal entities, even where the entities share overlapping ownership. *See CB&T*

¹ In this case, clean coal is first “loaded for shipment” on rail cars and trucks at the preparation plant. But the Tax Commissioner contends that the coal is again “loaded for shipment” at the river dock (simply by being dumped from the bottom of a rail car into a barge). Since title to the coal passes in the barge in this case, the second alleged “loading for shipment” at the river dock may be more accurately referred to as “delivery” to the customer, “re-loading” or (as the Tax Department’s counsel referred to it after hearing) “simply changing the mode of transportation.” In any event, the Tax Commissioner’s new theory in this case would equate the river dock activity to be a treatment process applied to coal in the immediate vicinity where severed.

² The Tax Commissioner states that the Appellant is “essentially” transporting coal “from one of its sites to another of its sites.” No it is not! A separate entity, Winifrede Dock, LLC, owns and operates (and pays its own debts, taxes and payroll respecting) the river dock as an independent business enterprise. Winifrede Dock, LLC also provides services to unrelated coal companies that compete with the Appellant. These two entities stand on their own for West Virginia Severance Tax purposes. Each is a separate “person” as defined in W.Va. Code § 11-13A-2(b)(9).

Operations Co. v. Tax Commissioner, 211 W.Va. 198, 564 S.E.2d 408 (2002).³ The Tax Commissioner's new policy that Kanawha Eagle Coal, LLC is "essentially" the same as Winifrede Dock, LLC has no support in the law or in the record. The Appellant requests that this Court reject the Tax Commissioner's attempt to disregard the existence of separate entities in this case.

C. Consequences of administrative delay.

Finally, the Tax Commissioner's Brief cites "important public policy" considerations for allowing this case to proceed despite its admitted failure to afford a taxpayer due process rights granted by the Legislature. The Tax Commissioner's Brief, however, ignores the context of the administrative proceeding and the significant tools that are available to the Tax Commissioner if and when the Tax Commissioner makes a mistake in cases like this one.

First, in this case, the Tax Commissioner issued a substantial assessment seeking additional tax against a taxpayer that timely submitted complete returns and remitted taxes to the State. The assessment is based upon an evolving new theory not asserted before these cases disallowing transportation costs for shipping clean coal to a river dock in some circumstances. Much of the assessment was issued against the *wrong taxpayer*. When the Appellant sought review through filing a timely petition that pointed out these problems, the Tax Commissioner simply failed to hold a hearing within the statutory deadline.

³ As recently reviewed by this Court in *Genesis, Inc. v. Tax Commissioner*, ___ W.Va. ___, 599 S.E.2d 689 (2004) (*per curiam*), the Tax Commissioner possesses limited authority to disregard values established among certain related parties for Severance Tax purposes. If a sufficient relationship exists, the Tax Commissioner can re-price a sale of coal among related parties to determine the arms' length gross value of coal. The purpose is to avoid a related party from buying coal from a producer at an artificially low price, depressing the true gross value. "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.*" 110 W.Va. C.S.R. § 13A-2.14 (emphasis added).

That is not what is occurring in this case. The Tax Commissioner here is not re-pricing a sale or making an allocation or apportionment of receipts. Instead, the Tax Commissioner is requiring the Appellant to include transportation costs paid to independent truckers and a railroad to artificially *inflate* gross value in the vicinity where severed, solely because the Appellant's owners also own an interest in a separate legal entity that owns and operates a river dock.

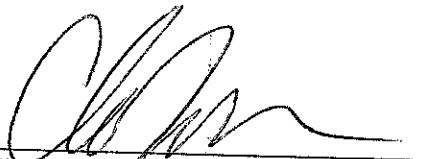
Second, the Tax Commissioner *could have* cured these errors by (1) withdrawing the flawed assessment for which no timely hearing was set and (2) issuing a supplemental or additional assessment (as expressly is provided for in W.Va. Code § 11-10-7(c) and (d)), thereby initiating a new administrative proceeding. This power provides a sufficient relief valve for the Tax Commissioner where it misses a deadline and assesses the wrong party.

Given the flexibility afforded the Tax Commissioner, the “important public policy” in this case is the fundamental due process right afforded to taxpayers to receive a prompt administrative review of the exercise of governmental powers after adequate notice. Ignoring the consequences of missing deadlines does *not* promote this policy.

III. CONCLUSION

Based upon the facts and arguments set forth herein and in the Appellant’s Initial Brief and the briefs filed on behalf of Pritchard Mining Company, Kanawha Eagle Coal, LLC requests that this Court reverse the circuit court’s order affirming the Tax Commissioner’s assessment.

Respectfully Submitted,
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CERTIFICATE OF SERVICE

I, Charles O. Lorensen, do hereby certify that service of the attached REPLY BRIEF OF KANAWHA EAGLE COAL, LLC was made upon the parties by hand delivering a true and exact copy thereof to the below address, on this 20th day of September, 2004 to the individual named below:

Steven Stockton, Esquire
Assistant Attorney General
West Virginia Attorney General's Office
West Virginia State Capitol Complex
1900 Kanawha Boulevard, East
Room W-435
Charleston, West Virginia 25305



Charles O. Lorensen