

**SANITIZED DEC. 03-610 SV – BY ROBERT W. KIEFER, JR. – SUBMITTED FOR
DECISION 05/16/05 – ISSUED 10/12/05**

SYNOPSIS

SEVERANCE TAX – DEDUCTIBILITY OF TRUCKING COSTS – For purposes of the severance tax, in determining the “gross value” of natural resources produced when the producer sells the natural resource products to a processor who is a *bona fide* purchaser, the producer of the natural resources is permitted to deduct the actual costs of transporting the natural resources to a processor’s place of business, so long as the transportation costs are incurred or absorbed, and actually paid, by the producer. W. Va. Code § 11-13A-2(c)(6); W. Va. Code St. R. § 110-13A-2; and W. Va. Code St. R. §§ 110-13A-4.7.3 & 4.7.6.

FINAL DECISION

A tax examiner with the Field Auditing Division of the West Virginia State Tax Commissioner’s Office conducted an audit of the books and records of the Petitioner. Thereafter, on August 27, 2003, the Director of the Division issued a severance tax assessment against the Petitioner. The assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 13A of the West Virginia Code. The assessment was for the period of January 1, 2000, through December 31, 2002, for tax and interest computed through September 30, 2003, for a total assessed tax liability. Written notice of this assessment was served on the Petitioner on September 3, 2003.

Thereafter, by mail postmarked October 15, 2003, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment.

Subsequently, notice of a hearing on the petition was sent to the Petitioner and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10 [2002].

FINDINGS OF FACT

1. The Petitioner is in the business of mining coal in the State of West Virginia., the Petitioner's president and sole shareholder, who represented the Petitioner at the evidentiary hearing in this matter, described the Petitioner as a "contract miner."

2. During the audit period, the Petitioner mined coal in the area. The Petitioner sold its coal to two customers, Company A and Company B.

3. The Petitioner used Company C to transport the coal it mined to its customers. Company C was the only company that the Petitioner used to transport the coal from its mine to its customers' locations. The Petitioner's witness testified that it chose Company C because that was who Company A used to transport its coal. He testified that Company C was not related to or otherwise affiliated with the Petitioner. He further testified that to the best of his knowledge and belief, expressed as reasonable certainty, Company C was neither owned by nor affiliated with Company B. He testified that he believed that Company C was an independent contractor.

4. The coal that the Petitioner sold to Company A was shipped to the Power Plant. Company A would pay Company C for the cost of transporting the coal to both the Power Plant and to Company B. Because Company A absorbed the cost of transporting the coal purchased by it, it paid the Petitioner less for the coal than it would have paid had the Petitioner absorbed the cost of transporting the coal.

5. The Petitioner also produced certain coal, which its witness referred to as "inferior quality coal." This inferior quality coal could not be sold to Company A for use in the Power Plant. Instead, the Petitioner sold this coal to Company B, pursuant to a verbal agreement. The coal sold to Company B was either delivered to Company Bs' tipple or to its railroad siding.

6. The Petitioner's witness testified that once the coal was dumped on the ground at Company Bs' tipple or railroad siding, the Petitioner had no control over how Company B used the coal or to whom Company B sold the coal.

7. The Petitioner was responsible for paying the cost of transporting the coal to Company B. Since the Petitioner was using Company C to transport its coal to the Power Plant, it determined that it would also use Company C to transport the coal that it sold to Company B.

8. The Petitioner did not present invoices from the third-party, Company C, which provided the trucking services.

9. With respect to the coal sold to Company B, Company A would pay Company C for the cost of transporting the coal to Company Bs' tipple or railroad siding. Company A would then deduct the cost of transporting the coal to Company B from the proceeds of coal that the Petitioner sold to Company A. The cost of transporting the coal to Company B was set out as a separate item on the statements issued by Company A to the Petitioner, memorializing the sale of coal by the Petitioner to Company A. Thus, the Petitioner absorbed the cost of transporting the coal to Company B.

10. Upon purchasing coal from the Petitioner, Company B either cleaned the coal for the purpose of selling the coal to its customers, or sold the coal directly to its customers.

11. The price paid by Company B to the Petitioner for the coal consisted of two components. The first component was a per-ton charge by Company B for cleaning the coal which was trucked to Company B. The second component was a per-ton payment by Company B for the coal after it was cleaned. The amount Company B paid the Petitioner in any given month was the second component (the price paid for clean coal) less the first component (the charge for cleaning the coal).

12. The State Tax Commissioner's auditor disallowed all costs for transporting the coal to Company B, which the Petitioner deducted from the gross proceeds from the sale of the coal.

13. For the year 2002, the Petitioner had a substantial drop-off in the amount of coal subject to the severance tax because the Petitioner mined less of its own coal and engaged in contract mining for either Company B or Company D.

14. Of the amount of severance tax assessed, the Petitioner does not dispute that it owes, which amount is the difference between the estimated severance tax reported for 2000, and the estimated severance tax that it remitted for 2000.

15. At the hearing, counsel for the State Tax Commissioner intimated, in general terms, that one of the principals of Company B should not be believed because of problems with his credibility. However, counsel for the State Tax Commissioner did not state or otherwise identify any specific facts to support his allegations.

16. Counsel for the State Tax Commissioner did not present any evidence to support his allegations respecting the credibility of one or more of Company Bs' principals.

17. The matters upon which counsel for the State Tax Commissioner attempts to challenge the credibility of one or more of Company Bs' principals are substantiated by the testimony of the Petitioner's witness, who was a credible witness, and by documents that were prepared by a third party, Company A, who does not appear to have any interest in the dealings between the Petitioner and Company B, or in the outcome of this matter.¹

¹ If Company A has any interest in the transactions between the Petitioner and Company B or the outcome of this matter, there is no evidence in the record to demonstrate this fact.

DISCUSSION

The first issue presented by this matter is whether the Petitioner is entitled to deduct the cost of trucking the coal from its mine to Company Bs' locations, or whether, as the State Tax Commissioner contends, those are amounts which may not be deducted. W. Va. Code § 11-13A-2(c)(6) provides, in relevant part:

(6) "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. For all natural resources, "gross value" is to be reported as follows:

(A) For natural resources severed or processed (or both severed and processed) and sold during a reporting period, gross value is the gross proceeds received or receivable by the taxpayer.

W. Va. Code St. R. § 110-13A-2 expands upon the statutory definition, by providing the following definition:

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 the 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.)

With respect to the deductibility of trucking costs by a producer of natural resources, such as the Petitioner, this rule is somewhat ambiguous, as the three emphasized sentences tend to be contradictory. The third emphasized sentence appears to prohibit the deduction of any expense incurred by a producer of coal, albeit in very general terms. The term “other costs, expenses or fees” would, in the absence of some indication to the contrary, include trucking costs. Thus, this sentence alone would prohibit the deduction trucking costs.

However, the first emphasized sentence contradicts the provisions of the third emphasized sentence, at least as it pertains to outgoing freight charges, including trucking costs. It expressly provides that a producer of coal is permitted to deduct actual, provable costs actually incurred by it for trucking coal from the point at which shipping originates to the point at which the coal is delivered to a purchaser. This sentence describes the Petitioner’s situation, indicating that it may deduct the costs incurred by it for trucking the coal from its mine to Company Bs’ tipple or railroad siding.

"The general rule of statutory construction requires that a specific statute be given precedence over a general statute relating to the same subject matter where the two cannot be reconciled." Syl. pt. 3, *Taylor-Hurley v. Mingo Co. Bd. of Ed.*, 209 W. Va. 780; 551 S.E.2d 702 (2001); and Syl. pt. 1, *UMWA by Trumka v. Kingdon*, 174 W. Va. 330, 325 S.E.2d 120 (1984). This rule of statutory construction also applies to legislative rules. In applying it to W. Va. Code St. R. § 110-13A-2.7, it must be concluded that the specific, permitting the deduction of actual, provable outgoing freight charges, prevails over the general, which prohibits the deduction of costs.

Also complicating the analysis respecting the deductibility of trucking expenses is the second emphasized sentence, the meaning of which is not absolutely clear. It seems clear that this sentence applies to a producer of a natural resource product that performs processing on its own product. If this sentence lacks clarity, it is in determining whether or not is intended to apply where the producer of a natural resource product sells the product to a purchaser, who then performs processing on the natural resource product. If this sentence is intended to apply to a purchaser who performs processing on the coal after its purchase, then this sentence is in apparent contradiction to the first emphasized sentence. Although it is not absolutely clear, it would seem logical that this sentence is intended to apply to a situation where a producer performs processing on its own natural resource products, not where it sells them to a purchaser. This is also consistent with the rule that requires specific language to prevail over general language in a statute.

Accordingly, W. Va. Code St. R. § 110-13A-2 appears to permit the deduction of trucking expenses when the natural resource products are sold to purchaser in a bona fide, arms length transaction.

It appears that W. Va. Code St. R. § 110-13A-4.6 provides further elucidation with respect to the deductibility of the costs of transporting natural resource products. However, W. Va. Code St. R. § 110-13A-4.6 is not relevant to the Petitioner, because it concerns the production or processing of natural resource products that are used or consumed the by producer or processor. W. Va. Code St. R. § 110-13A-4.6.1 is not germane, because it concerns the sale of natural resource products by the producer, where the proceeds of the sale do not reflect the true value of the natural resources.²

² In fact, W. Va. Code St. R. §§ 110-13A-4.6.1 appears to be misplaced under W. Va. Code St. R. § 110-13A-4.6, because it has nothing to do with the allowance of costs for transportation of natural resource products.

Of greater relevance are the provisions of W. Va. Code St. R. § 110-13A-4.7. In determining what constitutes the gross proceeds from the sales of natural resources, the provisions of W. Va. Code St. R. § 110-13A-4.7 are expressly applicable. They provide, in relevant part:

4.7. Treatment of Freight Charges Incurred by Producers. -- In certain instances, producers and processors of natural resource products are permitted to deduct freight charges from the gross proceeds of sale or value to arrive at taxable value under the severance tax.

4.7.1. In order to determine the value within the State and at the place where production or processing ends, there may be deducted from gross proceeds of sales certain outgoing freight charges actually incurred by the producer or processor, but no deduction will be allowed for expenses incurred by him through the use of his own equipment in transporting items produced except as provided in Sections 4.7.4, 4.7.6 and 4.7.7 of these regulations.

....

4.7.3. *Generally, in order to be deductible from gross proceeds of sales, freight charges must be incurred by or paid by the producer or processor for the delivery of natural resources to a bona fide purchaser.* To illustrate: Coal, at the place where production or processing ends, has a value or in the case of a processor a value added of ten dollars (\$10.00) per ton. If a purchaser buys the coal for said price, the producer or processor will report under the coal production classification the gross value or value added, \$10.00. However, if the purchaser buys the same coal delivered at eleven dollars (\$11.00) per ton, and the producer or processor pays a common carrier to make such delivery, the producer or processor may deduct such freight charges (\$1.00) from the gross proceeds of sale.

....

4.7.6. *If a producer sells natural resource products to a processor freight on board at the processor's facility and transportation charges are incurred by the producer or have been absorbed by the producer, such charges are deductible from the gross proceeds of the sale to arrive at the taxable value.* If the producer uses its own equipment in transporting the natural resource products to the processor's facility, it may deduct such transportation costs from the gross proceeds of sale in arriving at the taxable value for severance tax purposes, provided a fee is separately charged on the invoice or adequate cost records are maintained to document the transportation deduction.

4.7.7. If a producer sells natural resources products to a processor to be delivered at the producer's facility and transportation charges are incurred by the processor to its own facility, the processor may deduct such transportation charges from its gross proceeds of sale in arriving at the taxable value for severance tax purposes. If the processor purchases natural resource products from a producer and uses its own equipment in transporting the natural resource products to its facility, it may deduct such transportation costs from the gross proceeds of sales in arriving at the taxable value for severance tax purposes, provided adequate cost records are maintained to document the transportation deduction.

Subsection 4.7.3 and the first sentence of Subsection 4.7.6 each appear to be applicable to the factual situation presented by this matter. Subsection 4.7.3 permits trucking charges to be deducted where incurred by the producer for delivery to a *bona fide* purchaser. That is what occurred in this case.

W. Va. Code St. R. § 110-13A-4.7.6 uses the term “freight on board at the processor’s facility.” A search for the term “freight on board” yields no other case or statute in which that term is defined.³

The Uniform Commercial Code is codified in West Virginia in Chapter 46 of the Code. Article 2 of the Uniform Commercial Code uses the term “F.O.B.,” which means “free on board.” Cases from other jurisdictions indicate that the terms “freight on board” and “free on board” are used interchangeably. See *O’Quinn v. United States*, 24 Ct. Int’l Trade 324, 100 F. Supp. 1136 (2000); and *Government Technology Services, Inc. v. Optional Systems Resources, Inc.*, 2000 Del. Super. Lexis 505 (June 20, 2000). Accordingly, the term “freight on board,” as used in W. Va. Code St. R. § 110-13A-4.7.6, will be accorded the same meaning as the term “free on board” or “F.O.B.” is accorded by the Uniform Commercial Code.

Section 2-319 of the Uniform Commercial Code is codified in West Virginia at W. Va. Code § 46-2-319. That section provides, in relevant part:

³ The same legislative rule is cited in 01-187 SV, 2001 W. Va. Tax Lexis 103 (August 10, 2001). However, the meaning or proper use of the term is not discussed.

§ 46-2-319 F.O.B. and F.A.S. terms

(1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this article (section 2-504) [§ 46-2-504] and bear the expense and risk of putting them into the possession of the carrier; or

(b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this article (section 2-503) [§ 46-2-503];

W. Va. Code St. R. § 110-13A-4.7.6 is consistent with W. Va. Code § 46-2-319(1)(b) (F.O.B. place of destination), while W. Va. Code St. R. § 110-13A-4.7.7 is consistent with W. Va. Code § 46-2-319(1)(c) (F.O.B. place of shipment). If the contract between the parties was one that can reasonably be shown to be F.O.B. place of destination, then the trucking charges may be deducted by the Petitioner.

The contract between the Petitioner and Company B was verbal, not written. This being the case, there were no written provisions showing that the parties agreed that the coal was to be delivered F.O.B. at the Petitioner's place of business, or F.O.B. at Company Bs' place of business. Instead, the intent of the parties with respect to transportation of the coal from the Petitioner's mine to Company Bs' tipple and railroad siding must be determined by how they performed the contract.

The evidence in the record demonstrating how the parties performed the contract consists of the testimony and the documentary evidence respecting the charges paid to Company C for trucking the coal. The evidence shows that the coal was transported to Company B by Company C, a third party independent contractor. The cost of transportation was borne by the Petitioner, as testified that title passed when the coal was dumped on the ground at Company Bs' location.

Accordingly, the evidence is that the Petitioner bore any risk of loss during transportation. These factors indicate that the coal was sold to Company Bs', F.O.B. Company Bs' place of business. This is consistent with the provisions of 46-2-319(1)(b), and with W. Va. Code St. R. § 110-13A-4.7.6. Consequently, the Petitioner is entitled to deduct the costs of transporting the coal from the gross proceeds of the sales in computing gross proceeds for purposes of the severance tax.

Counsel for the State Tax Commissioner argued that if the costs of transportation are allowed in this matter, they would have to be allowed in every instance and that the State would never collect severance tax on transportation costs. There are two problems with this argument. First, the State Tax Commissioner presented no facts to support this argument. It is merely an unsubstantiated statement. He establishes no factual basis which would show that the legislative rules, as set forth above, do not apply to the Petitioner.

Second, the State Tax Commissioner presented no legal argument to demonstrate that the Petitioner is not legally entitled to deduct the costs of transportation under the facts and circumstances presented in this matter. As set forth above, the legislative rules permit the Petitioner to deduct the cost of transporting its coal to the processor. In light of the statute and the legislative rules, the State Tax Commissioner has the duty to point to some statute or legislative rule which would support his conclusion that these costs are not deductible.

A portion of the assessment was attributed to the fact that for the year 2000, the Petitioner reported that it made estimated severance tax payments, when it had actually made estimated payments. The Petitioner's witness admitted that this was an error on its part, and that it owed. Accordingly, the assessment must be affirmed.

CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that it is entitled to the refund. *See* W. Va. Code § 11-10A-10(e) [2002].
2. The Petitioner in this matter has carried its burden of showing that it was entitled to deduct the costs it incurred or absorbed trucking the coal from its mine to the tiple and railroad siding of Company B.
3. The Petitioner admitted that it paid less in estimated severance tax payments to the State Tax Commissioner than it claimed on its severance tax returns.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the tax assessment issued against the Petitioner for the period of January 1, 2000, through December 31, 2002, for tax and interest computed through September 30, 2003, for a total assessed tax liability, should be and is hereby **MODIFIED** in accordance with the above Conclusions of Law for **revised** tax plus interest on the revised tax.

Interest continues to accrue on this unpaid tax until this liability is fully paid.