SANITIZED DECS. – 03-556 FN, 03-557 SV, 03-558 U & 03-559 R – BY – GEORGE V. PIPER – CASE SUBMITTED ON BRIEFS – 5/5/04 – ISSUED – 6/4/04

SYNOPSIS

SEVERANCE TAX ON COAL -- GENERAL (3-YEAR) STATUTE OF LIMITATIONS ON ASSESSMENTS APPLICABLE DESPITE FILING OF NO-TAX-DUE RETURNS, UNDER CIRCUMSTANCES -- The State Tax Commissioner must issue an assessment of severance tax on coal within the general three-year period set forth in W. Va. Code § 11-10-15(a) [1986] in a matter in which the taxpayer's independent certified public accountant files for the taxpayer no-tax-due returns improperly but in good faith, in light of the findings of a prior severance tax audit that no tax was due and in light of the nature of the taxpayer's activities as a coal processor without extraction; under those circumstances the taxpayer did not intend to evade the tax, and the Commissioner may not issue the assessment at any time.

SEVERANCE TAX -- APPLICABILITY OF SPECIAL SEVERANCE TAX ON PRIVILEGE OF EXTRACTING GOB PILES -- Effective September 14, 2001, W. Va. Code § 11-13A-3e(d) provides for a lower tax rate on the recovering of material from refuse, gob piles, or from other sources of waste coal in this State, regardless of whether the person extracting same was also the owner of the gob pile prior to extraction.

SEVERANCE TAX -- BURDEN OF PROOF MET IN PART -- Revised tax liabilities may be further reduced upon a showing by the Petitioner that its cost of coal purchased and/or the proceeds from the sale of same should be revised in accordance with proper and conclusive documentation; however, when this tribunal finds that sufficient opportunity has been afforded the Petitioner to prove its case, the record will be closed, without allowing Petitioner to continually supplement the record post hearing.

SEVERANCE TAX -- BUSINESS FRANCHISE TAX -- PURCHASERS' USE TAX – NEGLIGENCE ADDITIONS TO TAX VACATED -- REASON(S) NOT STATED IN NOTICE OF ASSESSMENT AND WITH PARTICULARITY -- Because Tax Commissioner did not state with particularity in her notice of assessment the reason or reasons why she was imposing additions to tax for negligence, such additions must be vacated. W. Va. Code § 11-10-18(c) [1986].

FINAL DECISION
ON LEGAL ISSUES

The Director of the Field Auditing Division of the Commissioner's Office issued an estimated business franchise tax assessment against the Petitioner. This assessment was for the period of January 1, 1998 through December 31, 2002, for tax, interest through September 30, 2003, and additions to tax, for a total assessed liability.

Also, on August 13, 2003, the Commissioner issued an estimated severance tax assessment against the Petitioner, under the provisions of Chapter 11, Articles 10 and 13A of the West Virginia Code, for the period of January 1, 2000 through December 31, 2002, for tax, interest, through September 30, 2003, and additions to tax, for a total assessed liability.

Also, on August 13, 2003, the Commissioner issued an estimated purchasers' use tax assessment against the Petitioner under the provisions of Chapter 11, Articles 10 and 15 of the West Virginia Code, for the period of July 1, 2000 through June 30, 2003, for tax, interest, through September 30, 2003, and additions to tax, for a total assessed liability.

Also, on August 13, 2003, the Commissioner issued a business registration tax assessment against the Petitioner, under the provisions of Chapter 11, Articles 10 and 12 of the West Virginia Code for the period of July 1, 2001 through June 30, 2005, for tax, interest, and additions to tax, for a total assessed liability.

Written notice of these assessments was served on the Petitioner.

Thereafter, by mail postmarked September 16, 2003, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, petitions for reassessment. *See* W. Va. Code § 11-10A-8(1) [2002].

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

At the outset of the administrative hearing the parties agreed to the following:

1. The results of the recently conducted field audit as it pertained to the severance tax, business franchise tax, and purchasers' use tax assessments, would be controlling in lieu of the previously issued estimated assessments.

2. Concerning the business franchise tax and purchasers' use tax revisions, Petitioner's counsel agreed to the tax and interest portions thereof and requested only a waiver of the additions to tax.

3. Because Petitioner had very recently paid the tax portion of the business registration tax assessment, Commissioner's representative agreed to forego collection of the additions to tax portion thereof, thereby making that issue moot.

It should be noted that because the revised severance tax audit now included tax years 1998 and 1999 in addition to tax years 2000, 2001, and 2002, the administrative law judge ordered that the hearing be bifurcated so that the parties could present evidence first as to the 1998 and 1999 tax years and later as to the remaining tax years contained in the field audit.

FINDINGS OF FACT AND PROCEDURAL HISTORY

1. The Petitioner is a West Virginia corporation.

2. Petitioner's principal place of business is in West Virginia with an administrative location and an operations location, which are separately housed.

3. At the operations' location, Petitioner has a coal loading facility or tipple which is used to load coal onto railcars for delivery.

4. At the operations' location, Petitioner also has a coal cleaning facility which is used to process and wash class B coal and gob coal.

5. Petitioner's primary business activity is coal tippling services, which are provided to unrelated third party owners of coal.

6. Petitioner is also in the business of providing coal processing services to unrelated third party owners of coal.

7. The Petitioner does make acquisitions of class B coal and gob coal, which are then processed and sold by the Petitioner to others.

8. Petitioner's Manager is also the sole owner of another company.

9. Petitioner sells coal to his manager's other company without written contracts and brokers coal for his manager's other company in addition to brokering its own coal.

10. The issuance of the estimated assessments was necessitated by the failure and/or refusal of Petitioner's accountant and/or the Petitioner to make Petitioner's books and records available for audit beginning as far back as the year 2000.

11. The original hearing date was continued because an elected state government official urged the Tax Commissioner herself to request continuance of the same because the Petitioner's accountant suddenly was amenable to a detailed audit being conducted on November 4, 2003.

12. The results of the revised audit were contained in unsigned assessments and included additional tax years not reflected in the estimated assessments.

13. (a) The revised severance tax audit was for tax, interest, through December 31, 2003, and additions to tax, for a total liability; (b) the revised business franchise tax audit was for tax, interest, through December 2003, and additions to tax, for a total liability; (c) the revised purchasers' use tax audit was for tax, interest, through December 31, 2003, and additions to tax, for a total liability.

14. In conjunction with the filing of Petitioner's opening brief, it appended additional documentation in support of its claim that further adjustments to the severance tax audit needed to be made. Because Tax Commissioner's counsel had not responded directly to those particular documents, the administrative law judge ordered that the parties meet as soon as possible to review same and that the Tax Commissioner's counsel must respond in writing, as to whether he agreed or disagreed to each and if so in what amount(s); and that Petitioner's counsel could then reply to same in his final reply brief.

15. In Petitioner's reply brief its counsel took issue with the fact that opposing counsel, although requesting no further information concerning trucking expenses, continued to state that no such documentation exists, and that to counter same

Petitioner would shortly file a motion for leave to submit additional documentary evidence on this point.

16. This tribunal finds that it does not further the ends of justice to allow the parties, and in particular the Petitioner, to continue to supplement the record by producing facts and issues which should have been presented at hearing and, therefore, Petitioner's motion to reopen the record is denied.

DISCUSSION

The first issue is whether the Tax Commissioner is barred by the statute of limitations from issuing a revised severance tax calculation for a five (5)-year period (January 1, 1998 through December 31, 2002), in place of the earlier issued three (3)-year estimated assessment for severance taxes.

Tax Commissioner's counsel does not dispute the fact that severance tax returns were timely filed for 1998 and 1999; however, he argues that these returns showed no severance taxes due when the Petitioner knew, or should have known, that severance taxes were due and owing. He posits that this practice of filing no-tax-due returns for these two (2) years constitutes an intent to evade tax, thereby making inapplicable the three (3)-year statute of limitations in W. Va. Code § 11-10-15(a).

Petitioner's counsel argues that while it is true that the filed returns for 1998 and 1999 were, in hindsight, incorrect, his client was relying totally upon the expertise of his accountant whose job it was to prepare the returns and compute the

proper severance tax liability, if any. Further, the Petitioner had been the subject of an earlier severance tax audit, which found no severance tax due, leading Petitioner to believe that his accountant's preparation of the severance tax returns was correct.

To determine this issue, which appears to be one of first impression, it is important for this tribunal to look at the underlying facts which give rise to the revised tax figures.

Although Petitioner's counsel did not offer written proof that an earlier audit had produced a no-tax-due result, it is reasonable to assume that even an unenlightened tax return preparer would file a no-tax-due return, rather than no return at all, given the fact that the Petitioner had been previously audited and in light of the well known fact that failing to file can always be construed as noncompliance.

It is also significant that the Petitioner is primarily a coal tippler and coal processor, rather than a coal producer, which supports its good-faith belief at the time that its activities could not be construed to be coal production.

Accordingly, it is Determined that tax years 1998 and 1999 are indeed barred by the three-year statute of limitations set forth in W. Va. Code § 11-10-15(a), because there was no intent to evade the payment of taxes.

The second issue to be determined is whether the Petitioner has shown that the special severance tax imposed by W. Va. Code § 11-13A-3e on the privilege of extracting gob piles and other sources of waste coal, is applicable to the Petitioner after the effective date of the statute.

Effective September 14, 2001, W. Va. Code § 11-13A-3e(d) provides that the tax applied to all persons, "extracting and recovering material from refuse, gob piles or other sources of waste coal located in this state[.]" There is no requirement therein that the person also be the owner of the gob pile, but, rather, merely the one extracting and recovering material from the refuse or gob pile.

Accordingly, it is also Determined that Petitioner is entitled to employ the two and one-half percent (2½%) tax rate upon the gross value of the gob and waste coal produced and sold, instead of the higher five percent (5%) rate, but only for those periods subsequent to September 14, 2001.

The third issue to be determined is the matter of the tax adjustments which Petitioner is seeking for tax years 2000, 2001, and 2002.

Because Petitioner's counsel decided to follow the format and numbering sequence employed by the Tax Commissioner's counsel in his post-brief memorandum, this tribunal will also use same for purposes of clarity and uniformity.

ADJUSTMENTS FOR 2002

02-1, Duplication of advance payment for coal in both tax years 2001 and 2002 – This tribunal agrees that duplication has occurred in tax year 2002; however, amount of the other company's invoices, which Petitioner's manager is sole owner of, must all be included in tax year 2002.

02-2 through 02-6 – This tribunal finds that these particular tippling, trucking, and washing fees were misclassified as coal sales, as agreed to in the amounts set forth in the Tax Commissioner's post-brief memorandum.

02-7, Washing Fees Offset – In these series of invoices Petitioner was owed an amount for washing coal by a coal supplier and, rather than being paid that fee, it chose to offset the washing fee against the cost of coal being purchased, thereby issuing a check to the coal seller for the net amount, which in effect means that Petitioner was paid back with a portion of the coal which it had purchased.

In its brief, Petitioner's counsel has made a convincing argument that the severance tax audit did understate its coal costs for 2002 by not allowing the washing fees, which were neted out on the invoices and thus inadvertently reduced the true cost of the purchased coal on the Petitioner's general ledger. The assessment for that year will be so revised; however, Petitioner is now on notice that in the future it must utilize proper invoicing of such activities, rather than merely netting out everything on one invoice, which leads to confusion in auditing the true cost of its purchased coal.

02-8, Tippling Coal for Third Parties – Although this tribunal believes that the failure of the Petitioner and its related companies to employ written agreements in the conduct of their daily operations leaves many questions unanswered, Petitioner's counsel is correct in stating that the Tax Commissioner did not show in rebuttal why the amount paid by Petitioner's Manager's solely owned company for tippling was not at market, or why Petitioner's accounting for tippling coal for third parties, even if related, was improper. Further, because the tippling charges occurred after title

passed on the ground in the yard, the Pritchard Mining decision is not applicable. The assessment is revised accordingly.

02-9, Trucking expenses -

These numerous invoices directly pertain to the issue of whether the trucking charges picked up by the tax auditor involve Petitioner's own coal or coal which was owned by others.

In its opening brief Petitioner's counsel argues that the Petitioner purchased coal from various suppliers for delivery at Petitioner's processing and tippling facility and that under the terms of purchase, Petitioner was the one responsible for paying the cost of transporting the coal to its own facility.

Petitioner's counsel cites 110 C.S.R. 13A, § 4.7.7:

> 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.

At the hearing, the tax auditor testified that she had not allowed any deduction for transportation costs because in her opinion, adequate cost records were not maintained to document the transportation deduction. Post-hearing the Tax Commissioner's counsel continues to argue that no proper showing of trucking charges has yet to be made although he has made no effort to be more specific about his real problems with any of the charges for trucking contained in Exhibit C appended to Petitioner's "Reply To Respondent's Post-Brief Memorandum."

This tribunal believes that this issue continues to fester because these records were not made available in a conclusive format at the time of the detailed audit and the parties are essentially conducting another hearing by mail.

In its initial brief, Petitioner's counsel reached the following conclusion with which this tribunal concurs: "For 2002 the trucking expense is as shown on the taxpayer's Profit and Loss Statement. 'Trucking Income,' is as shown on that same statement. In a worst case scenario, assuming that the expenses associated with the trucking income were included in the 'Trucking Expense' cost category (Which they are not) and assuming that the trucking expense associated with a trucking income was equal to the full amount of such income, the taxpayer would still have excess trucking expenses."

The best evidence in this matter is of course Petitioner's profit and loss statement for 2002, because <u>all</u> of the trucking income and expenses are included there. This approach is better than an eleventh hour approach, piecemeal if you wish to prove what was hauled and for whom. Again, there are no contracts to assist the trier of fact, only a listing of invoice numbers with trucking company names, which is less than clear.

Accordingly, it is Determined that Petitioner's argument in the alternative will be accepted to resolve this matter once and for all.

ADJUSTMENTS FOR 2000 AND 2001

Because the issues, concessions, and the like, only in differing amounts, are essentially the same for 2000 and 2001, as was the case for 2002, this tribunal will not endeavor to plough the same ground again, but only to note those additional issues which require determinations.

COAL COSTS POSTED TO CONTRACT SERVICES

These costs were allowed by the tax audit for 2002 and, therefore, Petitioner is entitled to same for both 2001 and 2000.

REVISED RECOVERY RATE FOR GOB COAL

In its "Reply To Respondent's Post-brief Memorandum," Petitioner's counsel now asserts that at the hearing the Petitioner had underestimated the recovery rate for gob coal at approximately forty percent (40%), because they too believed that the gob coal was mixed with other coal. In fact, they argue that the coal produced from the gob coal was separately invoiced and, therefore, identifiable. As such, the net result of the revised gob coal adjustment for 2002 should be raised and for 2001, because the recovery rate for gob was actually forty-nine percent (49%) for 2002 and forty-four percent (44%) for 2001. Petitioner is now seeking to have schedules

attached as D and E as well as affidavits be admitted into evidence. There was no gob production for tax year 2000.

As referenced earlier in this decision, this tribunal finds that the Petitioner has been given more than enough bites of the apple and no further evidence will be taken or otherwise considered, subsequent to Petitioner's reply brief.

NEGLIGENCE PENALTY

The fourth issue to be determined is whether the Petitioner is correct in asserting that, because the revised severance, business franchise, and use tax assessments do not state with particularity why the negligence penalty was assessed, the same may not, therefore, be imposed, pursuant to W. Va. Code § 11-10-18(c).

W. Va. Code § 11-10-18(c) states as follows:

> *(c) Negligence or intentional disregard of rules and regulations.* – If any part of any underpayment of any tax administered under this article is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the amount of tax due five percent of the amount of such tax if the underpayment due to negligence or intentional disregard of rules and regulations is for not more than one month, with an additional five percent for each additional month, or fraction thereof during which such underpayment continues, not exceeding twenty-five percent in the aggregate: Provided, That these additions to tax shall be imposed only on the net amount of tax due and shall be in lieu of the additions to tax provided for in subsection (a), and the tax commissioner shall state in his notice of assessment the reason or reasons for imposing this addition to tax with sufficient particularity to put the taxpayer on notice regarding why it was assessed.

Although Petitioner's accountant admitted that he had not kept current with state tax statutes and, in hindsight, filed incorrect tax returns year after year, the evidence here is that the filing of no-tax-due severance tax returns was in and of

itself not negligence or intentional disregard of the tax rules or regulations in this matter, in light of the findings of the prior severance tax audit and the nature of the Petitioner's activities as a processor of coal.

Moreover, the statute in question expressly requires that the Tax Commissioner, "shall state in his [or her] notice of assessment the reason or reasons for imposing this addition to tax with sufficient particularity to put the taxpayer on notice regarding why it was assessed."

To comply with the above means that the reasons for imposing same must appear on the notice of assessment itself, rather than just in the form of checking boxes on the last page of the audit work papers. Because the Tax Commissioner failed to state, in the notice of assessment, with particularity, the reasons why the negligence penalty (additions to tax) were imposed, the negligence penalty must be vacated.

It should be noted that although Petitioner's counsel argued that reasonable cause had been shown for waiver of additions to tax imposed under W. Va. Code § 11-10-18(a)(1)(-2), that issue is now moot because the State proceeded under W. Va. Code § 11-10-18(c), and because there is no basis for the Commissioner to have proceeded under section 18(a)(1)-(-2), as there was no failure to file, and no failure to pay the amount on the return.

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 a petitioner-taxpayer to show that the

assessment is incorrect and contrary to law, in whole or in part. *See* W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

2. Petitioner-taxpayer in this matter has carried the burden of proof with respect to the issues of statute of limitations, applicability of gob coal rate, certain adjustments pertaining to duplication of invoices, washing fees offsets, tippling fees, trucking charges in part, and with respect to vacating the additions to tax for negligence.

3. On the other hand, Petitioner has failed to carry the burden of proof with respect to its argument that Petitioner was entitled to deduct all of the trucking charges.

DIRECTIVES RESPECTING COMPUTATION OF THE AMOUNT OF TAX DUE

1. In accordance with 121 C.S.R. 1, § 73.1.1, the above shall constitute a statement of the opinion of the West Virginia Office of Tax Appeals determining the issues in the above-captioned matter;

2. The West Virginia Office of Tax Appeals is withholding entry of its decision for the purpose of requiring the parties to submit computations of the tax due and owing consistent with the opinions set forth above;

3. Within thirty (30) days of service of this Final Decision on the Legal Issues, the parties shall meet with an attempt to reach an agreement with respect to the computation of tax due in accordance with the above-stated Division;

4. If the parties are unable to agree upon an amount of tax due, then

in accordance with the provisions of 121 C.S.R. 1, § 73.2.1, and within forty-five (45) days of service of this Decision, either party may submit a computation of the amount of tax that it believes is due, and serve its computation on the West Virginia Office of Tax Appeals and on the other party;

5. If only one party submits a computation of the amount of tax it believes is due, the Office of Tax Appeals shall proceed in accordance with the provisions of 121 C.S.R. 1, § 73.2.2;

6. If both parties submit a computation of the amount of tax they believe is due, either in accordance with the provisions of 121 C.S.R. 1, § 73.2.1 (where both parties file their computations simultaneously) or 121 C.S.R. 1, § 73.2.2 (where one party files its computation and the other party files its computation in response), the Office of Tax Appeals shall proceed in accordance with the provisions of 121 C.S.R. 1, § 73.2.3;

7. If, after the submission of computations of the amount of tax due by both parties, either party believes that an evidentiary hearing is necessary, within ten (10) days of receipt of the opposing party's computation, it shall submit a request for an evidentiary hearing, clearly and succinctly setting forth the grounds upon which its request is based, and describing the nature of any evidence that it intends to introduce.

Upon receipt of an agreed upon computation of tax due, pursuant to 121 C.S.R. 1, § 73.1.2, or upon resolution of any dispute in the computations of tax due submitted by the parties, pursuant to 121 C.S.R. 1, §§ 73.2.1 & 2, the West Virginia Office of Tax Appeals will enter its computation of tax due.