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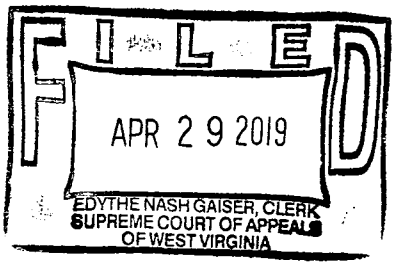
IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA
Docket No. 18-1106



ANTERO RESOURCES CORPORATION,
Respondent Below, Petitioner,

v.

DALE W. STEAGER, as
STATE TAX COMMISSIONER of WEST VIRGINIA
Petitioner Below, Respondent.

RESPONSE BRIEF OF THE WEST VIRGINIA STATE TAX DEPARTMENT

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DALE W. STEAGER, as
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Petitioner Below, Respondent.

RESPONSE BRIEF OF THE WEST VIRGINIA STATE TAX DEPARTMENT

I. STATEMENT OF THE CASE

Who should determine tax policy for the State of West Virginia? That is the fundamental question before the Supreme Court of Appeals in this matter. Should tax policy be crafted by the WV Legislature or should private parties be allowed to create their own tax exemption? The Tax Department argues that tax policy should be crafted by the Legislature and that the direct use exemption should be applied as written. On the other hand, the Office of Tax Appeals expanded the direct use exemption and authorized a consumers sales tax exemption based upon contractual obligations between Antero and its subcontractors. In short, the Office of Tax Appeals ruled that the expenses are essential, and therefore exempt, simply because Antero thinks the expenditures are essential and spent money to make it happen. *See* OTA Decision at AR 0021 & AR 0027.

Antero Resources Corporation (hereinafter, "Antero") is a producer of natural gas in West Virginia. The Tax Department conducted an audit of Antero's West Virginia operations for the calendar years of 2011, 2012 and 2013. The State Tax Department issued two combined

Consumers Sales Tax and Use Tax assessments against Antero Resources which were timely appealed to the WV Office of Tax Appeals (hereinafter, OTA or Office of Tax Appeals). The first assessment was issued against Antero Resources for $1,070,940 in combined sales and use tax plus interest while the second assessment was issued against Antero Resources Bluestone for $1,058 plus interest. *See* AR 0019; *see* also AR 0329 & AR 0642.

Generally, the tax assessments included the rental of three types of tangible personal property and services utilized by Antero in its horizontal drilling operations. Antero argued that the tangible personal property and services at issue should be exempt from consumers sales tax as being directly used in the production of natural resources. *See* W. Va. Code § 11-15-9(b)(2). In a nutshell, the consumers sales tax exempts tangible personal property and services that are directly used and consumed in the production of natural resources, or other specified industry, while taxing property or services that are indirectly used or simply incidental, convenient, or remote to the production of natural resources. The Tax Department classified all of the items which were subject to the assessment as **not** being directly used in the production of natural resources; consequently, they are subject to tax.

OTA agreed with Antero and modified the two tax assessments. The consolidated assessment was reduced from approximately $1,072,000 plus statutory interest to only $22,602 plus statutory interest. *See* AR 0019 & AR 0033. The Tax Department timely appealed the OTA Decision to the Circuit Court of Kanawha County and it was correctly reversed. *See* AR 1214 & AR 1250. Antero seeks review of the Circuit Court decision by the Supreme Court.

II. SUMMARY OF ARGUMENT

West Virginia imposes a consumers sales tax on all purchases of tangible personal property and services. W. Va. Code § 11-15-3. All purchases are deemed by statute to be taxable until the contrary is clearly proven by the taxpayer. W. Va. Code § 11-15-6(b). The consumers sales tax includes a specific exemption for purchases that are directly used or consumed in the production of natural resources and other specific industries. W. Va. Code § 11-15-9(b)(2).

During the audit period, Antero rented single wide trailers which were utilized as Crew Quarters at the drill site. One third of the Crew Quarters housed the computer equipment that directed and controlled all of the drilling operations for that location. The Tax Department classified the office area as a direct use purchase since it controlled the drilling operations; that portion of the rental charge was exempt from consumers sales tax. However, the remaining two thirds was utilized by Antero as bedrooms, breakrooms, kitchen and dining areas, and living rooms. The Tax Department assessed tax on the two thirds portion since it was not directly used in the production of natural resources. *See* OTA Decision at AR 0026.

In the administrative decision, OTA committed two fundamental errors of law. First, OTA chose to expressly "moot" the lion's share of the direct use exemption. The consumers sales tax specifically list thirteen categories of activities that qualify for the direct use exemption plus a catchall provision. *See* W. Va. Code §§ 11-15-2(b)(4)(A). Subparagraph (i) through Subparagraph (xiii) explain in great detail the types of activities that qualify as a direct use purchase which are exempt from tax. The catchall provision is set forth in Subparagraph (xiv).

However, OTA expressly ruled that the catchall provision in "... subparagraph xiv **seems to render the specificity in the subparagraphs above it moot**." OTA Decision at AR 0023 n.3 (emphasis added). OTA lacks jurisdiction to "moot" any portion of a statute. As a result of

mooting Subparagraph (i) through Subparagraph (xiii), OTA created a new standard for claiming the direct use exemption. Rather than examining the specific activities chosen by the Legislature for direct use purchases, OTA ruled that the exemption should be based on whether the purchase was "... critical and essential to Antero's drilling operations." *See* OTA Decision at AR 0028. As the Circuit Court correctly found, Antero's business model should not be allowed to trump the statute or the legislative rule.

The second fundamental flaw compounded the first. OTA ruled that Antero was "contractually bound" to provide sleeping quarters for the directional drillers. *See* OTA Decision at AR 0021, Finding of Fact 13. OTA resorted to circular logic in order to rewrite the direct use exemption. Accordingly, OTA ruled, "Obviously, Antero thinks having two directional drillers on site at all times is essential, otherwise they would not be spending the money required to make that happen." OTA Decision at AR 0027. Since Antero was "contractually bound" to provide sleeping quarters for its directional drillers, OTA ruled that the associated rental charges were essential and, therefore, exempt from tax.

However, the legislative rule includes specific examples of purchases that qualify for the direct use exemption in every enumerated industry as well as numerous examples of purchases that are indirectly used and, therefore, taxable. Most importantly, the legislative rule only lists the following purchases as being directly used in the production of natural gas and oil:

> 123.4.3.7.d. Natural Gas and Oil Production.
>
> > 123.4.3.7.d.1. Gas and oil drilling rigs and equipment.
> > 123.4.3.7.d.2. Chemicals used in gas and oil well completion.

W. Va. Code R. § 110-15-123.4.3.7.d. (1993). No other purchases are listed in the rule as being directly used in the production of natural gas and oil.

The Tax Department classified the portion of the Crew Quarters which housed computer equipment that controlled the drilling activities and all drilling equipment purchases as being directly used in the production of natural gas; consequently, those items were **not** included in the assessment. However, the Tax Department assessed tax on the portion of the rented Crew Quarters used primarily as sleeping areas and break areas for Antero's independent contractors; the rental of Porta-Potties and related sanitary charges; and the rental of various trash bins and dumpsters. The direct use exemption does not specifically include sleeping quarters, breakrooms, kitchenettes, Porta-Potties or bathrooms, and dumpsters, within the scope of activities for any of the industries that qualify for the direct use exemption. *See* W. Va. Code R. § 110-15-123.

III. STATEMENT REGARDING ORAL ARGUMENT

The Tax Department requests Rule 20 Oral Argument, pursuant to the Rules of Appellate Procedure in this case, because the case involves fundamental issues regarding the application of the direct use exemption set forth in the W. Va. Consumers Sales Tax. The Circuit Court correctly ruled that OTA exceeded its jurisdiction and rewrote the direct use exemption to expand the scope of the exemption.

IV. ARGUMENT

Antero listed five assignments of error in their Supreme Court Brief that parallel the case as outlined in the Circuit Court decision on appeal. *See* Antero's Sup. Ct. Br. at 1. However, the Argument section of Antero's Supreme Court Brief lists arguments that do not correspond to the assignments of error. The Tax Department has organized this Response Brief to address the various arguments from Antero as listed on page 1 of Antero's Supreme Court Brief.

ERROR A. THE CIRCUIT COURT CORRECTLY DECIDED THAT THE TAX DEPARTMENT PROPERLY APPLIED THE CONSUMERS SALES TAX AND LEGISLATIVE RULE.

A. 1. The proper scope of the direct use exemption.

The first question the Supreme Court must address is whether the Tax Department correctly applied the consumers sales tax and the applicable legislative rules. Based upon a review of the administrative record and the briefs by the litigants, the Circuit Court concluded that the Tax Department correctly applied the direct use exemption in auditing Antero and reversed the OTA Decision. *See* AR 1214; AR 1249-50.

The consumers sales tax applies to all purchases of tangible personal property and services in this State. *See* W. Va. Code § 11-15-1, *et seq*. In order to prevent evasion, all sales are considered taxable until the contrary is clearly established. W. Va. Code § 11-15-6(b). The consumers sales tax includes a specific statutory exemption for the purchase of tangible personal property and services that are directly used or consumed in the production of natural resources and seven other designated industries. The consumers sales tax exemption before the Court is:

> (2) Sales of services, machinery, supplies and materials **directly used or consumed in the activities of** manufacturing, transportation, transmission, communication, **production of natural resources**, gas storage, generation or production or selling electric power, provision of a public utility service or the operation of a utility service or the operation of a utility business, in the businesses or organizations named in this subdivision and does not apply to purchases of gasoline or special fuel;

W. Va. Code § 11-15-9(b)(2) (2008) (emphasis added). In addition, the consumers sales tax statute expressly defines the operative phrase "directly used or consumed" as:

> (4) "Directly used or consumed" **in** the activities of manufacturing, transportation, transmission, communication or **the production of natural resources** means used or consumed in **those activities or operations which constitute an integral and essential part of the activities,** as contrasted with and distinguished from those

> activities or operations which are simply incidental, convenient or remote to the activities.

W. Va. Code § 11-15-2(b)(4) (2008) (emphasis added).

Before this Court, Antero argues that the direct use exemption should be an expansive or broad exemption for severance taxpayers. *See* Antero's Sup. Ct. Br. at 13, 19-20, 21, 29, 30 & 35-36. Similarly, Antero argues that the Tax Department has used a legislative rule to amend or restrict the statutory framework. *See* Antero's Sup. Ct. Br. at 29-32. It is well settled under West Virginia law that exemptions from tax are strictly construed against the taxpayer. *See, e.g.*, Syl. Pt. 1, *RGIS Inventory Specialists v. Palmer*, 209 W. Va. 152, 544 S.E. 2d 79 (2001) (consumers sales tax); and *Wooddell v. Dailey* 160 W. Va. 65 at ___, 230 S.E. 2d 466 at 469 (1976) (consumers sales tax). The decisions of this Court on this exact point of law were codified by the Legislature in 2009 in W. Va. Code § 11-10-25(a) which states, "...Tax exemptions administered by the Tax Commissioner shall be strictly construed against the taxpayer and for the payment of any applicable tax." Contrary to Antero's argument, tax exemptions are strictly construed against the taxpayer. Argued below at AR 1126; AR 0177; & AR 0184.

Consequently, Antero was required to meet a high standard of proof. Antero must prove not merely that the property was used adjacent to the work site or drill pad for the production of natural resources. Instead, Antero must prove that tangible personal property and services in the assessment were directly used in the production of natural resources. OTA failed to properly apply the statutory language as crafted by the Legislature and the Circuit Court properly reversed the administrative decision. *See* Cir. Ct. Decision at AR 1221-22. Antero argues that the Circuit Court failed to cite to any specific subsection of W. Va. Code § 29A-5-4 in reversing the administrative decision. *See* Antero's Sup. Ct. Br. at 12. Nevertheless, the Circuit Court clearly ruled that OTA

lacks jurisdiction to moot parts of a statute even though the Circuit Court did not specifically cite to W. Va. Code § 11-29A-5-4(g)(1) or (g)(2).

The underlying issue revolves around what property is being used by Antero and the purpose for which the property is used. These two simple questions must be asked regarding all of the property and services which were assessed. Generally, the assessment includes three broad categories of tangible personal property rented by Antero. Counsel for Antero described the categories as 1) Crew Quarters or Skid Houses which are single wide trailers; 2) Porta-Potties and related sanitary equipment including septic systems and bathroom facilities; and 3) Trash Trailers and Trash Bins. *See* OTA Transcript, AR at 0248-49. In addition, the assessment also includes the rental of electrical generating equipment which was used to provide electrical power for the drilling operations and crew quarters at the well sites. *See* Opening Statement of Counsel for the Tax Department, OTA Transcript at AR 0251. Argued below at AR 1125-27.

The Consumers Sales Tax assessment reflects the three broad categories:

Crew Quarters/skid houses	$122,225
Generator Rentals, including hookups	135,641
Portable Toilets and cleanings	95,401
Conex Temporary Sewer System, incl. hookup and disconnect	64,436
Conex Temporary Water System, incl. hookup and disconnect	60,601
Gallons of potable water including delivery	201,690
Septic Tank cleaning	282,366
Trash trailers and disposals	81,024
TOTAL	$1,043,384

Argued below at AR 0179 & AR 1127.

Antero has admitted that the audit conducted by Ms. Evelyn Furbee, Tax Unit Supervisor for the State tax Department, did not include consumers sales tax on the purchase of any water used as drinking water at the job site. The purchase of food, which would include drinking water,

is exempt from consumers sales tax. *See* Antero's Cir. Ct. Br. at AR 1174 and OTA Tr. at AR 0312, line 15. Argued below at AR 1206.

A. 2. The Legislative Rule is Not Antiquated.

Antero argues that the legislative rule is outdated because it has not been amended since being promulgated in 1993. In fact, Antero argues "Alas, the Legislative Rule in its current form is a labyrinth of provisions that may or may not still be valid." Antero's Sup. Ct. Br. at 19. Antero further argues that the legislative rule "...was not intended to guide natural resource producers, like Antero, that are subject to the severance tax." Antero's Sup. Ct. Br. at 20.

Antero's argument fails for three reasons. First, the legislative rule specifically addresses the application of the direct use exemption to oil and gas producers. The legislative rule specifies only two types of purchases that qualify as direct use for oil and gas producers—drilling rigs and equipment plus chemicals used to complete the well. *See* W. Va. Code R. § 123.4.3.7.d.1 & 123.4.3.7.d.2. The scope of the exemption is narrow by design. Sleeping quarters required pursuant to a contract with independent contractors, Porta-Potties, water and sewage systems, and trash bins, are **not** listed as exempt purchases under the direct use exemption for oil and gas producers or any other direct use industry. The guidance set forth in the legislative rule could not be any clearer on this point; Antero simply wants to expand the direct use exemption in order to reduce its consumers sales tax liability.

Second, the Legislature specifically addressed the validity of the existing body of legislative rules in 2016 and enacted a sunset provision for the promulgation of new legislative rules. New legislative rules promulgated on or after April 1, 2016, will automatically sunset after a five year lifespan. However, legislative rules existing on or before April 1, 2016, will continue to have the full force and effect of law unless the rule is subsequently amended. *See* W. Va. Code

§ 29A-3-19(a) & 19(b). The statutory sunset provision does not affect the body of legislative rules existing prior to April 1, 2016. Therefore, the Legislature has expressly considered the argument that older rules should be negated and rejected that argument. Antero is attempting to obtain through the courts what the Legislature specifically chose not to do.

Third, the Legislature chose to reduce the breadth of the consumers sales tax exemption in 1993. Producers of oil and natural gas, as well as many other industries, are subject to the severance tax. *See* W. Va. Code § 11-13A-3a. In 1993, the Legislature promulgated the existing legislative rule and amended the direct use exemption. Prior to 1993, producers of natural gas, such as Antero, were exempt from consumers sales tax on all purchases that were directly used as well as **not** directly used. W. Va. Code § 11-15-9(v) (1992) (emphasis added) specifically stated:

> (v) Notwithstanding the provisions of subsection (g) of this section or any provisions of this article to the contrary, sales of property and services to persons subject to tax **under article** thirteen, **thirteen-a** or thirteen-b of this chapter: Provided, That the exemption herein granted **shall apply both to property or services directly or not directly used or consumed** in the conduct of privileges which are subject to tax under such articles but shall not apply to purchases of gasoline or special fuel;

The direct use exemption was codified in W. Va. Code § 11-15-9(g) in 1992 and the prior language was substantially the same as the current language found in W. Va. Code § 11-15-9(b)(2) regarding natural resource producers. However, in 1993, Subparagraph 9(v) was changed to exempt propane purchased to heat poultry houses; severance taxpayers lost the very broad exemption that applied to purchases for both direct use and indirect use set forth in previous versions of Subparagraph 9(v). *See* W. Va. Code §§ 11-15-9(g) and -9(v) (1993). The conclusion is obvious. The Legislature clearly chose to remove the sales tax exemption applicable to severance taxpayers for indirect use purchases. In 1993, the Legislature chose to narrow the breadth of the consumers sales tax exemptions for severance taxpayers such as producers of natural resources like Antero.

ERROR B. THE CIRCUIT COURT CORRECTLY RULED THAT OTA LACKS JURISDICTION TO "MOOT" PORTIONS OF A STATUTE.

The decision issued by OTA contained two fundamental legal flaws which the Circuit Court correctly addressed. *See* Cir. Ct. Decision at AR 1217, 1240-45. Antero acknowledges that OTA cannot "moot" a statute. However, Antero also attempts to minimize the impact of the main thesis set forth by OTA in creating a new test of whether the rental charges are essential to Antero's business operations. *See* Antero's Sup. Ct. Br. at 15 n.54; *id.* at 16 & 20-21.

The Circuit Court decision was clear. The Office of Tax Appeals "mooted" the specific activities chosen by the Legislature as qualifying for the direct use exemption. OTA reviewed the direct use exemption set forth in W. Va. Code § 11-15-2(b)(4) and ruled:

> **We find the remainder of subdivision 4 to be somewhat confusing.** Paragraph A of Subdivision 4 offers a list of fourteen (14) uses of property or services that **purports to be the entire list of uses that are direct.** "(A) Uses of property or consumption of services which constitute direct use or consumption in the activities of manufacturing, transportation, transmission, communication or the production of natural resources include <u>only:</u>..." *Id* at (b)(4)(A)(emphasis added). Interestingly, subparagraph xiv of paragraph A then has a catchall that mirrors the same language as subdivision 4. "Otherwise using as an integral and essential part of transportation, communication, transmission, manufacturing production or production of natural resources." *Id* at (b)(4)(A)(xiv). **As such, subparagraph xiv seems to render the specificity in the subparagraphs above it moot.**

OTA Decision at AR 0023 n.3) (<u>emphasis in OTA Decision</u>; **emphasis**). *See* also Cir. Ct. Decisions at AR 1240. Rather than give effect to Subparagraphs 2(b)(4)(A)(i) through 2(b)(4)(A)(xiii) as Courts must do, OTA chose to "moot" the greater part of the direct use exemption. Administrative agencies, such as OTA, cannot moot portions of a statute.

It is well settled that the Legislature does not perform a useless act. *See* Syl. Pt. 4, *Hardesty v. Aracoma-Chief Logan No. 4523 Veterans of Foreign Wars of the United States, Inc.*, 147 W. Va. 645, 129 S.E. 2d 921 (1963). If the Legislature had wanted the litmus test to be whether a purchase was deemed "integral and essential", as OTA ruled, then the Legislature would have

omitted the categories under Subparagraphs 2(b)(4)(A)(i) through 2(b)(4)(A)(xiii). Courts have long recognized that each word of a statute must be given some effect and a statute must be construed in accordance with the import of its language. *See Wooddell v. Dailey*, cited *supra*, at 68, 469; *see also* Syl. Pt. 6, *Davis Mem'l Hosp. v. State Tax Comm'r*, 222 W. Va. 677, 671 S. E. 2d 682 (2008) ("A cardinal rule of statutory construction is that significance and effect must, if possible, be given to every section, clause, word or part of the statute." (quoting Syl. Pt. 3, *Meadows v. Wal–Mart Stores, Inc.*, 207 W.Va. 203, 530 S.E.2d 676 (1999)).

The Legislature selected thirteen specific categories of activities that qualify for the direct use exemption under the consumers sales tax. The specific categories run the gamut from machinery and equipment causing a physical change upon property undergoing manufacturing production or the production of natural resources; to directing the physical movement of the production of natural resources; to producing energy used in the production of natural resources; and to pollution control equipment utilized in the eight specific industries. *See* W. Va. Code §§ 11-15-2(b)(4)(A)(ii); 11-15-2(b)(4)(A)(v); 11-15-2(b)(4)(A)(vii); & 11-15-2(b)(4)(A)(xii).

When the Legislature created the direct use exemption in 1987, it could be certain of two things. First, no matter how detailed an exemption was written, the Legislature would inadvertently overlook something that was directly used in the specified industries. Second, technology would continue to progress. Therefore, the Legislature included the "catchall" provision which authorizes an exemption for any uses of property or consumption of services "...[o]therwise using as an integral and essential part of ... the production of natural resources." W. Va. Code § 11-15-2(b)(4)(A)(xiv). Contrary to OTA's assertions, the "catch-all" provision does **not** moot Subparagraphs (i) through (xiii).

Instead of properly applying Subparagraph (xiv) as intended by the Legislature, OTA chose to re-write the statute. OTA used Subparagraph (xiv) to swallow and "moot" the previous thirteen subparagraphs. Consequently, the tail literally wags the dog. As a result, OTA adopted a test of whether the rental charges in the audit were essential to Antero's business operations instead of examining the rental charges in light of the thirteen types of activities specified in the statute. OTA clearly failed to analyze the purchases at issue to determine whether the purchases reflected the type of activities classified by the statute as direct use purchases. For example, sleeping quarters and Porta-Potties do not fall within the thirteen types of activities set forth by the Legislature in Subparagraphs (i) through (xiii). *See* OTA Decision at AR 0024. Therefore, the OTA Decision rewrote the statute and ignored subparagraph (i) through subparagraph (xiii) of the statute. OTA further erred by expanding the catch all provision to include remote activities that are not directly related to the production of natural resources.

The second flaw compounded the first. The OTA Decision focused on contractual requirements agreed to by Antero and not the statutory language. In Finding of Fact 13, OTA found that Antero "...is contractually bound to provide housing on the well pad for the directional drillers." *See* OTA Decision at AR 0021. OTA proceeded to apply this elevated contractual requirement as a basis for expanding the direct use exemption and claimed it to be essential to the production of natural resources. OTA ruled:

> Antero has, as part of contracting for these directional drillers services, **agreed to provide housing** for them during these periods of required availability. Obviously, Antero thinks that having two directional drillers on site at all times **is essential, otherwise they would not be spending the money required to make that happen.**

OTA Decision at AR 0027 (emphasis added).

The rationale employed by OTA was obviously circular. Antero is contractually bound to provide on-site housing to the directional drillers because Antero "... thinks that having two directional drillers on site at all times is essential..." *Id.* Since the on-site housing requirement is required under the contract with Antero's subcontractors, the on-site housing requirement is "integral and essential" to the production of natural resources. Therefore, rental charges for the sleeping quarters must be exempt. *See* OTA Decision at AR 0023 n.3, quoted *supra*. According to the OTA Decision, two parties to a contract can now create their own tax exemption simply by agreeing to contract terms and paying for the associated expense.

However, tax policy is exclusively the province of the Legislature. *See Killen v. Logan Cnty Comm'n*, 170 W. Va. 602, 606, 295 S.E. 2d 689, 693 (1982) (overruled, in part, on other grounds, in Syl. Pt. 5, *In Re Tax Assessment of Foster Found.'s Woodlands Ret. Cmty.*, 223 W. Va. 14, 672 S.E. 2d 150 (2008)). Furthermore, tax exemptions are a matter of legislative grace. *See Shawnee Bank v. Paige*, 200 W.Va. 20, 27, 488 S.E.2d 20, 27 (1997).

In this case, the OTA Decision ruled that the Crew Quarters including break rooms, kitchen and dining areas, and employee lounges, were exempt based on its tail wagging the dog exemption.

> We agree with the Tax Commissioner, to the extent that if we were talking about a typical factory or manufacturing facility that had a killer break room with a cappuccino machine, foosball table and comfy sofas, our conclusion would be different. However, the situation before us is quite different. In fact, Antero's witness testified as to the spartan nature of the skid houses.

OTA Decision at AR 0027. Auditor Furbee apportioned the costs of the Crew Quarters based upon the use of the single wide trailers. The portion that was directly used to produce natural gas was exempt while the portion that was used for bedrooms, kitchenettes, and restrooms was taxable. Whether the breakrooms are lavish or Spartan is irrelevant; breakrooms and bedrooms are **not**

listed as being directly used in the production of natural resources in the statute or in the legislative rule. *See* W. Va. Code § 11-15-2(b)(4)(A). Therefore, these areas are subject to tax.

Furthermore, Antero should not be allowed to expand a tax exemption to accommodate its staffing considerations. Antero argues that the Crew Quarters are essential because Antero must keep two directional drillers on site around the clock. *See* Antero's Sup. Ct. Br. at 6-7. However, during the first half of the audit period, Antero employed one company man, an independent contractor, who stayed at the drill site around the clock for a two week period. At the end of two week period, the company man left the drill site and was replaced by a different independent contractor working as the company man. During the second half of the audit period, Antero hired a second company man. As a result, only one company man remained at the drill site during each twelve hour work period. *Id.* Consequently, Antero's staffing needs were met simply by hiring a second company man to work the night shift. Antero could accomplish the same end by hiring an additional set of two directional drillers to work the night shift for the two week periods or utilize a different business model. In addition, the OTA Decision specifically found that the "tool pusher" stays in the Crew Quarters for a two week period. *See* Finding 12, AR 0021. Even though OTA expanded the exemption based on Antero's "contractual obligations" to provide sleeping quarters for the directional drillers, the OTA Decision opened the flood gate for all employees of Antero. The point is simple. The direct use exemption may not be expanded by OTA to accommodate Antero's business operations and staffing needs or the business operations of any individual company in the eight industries subject to the direct use exemption.

The Circuit Court properly ruled that OTA does not have jurisdiction to "moot" portions of a statute and that OTA failed to apply the statute as written by the Legislature. Accordingly,

the Circuit Court properly ruled that the Tax Department correctly applied the direct use exemption in the consumers sales tax audit of Antero.

ERROR C. THE CIRCUIT COURT CORRECTLY RULED LIVING QUARTERS DO NOT QUALIFY FOR THE DIRECT USE EXEMPTION.

Antero argues before this Court that the rental charges for the Crew Quarters should be exempt from consumers sales tax as a direct use purchase. Antero argues that it is essential to provide sleeping quarters, break rooms, and kitchenettes, for the production of natural resources. Since the Crew Quarters are essential to its business operations, the rental charges should be exempt from consumers sales tax as a direct use purchase. *See* Antero's Sup. Ct. Br. at 22-26. OTA agreed with Antero's argument in *toto*, ruled that the Crew Quarters were "integral and essential" and granted the exemption requested by Antero. *See* OTA Decision at AR 0032.

When the Tax Department issued the underlying tax assessment, Auditor Furbee determined that the portion of the Crew Quarters dedicated to housing the computer equipment that controlled the drilling activities qualified as a direct use purchase. Therefore, the Tax Department exempted one third of the Crew Quarters and supporting electrical generating equipment while assessing tax on the two thirds utilized as sleeping quarters, breakrooms, kitchenettes and TV rooms. *See* AR 0179-81. The Circuit Court correctly ruled that the two thirds of the Crew Quarters used for such indirect activities at the well sites did not qualify for the direct use exemption contrary to Antero's argument. The Circuit Court correctly affirmed the tax assessment. *See* AR 1232.

C.1. The Office Area in the Crew Quarters Controlling the Drilling Activity Is Exempt as a Direct Use Purchase.

One fundamental question before the Supreme Court is whether the Crew Quarters, or the single wide trailers rented by Antero, were directly used in the production of natural resources.

On direct examination Auditor Furbee explained how she approached the first of the broad categories in the audit.

Q. By Attorney Waggoner:
You mentioned that there was a portion of the crew quarters that you considered taxable?

A. By Ms. Furbee:
Yes. I allowed part of it as being exempt. And the rest of it, I consider taxable. I did this based on square footage. That information was provided to me by Antero employees. So I came up with a percentage of roughly 68 percent being taxable.

Q: And the reason you considered that 67, 68 percent table was what? What was your basis for --?

A. I considered the living quarters of the people who were there. It included the restroom, the bedrooms, the kitchenette, the living area, **as compared to a little area that wasn't necessarily office as being administrative, but being an office area in that [it] did have the computers and the monitors for the directional driller. That sort of thing.**

Q. So it looked like there was a portion of these crew quarters that had equipment in it that was used to control or monitor aspects of the actual drilling rig.

A. That's correct.

Q. And you considered the square footage dedicated to that equipment to be directly used in the production of natural resources?

A. Yes.

Q. And the bedroom, the living room, the kitchenette, those types of areas – you considered the square footage attributable to those areas to be indirectly used?

A. That is correct.

OTA Tr. at AR 0304 (emphasis added); *see* OTA Tr. at AR 0312-13 (consistent testimony on cross-examination). The reasonableness of Ms. Furbee's allocation percentage is confirmed by Antero's own witness. Mr. Alvyn Schopp, Chief Administrative Officer and Senior Regional Vice

President for Antero, testified regarding the use of the single wide trailers for the Crew Quarters. On direct examination, Mr. Schopp admitted that roughly two-thirds was used for a kitchenette and living areas. *See* Test. of Mr. Schopp, OTA Tr. at AR 0275, ln. 12-15.

Ms. Furbee's testimony was clear. The one-third of the single wide trailer that housed the computers which controlled the drilling equipment was classified as directly used in the production of natural resources and was, therefore, exempt from tax. According to the legislative rule, if any property or services can be used in both a tax exempt manner and a taxable manner, then the Tax Department is authorized to apportion the cost between the two different uses on any reasonable basis. *See* W. Va. Code R. § 110-15-123.4.3.8. Rental charges that were classified as exempt under the direct use exemption were **not** included in the tax assessment. The Tax Department correctly applied both the statute and the legislative rule. Argued below at AR 1127-29

The tax statute expressly limits the direct use exemption. The Legislature chose to enumerate fourteen different activities that qualify for the direct use exemption for the production of natural resources and the other specified industries.[1] Direct use is limited to, *inter alia*:

> (v) **Physically controlling or directing the physical movement** or operation **of property directly used** in transportation, communication, transmission, manufacturing production or **production of natural resources;**

W. Va. Code § 11-15-2(B)(4)(v) (emphasis added). Based upon the testimony in the administrative record, the computer equipment utilized by Antero controls the drill bit which drills the natural gas wells. There is no doubt that drilling equipment is directly used in the production of natural resources. The legislative rules for the consumers sales tax include several examples of

[1] The direct use exemption dates back to 1987. The outline of fourteen specific categories of purchases that qualify as being directly used in the specific industries dates back to 1987 and have remained substantially unchanged since their enactment. Similarly, the six rather expansive categories of purchases that are classified as being indirectly used (and, therefore taxable) have remained substantially unchanged since 1987 as well. However, additional qualifying industries have been added to the direct use exemption over that time period.

purchases which are directly used and, therefore, tax exempt for each of the eight specific industries. The legislative rule specifically lists only two categories of purchases for the production of natural gas which would be exempt—drilling rigs and equipment plus chemicals used to complete the oil and gas wells. *See* W. Va. Code R. § 110-15-123.4.3.7.d. (1993).

In addition, Ms. Furbee testified that she also viewed the well-head cage as being directly used in the production of natural resources. *See* Test. of Ms. Furbee OTA Tr. at AR 0312, ln. 7-15. The legislative rule clearly states that the list of exempt purchases and the list of taxable purchases for all natural resource producers is not exhaustive. *See* W. Va. Code R. § 110-15-123.4.3.6. (1993). Therefore, Ms. Furbee classified both the office space dedicated to directing the drilling operations and the drilling equipment *per se* as directly used and exempt from tax.

The assessment also includes the rental of generators including hook ups to power the single wide trailers. Ms. Furbee testified that she apportioned the cost of the electrical generators which powered the Crew Quarters in the same one-third versus two-thirds manner. *See* OTA Tr. at AR 0312, ln. 12-15. The consumers sales tax specifically classified producing power for property directly used in the production of natural resources as being exempt from Consumers Sales Tax. *See* W. Va. Code § 11-15-2(b)(4)(A)(vii). Accordingly, since the electrical generators powered the Crew Quarters, the single wide trailers, one-third of the cost was tax exempt while two-thirds of the cost was subject to tax.

C. 2. Bedrooms, Kitchen and Dining Areas, Bathrooms, and Lounge Areas, Are Not Directly Used in the Production of Natural Resources.

However, the two-thirds of the Crew Quarters that constituted bedrooms, a kitchenette, break rooms, and TV areas, were classified as indirectly used in the production of natural resources and, therefore, subject to tax. The nature of the indirect portion is not in dispute. Antero even admits that the "living quarters" on which tax was assessed include bedrooms, bathrooms, a

kitchen and dining area, and a living room. *See* Antero's Sup. Ct. Br. at 23. Auditor Furbee's conclusion was based on a simple application of the statute. The consumers sales tax includes six rather expansive categories of **indirect use** which are taxable.

> (i) Heating and illumination of office buildings;
>
> (ii) Janitorial or general cleaning activities;
>
> (iii) **Personal comfort of personnel;**
>
> (iv) Production planning, scheduling of work or inventory control;
>
> (v) Marketing, general management, supervision, finance, training, accounting and administration; or
>
> (vi) An activity or function **incidental or convenient to** transportation, communication, transmission, manufacturing production or **production of natural resources, rather than an integral and essential part of these activities.**

W. Va. Code § 11-15-2(b)(4)(B) (emphasis added). Kitchen and dining areas and bedrooms are not directly used in the production of natural gas. If kitchen and dining areas and bedrooms are not provided for the personal comfort of the drilling personnel, they are certainly incidental or convenient to the production of natural gas. The legislative rules for the direct use exemption do not list kitchen and dining areas and bedrooms among the direct use purchases for any of the eight enumerated industries. *See* W. Va. Code R. § 110-15-123.

Auditor Furbee based the classification on her observations during the site visit, information provided by Antero, and the applicable legislative rules. For example, the general application section of the legislative rule states that tangible personal property or services used for the personal comfort of employees is taxable; the legislative rule employs the specific example of couches purchased for the employee lounge would not be directly used in the designated industries. *See* W. Va. Code R. § 110-15-123.3.2.3. Furthermore, the section of the legislative rules that apply

to the production of natural resources clearly states that light bulbs and fixtures used in bath-houses and similar facilities as well as supplies used in bath-houses are taxable. *See* W. Va. Code R. §§ 110-15-123.4.3.6.a.5 & 110-15-123.4.3.6.a.6. Similarly, the purchase of parts and materials used to maintain bath-houses or eating facilities are classified as subject to tax. *See* W. Va. Code R. § 110-15-123.4.3.6.a.11. While the transportation industry is designated by statute as a direct use industry, purchases of linens, beds, as well as dishwashers, stoves, and other kitchen items, are expressly designated as taxable purchases according to the legislative rules. *See* W. Va. Code R. §§ 110-15-123.4.1; 4.1.1.k; 4.1.1.l; & 4.1.1.m. Argued below at AR 1129-31.

The statutory language set forth in W. Va. Code § 11-15-2(b)(4)(A) does not include any language even implying that bedrooms, breakrooms, break areas, restrooms, bath-houses, TV lounges, kitchenettes, and similar rest areas, would be directly used in the production of natural resources or the other seven designated industries. Similarly, the enumerated examples in the legislative rule clearly indicate that the Legislature considered whether employee rest areas and bathroom facilities should be classified as qualifying for the direct use exemption and decided against extending the exemption to include rest areas, sleeping quarters, break rooms, kitchenettes, bathrooms, and TV areas. Therefore, Tax Department's decision to assess tax on these purchases was correct under the statute and the legislative rule.

In its brief to this Court, Antero argued that the Circuit Court failed to base the conclusion that the rental charges related to the portions of the crew quarters dedicated to bedrooms, kitchenettes, bathrooms, TV lounges, and the rental charges related to Porta-Potties and other sanitary facilities, on the specific language found in W. Va. Code § 11-15-2(b)(4)(A). *See* Antero's Sup. Ct. Br. at 20-23. From a factual standpoint, Antero is simply wrong. The Tax Department has consistently argued that the area devoted to directing the drilling equipment is exempt since it

is used to physically direct and control equipment performing the activity of producing natural resources. *See* W. Va. Code § 11-15-2(b)(4)(A)(v), quoted *supra*; Argued below at AR 1129 & 1201. The Circuit Court agreed. *See, e.g.*, AR 1224-26.

More importantly, Antero has missed the obvious point. According to statute, in order to prevent evasion, all sales are presumed to be subject to tax until the contrary is clearly proven. W. Va. Code § 11-15-6(b). Under West Virginia law, exemptions from tax are strictly construed against the taxpayer. *See, e.g.*, Syl. Pt. 1, *RGIS Inventory Specialists v. Palmer*, 209 W. Va. 152, 544 S.E. 2d 79 (2001) (consumers sales tax). Contrary to Antero's assertions, the Tax Department is **not** required to prove that the rental charges are subject to tax. Antero **is required to prove** that the rental charges are exempt from the consumers sales tax. *See* W. Va. Code §§ 11-15-6(b) and 11-10A-8(e). Argued below at AR 1199-200.

In the Circuit Court, the Tax Department argued that the legislative rules regarding whether linens, beds, dishwashers, stoves and other kitchen items were directly used in transportation industry should be examined as insight for the production of natural resources. *See* AR 1131-32. Before this Court, Antero abruptly dismisses the analogy and states that the Tax Department's:

> "...reference to W.Va. Code R. § 110-15-123.4.1, 4.1.1k, 4.1.1l, and 4.1.1m (linens beds, dishwasher, stoves and other kitchen items) is to the direct use exemption for transportation activity and is not applicable to the natural resource industry."

Antero's Sup. Ct. Br. at 25 n.82. However, Antero's abrupt dismissal of the analogy is simply wrong. The Legislature adopted the direct use exemption for several industries including manufacturing, transportation, transmission, and communication, production of natural resources, gas storage, general or production or selling electric power, or provision of a public utility service. *See* W.Va. Code § 11-15-9(b)(2). Eight broad industries qualify according to statute for the direct use exemption. While the eight industries are quite different, they share many common elements.

Antero has ignored one obvious fact – none of the enumerated industries classify the crew quarters including bedrooms, bathrooms, TV rooms, break areas and kitchenette as being directly used in any of the seven enumerated industries. Antero has failed to meet its burden of proof under West Virginia law. Argued below at AR 1201-02.

Antero argues that this Court should draw a distinction between restroom facilities or bathrooms as compared to bathhouses based on Taxpayer Services Publication 358 (hereinafter, TSD 358). Antero argues that the legislative rule is out of date and that production of natural resources continues from exploration up to the point where the natural resource is sold to a buyer. In addition, Antero argues that the term "bath-houses" should be restricted to a locker room or changing room provided for the convenience of employees "...typically [at] coal mines." *See* Antero's Sup. Ct. Br. at 13-14 n.47; *id.* at 17-18 n.66; *id.* at 19.

Assuming *arguendo* that Antero's distinction is correct, and that bath-houses should be viewed by the Circuit Court, as changing rooms, then the restroom facilities are still subject to the consumers sales tax. Whether a bath-house is a restroom for employees or a changing room for swimmers is irrelevant for this Court's analysis. As argued above, the rental of restroom facilities, septic systems, and purchase of water for septic system, does not fall within the thirteen categories of purchases that are directly used in the production of natural resources under the statute or under the legislative rule. The Tax Department properly classified these charges as being used for the comfort of employees which is a taxable purchase.

Furthermore, Antero's reading in Footnote 66 is unduly restrictive. Antero bases Footnote 66 on the Taxpayer Services Publication TSD-358. The language quoted by Antero from TSD-358 is expansive not restrictive. TSD-358 clearly speaks in terms of bath-houses or similar facilities which are expressly classified as taxable purchases. Argued below at AR 1208-10.

Finally, Antero argues that it must provide the crew quarters including the bedrooms and restroom facilities due to the remote location of drill sites. However, many of the eight industries that qualify for the direct use exemption have traditionally been conducted in remote locations. For example, timber and coal mining are generally conducted out in the countryside where the natural resources are found and not necessarily in close proximity to motels and restaurants. The Legislature could have adopted an exemption for crew quarters in remote locations, but did not do so. Nevertheless, Antero argues that the crew quarters are necessary because of the remote location for the oil and gas wells. But, Antero admits that, "Food preparation in the crew quarters is minimal, as the Petitioner has food brought in for the well site workers using food trucks." *See* Antero's Sup. Ct Br. at 6, 23-24 n.79. Apparently, the drill sites may not be as remote as it would appear. Argued below at AR 1202-03. The Circuit Court decision is correct. *See* AR 1230.

C. 3. Living Areas in the Crew Quarters Are Not Exempt Under the Direct Use Exemption Based on Legal Log Correspondence.

In addition, Antero argues that six letters from the Tax Department's Legal Log support Antero's claim that the rental charges for the crew quarters should be exempt. Antero based its argument, in part, on Legal Log Numbers 08-151, 08-198, and 09-072. *See* Antero's Sup. Ct. Br. at 24-25 n.80; Legal Log 09-248 at 13-14 n.47.[2]

Antero's reliance on the Legal Log correspondence simply fails upon analysis for three reasons. First, Antero is attempting to bootstrap an expansion of the statutory exemption by citing to the Legal Log correspondence as precedent. Such bootstrapping is unwarranted. The Circuit Court found that the Legal Log correspondence upon which Antero relies has no precedential value according to law. *See* Cir. Ct. Decision at AR 1231-32. While a Technical Assistance

[2] Legal Log correspondence regarding Porta-Potties is specifically addressed in Argument D.3., *infra*.

Advisory explaining the Tax Commissioner's opinion on a specific transaction does have limited precedential value, the Legal Log correspondence is not a Technical Assistance Advisory. *See* W. Va. Code § 11-10-5r(a). Assuming *arguendo* that the Supreme Court were to construe the Legal Log correspondence as Technical Assistance Advisory, TAA's only provide precedential value for the individual taxpayer who requested the Technical Assistance Advisory for the specific transaction at issue and do not apply to other taxpayers. *See* W. Va. Code § 11-10-5r(b).

Second, Antero has admitted that the Legal Log correspondence does not address the specific situation before the Supreme Court. Before the Circuit Court, Antero admitted that:

> "...none of the three legal logs expressly analyze modular buildings that included a 'living area' space and are intended to serve as 'skid houses/crew quarters' for workers who are required to remain on site twenty-four hours a day over extended periods of time..."

See Antero's Cir. Ct. Br. at AR 1179-81. Significantly, the Legal Log correspondence on which Antero relies does not even address bedrooms, restrooms, kitchenettes, TV lounges, and breakrooms; these are the portions of the Crew Quarters that Auditor Furbee classified as being indirectly used and, therefore, subject to Consumers Sales Tax. Argued below at AR 1203-04.

Third, and more importantly, by applying the statutory language in the direct use exemption, Auditor Furbee already complied with the spirit of these three Legal Log letters. The administrative record is clear. Approximately one-third of the Crew Quarters housed the computers that controlled the drilling equipment utilized by Antero. Auditor Furbee already classified this one-third of the crew quarters as being directly used in the production of natural resources since the computer equipment physically directed and controlled the drilling equipment used in the production of natural resources. *See* W. Va. Code § 11-15-2(b)(4)(A)(v). The portion of the single-wide trailer that is actually used in the production process is exempt and is not taxed in the assessment before this Court. Argued below at AR 1203-05.

The Circuit Court ruled that nothing in the statutory language or the legislative rule indicates the Legislature has classified restrooms, kitchenettes, TV Lounges, or breakrooms, as being directly used on the production of natural resources. The Circuit Court decision correctly applied the statute and the legislative rule on this issue. *See* Cir. Ct. Decision at AR 1232.

ERROR D. THE CIRCUIT COURT CORRECTLY RULED PORT-POTTIES DO NOT QUALIFY FOR THE DIRECT USE EXEMPTION.

Antero argues that the rental charges related to Port-Potties, Conex water and septic systems used to support the Crew Quarters; charges for potable water used in the restrooms and Crew Quarters for sanitary purposes; and septic cleaning charges; should be exempt from consumers sales tax pursuant to the direct use exemption. *See* Antero's Sup. Ct. Br. at 7-9, 14 & 26-36. OTA agreed with Antero's claim and exempted these items from the sales tax assessment. *See* AR 0030-0031. As noted above, the Tax Department assessed approximately $704,000 in consumers sales tax against the Porta-Potties and sanitary related rental charges.

However, the Office of Tax Appeals only devoted one single page to the issue. The OTA Decision simply concluded that the rental charges should be exempt from consumers sales tax because the federal Occupational Safety and Health Administration (hereinafter, "OSHA") regulations require Antero to provide bathroom facilities for its workers. *See* AR 0030-31 including n.4. OTA summarily ruled:

> We find the Tax Commissioner's arguments regarding these rentals to be unpersuasive, and rule that it would be critical and essential to have proper sanitation facilities for an outdoor workplace such as Antero's.

OTA Decision at AR 0031. The Circuit Court observed that OTA failed to analyze the claimed exemption for Porta-Potties in the context of the activities specifically listed as direct use purchases. *See* AR 1233-35. OTA has substituted its judgment in place of the WV Legislature's judgment.

In addition, the OTA Decision creates problems vis-a-vis several other direct use industries. OTA has ignored the obvious language from both the statute and the legislative rule. As noted above, the direct use exemption includes indoor industries such as manufacturing, communications, generation of electric power and public utility businesses as well as outdoor industries such as transportation, production of natural resources, natural gas transmission, and gas storage. *See* W. Va. Code § 11-15-9(b)(2). OTA has erroneously re-written the direct use exemption and created a distinction between indoor industries versus outdoor industries which has never been drawn by the Legislature. Since OTA has chosen to exempt Porta-Potties, sanitary facilities, septic systems, and related water services, as well as the portion of the Crew Quarters used for sleeping quarters, kitchen and dining areas, in the production of natural gas, then all eight direct use industries could possibly claim the broadened exemption. OTA clearly lacks the authority to re-write a properly enacted legislative rule or statute. Argued below at AR 1135-36.

D.1. OSHA Regulations Do Not Create a Tax Exemption Under the West Virginia Consumers Sales Tax.

Antero argues that OSHA created a *de facto* exemption from the West Virginia Consumers Sales Tax. *See* Antero's Sup. Ct. Br. at 27-29. Also, Antero argues that it would be impossible to operate the job site without restroom facilities which are required by the OSHA rules. *See* Antero's Sup. Ct. Br. at 30-32 (addressed, *infra*). OTA referenced the OSHA regulations which require employers to provide bathroom facilities for their employees as the only authority before granting the consumers sales tax exemption to Antero. *See* AR 0030. The Circuit Court correctly reversed the OTA Decision on this point. *See* AR 1230 & 1234-35.

The fundamental question before this Court is whether the consumers sales tax statute exempts restrooms, Porta-Potties, and related sanitary charges, under the direct use exemption. The Tax Department has never disputed whether the OSHA regulations require employers to

provide restroom facilities for their employees. Antero also argues that the bathroom facilities should be exempt under the direct use exemption. *See* Antero's Sup. Ct. Br. at 35-36. However, there is no express or implied language set forth in the direct use exemption authorizing an exemption from the consumers sales tax simply because a federal regulation requires restroom facilities for employees. The plain language of W. Va. Code § 11-15-2(b)(4) belies any argument to the contrary from Antero. Argued below at AR 1134-35; AR 1200-01. Antero has failed to point out any consumers sales tax exemption related to Porta-Potties, Conex water and sewer systems, or any other sanitary related expense. In short, whether Porta-Potties are exempt from the consumers sales tax under the direct use exemption is a question to be decided by the West Virginia Legislature and not OSHA. Argued below at AR 1134-35; AR 1210-11.

The Legislature crafted the direct use exemption. The statutory definition of direct use includes thirteen specific examples of the types of purchases that would be statutorily classified as directly used and, therefore, exempt from tax. None of the thirteen categories of exempt activities specifically list or even allude to the rental charges for Porta-Potties, portable sewage systems, related water systems or septic cleaning charges. All thirteen categories of activities directly affect the production of natural resources *per se*. It is difficult to argue that Porta-Potties are exempt under the direct use exemption when the statute does not include the words "Porta-Potties", "Porta-Johns", "bathrooms", "restrooms", "septic systems", and "sanitary facilities". *See* W. Va. Code § 11-15-2(b)(4). These words are not found in the legislative rule either. While the legislative rule does include three specific references to bath-houses, all three references are expressly listed as subject to the consumers sales tax. *See* W. Va. Code R. §§ 110-15-123.4.3.6.a.5; 123.4.3.6.a.6; & 123.4.3.6.a.11. Argued below at AR 1134.

There is an obvious need for sanitary facilities at remote job locations in the production of natural resources; however, that obvious need is not new. The need for sanitary facilities was just as obvious in 1987 when the direct use exemption was enacted by the Legislature. The Legislature could have included Porta-Potties or other sanitary facilities as a specific category when the direct use exemption was enacted in 1987, when the consumers sales tax was last amended in 2008, or when the tax was amended numerous times in the intervening years.[3] However, the Legislature chose not to do so. When the legislative rule addresses any type of personal comfort facility, such as a breakroom, employee lounge areas, or bathhouse, those facilities are always listed as an indirect use purchases which is taxable under the rule. Argued below at AR 1133-34 & 1207.

Antero has failed to prove that the direct use exemption authorizes a tax exemption based on OSHA regulations or any other federal rule. Therefore, the Tax Department correctly classified Porta-Potties and other sanitary related charges as taxable.

D. 2. Porta-Potties Are Not Pollution Control Abatement Equipment.

Antero argues that Porta-Potties, the Conex water and sewer systems, and the associated charges, should be exempt under the direct use exemption as pollution control or environmental protection allegedly based on guidance provided by the W. Va. Department of Environmental Protection (hereinafter, "DEP List"). Antero specifically cited to the DEP List of pollution abatement control equipment. *See* Antero's Sup. Ct. Br. at 28-30.

The Supreme Court's analysis must begin with the language of the consumers sales tax statute which creating the direct use exemption which includes:

> (xiii) Engaging in pollution control or environmental quality or protection activity **directly relating to the activities of** manufacturing, transportation,

[3] *See e.g.*, W. Va. Code § 11-15-8d(c) which addressed the direct use exemption as it applied to purchases for natural gas transmission lines with a diameter of at least twenty inches. Paragraph (c) was added in 2011. The Legislature has addressed the direct use exemption statutorily at various times since the legislative rule to the consumers sales tax was originally promulgated in 1993.

> communication, transmission or **the production of natural resources** and **personnel,** plant, product or **community safety** or security activity **directly relating to the activities of** manufacturing, transportation, communication, transmission or **the production of natural resources**;

W. Va. Code § 11-15-2(b)(4)(A)(xiii)(emphasis added). The direct use exemption clearly requires that pollution control must be **directly related** to the production of natural resources in order to be exempt from tax. Pollution control efforts that are remote or incidental to the production of oil and natural gas, while still valuable, are taxable.

The Legislature specifically classified the activities enumerated in subparagraph (i) through subparagraph (xiii) of W. Va. Code § 11-15-2(b)(4)(A) as tax exempt under the direct use exemption. However, OTA reviewed the direct use exemption and expressly ruled the general language in subparagraph (xiv) of the direct use exemption "...seems to render the specificity in the subparagraphs above it moot." *See* OTA Decision at AR 0023 n.3. It is difficult for Antero to base its pollution argument on subparagraph (xiii) of the statute since OTA expressly chose to moot the specificity of subparagraph (xiii) in the administrative decision.

Nevertheless, Antero argues that the Porta-Potties and associated rental charges should be exempt based on information in the DEP List. Antero argues that the Porta-Potties should be exempt as either Groundwater Treatment Systems or Hazardous Spill Prevention Equipment. The DEP List is authorized pursuant to W. Va. Code § 11-6A-1, *et seq.*, which states that eligible pollution control abatement equipment is valued at salvage value for ad valorem property tax purposes. *See* Antero's Sup. Ct. Br. at 28.

Therefore, Antero argues that the Porta-Potties could be viewed as Groundwater Treatment Systems or Hazardous Spill Prevention Equipment. However, Antero does not state and has failed to prove that the DEP has actually classified Porta-Potties as Groundwater Treatment Systems or Hazardous Spill Prevention Equipment. Antero is merely speculating. The pertinent statute states:

> As used in this article, "**pollution control facility**" means any personal property designed, constructed or **installed primarily for the purpose of abating** or reducing **water or air pollution** or contamination by removing, altering, disposing, treating, **storing** or dispersing the concentration of pollutants, **contaminants, wastes** or heat in compliance with air or water quality or effluent standards prescribed by or promulgated under the laws of this state or the United States, **the design, construction and installation of which personal property was approved as a pollution control facility by either the office of water resources** or the office of air quality, both **of the division of environmental protection**, as the case may be.

W. Va. Code § 11-6A-2 (emphasis added).

While Antero put the DEP List of Pollution Abatement Items into the administrative record, Antero produced no evidence that the DEP has ever approved Porta-Potties, Conex water and sewer systems, or charges for septic system cleaning and disposal charges, as Pollution Control Abatement Items. *See* AR 0496-505. If any such evidence existed, Antero would have put that evidence into the administrative record. Because Antero has failed to prove that the DEP has approved the design, construction, and installation of Porta-Potties as Pollution Control Abatement Items, they do not qualify for the DEP List. *See* W. Va. Code § 11-6A-2, quoted, *supra.*

In addition, Groundwater Treatment Systems and Hazardous Spill Prevention Equipment as defined in the DEP List do not include the words Porta-Potties or sewer systems. Consequently, Porta-Potties do not fall within the plain language of the definition of those terms as set forth in the DEP List. *See* AR 0502. Furthermore, the statute authorizing the DEP List contains only two types of qualifying projects for pollution control facilities — coal waste disposal power projects and wind power projects. *See* W. Va. Code §§ 11-6A-5 & 11-6A-5a. Drilling for natural gas and oil is not listed in Article 6A of Chapter 11 regarding Pollution Control Abatement Items.

Antero further argues that the Tax Department has failed to give every part of the direct use exemption significance and effect by narrowly construing the statutory language. Antero bases the argument on *Ferroletto Steel Co. v. Oughton*, 230 W. Va. 5, 736 S.E. 2d 5 (2012) and *Woddell*

v. Dailey, 160 W. Va. 65, 230 S. E.2d 466 (1976). *See* Antero's Sup. Ct. Br. at 30-32. Contrary to Antero's assertions, the Tax Department has given every part of the statute and the applicable legislative rule fair significance, effect, and a fair application. Antero is simply trying to expand the direct use exemption far beyond the language chosen by the Legislature in crafting the statute and promulgating the legislative rule. As argued above, Antero has provided no proof that the DEP has approved the design, construction and installation of Porta-Potties as Pollution Abatement Control Equipment as required by W. Va. Code § 11-6A-2.

Specifically, Antero argues that Porta-Potties should be classified as Pollution Abatement Control Facilities under W. Va. Code § 11-6A-2, quoted *supra*. The legislative rule for the Pollution Control Facilities reiterates the term "Pollution Control Facility" as defined by the statute and emphasizes that the definition for salvage tax treatment shall be strictly construed. *See* W. Va. Code R. § 110-6-2.4. Just like all consumers sales tax exemptions, the exemption related to Pollution Control Facility must be strictly construed against the taxpayer.

The same legislative rule also states that Pollution Control Facilities which may "... coincidentally comply with air or water quality or effluent standards... but which are primarily installed for plant operations... will not be considered eligible for salvage tax treatment." W. Va. Code R. § 110-6-2.4. The Porta-Potties are provided because they fit Antero's business model. Antero argues that the Porta-Potties are essential because "[i]t would be impossible to operate any well site without making bathroom facilities available..." since the drill sites are too remote for workers to leave the drill site to go the bathroom elsewhere. *See* Antero's Sup. Ct. Br. at 32; Antero's Cir. Ct. Br. at AR 1188 (identical quote). However, at OTA, Antero inadvertently admitted that "...the facilities are necessary in order to allow these individuals to remain at the drill site in order to satisfactorily perform the duties expected by the Petitioner." AR 0222.

Therefore, the Porta-Potties are utilized primarily for plant operation purposes and not primarily for pollution abatement purposes. The pollution control aspects are secondary and coincidental compared to the productivity aspects. Consequently, the rental charges for Porta-Potties fall outside of the plain language of the legislative rule regarding Pollution Control Facilities.

Also, Antero argues that the discharge of sewage from the Crew Quarters could be classified as water pollution under legislative rule for the consumers the sales tax. *See* Antero's Sup. Ct. Br. at 7-8 & 28-31. The legislative rule for the consumers sales tax defines the term "Water Pollution" as including among other things the deposit of sewage so as to cause ground or surface water to become contaminated, unclean, or impure. *See* W. Va. Code R. § 110-15-2.27.1.13.d. However, this definition found in the legislative rule must be tempered with the further requirement also found in the legislative rule for all natural resources stating:

> 123.4.3.7.a.1. Pollution control equipment used to eliminate, prevent, or reduce air, water, or noise pollution **resulting directly from production activity**.

W. Va. Code R. § 110-15-123.4.3.7.a.1 (emphasis added). Similarly, the examples of "pollution control equipment" in the legislative rule demonstrate that the exemption only applies where the equipment is "directly used" in the enumerated industries. *See* W. Va. Code R. § 110-15-123.1.13 ("For example, a scrubber used to clean air emissions from a manufacturing facility would be directly used in manufacturing or a slurry pond used to collect runoff from a mine would be directly used in the production of natural resources."). The import of these examples is clear. In order to be exempt, Antero's Porta-Potties must be directly related to the production of natural resources; however, they are not. Restroom facilities are conspicuously absent from the scope of pollution control or environmental quality or protection. There is a qualitative difference between smokestack scrubbers and coal slurry ponds, as quoted above, versus Porta-Potties.

Contrary to Antero's argument, Auditor Furbee's testimony supports classifying Porta-Potties as a taxable indirect use. *See* Antero's Sup. Ct. Br. at 29-30; OTA Decision at AR 0026 (quoting OTA Tr. at AR 0316). Ms. Furbee testified that Porta-Potties and related disposal charges, were not directly used in the production of natural resources. These charges were related to the Crew Quarters which consisted of sleeping quarters for the directional drillers, breakrooms, restroom facilities, and kitchenettes. The Crew Quarters are not directly used in the production of natural gas and oil. Every time these ancillary activities are mentioned in the legislative rule, they are specifically classified as an indirect use which is taxable. *See e.g.*, W. Va. Code § 11-15-2(b)(4)(B)(iii) (personal comfort of personnel classified as indirect by statute); W. Va. Code R. § 110-15-123.3.2.3 (employee lounges); W. Va. Code R. § 110-15-123.4.3.6.a.11 (bathhouses and eating areas). Argued below at AR 1130-31; AR 1133-35; AR 1206-08; AR 0182-83.

If the Legislature had meant for Porta-Potties to be classified as a direct use exemption, the Legislature could have easily done so.

D. 3. Porta-Potties Are Not Exempt Under the Direct Use Exemption Based on Legal Log Correspondence.

Finally, Antero argues that Porta-Potties should be exempt based on Legal Log correspondence from the State Tax Department. *See* Antero Sup. Ct. Br. at 33-36. This argument relies on Legal Log 01-003 which summarily concluded that Porta-Potties are safety items if used in the manufacturing process. *See* Antero Sup. Ct. Br. at 33-34.

As argued above, OTA only devoted a single page to the issue of Porta-Potties. *See* OTA Decision at AR 0030-31. During the administrative hearing, Chief Administrative Law Judge Heather Harlan admitted eight letters from the legal log into the administrative record over the objection of the Tax Department. However, ALJ Harlan stated that she would give the letters the

weight they deserve when making her decision.[4] *See* OTA Tr. at AR 0298-301. The OTA Decision did not even mention the legal log correspondence. Consequently, OTA did not rely on the legal log correspondence in its decision.

The Tax Department consistently argued that the Legal Log correspondence carried no legal authority and should not be relied on by the Court. Argued below at AR 1204-05. The Circuit Court agreed and ruled that Antero's reliance on the Legal Log correspondence simply fails upon analysis. *See* AR 1231-32. The same reasoning applies before this Court. As argued above in Section C.3., Antero's reliance on the legal log correspondence fails. The letters are not Technical Assistance Advisories and have no precedential value under the law. Assuming *arguendo* that the Supreme Court chooses to construe the letters as a Technical Assistance Advisory, the TAA only applies to the particular taxpayer who requested the legal advice for the particular transaction in the letters. *See* W. Va. Code § 11-10-5r(a). Therefore, the Coal Company that requested the letter could rely on Legal Log 01-003; but, Antero cannot do so.

Significantly, the analysis in Legal Log 01-003 was both conclusory and contrary to the plain language of the law. Legal Log 01-003 simply stated that portable toilets are safety items with no analysis beyond that conclusory statement. *See* AR 0756 at Point 4. Both the statute and the legislative rule state that the safety equipment must be resulting from or directly related to the production of natural resources. *See* W. Va. Code § 11-15-2(b)(4)(A)(xii); W.Va. Code R. 110-15-123.4.3.7.a.3. Legal Log 01-003 does not even mention the language in the statute or legislative rule or attempt to explain how portable toilets can be used directly in the production process. It is a *non sequitur* to argue that Porta-Potties are directly used in the production of natural resources.

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[4] Sometime after the administrative hearing was completed, Chief ALJ Harlan resigned from OTA. A. M. Pollack was appointed as the new Chief ALJ to replace Ms. Harlan. Chief ALJ Pollack wrote the OTA Decision which was reversed by the Circuit Court and is before this Court on appeal by Antero.

Furthermore, it is well settled that estoppel may not be invoked against the state when acting in a governmental capacity. *See, e.g., W. Md. Ry. Co. v. Goodwin*, 167 W. Va. 804 at 819-821, 282 S.E. 2d 240 at 250-251(1981); Syl. Pt. 3, *Freeman v. Poling*, 175 W. Va. 814 at 819-820, 338 S.E. 2d 415 at 420-421 (1985). Therefore, to the extent that the Tax Department may have provided erroneous advice to the Coal Company in Legal Log 01-003, the Coal Company may be entitled to rely on the letter; but, Antero cannot. Furthermore, the general principle of estoppel which prohibits a litigant from asserting estoppel against the state was codified by the Legislature in W. Va. Code § 11-10-5r which limits Technical Assistance Advisories to the particular taxpayer who requested the advice.

Since the conclusory opinion in Legal Log 01-003 contradicts the plain language of the statute and the legislative rule, Legal Log 01-003 does not support Antero's argument that Porta-Potties qualify for the direct use exemption. The Circuit Court correctly reversed the OTA decision regarding the Porta-Potties and related sanitary charges. *See* AR 1238.

ERROR E. THE CIRCUIT COURT CORRECTLY RULED THAT TRASH BINS DO NOT QUALIFY AS DIRECT USE PURCHASES.

Antero argues that the trash bins and trash trailers rented for use at its various drilling sites in West Virginia should be exempt from consumers sales tax as direct use purchases for the production of natural resources. Antero argues that the trash bins were used for the removal of "commercial waste" including the disposal of mud products and packaging for drilling parts. In addition, Antero argues that the trash bins are required under the OSHA rules in order to prevent a menace to public health and to preserve sanitary conditions. *See* Antero's Sup. Ct. Br. at 36-40.

The Tax Department classified the trash bins as subject to consumers sales tax because the trash bins were used in activities that were incidental or remote to the production of natural resources. Contrary to Antero's argument, Auditor Furbee testified that it was her understanding

that no mud or other drilling related trash was put into the trash bins or trash trailers. Therefore, the trash bins were not a direct use purchase. Argued below at AR 1136-37; AR 0183-84. The Tax Department acted correctly based upon the facts provided by Antero during the audit.

The direct use exemption specifically addresses waste removal activities which can be classified as a direct use purchase and states "[s]toring, removal or transportation of economic waste resulting from the activities of ... the production of natural resources;..." W. Va. Code § 11-15-2(b)(4)(A)(xii). Although the statute does not include the words "directly related", the statute obviously states that the waste must be **resulting from** the production of natural resources.

In addition, the statute includes the modifier "economic" in relation to the term "waste". Therefore, some meaning must be ascribed to the term "economic" as it modifies waste. The statute and the legislative rule do not define the term "economic waste" and Antero even admits as much. *See* Antero's Sup. Ct. Br. at 38. According to the rules of statutory construction, undefined terms in a statute shall be given their ordinary, everyday meanings. *See, e.g.*, Syl. Pt. 5, *Daily Gazette Co., v. W. Va. Dev. Office*, 206 W. Va. 51, 521 S.E. 2d 543 (2001). The American Heritage College Dictionary, Third Edition (1973), defines the word "economic" as "[o]f or relating to the production, development, or management of wealth, as of a country or household" in the primary definition. Therefore, the term "economic waste" should be read as waste related to the production, development and management of the production of natural resources.

Nevertheless, Antero argues that 90% of the waste from the job site is commercial waste. Antero's preferred term of "commercial waste" is not found in the direct use exemption statute or in the legislative rule. *See* W. Va. Code § 11-15-2(definitions); W. Va. Code R. § 110-15-123. Essentially, Antero uses the term "commercial waste" in the generic sense of any waste generated

by a business. In short, Antero is arguing that storage, removal and transportation of virtually all waste, from the drill site is economic waste. *See* Antero's Sup. Ct. Br. at 37-38.

The legislative rule further addresses the scope of economic waste.

> Tangible personal property or services used in the storage, removal or transportation of **economic waste directly resulting from** the activities of transportation, communication, transmission, manufacturing production, production of natural resources, or in contracting activity during the period July 1, 1987 to February 28, 1989. For example, **trash bins used to store waste directly resulting** from manufacturing are directly used in manufacturing.

W. Va. Code R. § 110-15-123.3.1.12. (emphasis added). By requiring that the waste must be directly "resulting from" the production of natural resources, the legislative rule reflects the language in the statute that the economic waste **must result from** the production of natural resources. The legislative rule is proper. *See* Syl. Pt. 5, *Appalachian Power v. State Tax Dep't*, 195 W. Va. 573, 466 S.E. 2d 424 (1995).

If the Legislature had intended for virtually all waste to be exempt under the direct use concept, as argued by Antero, then the Legislature would not have limited direct use to waste resulting from the production of natural resources or added the modifier "economic" in the statute. The Legislature would have simply stated that waste removal is a direct use purchase. Courts have long recognized that each word of a statute must be given some effect and a statute must be construed in accordance with the import of its language. *See e.g., Davis Mem'l Hosp. v. State Tax Comm'r*, cited *supra*, (Syl. Pt. 6. "A cardinal rule of statutory construction is that significance and effect must, if possible, be given to every section, clause, word or part of the statute."); and Syl. Pt. 3, *Meadows v. Wal–Mart Stores, Inc.*, cited *supra*. By limiting the application of the direct use exemption to waste removals resulting from the production activity, the Tax Department has complied with the requirements of both the statutory language and the legislative rule.

Furthermore, Antero argues that the definition of the production of natural resources includes "waste disposal"; therefore, Antero argues that the trash bins and dumpsters should be exempt as direct use purchases. Antero bases this specific argument on, *inter alia*, the legislative rule and specifically cites to W. Va. Code R. § 110-15-123.4.3. *See* Antero's Sup. Ct. Br. at 38-39 n.116. However, Antero has ignored the most critical portion of Section 123.4.3 a few pages later in the rule which only lists two direct use purchases for the production of oil and natural gas drilling rigs and chemicals used in gas and oil well completion. *See* W. Va. Code R. § 110-15-123.4.3.7.d. (1993). No other purchases are listed in the legislative rule as direct use purchases.

Further, Antero argues that waste disposal could be exempt as pollution control required pursuant to OSHA regulations. *See* Antero's Sup. Ct. Br. at 38-39. The consumers sales tax statute expressly requires that pollution control, environmental quality or protection activities must be "... **directly relating** to....the production of natural resources...." W. Va. Code § 11-15-2(b)(4)(A)(xiii)(emphasis added). The argument is contrary to the plain language of the statute.

Antero argues that the DEP List for Pollution Control Abatement Equipment should be read to exempt rental charges for trash bins and dumpsters. *See* Antero's Sup. Ct. Br. at 38-39. However, the ad valorem valuation statutes related to Pollution Control specifically require that the DEP must approve the design, construction and installation of the tangible personal property as a Pollution Control Facility. *See* W. Va. Code § 11-6A-2, *supra*. Antero has provided no evidence to support the argument that the DEP actually approved the design, construction and installation of trash bins as Pollution Control Abatement Equipment.

Finally, Antero argues that trash bins could also be exempt as a safety item. *See* Antero's Sup. Ct. Br. at 39-40. This argument fails as well. The direct use exemption expressly states that purchases related to "... personnel, plant, product or community safety .... **directly used** in the

production of natural resources...." are exempt. W. Va. Code § 11-15-2(b)(4)(A)(xiii). According to the legislative rule, safety items qualify as a direct use purchase "... but only if used directly in the production process." *See* W. Va. Code R. § 110-15-123.4.3.7.a.3 (emphasis added). The legislative rule for all qualifying industries further requires safety items must be directly used in the qualifying industry. *See also* W. Va. Code R. § 110-15-123.3.1.14.

V. CONCLUSION

The Tax Department correctly applied the direct use exemption when it audited Antero's operations in West Virginia. The Circuit Court of Kanawha County correctly ruled that the Office of Tax Appeals lacked jurisdiction to "moot" portions of a statute and to create its own test for exempting transactions from the consumers sales tax. Antero Resources has failed to meet its burden of proof and failed to prove that the purchases which were taxed in the audit were, in fact, directly used in the production of natural resources as required by law. The Supreme Court should affirm the decision of the Honorable Charles E. King, Jr., as entered on November 15, 2018.

Respectfully submitted,

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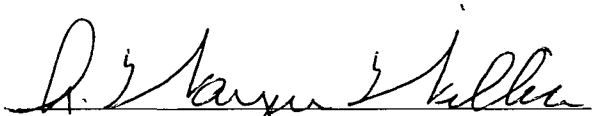

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