

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

January 2005 Term

No. 31735

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SUPREME COURT OF APPEALS
OF WEST VIRGINIA

MT. STATE BIT SERVICE, INC.,
A WEST VIRGINIA CORPORATION,
Petitioner Below, Appellant,

v.

STATE OF WEST VIRGINIA,
DEPARTMENT OF TAX AND REVENUE,
Respondent Below, Appellee

Appeal from the Circuit Court of Monongalia County
The Honorable Russell M. Clawges, Jr., Judge
Case No. 98-C-AP-76

REVERSED

Submitted: January 11, 2005
Filed: February 10, 2005

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CHIEF JUSTICE ALBRIGHT delivered the Opinion of the Court.
JUSTICES DAVIS and MAYNARD dissent and reserve the right to file dissenting opinions.
JUSTICE STARCHER concurs and reserves the right to file a concurring opinion.

SYLLABUS BY THE COURT

An individual or business entity who is not subject to the severance tax but seeks exemption from the use tax imposed by the West Virginia Department of Tax and Revenue pursuant to West Virginia Code § 11-15-9(g) (1987) [now W.Va. Code § 11-15-9(b)(2) (2002)] based on its involvement in the production of natural resources must demonstrate that the sale or service for which exemption is sought is directly used or consumed within the production process and that such entity is engaged in one or more activities or operations that constitute the act or process of producing natural resources within the meaning of applicable statutory and regulatory provisions.

Albright, Chief Justice:

Mt. State Bit Service, Inc. (hereinafter referred to as “Taxpayer”) appeals from the June 17, 2003, ruling of the Circuit Court of Monongalia County upholding the assessment of a use tax against Taxpayer in connection with its out-of-state purchase of blasting materials that were subsequently used in this state. Arguing that it is entitled to an exemption from the use tax based on its status as either a producer of natural resources or as a contractor, Taxpayer seeks relief from the tax assessment at issue. After careful review of the arguments raised by Taxpayer in conjunction with the applicable statutes and regulations, we conclude that the lower court committed error in upholding the tax assessment. Accordingly, the decision of the lower court is reversed.

I. Factual and Procedural Background

The business that Taxpayer operates in Morgantown, West Virginia, is primarily involved in the sale of explosive materials and blasting supplies, but secondarily includes the direct use of those blasting materials by Taxpayer. While ninety percent of Taxpayer’s business involves the sale of blasting materials and supplies, the remaining ten percent of the business involves the use of Taxpayer’s own employees to perform blasting services for its customers. The provision of these blasting services, and not the sale of explosive materials, is the subject of the use tax assessment at issue in this appeal.

As the result of an audit performed by the West Virginia Department of Tax and Revenue (“Tax Department”), Taxpayer was assessed a use tax¹ in the amount of \$78,443 for the 1990, 1991, and 1992 tax periods² and interest in the amount of \$11,245³ for a total due of \$115,152. The use tax was assessed on supplies Taxpayer purchased from out-of-state vendors that it then used to perform blasting services for a small percentage of its customers.

Taxpayer filed a timely petition for reassessment, arguing that the use tax assessment was improperly levied against it based on its entitlement to a tax exemption as either a producer of natural resources⁴ or as a contractor.⁵ By decision dated July 20, 1998, an administrative law judge affirmed the use tax assessment on the grounds that neither of the two exemptions raised by Taxpayer were applicable. Taxpayer appealed the administrative decision to the circuit court, who affirmed the decision by order dated

¹Taxpayer was also assessed a consumer sales and service tax as a result of the audit, but that assessment is not the subject of this appeal as Taxpayer conceded its obligation to pay such tax during the administrative proceedings below.

²The use tax assessment covered the period of February 1, 1990, to December 31, 1992.

³The interest figure will accrue until the date of actual payment.

⁴See W.Va. Code § 11-15-9(g) (1987).

⁵See W.Va. Code § 11-15-8a (1989) (Repl. Vol. 1991).

June 17, 2003. Through this appeal, Taxpayer seeks relief from the lower court's affirmance of the use tax assessment.

II. Standard of Review

Our review in this case is *de novo*, given the tax questions presented which require interpretation of both statutes and regulations promulgated in furtherance of those statutory provisions. *See* Syl. Pt. 1, *Appalachian Power Co. v. State Tax Dep't*, 195 W.Va. 573, 466 S.E.2d 424 (1995) (holding that "[i]nterpreting a statute or an administrative rule or regulation presents a purely legal question subject to *de novo* review"). We proceed to review this matter to determine whether the circuit court committed error by upholding the administrative affirmance of the use tax assessment issued against Taxpayer.

III. Discussion

The first exemption asserted by Taxpayer is referred to as the "producer" exemption and it extends relief from taxation to

[s]ales of property or services to persons engaged in this state in the business of contracting, manufacturing, transportation, transmission, communication or in the *production of natural resources*: Provided, That the exemption herein granted shall apply only to services, machinery, supplies and materials *directly used* or consumed in the businesses or organizations named above

W.Va. Code § 11-15-9(g) (1987) (emphasis supplied).

To determine who is engaged in the “production of natural resources,” we look to the definition provided by statute. This term encompasses entities who engage in the performance, by either the owner of the natural resources or another, of the act or process of exploring, developing, severing, extracting, reducing to possession *and* loading for shipment for sale, profit or commercial use of any natural resource products and any reclamation, waste disposal or environmental activities associated therewith.

W.Va. Code § 11-15-2(t) (1987) (emphasis supplied).

Viewing its blasting services as falling within the delineated mining activity of severing,⁶ Taxpayer asserts that it qualifies as a producer of natural resources. Conversely, the Tax Department views the statutory inclusion of the term “and” as significant and takes the position that unless a taxpayer engages in the complete list of activities or operations identified within the definition of “production of natural resources,” the subject exemption cannot be invoked. *See id.*

The position advocated by the Tax Department – requiring an all or none approach to the exemption’s application – does not withstand scrutiny. The Tax Department’s contention that the exemption is available to only those entities who engage

⁶While the term “severing” is not defined by statute, the regulations provide that this mining related activity “means the physical removal of the natural resources from the earth or waters of this State by any means or from the waste or residue of prior mining.” 110 W.Va.R. *Taxation* § 15.123.4.3.2.

in the complete list of activities or operations designated to embody the “production of natural resources” quickly collapses upon examination. It stands to reason that although business entities may engage in several of the qualifying activities, they will not necessarily engage in each and every one of the statutorily-delineated list of activities or operations that begins with exploring and ends with loading for shipment. To illustrate this point, we are doubtful that the Tax Department denies the exemption to a company that comes in to work a coal mine after the exploration stage has been completed based solely on the taxpayer’s non-participation in the development stage of the mining process. In addition, the inclusion of activities that are clearly limited in scope such as reclamation, waste disposal, or other environmental activities as operations that qualify for the exemption suggests a legislative intention of extending the exemption to entities that perform less than the full gamut of delineated mining activities or operations.

We are not persuaded by the Tax Department’s argument that the exemption at issue was only intended to apply to those entities who pay the severance tax.⁷ As Taxpayer correctly explains, the regulations make clear that the producer exemption was not written to solely benefit those entities paying severance taxes. Pursuant to the regulations, an entity who pays severance tax, in comparison to non-severance tax payers, does receive a benefit. By paying severance taxes, a taxpayer is exempted from having to meet the “direct

⁷The Tax Department suggests that the purpose of the legislative and statutory scheme under consideration was to benefit those entities who pay severance taxes.

use” test that ordinarily must be fulfilled before the producer exemption can be implemented. *See* 110 W.Va.R. *Taxation* § 15.123.4.3.4.; W.Va. Code § 11-15-9(g). Regardless of the benefit severance tax payers receive by not having to prove direct use for items on which they paid severance tax, the producer exemption is still available to non-severance tax payers. To qualify for the exemption, the non-severance tax paying entities are simply required to demonstrate that the goods or services at issue are “directly used or consumed.” W.Va. Code § 11-15-9(g).⁸

⁸The term “directly used or consumed” is defined as follows:

(n)(1) “Directly used or consumed” in the activities of contracting, manufacturing, transportation, transmission, communication or the production of natural resources shall mean used or consumed in those activities or operations which constitute an integral and essential part of such activities, as contrasted with and distinguished from those activities or operations which are simply incidental, convenient or remote to the activities.

(2) Uses of property or consumption of services which constitute direct use or consumption in the activities of contracting, manufacturing, transportation, transmission, communication or the production of natural resources shall include only:

. . . .

(B) Causing a direct physical, chemical or other change upon property undergoing manufacturing production or production of natural resources or which is the subject of contracting activity;

W.Va. Code § 11-15-2(n)(1), (2) (1987).

As a non-severance tax paying entity, Taxpayer argues that it meets the “direct use” test based on the statutory definition, which defines direct use to include the “[c]ausing [of] a direct physical, chemical or other change upon property undergoing . . . production of natural resources. . . .” W.Va. Code § 11-15-2(n)(2)(B). When it engages in blasting services for its customers, Taxpayer maintains that the changes to the property caused by the performance of such blasting activities squarely fall within the statutory definition provided for “direct use.” *See id.* As further support for this position, Taxpayer cites the regulatory specification of “[b]lasting equipment and explosives” as “examples of exempt items” based on the direct use of such items “when used by a person engaged in the business of production of natural resources.” 110 W.Va.R. *Taxation* §§ 15.123.4.3.7; 15.123.4.3.7.b.4.

Given the statutory definition of direct use combined with the clear regulatory identification of blasting materials as items constituting direct use, the only hurdle Taxpayer must clear to assert the producer exemption is to come within the definition of “[p]roduction of natural resources.” W.Va. Code § 11-15-2(t). To resolve the critical issue of whether Taxpayer fulfills the statutory definition of being a producer of natural resources, we turn again to the regulations for guidance in resolving this definitional query. Pursuant to applicable regulatory provisions,

Contract miners or cutters are considered to be engaged in the production of natural resources and their purchases are subject to the direct use concept when engaged in the activities outlined

in Section 123.4.3⁹ of these regulations. Purchases made by a contract miner or cutter for direct use in the production of natural resources are exempt, while purchases made for indirect use are taxable.

110 W.Va.R. *Taxation* § 15.123.4.3.5 (footnote added).

We acknowledge that under a strict interpretation of the requirements necessary to qualify as a contract miner or cutter, Taxpayer does not fit neatly into either of those two occupational descriptions. In describing those positions, the regulations provide: “A contract miner or cutter is a person engaged as an independent contractor in producing natural resources which are owned by others.” 110 W.Va.R. *Taxation* § 15.123.4.3.5. Thus, the regulations require that the entity must be an independent contractor who is hired to engage in activities that qualify as mining-related under the “[p]roduction of natural resource” definition. W.Va. Code § 11-15-2(t). While Taxpayer easily qualifies as an independent contractor, the critical, but unresolved, question remains as to whether in performing his blasting services he is fulfilling the definitional purview of “[p]roduction of natural resources.” *See id.*

⁹The activities included in Section 123.4.3 are the same list of mining activities or operations identified in West Virginia Code § 11-15-2(t): “the act or process of exploring, developing, severing, extracting, reducing to possession and loading for shipment. . . .” 110 W.Va.R. *Taxation* § 15.123.4.3.

Having come full circle now, we are back where we started with the initial question of whether to qualify as a producer of natural resources and be entitled to the exemption at issue, an entity must be engaged in the complete laundry list of mining operations provided by statute. *See id.* Given the admittedly circular nature in which these statutory definitions and regulations have been drafted, we find ourselves with a paucity of useful guidance to aid us in resolving this issue of statutory interpretation. And, while we are certainly cognizant of the practice of according deference to administrative law decisions, we find little other than conclusory statements in the administrative ruling below on the critical issues under consideration.¹⁰ *See Lincoln Co. Bd. of Educ. v. Adkins*, 188 W.Va. 430, 434, 424 S.E.2d 775, 779 (1992) (requiring that deference be shown to administrative bodies charged with implementation of specific bodies of law unless clearly erroneous); *Boley v. Miller*, 187 W.Va. 242, 246, 418 S.E.2d 352, 356 (1992) (recognizing that administrative interpretations of statutes are given great weight unless unduly restrictive and in conflict with legislative intent).

Taxpayer argues that it is illogical to suggest that the Legislature would have intended certain “bit players” in the mining process, such as those who are hired to perform limited post-mining operations, like reclamation and waste removal, to benefit from the use

¹⁰We note that the administrative law judge never made any findings on the issue of direct use or to support its position that Taxpayer was not a producer of natural resources.

tax exemption, while someone who performs a service that is integral to the mining process, such as itself, is denied the exemption. We find Taxpayer's argument on this issue to be compelling. Without the blasting services that it performs for those customers who do not regularly employ a licensed blaster, the coal that is embedded in the overburden could not be mined. Consequently, there can be no dispute that the blasting services at issue are "an integral and essential part" of the mining process itself and not merely "incidental, convenient or remote to such activities." W.Va. Code § 11-15-2(n)(1). Without a doubt then, the blasting services performed by Taxpayer are "directly used" in the process or act of producing natural resources. *Id.* To limit the producer exemption to only those entities whose involvement in the production of natural resources includes each and every listed aspect of the mining process seems counterintuitive. Rather than focusing in such an exclusive manner on meeting a definition that arguably was never intended to operate in such a limiting fashion, we think the better test is to turn the exemption's application on the issue of meeting the "direct use" test, provided that the entity seeking the exemption can qualify as performing at least one of the delineated mining activities or operations. This result seems more in accord with the intent of the legislation at issue and should not serve to improperly extend the exemption to entities not contemplated by the Legislature as being subject to its benefit.¹¹ See *Carper v. Kanawha Banking & Trust Co.*, 157 W.Va. 477, 517,

¹¹If this Court has wrongly interpreted the statute and regulations under discussion, we are confident that the Legislature will quickly act to remedy any misinterpretation on our part.

207 S.E.2d 897, 921 (1974) (recognizing that ““courts have power to change and will change “and” to “or” and vice versa, whenever such conversion is required by the context, or is necessary to harmonize the provisions of a statute and give effect to all of its provisions, or to save it from unconstitutionality, or, in general to effectuate the obvious intention of the Legislature””) (quoting 50 Am. Jur. *Statutes* § 281 (1944)).

Accordingly, we hold that an individual or business entity who is not subject to the severance tax but seeks exemption from the use tax imposed by the West Virginia Department of Tax and Revenue pursuant to West Virginia Code § 11-15-9(g) (1987) [now W.Va. Code § 11-15-9(b)(2) (2002)] based on its involvement in the production of natural resources must demonstrate that the sale or service for which exemption is sought is directly used or consumed within the production process and that such entity is engaged in one or more activities or operations that constitute the act or process of producing natural resources within the meaning of applicable statutory and regulatory provisions. *See* W.Va. Code § 11-15-9-2(t); 110 W.Va.R. *Taxation* § 15.123.4.3. As discussed above, the blasting services for which Taxpayer seeks exemption from use tax assessment clearly constitute a direct use under both the statutory definition and the regulations which expressly identify blasting and explosive materials as items that are directly used in the production of natural resources. *See* W.Va. Code § 11-15-2(n)(2)(B); 110 W.Va.R. *Taxation* § 15.123.4.3.7.b.4. In this Court’s opinion, Taxpayer comes within the statutory definition of “[p]roduction of natural

resources” in connection with its severance-related blasting activities. W.Va. Code § 11-15-2(t). But for the blasting operations performed by Taxpayer, the coal could not easily be removed from the overburden and placed into production. Consequently, we find that the lower court was in error in affirming the use tax assessment against the Taxpayer. Under the reasoning stated above, we conclude that on the facts of this case Taxpayer is entitled to an exemption from use tax under the provisions set forth in West Virginia Code § 11-15-9(g).¹²

Based on the foregoing, the decision of the Circuit Court of Monongalia County is hereby reversed.

Reversed.

¹²Given our determination that an exemption from the use tax was available to Taxpayer under W.Va. Code § 11-15-9(g), we do not proceed to consider the applicability of the contractor exemption set forth in W.Va. Code § 11-15-8a.