IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

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CATHY S. GATSON, CLERK
KANAWHA COUNTY CIRCUIT COURT

ANTERO RESOURCES CORPORATION,
Petitioner Below, Respondent,

v. Civil Action No. 18-AA-218

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

FINAL ORDER GRANTING THE WEST VIRGINIA STATE TAX DEPARTMENT'S PETITION FOR APPEAL

ON A PRIOR DAY the West Virginia State Tax Department filed an appeal from the decision of the West Virginia Office of Tax Appeals which reduced an assessment for Consumers Sales Tax issued against Antero Resources Corporation. Specifically, the Tax Department sought judicial review of the administrative decision in OTA Docket Numbers 15-040 CU and 15-041 CU pursuant to W. V. Code § 11-10A-19. The Court has reviewed the pleadings in this matter filed by the State Tax Department and Antero Resources, reviewed the administrative decision before the Court, reviewed the statutory language and the prevailing case law. The Court concludes that oral argument by the Parties is not necessary to decide the issues on appeal. *See* Rule 6(b), Rules of Procedure for Administrative Appeals.

Based upon the administrative record and the pleadings in this matter, the Court reverses the decision of the WV Office of Tax Appeals and affirms the two Consumers Sales Tax assessments in this matter for the reasons set forth below.

I. PROCEDURAL BACKGROUND

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). Generally, the tax assessments included the rental of five types of tangible personal property and services utilized by Antero in its horizontal drilling operations. The property included 1) skid houses or crew quarters used at the drilling sites; 2) generators and equipment used to supply power to the skid houses; 3) equipment used to provide potable water at the drill sites; 4) equipment used to provide sanitation and sewage to the drill sites; and 5) dumpsters used to store waste until it is removed from the drill sites. *See* Office of Tax Appeals Decision, OTA Docket Numbers 15-040 CU and 15-041 CU (hereinafter, OTA Decision) at p. 2.

The Tax Department issued one assessment against Antero Resources for $1,070,940 in combined sales and use tax plus interest and a second assessment against Antero Resources Bluestone for $1,058 plus interest. The audit period covered the calendar years of 2011, 2012, and 2013. *See* Audit Notice of Assessment, OTA Administrative Record, Document 18 (hereinafter, OTA Record). Subsequently, the two corporations merged and the administrative hearings were combined. The Office of Tax Appeals consolidated the two combined Consumers Sales Tax and Use Tax assessments (hereinafter, Consumers Sales Tax). *See* OTA Decision at p. 2.

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 only 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.

The Office of Tax Appeals agreed with Antero Resources 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* OTA Decision at pp. 2 & 16. The Tax Department timely appealed the OTA Decision to the Circuit Court of Kanawha County seeking judicial review of the erroneous administrative decision. *See* W. Va. Code §§ 11-10A-18 and 11-10A-19; *see* also W. Va. Code § 29A-5-4.

II. STANDARD OF REVIEW

In essence, the circuit court sits as an appellate court in reviewing the decisions of administrative agencies. The standard of review on appeal is well-settled. Legal questions before the court are subject to *de novo* review. *See* Syl. pt. 1, *In re Tax Assessment Against American Bituminous Power Partners, L.P.*, 208 W. Va. 250, 539 S.E.2d 757 (2000). On the other hand, factual findings made by the WV Office of Tax Appeals or any other administrative agency receive deference. *See* Syl. pt. 2, *CB&T Operations Co., Inc. v. Tax Commissioner of State*, 211 W. Va. 198, 564 S.E.2d 408 (2002).

According to the WV Administrative Procedures Act:

> (g) The court may affirm the order or decision of the agency or remand the case for further proceedings. It shall reverse, vacate or modify the order or decision of the agency if the substantial rights of the petitioner or petitioners have been prejudiced because the administrative findings, inferences, conclusions, decision or order are:
>
> (1) In violation of constitutional or statutory provisions; or

(2) In excess of the statutory authority or jurisdiction of the agency; or

(3) Made upon unlawful procedures; or

(4) Affected by other error of law; or

(5) Clearly wrong in view of the reliable, probative and substantial evidence on the whole record; or

(6) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

W. Va. Code § 29A-5-4(g). The Court finds that the OTA Decision violates the Administrative Procedures Act on several fronts and must be reversed.

III. FINDINGS OF FACT

One fact set forth in the OTA Decision holds critical importance in the Court's analysis. The Office of Tax Appeals found that Antero Resources "...is **contractually bound** to provide housing on the well pad for the directional drillers." *See* Finding of Fact 13, below, (emphasis added). Furthermore, the OTA Decision reasserted this erroneous conclusion and stated, "It is the directional drillers who stay in the skid houses and they, (the skid houses) are there because Antero is **contractually bound** to provide them." OTA Decision at p. 7 (last sentence; emphasis added). It is clear to the Court that when the Office of Tax Appeals concluded that Antero was "required" to provide housing for its subcontractor, the directional drillers, the Office of Tax Appeals has elevated a contractual requirement between Antero and its subcontractors to the status of a direct use requirement under the Consumers Sales Tax. *See* OTA Decision at p. 10. The Office of Tax Appeals clearly lacks any authority to do so.

The Court adopts the findings of fact set forth in the OTA Decision as listed below.[1]

[1] The Court adopts the Findings of Fact verbatim from the OTA Decision at pp. 2-5.

1. The Petitioner is a C corporation with its corporate offices in Denver, Colorado. TR P9 at 17-18.

2. The Petitioner's business consists of what it characterizes as "drilling for minerals". It conducts these drilling operations in numerous states, including West Virginia.

3. A typical drilling site of Antero's will consist of the "drilling rig" and various pieces of supporting equipment. Included among this equipment are machines to generate electricity, provide potable water, provide sanitation, and treat sewage. A typical site also contains what Antero calls "skid houses", or crew quarters, which are modular buildings to provide temporary housing and office space.

4. In a typical drilling operation of Antero's, it will not own any of the equipment on site, but rather will rent it all. TR P27 at 6-22.

5. The actual drilling takes place on what Antero calls a "pad". A pad can contain anywhere from two (2) to eight (8) wells (a well being the actual hole drilled into the ground) TR P11 at 6-7. These wells can be as close as ten feet apart. TR P18 at 8.

6. Petitioner's Exhibit 19 is a photograph of a typical drilling site operated by Antero.

7. A typical well pad will have thirty (30) to forty (40) people working at any one time. TR P19 at 5-6. Virtually all of those people will be employed by the company from which Antero rents the drilling rig. TR P33 at 3-5. The drilling rig rental company will have a person in charge at the pad site, and that person's job title is "tool pusher". TR P34-35 at 18-5.

8. The Petitioner will typically have one person on the pad site who is their direct representative, and their job title is "company man". TR P20 at 6-12. However, even the company man is a subcontracted employee of a specialized consulting firm, and is not employed by Antero, TR P50 at 1-5.

9. Due to the close proximity between the well holes, it is imperative to Antero that each well travel in a straight line, to ensure that the drill bit does not stray and break a pipe in a nearby well hole. TR P37 at 1-6. To that end, Antero subcontracts with specialists called "directional drillers", whose main job function is to prevent that scenario from happening.

10. There are two directional drillers on the well pad at all times. Typically, each works a twelve (12) hour shift while the other is off. However, at certain times, both directional drillers have to independently, but contemporaneously, program coordinates into a computer regarding the current and future location of the drill bit. At those times, the directional driller who is "off duty" will be summoned, even if he or she is asleep, to perform this function. TR P35-37, P48 at 11-22. Both the company man and the tool pusher are also required to participate in the drill bit location programming. TR P37 at 412.

11. The company man works on the well pad site for twelve hours and then is housed in a hotel when he or she is not at the well site. TR P47 at 14-19.

12. The tool pusher is on the well pad 24 hours a day, 7 days a week, for 2 weeks at a time. TR P50 at 6-17. **When he or she is not working they stay in a trailer that is part of the drilling rig rental package.** TR P35 at 1-5. (Emphasis added by the Court.)

13. **The Petitioner is contractually bound to provide housing on the well pad for the directional drillers.** TR P38 at 11-15. (Emphasis added by the Court.)

14. During the audit in this matter the auditor found some of the rentals utilized by Antero to be subject to use tax, some to be partially subject to use tax and some to be exempt from use tax. All of these calculations were based upon whether the rented items were directly or indirectly used in the mineral extraction process.

15. Specifically, the auditor found that a percentage of the skid house/crew quarters were directly used in extraction, because a portion of them had "office space" that housed the computers that controlled the drilling. Conversely, the auditor found that the parts of the quarters that were used for "living" ie; the bedrooms, restrooms, kitchen and living area were subject to use taxes. TR P61 at 8-11.

16. The auditor also found that a portion of the equipment that supports the crew quarters, equipment such as generators was subject to use tax, because a percentage of those rentals was used to support the living quarters. TR P72 at 6-8.

17, The auditor found certain rentals to be entirely subject to use tax, those items being Porta-Potties, all equipment for portable sewage/sanitation systems, and all trash/waste dumpsters/bins.

IV. THE TAX DEPARTMENT CORRECTLY APPLIED THE STATUTE AND THE LEGISLATIVE RULE.

The first question the Court must address is whether the State Tax Department correctly applied the Consumers Sales Tax and the applicable legislative rules. 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).

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); Syl. Pt. 4, *Shawnee Bank v. Paige*, 200 W.Va. 20 488 S.E.2d 20 (1997) (Business and Occupation Tax); Syl. Pt. 5, *CB & T Operations v. Tax Commissioner of the State of West Virginia*, 211 W. Va. 198, 564 S.E. 2d 408 (2001) (Use Tax); and *Wooddell v. Dailey* 160 W. Va. 65 at ___, 230 S.E. 2d 466 at 469 (1976) (Consumers Sales Tax). Furthermore, a taxpayer who challenges a tax assessment before the Office of Tax Appeals bears the burden of proving that the assessment is erroneous. W. Va. Code § 11-10A-10(e).

Consequently, Antero Resources 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; but, Antero must prove that tangible personal property and services in the assessment were directly used in the production of natural resources. If it is a close

question, then the taxpayer has failed to meet the requisite standard of proof. The Office of Tax Appeals failed to properly apply the statutory language as crafted by the Legislature.

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.

Mr. Griffith, Counsel for Antero, argued that the assessment includes three broad categories of tangible personal property rented by Antero Resources during the audit period. The assessment was described by Mr. Griffith 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* Transcript at pp. 5-6.[2] 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 Mr. Waggoner, Counsel for the Tax Department, at OTA Transcript p. 8.

The Consumers Sales Tax assessment reflects the three broad categories as outlined by Mr. Griffith:

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

[2] The Transcript of the administrative hearing is Document 17 of the OTA Record. For the sake of simplicity, the Court will refer to the document as the Transcript.

See Tax Department's Response Brief, OTA Record, Document 11 at p. 5.

IV.A. Crew Quarters and Related Equipment.

The fundamental question is whether the Crew Quarters, or the single wide trailers rented by Antero Resources, were directly used in the production of natural resources. Are the Crew Quarters used in an activity which constitutes an integral and essential part of the production of natural gas and oil? Essentially, what are the Crew Quarters used for?

On direct examination Ms. Evelyn Furbee, Tax Unit Supervisor for the State Tax Department, 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 Transcript at P. 61: 1-22 (emphasis added). In addition, Ms. Furbee confirmed this dichotomy on cross examination. *See* OTA Transcript at P. 69:21 - P. 70:4.

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 acted consistent with the Consumers Sales Tax statute and the legislative rule.

The Consumers Sales Tax statute expressly limits the direct use exemption. The Legislature chose to enumerate fourteen different examples of the direct use exemption for the production of natural resources and the other specified industries.[3] 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;**

[3] 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.

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 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:

> 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). In addition, Ms. Furbee testified that she also viewed the well-head cage as being directly used in the production of natural resources. *See* Testimony of Evelyn Furbee at Transcript, p. 69:7-15. 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.

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. 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).

As quoted above, Ms. Furbee testified that the two-thirds of the Crew Quarters were indirectly used for the production of natural resources included the restroom, the bedrooms, the kitchenette, and the living area. *See* Transcript at P. 61:8-9 and P. 73:10-14. Furthermore, the living space also included a couch, a television, coffee pot, and a kitchenette. *See* OTA Transcript at P. 82: 6-12.

Auditor Furbee based the classification on her observations during the site visit, information provided by Antero Resources, 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 Rules § 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 Rules §§ 110-15-123.4.3.6.a.5 and 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 the Consumers Sales Tax. *See* W. Va. Code Rules § 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 Rules § 110-15-123.4.1; 123.4.1.1.k; 123.4.1.1.l; and 123.4.1.1.m.

The statutory language set forth in W. Va. Code § 11-15-2(d)(4) 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. A simple review of the legislative rules does not include any language implying that these rest areas would be exempt from the Consumers Sales Tax. In fact, 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.

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 Transcript at P. 69:12-15. The Consumers Sales Tax specifically classifies 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)(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.

Furthermore, the OTA Decision criticized the Tax Department for prorating the use of Crew Quarters between taxable and tax exempt uses. The OTA Decision stated that only "...the small portion the auditor found to be utilized for drilling..." was exempt. *See* OTA Decision at p. 10. However, the Tax Department's allocation of the percentage of the Crew Quarters directly used versus the indirect usage was based on the specifics of the single wide trailers rented by Antero. On direct examination, Mr. Alvyn Schopp, Chief Administrative Officer and Senior Regional Vice President for Antero Resources, testified regarding the use of the single wide trailers for the Crew Quarters. Mr. Schopp admitted that roughly two-thirds was used for a kitchenette and living areas. *See* Testimony of Mr. Schopp at Transcript, p. 32, lines 12-15. The "small portion" as characterized by the Office of Tax Appeals simply reflects the fact that only one-third of the Crew Quarters was dedicated to housing the computer equipment that controlled the drilling operations which is an activity that is directly used in the production of natural gas while two-thirds was dedicated to a kitchenette, restrooms, TV lounge, bedrooms and break rooms. The Tax Department correctly prorated the Crew Quarters between direct use which is exempt and indirect use which is taxable.

In its brief to this Court, Antero Resources argued that the Tax Department 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 Brief at PP. 24-25. 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. According to law, 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).

Antero has failed to cite to any language in W. Va. Code § 11-15-2(b)(4) which specifically classifies rental charges related to bedrooms, kitchenettes, bathrooms, TV lounges, and break rooms, as being directly used in the production of natural resources. Similarly, Antero has failed to point to any specific language in W. Va. Code § 11-15-2(b)(4) which would exempt rental charges related Porta-Potties and other sanitary facilities incurred in the production of natural resources. Nor has Antero cited any statutory authority to exempt the rental charges for dumpsters used merely for the normal waste disposal as opposed to the disposal of waste products related to the production of natural gas. In short, Antero is trying to reverse the burden of proof imposed by statute on all taxpayers who challenge tax assessments. W. VA. Code § 11-10A-10(e).

In the Tax Department's initial brief filed with the 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* Tax Department's Initial Brief at p. 9.

Antero abruptly dismissed the analogy and stated 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 Brief at p. 34.

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). Seven broad industries qualify according to statute for the direct use exemption. While the seven industries are quite different, they share many common elements. Antero has ignored one obvious fact – none of the seven 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.

Antero also argues that it must provide the crew-quarters including the bedrooms and restroom facilities due to the remote location of drill sites. *See* Antero's Brief at p. 4, Fact 8. However, many of the seven 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 for the production of natural resources 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. However, 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 Brief at Footnote 46. Apparently, the drill sites may not be as remote as it would appear at first glance. Consequently, the arguments of necessity due to the remote nature of the drill sites fails.

In addition, Antero argues that several 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 Brief at Footnotes 47, 48, and 49; and pp. 31-32.

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 Court notes that the Legal Log correspondence upon which Antero relies has no precedential value according to law. While a Technical Assistance 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 Court were to construe the Legal Log correspondence as Technical Assistance Advisory, the Advisories 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).[4]

Second, Antero has admitted that the Legal Log correspondence does not address the specific situation 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..."

[4] Similarly, Antero argues that Legal Log Number 01-003 supports Antero's argument that portable toilet facilities should be classified as a safety item which would be tax exempt under the direct use exemption. *See* Antero's Brief at pp. 40-42. Since the Legal Logs correspondence only applies to the party that requested the advice, Legal Log 01-003 has no precedential value for Antero. In addition, the conclusion of Legal Log 01-003 directly contradicts the legislative rule which classifies toilet supplies as being subject to consumers sales tax in the context of manufacturing and transportation as discussed *infra*.

See Antero's Brief at p.32. The administrative record is clear that the "requirement" to provide sleeping quarters and living quarters is a contractual requirement between Antero Resources and its subcontractors; Antero has failed to point out any statutory authority under West Virginia law for this "requirement." The Legal Log correspondence does not 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.

Third, and more importantly, by applying the statutory language in the direct use exemption, Auditor Furbee already complied with the spirit of the 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 Resources. 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 the Court.

The Court finds that nothing in the statutory language or the legislative rule that indicates the WV Legislature has classified restrooms, bedrooms, kitchenettes, TV Lounges, as breakrooms, as being directly used on the production of natural resources. The OTA Decision has erroneously applied the statute and the legislative rule on this issue.

IV.B. Portable Toilets, Sewage Systems, Related Water Systems, and Septic Cleaning Charges.

As Mr. Griffith explained, the second broad category in the Consumers Sales Tax assessment included the Porta-Potties, sewage systems, related water systems, and costs for

cleaning the septic systems at the drill pads. The question becomes whether the Porta-Potties, sewage systems, related water systems and costs for cleaning the septic systems, are directly used in the production of natural gas and oil.

The Court finds that the Tax Department correctly assessed Consumers Sales Tax on the bathroom related purchases for several reasons. First, 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 of the specific categories describe activities that are incorporated into the production of natural resources, direct the production of natural resources, provide power to the equipment utilized in the production of natural resources, cause a physical or chemical change in the production of natural resources, maintain or repair property used in the production of natural resources, and pollution control or environmental quality directly related to the production of natural resources. The thirteen identified categories are directly involved in producing natural resources as opposed to having a tangential relationship. All thirteen categories of purchases directly affect the production of natural resources *per se*.

In the Antero Resources tax assessment, the sanitary charges are significant and total approximately $700,000 over a three year audit period. 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. Clearly, the Legislature could have included 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. However, the Legislature chose not to do so.

The second reason that the Tax Department correctly classified the sanitary charges as indirect reflects the treatment of restrooms, bathroom facilities and general lounge areas, under the legislative rule. As argued by the Tax Department, the legislative rule is replete with examples of purchases that qualify for the direct use exemption and purchases that are taxable. None of the examples in the legislative rule authorize an exemption for restrooms, bathrooms, Porta-Potties, septic systems or other sanitary purchases. In fact, the legislative rule does not even include the words restroom, bathroom, Porta-Potties (or Porta Johns), septic systems, sanitary systems, or sewage. While the legislative rule does include three references to bath-houses, all three references are expressly listed as subject to the Consumers Sales Tax. *See* W. Va. Code Rules § 110-15-123.4.3.6.a.5; 123.4.3.6.a.6. and 123.4.3.6.a.11.

Before the Office of Tax Appeals, Antero argued that it should be allowed to claim the exemption for Port- Potties, septic systems, and sanitary systems, because the federal Occupational Safety and Health Administration required that restroom facilities must be provided at the well site. *See* Antero's initial Brief at OTA at PP. 35-39, OTA Document 12; *see* also OTA Decision at P. 13-14. There is no dispute that OSHA rules require the provision of restroom facilities at the job site under federal law. However, the question before this Court is whether the direct use exemption in the WV Consumers Sales Tax applies to Porta-Potties and sanitary systems. Simply put, this a question for the WV Legislature to determine not OSHA.

Nevertheless, the Office of Tax Appeals erroneously ruled that "... it would be critical and essential to have proper sanitation facilities for an outdoor workplace such as Antero's." OTA Decision at P. 14. The Office of Tax Appeals has substituted its judgment in place of the actions

of the WV Legislature. In addition, the OTA Decision discriminates against several of the direct use industries. The Office of Tax Appeals 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 the Office of Tax Appeals has chosen to exempt Porta-Potties, sanitary facilities, septic systems, and related water services in the production of natural gas; then all eight direct use industries could possibly claim the broadened exemption. The Office of Tax Appeals clearly lacks the authority to re-write a properly enacted legislative rule or statute.

Furthermore, the OTA Decision creates several glaring contradictions when compared to the Consumers Sales Tax statute. The Tax Department viewed the rental of Porta-Potties and sanitary systems as purchases related to the personal comfort of employees. However, the Office of Tax Appeals has ruled that Porta-Potties and septic systems are exempt from tax despite the fact that W. Va. Code § 11-15-2(b)(4)(B)(iii) expressly classifies purchases related to the personal comfort of personnel as taxable. The Legislature has clearly stated that purchases related to production planning and scheduling of work are taxable purchases under W. Va. Code § 11-15-2(b)(4)(B)(iv) while the Office of Tax Appeals has now chosen to exempt Porta-Potties. Few people would dispute that production planning and scheduling of work have a far greater impact on the production of natural resources than the availability of Porta-Potties at a remote job site.

However, the Office of Tax Appeals has chosen to re-write the clear statutory language and to expand the statutory exemption.

In addition, Antero argues that the legislative rule was promulgated in 1993 and that its "...usefulness is greatly hindered by the fact that it has not been updated...in the last quarter century." *See* Antero's Brief at p.23. Antero found the legislative rule to be confusing. *See* Antero's Brief at p.24; *see* also Antero's Brief at Footnotes 9 & 10; and p.22. Antero's assertion is an obvious attempt to circumvent the statutory language of W. Va. Code §11-15-2(b)(4) and also the legislative rule.

The legislative rule, as previously noted by this Court, actually supports the Tax Department's assessment since the rule specifically classifies supplies used in bath-houses or similar facilities as taxable purchases **for all natural resources**. *See* W. Va. Code R. § 110-15-123.4.3.6.a.5; 123.4.3.6.a.6; and 123.4.6.a.11. Antero's argument that Porta-Potties should be classified as being directly used in the production of natural resources creates an interesting contradiction. According to Antero, rental charges for Porta-Potties and other sanitary facilities should be exempt; however, the legislative rules for manufacturing and transportation clearly classify the purchase of toilet supplies as subject to the Consumers Sales Tax. *See* W. Va. Code R. § 110-15-123.4.2.1.i and 110-15-123.4.1.1.i. The contradiction is obvious. While the case before the Circuit Court deals with the production of natural resources as opposed to manufacturing, the legislative rule is applicable to Antero's assessment because manufacturing, transportation and the production of natural resources are industries subject to the same direct use statutory exemption. *See* W. Va. Code § 11-15-9(b)(2). The same principles apply. Antero has failed to cite any statutory authority or provision in the legislative rules that specifically classify

Porta-Potties or any similar sanitary facility as being directly used in the production of natural resources.

Finally, Antero argues that the Porta-Potties and other related sanitary charges should be exempt as pollution control under the Consumers Sales Tax. *See* Antero's Brief at pp. 35-37. However, the statutory language does not support Antero's argument. The Direct Use exemption is set forth in W. Va. Code § 11-15-9(b)(2). The production of natural resources has a very specific definition under the Consumers Sales Tax.

> (14) Production of natural resources....
>
> (B) **For the natural resources oil and gas,** "production of natural resources" means the performance, by either the owner of the natural resources, a contractor or a subcontractor, of the act or process of exploring, developing, drilling, well-stimulation activities such as logging, perforating or fracturing, well-completion activities such as the installation of the casing, tubing and other machinery and equipment and **any reclamation, waste disposal or environmental activities associated therewith,** including the installation of the gathering system or other pipeline to transport the oil and gas produced or environmental activities associated therewith and any service work performed on the well or well site after production of the well has initially commenced.

W. Va. Code § 11-15-2(b)(14)(B)(emphasis added). The clear import of the definition relates to waste disposal or environmental activities associated with the activity of drilling the well and reclamation activities-- not Porta-Potties or related sanitary activities for the drillers and work crews. If the Legislature had intended for pollution control to include human waste from the work crews, the Legislature would have clearly written the statute to include human waste as opposed to only gas and oil well-related waste. Porta-Potties existed in one form or another long before 1987 when the direct use exemption was added to the Consumers Sales Tax.

Furthermore, Antero's reliance on the legislative rule is misplaced for two reasons. In order to qualify as "pollution control" under the legislative rule, the action must be taken "...

primarily for the protection of the public and the public interest..." *See* W. Va. Code § 110-15-2.27.1.13.b. Antero's primary purpose is to facilitate the production of natural gas in allegedly remote locations according to Antero's business model. Furthermore, the definitions on the legislative rules expressly classify janitorial, general cleaning and the personal comfort of employees as being subject to tax. *See* W. Va. Code § 110-15-2.27.2.2 and 2.27.2.3. The sections of the legislative rule which address the definitions reflect the same position of the legislative rule which addresses the direct use exemption. *See, e.g.* W. Va. Code R. § 110-15-123.4.2.1.i and 110-15-123.4.1.1.i., which specifically classify the purchase of "toilet supplies" as being subject to the Consumers Sales Tax, discussed *supra*.

The Tax Department correctly assessed Consumers Sales Tax on the Porta-Potties and other sanitary charges because the direct use exemption and the legislative rule do not include any language authorizing or even suggesting such an exemption. Furthermore, exemptions are strictly construed against the taxpayer under West Virginia law. *See* e.g., *RGIS Inventory Specialists* and *CB&T Operations*, cited *supra*. The Legislature has the power to craft tax policy for the State; the Office of Tax Appeals does not.

IV.C. Rentals of Trash Trailers and Waste Receptacles.

The Tax Department assessed Consumers Sales Tax on the rental of dumpsters and trash removal services during the audit period. The Office of Tax Appeals ruled that the charges for the dumpsters and trash removal were exempt. *See* OTA Decision at P. 11-13. OTA ruled:

> Obviously, the removal of trash is essential, and, as Antero points out in its post hearing briefs, not doing so would cause it to run afoul of the environmental laws and potentially subject it to federal and state fines for pollution.

OTA Decision at P. 13.

Merely calling an expense "essential" does not automatically qualify that expense for the direct use exemption as written by the Legislature. The Office of Tax Appeals has ignored the statutory language. Direct use explicitly includes "[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). The OTA Decision referred to Auditor Furbee's testimony "...that no waste from the actual well hole was put into the dumpsters and rollouts at the well pad." OTA Decision at P. 11. Ms. Furbee testified that the type of waste put into the dumpsters was regular waste from the trailers, the Crew Quarters, and some packaging materials. *See* OTA Transcript at PP. 78-79. In addition, Auditor Furbee testified, "We were under the impression there's no mud products in those bins, that it had to be disposed of separately through a particular type of maybe landfill. That was our understanding." OTA Transcript at P. 79:10-12.

In assessing tax on the rental of dumpsters and trash trailers, the Tax Department relied on the legislative rule which limits the direct use exemption to "...waste directly resulting from the..." production of natural resources in this case. *See* W. Va. Code Rule § 110-15-123.3.1.12. Legislative rules have the full force and effect of law in this State. *See, e.g., Appalachian Power Company v. State Tax Department of West Virginia*, 195 W. Va. 573, 585, 466 S.E.2d 424, 436 (1995). Ms. Furbee's testimony was clear; no waste from the drilling of the well was disposed of in the dumpsters and trash trailers at the job site. The only waste put into the receptacles was from the living areas, kitchenettes, and bedrooms of the Crew Quarters which were not directly used in the production of natural resources.

V. THE OFFICE OF TAX APPEALS RE-WROTE THE DIRECT USE EXEMPTION

The Office of Tax Appeals began its analysis at the correct starting point--the direct use exemption as defined in W. Va. Code § 11-15-2(b)(4). Rather than analyzing the facts set forth in the audit and applying the statutory exemption as written, OTA declared the statutory language to be confusing and re-wrote the statutory exemption.

> **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 only:..." *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 Footnote 3 (emphasis in OTA Decision; **emphasis added**). After becoming somewhat confused, OTA chose to "moot" the thirteen specific categories of purchases as crafted by the Legislature. The focus of the OTA Decision became whether the rented items were "integral and essential" to Antero's business model in lieu of the carefully framed and deliberate statutory language. *See* OTA Decision at P. 7.

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 *Davis Memorial Hospital v. State Tax Commissioner*, 222 W. Va. 677, 671 S. E. 2d 682 (2008) (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." Syl. Pt. 3, *Meadows v. Wal–Mart Stores, Inc.*, 207 W.Va. 203, 530 S.E.2d 676 (1999)); *see* also, Syl. Pt. 2, *State v. White*, 188 W. Va. 534, 425 S.E. 2d 210 (1992).

Rather than give effect and import 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. The Legislature selected thirteen specific categories of expenses 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); and 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 purchase of tangible personal property or services which is directly used in the designated industries but not specifically listed in Subparagraphs (i) through (xiii). The "catchall" provision includes the same language found in the direct use exemption; the property must be used as an integral and essential part of the production of natural

gas. The "catch-all" provision reflects the statutory language and, contrary to the Office of Tax Appeals' assertions, does not moot Subparagraphs (i) through (xiii).

The logic is obvious and is especially applicable to the Antero Resources assessment. Ms. Furbee, the Tax Department's Auditor, testified that the computers and equipment housed in the office area section of the Crew Quarters were utilized to control the drilling equipment used by Antero in drilling horizontal oil and gas wells. Laptop computers were extremely rare in 1987 when the direct use exemption was created. Horizontal drilling was also rare until the early years of 2000. GPS, the internet, and cellphones, were not prevalent in 1987. Today all of these technological advancements are ubiquitous. The "catchall" in Subparagraph (xiv) was included to ensure that the direct use exemption did not become ossified.

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. OTA phrased its decision in terms of whether a specific purchase appeared to be "integral and essential" to Antero's business model instead of whether the purchase was directly used in the production of natural resources. As noted above, OTA concluded that Porta-Potties and septic systems were essential to the production of natural resources rather than examining the statutory language chosen by the Legislature and the purpose for which those rentals were used. The correct focus must be the use of the property at issue.

The OTA Decision focused on contractual requirements and not the statutory language. The Office of Tax Appeals found that Antero Resources "...is contractually bound to provide housing on the well pad for the directional drillers." *See* Finding of Fact 13 (emphasis added), *supra*, and OTA Decision at p. 7. It is clear to the Court that when the Office of Tax Appeals

concluded that Antero was "required" to provide housing for its subcontractor, the directional drillers, the Office of Tax Appeals elevated a contractual requirement agreed to between Antero and its subcontractors to the status of a requirement under the Consumers Sales Tax. *See* OTA Decision at p. 10. The Office of Tax Appeals clearly lacks any authority to do so.

Furthermore, the OTA Decision proceeded to apply this elevated contractual requirement as a basis for justifying the administrative decision 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 P. 10 (emphasis added). The assessment imposed tax on the portion of the Crew Quarters used to provide bedrooms, break rooms, kitchenettes, TV lounges, and restroom facilities. The OTA Decision deemed the bedrooms, break rooms, kitchenettes, TV lounges, and restroom facilities in the Crew Quarters to be essential despite the fact that the statute and legislative rule do not classify them as being directly used in the production of natural resources.

The rationale employed by the Office of Tax Appeals was circular. Antero Resources 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..." *See* OTA Decision at P. 10, as quoted immediately above. Since the on-site housing requirement is essential under the contract, the on-site housing requirement is "integral and essential" to the production of natural resources and, therefore, must be exempt under the statute. *See* OTA Decision at Footnote 3, quoted *supra*.

By mooting the thirteen specific categories chosen by the Legislature and focusing exclusively on the word "essential", the Office of Tax Appeals has created two new bases for exemptions from the Consumers Sales Tax. First, the contractual relationship between Antero and its subcontractors to provide housing and break rooms for the directional drillers was the determining factor in granting the exemption. A contractual requirement is now deemed to be essential and, therefore, results in a direct use exemption. Second, according to OTA, the cost of providing housing for two directional drillers on site at all times is now exempt because Antero "thinks" it is essential and chooses to spend money to accomplish it. According to OTA, the taxpayer can create its own exemption. Tax policy is exclusively the province of the Legislature. *See Killen v. Logan County Commission*, 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 Foundation's Woodlands Retirement Community*, 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).

Similarly, the OTA Decision ruled that the Crew Quarters 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 P. 10. Auditor Furbee apportioned the costs of the Crew Quarters based upon an analysis of 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 does not matter; 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, break areas are subject to tax.

Similarly, the OTA Decision failed to correctly apply the legislative rule. For example, OTA ruled that the legislative rule "clearly exceeded its statutory authority" by requiring that waste receptacles must be limited to waste that directly results from the production of natural resources. *See* OTA Decision at P. 11. OTA has ignored the fact that the direct use exemption only applies to purchases that are directly used or integral and essential to the production of natural resources as contrasted with incidental, convenient or remote activities. *See* W. Va. Code § 11-15-2(b)(4). The testimony at the administrative hearing was clear that the trash bins and trailers were filled with the waste from the sleeping and break areas of the Crew Quarters and not the gas wells.

VI. CONCLUSIONS OF LAW

The Court finds the following conclusions of law to be applicable to the *Petition for Appeal* filed by the State Tax Department.

1. 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.*

2. In order to prevent evasion, all sales are considered taxable until the contrary is clearly established. W. Va. Code § 11-15-6(b).

3. 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 specific industries.

> (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).

4. 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).

5. 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); Syl. Pt. 4, *Shawnee Bank v. Paige*, 200 W.Va. 20 488 S.E.2d 20 (1997) (Business and Occupation Tax); Syl. Pt. 5, *CB & T Operations v. Tax Commissioner of the State of West Virginia*, 211 W. Va. 198, 564 S.E. 2d 408 (2001) (Use Tax); and *Wooddell v. Dailey* 160 W. Va. 65 at ___, 230 S.E. 2d 466 at 469 (1976) (Consumers Sales Tax); *Davis Memorial Hosp. v. West Virginia State Tax Com'r*, 222 W. Va. 677 at 684, 671 S. E. 2d 682 at 689 (2008).

6. Furthermore, a taxpayer who challenges a tax assessment before the Office of Tax Appeals bears the burden of proving that the assessment is erroneous. W. Va. Code § 11-10A-10(e).

7. The Tax Department is not required to prove that the rental charges assessed during the audit period are subject to tax. *See* W. Va. Code § 11-15-6(b). Under West Virginia law, the

taxpayer challenging a tax assessment is required to prove that the rental charges are exempt from the Consumers Sales Tax. *See* W. Va. Code §§ 11-10A-10(e) and 11-15-6(b).

8. Legislative rules have the full force and effect of law in this State. *See, e.g., Appalachian Power Company v. State Tax Department of West Virginia*, 195 W. Va. 573, 585, 466 S.E.2d 424, 436 (1995).

9. 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.

10. The legislative rule specifically lists only two categories of purchases for the production of natural gas which would qualify for the direct use exemption:

> 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).

11. Computer equipment used to direct the drilling machinery in drilling an oil and gas well qualifies as exempt under the direct use exemption as physically controlling or directing movement or the operation in the production of natural resources. W. Va. Code § 11-15-2(b)(4)(A)(v).

12. The legislative rule which governs the Consumers Sales Tax does not include any language specifically classifying the use of living quarters such as bedrooms, bathrooms kitchenettes, and TV lounges; Porta-Potties and related sanitary systems; and trash bins used for

normal waste from the living quarters; as being directly used in the production of natural resources. *See* W. Va. Code State Rules § 110-15-123.

13. In fact, the legislative rules specifically classify couches purchased for an employee lounge as being taxable. *See* W. Va. Code State Rules § 110-15-123.3.2.3. Bathhouses, supplies for bathhouses and similar facilities are taxable. *See* W. Va. Code State Rules § 110-15-123.4.3.6.a.5 and 6.a.6. The purchase of linens, beds, kitchen appliances, stoves and coffee pots, are subject to the Consumers Sales Tax. *See* W. Va. Code State Rules § 110-15-123.4.1; 123.4.1.1.k; 123.4.1.1.l; and 123.4.1.1.m.

14. W. Va. Code § 11-15-2(d)(4) 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.

15. Rental charges for singlewide trailers used as Crew Quarters which include bathrooms, bedrooms, TV lounges, kitchenettes, and breakrooms, are not directly used in the production of natural resources. Consequently, these rental charges do not qualify for the direct use exemption set forth in W. Va. Code § 11-15-2(b)(4).

16. Rental charges for Porta-Potties, related sanitary systems, and potable water used to clean and operate the sanitary systems, not directly used in the production of natural resources. Consequently, these rental charges do not qualify for the direct use exemption set forth in W. Va. Code § 11-15-2(b)(4).

17. Rental charges for trash bins, dumpsters, and disposal charges, related to normal trash from the living quarters are not directly used in the production of natural resources.

Consequently, these rental charges do not qualify for the direct use exemption set forth in W. Va. Code § 11-15-2(b)(4).

18. The power to tax privileges is exclusively the function of the legislative branch of government. *See* W. Va. Const., Article X, § 1.

19. The West Virginia Legislature enacted the direct use exemption and enumerated thirteen specific categories of purchases and one "catch-all" provision to explain the direct use exemption. *See* W. Va. Code § 11-15-2(b)(4)(A)(i) – 2(b)(4)(A)(xiii).

20. 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). S*ee Davis Memorial Hospital v. State Tax Commissioner*, 222 W. Va. 677, 671 S. E. 2d 682 (2008)-(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." Syl. Pt. 3, *Meadows v. Wal–Mart Stores, Inc.*, 207 W.Va. 203, 530 S.E.2d 676 (1999)); *see* also, Syl. Pt. 2, *State v. White*, 188 W. Va. 534, 425 S.E. 2d 210 (1992).

21. The Office of Tax Appeals has no authority to declare that portions of a tax statute are "mooted" and to rewrite the statute accordingly. *See* W. Va. Code § 11-10A-8.

22. Any decision by the Office of Tax Appeals purporting to "moot" sections of a tax statute constitute a violation of law, are in excess of statutory authority, made upon unlawful procedures, affected by other errors of law, and are arbitrary and capricious. *See* W. Va. Code § 11-10A-8 and W. Va. Code § 29A-5-4(g).

23. The Office of Tax Appeals lacks any authority to elevate a "contractual requirement" agreed to between Antero Resources and its subcontractors, or between any private

parties, to the level of statutory exemption from the Consumers Sales Tax since the crafting of tax policy is a function of the West Virginia Legislature. *See* W. Va. Const., Article X, § 1.

VII. DISPOSITION

The administrative decision issued by the Office of Tax Appeals in OTA Docket Numbers 15-040 CU and 15-041 CU is hereby REVERSED. The tax assessment issued by the WV State Tax Department are AFFIRMED. Interest continues to accrue until the tax liability is paid in full as set forth in W. Va. Code § 11-10-17.

The objections of all parties are noted for the record and preserved.

The matter shall be stricken from the active docket of the Court.

The Clerk of the Circuit Court is directed to transmit a true copy of the Final Order to the parties at the addresses listed below.

It is so ORDERED.

Entered: 11-15-18

Charles E. King, Jr., Judge
Circuit Court of Kanawha County

Prepared by:

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STATE OF WEST VIRGINIA
COUNTY OF KANAWHA, SS
I, CATHY S. GATSON, CLERK OF THE CIRCUIT COURT OF SAID COUNTY AND IN SAID STATE, DO HEREBY CERTIFY THAT THE FOREGOING IS A TRUE COPY FROM THE RECORDS OF SAID COURT
GIVEN UNDER MY HAND AND SEAL OF SAID COURT THIS 19
DAY OF November 2018
CLERK
CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

Copy to:

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