IN THE INTERMEDIATE COURT OF APPEALS OF WEST VIRGINIA

FILED
July 1, 2024
ASHLEY N. DEEM, CHIEF DEPUTY CLERK
INTERMEDIATE COURT OF APPEALS
OF WEST VIRGINIA

J.F. ALLEN COMPANY,
Petitioner Below, Petitioner

v.) **No. 23-ICA-327** (West Virginia Office of Tax Appeals No. 21-169)

MATTHEW R. IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,
Respondent Below, Respondent

MEMORANDUM DECISION

Petitioner J.F. Allen Company ("J.F. Allen") appeals the June 22, 2023, final decision of the West Virginia Office of Tax Appeals ("OTA") which granted, in part, and denied, in part, J.F. Allen's petition for refund. Respondent Matthew R. Irby, State Tax Commissioner of West Virginia ("Tax Commissioner") filed a timely response and cross-assignment of error. J.F. Allen filed a reply.[1] The issue on appeal is whether OTA erred when it found that the direct use exemption from sales and use tax[2] did not apply to certain repair parts and supplies purchased for equipment used, in part, on public service district ("PSD") and municipal public utility construction worksites but also used off-site for other projects. The issue in the cross-assignment of error is whether OTA erred when it found that the direct use exemption applied to repair parts and supplies purchased for trucks used to transport finished, crushed limestone to stockpiles.

This Court has jurisdiction over this appeal pursuant to West Virginia Code § 51-11-4 (2022) and § 11-10-19(a) (2023). After considering the parties' oral and written arguments, the record on appeal, and the applicable law, this Court finds there is error in the OTA decision, but no substantial question of law. Therefore, this case satisfies the "limited circumstances" requirement of Rule 21 of the Rules of Appellate Procedure. For

[1] J.F. Allen is represented by Floyd M. Sayre, III, Esq. The Tax Commissioner is represented by Patrick Morrisey, Esq., Sean M. Whelan, Esq., Kevin C. Kidd, Esq., and Grant A. Newman, Esq.

[2] The West Virginia Consumers Sales and Service Tax ("sales tax") is generally imposed by article 15, Chapter 11 of the West Virginia Code. The West Virginia Use Tax ("use tax") is generally imposed by article 15A, Chapter 11 of the West Virginia Code. *See also* W. Va. Code § 11-15B-1 *et seq.* Sometimes the sales tax and use tax in combination are referenced as the "sales and use tax" in this decision.

these reasons, a memorandum decision affirming, in part, and reversing, in part, the Office of Tax Appeals' decision is appropriate.

J.F. Allen is a West Virginia corporation with a principal place of business in Buckhannon, West Virginia. J.F. Allen engaged in extensive business activities, including quarrying and producing limestone aggregate, selling aggregate and asphalt, highway construction, site development for the oil and gas industry, and construction and installation of structures and systems used by municipal utilities and PSDs. The separate business activities at issue in this appeal are (1) utility construction for municipalities and PSDs and (2) the production, processing, and storage of limestone aggregate.

J.F. Allen's utility division digs ditches, lays pipe, fills trenches, and installs manholes. J.F. Allen does not operate the utilities but uses its own equipment to construct and repair structures and systems for municipal utilities and PSDs. These jobs are typically awarded through a public bidding process, which include an estimate for labor, materials, equipment, fuel, and repair parts. The appeal concerns repair parts and supplies for J.F. Allen's equipment used partly in connection with municipal utility and PSD jobs and partly in connection with other jobs unrelated to municipal and PSD construction activity.

J.F. Allen's limestone production and processing activities at issue considering the cross appeal involve quarrying stone, crushing the stone at a crusher, and moving finished limestone aggregate to the appropriate stockpile depending on the size of the crushed stone. At issue with respect to limestone production and processing are repair parts and supplies purchased to maintain certain trucks. J.F. Allen uses three types of trucks when moving limestone. The first type of truck hauls the newly quarried limestone from the pit floor to a piece of equipment called a crusher. These trucks can haul 50-75 tons at a time. Once the limestone is crushed to the desired dimension at the crusher, it is hauled by a second type of truck ("type II truck") from the crusher to J.F. Allen's stockpile. Once the limestone is sold and leaves J.F. Allen's stockpile it is transported on a third type of truck suitable for travel on the highways. The cross-appeal concerns repair parts and supplies for type II trucks which haul finished limestone to the stockpile.

Predating this case, in 2014, the Tax Commissioner audited J.F. Allen for tax years 2011 through 2013. At the conclusion of the audit, the Tax Commissioner alleged that J.F. Allen incorrectly determined sales and use tax on purchases of tangible personal property and taxable services. The parties settled all the issues resulting from the audit.[3]

In 2021, the Tax Commissioner audited J.F. Allen for the period of January 1, 2018, through March 31, 2021. The Tax Commissioner determined that J.F. Allen underpaid

[3] J.F. Allen conceded at oral argument that the terms and basis of the settlement concerning the 2014 audit were not reduced to writing.

sales and use tax in the amount of $131,316.41, $27,814.43 in interest, and $32,829.17 in additions to tax for a total assessed liability of $191,960.01. J.F. Allen paid the assessment and timely filed a petition for refund with OTA. Prior to the hearing, the parties settled most of the significant issues raised by the audit and assessment, leaving three relatively minor issues unresolved. At the hearing, J.F. Allen argued that: (1) $5,935.12 of the assessment was improper because it disallowed the direct use exemption for certain purchases of supplies and repair parts used on trucks used to transport finished limestone aggregate from the crusher to storage piles; (2) $7,886.09 of the assessment was improper because it disallowed the direct use exemption for certain purchases of parts and supplies used to maintain and repair equipment used in constructing and repairing structures and systems for PSDs and municipal utilities; and (3) the assessment improperly imposed additions to tax.

On June 22, 2023, OTA entered a final decision. OTA reversed the Tax Commissioner's imposition of additions to tax, finding that J.F. Allen did not intentionally disregard tax statutes or rules and that J.F. Allen was not negligent by its underpayment of sales and use tax. *See* W. Va. Code § 11-10-18(c). This determination was not appealed.

OTA's decision concerning the application of sales and use tax to two categories of J.F. Allen's purchases are in dispute before this Court. First, OTA addressed whether West Virginia Code § 11-15-9(b)(2) exempted J.F. Allen's purchases of parts and supplies to repair and maintain equipment used in performing contracting work for public service districts and municipal utilities when the equipment was also used for other projects. OTA used the following representative scenario to illustrate the issue: assume that J.F. Allen is digging a trench to install a sewer line extension for a PSD and a hose on the backhoe is worn or breaks so that J.F. Allen must purchase and install a replacement hose. Is the purchase and use of this hose exempt from sales and use tax when the backhoe (upon which the replacement hose is installed) is later removed from the site to be used on other jobs for other customers that are not municipal utilities or PSDs?[4] OTA upheld the assessment of sales and use tax on purchases of parts and supplies for repairs to and maintenance of construction equipment used in part for PSD and municipal utility contracting jobs, where the equipment was used for other, unrelated contracting jobs. OTA found that J.F. Allen failed to meet its burden of establishing that an exemption applied to such purchases.

[4] OTA found that both parties failed to cite legal authority to address relevant issues despite ample opportunity to brief and argue the issues. Moreover, J.F. Allen single mindedly argued that there was a binding agreement arising from the 2014 settlement related to other tax years, but J.F. Allen never produced a written document specifying a method of apportionment of the types of purchases at issue. The Tax Commissioner disputes that there was a forward-looking, binding agreement arising out of the global settlement of the 2014 assessment.

Second, OTA addressed whether J.F. Allen's purchases to make repairs to type II trucks used to transport limestone from a crusher to stockpiles are subject to the direct use exemption. OTA reversed the Tax Commissioner and held that J.F. Allen met its burden to establish that the direct use exemption applied to the repairs to and maintenance of type II trucks and vacated $5,935.12 of the assessment related to that issue. OTA found that the type II trucks were used either in the activity of production of natural resources or in the activity of manufacturing. This appeal and cross-appeal followed.

The standard of review applicable to this appeal is as follows:

> In an administrative appeal from the decision of the West Virginia Office of Tax Appeals, this Court will review the final order of the circuit court pursuant to the standards of review in the State Administrative Procedures Act set forth in W. Va. Code § 29A-5-4(g) [2021]. Findings of fact of the administrative law judge will not be set aside or vacated unless clearly wrong, and, although administrative interpretation of State tax provisions will be afforded sound discretion, this Court will review questions of law *de novo.*

Syl. Pt. 1, *Griffith v. ConAgra Brands, Inc.*, 229 W. Va. 190, 191, 728 S.E.2d 74, 75 (2012); *accord Far Away Farm, LLC v. Jefferson Cnty. Bd. of Zoning Appeals*, 222 W. Va. 252, 256, 664 S.E.2d 137, 141 (2008) (quoting *Webb v. W. Va. Bd. of Med*., 212 W. Va. 149, 155, 569 S.E.2d 225, 231 (2002) ("It is well-established that '[o]n appeal, this Court reviews the decisions of the circuit court under the same standard of judicial review that the lower court was required to apply to the decision of the administrative agency.'"); *W. Va. Dep't of Health and Human Res. v. Downs-Jamal*, No. 22-ICA-129, 2023 WL 4027502, at * 3 (W. Va. Ct. App. June 15, 2023) (memorandum decision) (applying the same standard of review as the circuit court upon our review of its order following an appeal of an administrative decision).

In turn, West Virginia Code § 29A-5-4(g) provides:

> (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:
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> (1) In violation of constitutional or statutory provisions;
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> (2) In excess of the statutory authority or jurisdiction of the agency;
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> (3) Made upon unlawful procedures;

(4) Affected by other error of law;

(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.

On appeal, J.F. Allen asserts one assignment of error: OTA erred when it found that repair parts and supplies for J.F. Allen's equipment used on PSD and municipal utility construction worksites were not eligible, in part, for the direct use exemption. J.F. Allen bases its argument entirely upon the settlement of a 2014 assessment that purportedly incorporated an unwritten apportionment understanding concerning the purchase of similar repair parts and supplies.

West Virginia imposes a sales tax broadly on sales of tangible personal property and taxable services and use tax on the use of tangible personal property and taxable services. *See* W. Va. Code § 11-15-3(a); W. Va. Code § 11-15A-2(a). The sales tax and use tax are complementary. *See* W. Va. Code § 11-15A-1a(1). Sales tax exemptions are expressly incorporated into the use tax law. *See* W. Va. Code § 11-15A-3(a)(2). While this is a use tax refund matter, analysis of exemptions in the sales tax law is appropriate. Generally, the burden is squarely upon a taxpayer to prove an exemption from sales and use tax. *See* W. Va. Code § 11-10-25(a), W. Va. Code § 11-15-6(a). Moreover, all sales and services are presumed to be subject to sales and use tax until the contrary is clearly established. *See* W. Va. Code § 11-15-6(b).

The two separate issues in this case concern what is commonly known[5] as the *direct use* exemption, which exempts sales of tangible personal property and services from sales and use taxation in the following circumstances:

> 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[.]

[5] *See Antero Resources Corp. v. Steager*, 244 W. Va. 81, 85, 851 S.E.2d 527, 531 (2020).

See W. Va. Code § 11-15-9(b)(2) (emphasis added). The direct use exemption is generally classified as a "refundable exemption" requiring businesses who assert the direct use exemption as it relates to qualifying activities to follow a special process to limit potential abuse.[6] We now turn to the application of the direct use exemption to the two distinct factual scenarios at issue in this case.

Utility Contracting for Municipalities and PSDs

In general, sales and use tax does not apply to charges by a contractor paid by a purchaser of contracting services;[7] however, purchases by a contractor of tangible personal property or taxable services for use or consumption in the activity of contracting are generally subject to sales and use tax. *See* W. Va. Code § 11-15-8a(a). Moreover, contractors are generally not entitled to assert the exemptions to which its customer may have been entitled. *See* W. Va. Code § 11-15-8d(a). However, effective in July 2007, contractors may assert a *customer*'s direct use exemption in purchasing services, machinery, supplies, and materials, to the extent the customer directly purchasing these items would be exempt had the customer itself purchased these items. *See* W. Va. Code § 11-15-8d(b).

After this law change, the Tax Commissioner in 2011 adopted an interpretive rule allowing contractors, in certain limited circumstances, to be eligible for a *per se* exemption from sales and use tax[8] on:

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[6] West Virginia Code § 11-15-9(b) provides:

> *Refundable exemptions*. - Any person having a right or claim to any exemption set forth in this subsection shall first pay to the vendor the tax imposed by this article and then apply to the Tax Commissioner for a refund or credit, or as provided in section nine-d of this article, give to the vendor his or her West Virginia direct pay permit number.

[7] The term "contracting" is extensively defined in the sales and use tax statute and legislative rule and broadly includes (among other things) alteration, improvement, or development of real property. *See* W. Va. Code § 11-15-2(b)(3). While the OTA decision and J.F. Allen's briefs are silent as to this fundamental point, the Tax Commissioner asserts (and it is evident in the record) that the activities of J.F. Allen undertaken for PSDs and municipalities constitute *contracting* for sales and use tax purposes.

[8] A *per se* exemption under sales and use tax law allows a purchaser to lawfully avoid paying the sales and use tax up front and to further avoid the process (involving direct pay permit compliance or verified, documented refund applications) imposed on persons asserting *refundable* exemptions. The Tax Commissioner is expressly empowered by the

> Purchases of services, machinery, supplies, or materials, except gasoline and special fuel, to be directly used or consumed in the construction, alteration, repair or improvement of a new or existing public utility[9] structure or system by a contractor or subcontractor providing contracting services to a public utility[.]

W. Va. Code St. R. § 110-15J-4.2. To be eligible for this *per se* exemption, the purchases must "remain on the construction site after the construction activity is completed." W. Va. Code R. § 110-15J-5.1. The interpretive rule expressly excludes from the *per se* exemption "purchases of tools, bulldozers, cranes, etc. that become the property of the construction contractor or subcontractor and are removed from the site after construction is completed." W. Va. Code St. R. § 110-15J-5.2.

J.F. Allen engages in contracting for PSDs and municipal utilities by digging ditches, laying pipe, filling trenches, and installing manholes as contemplated by West Virginia Code St. R. § 110-15J-4.2. In the performance of such contracting, J.F. Allen is now seeking an exemption (at least in part) for the purchase of repair parts and supplies used in equipment necessary for constructing these facilities. However, such equipment, repair parts, and supplies are also used on unrelated projects and not exclusively at the public utility site. J.F. Allen's sole argument below and before this Court, is that the Tax Commissioner is bound to abide by an apportionment method purportedly applied to similar repair parts and supplies previously resolved in a settlement of the 2014 audit and assessment.[10] J.F. Allen failed to provide a copy of the agreement that allegedly specified

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legislature to designate by rule certain sales and use tax exemptions as being a *per se* exemption. *See* W. Va. Code § 11-15-9m.

[9] For purposes of this interpretive rule, the phrase "public utility" is limited solely to PSDs and government-owned utilities and would not include investor-owned utilities. *See* W. Va. Code St. R. § 110-15J-3.3.

[10] J.F. Allen bases its entire appeal on the terms of a settlement for a prior tax period that were not reduced to writing and that the Tax Commissioner contends is not binding upon future periods. J.F. Allen does not argue equitable estoppel or collateral estoppel concerning the 2014 settlement. Moreover, despite its burden of proof and the presumption of taxability, J.F. Allen did not cite any statute or rule to OTA that would entitle J.F. Allen to apply the direct use exemption where property was not *exclusively* used nor completely consumed in a qualifying direct use activity. For instance, J.F. Allen did not cite or rely upon West Virginia Code § 11-15-9e below nor in its initial brief to this Court. Nor did J.F. Allen develop how that statute applies to the direct use exemption in the absence of a rule "established as reasonable by the Tax Commissioner." Nor did J.F. Allen challenge or otherwise address as an assignment of error the scope or application of the interpretive rule relied upon by the Tax Commissioner. This interpretive rule expressly limits contractors,

what was agreed upon and whether such agreement was meant to have prospective application. The Tax Commissioner denies that any prospective agreement arose from the 2014 settlement. In light of the conflicting positions, OTA found that J.F. Allen failed to satisfy its burden and failed to overcome the statutory presumption of taxability.[11] On the record before us, in light of J.F. Allen's narrow assignment of error, the burden upon J.F. Allen to establish an exemption, the presumption of taxability, and our deferential standard of review, we find that OTA did not commit clear error or abuse its discretion when it affirmed the Tax Commissioner's assessment of $7,886.09 concerning the purchases of parts and supplies pursuant to West Virginia's sales and use tax. Accordingly, we affirm OTA's decision as it relates to the purchase of property and supplies to maintain equipment not exclusively used or consumed while performing contracting for PSDs and municipal utilities.

Production of Natural Resources and Manufacturing

We now consider the Tax Commissioner's cross-assignment of error. The Tax Commissioner argues that OTA erred when it found that purchase of parts and supplies for repairs to and maintenance of J.F. Allen's type II trucks (that hauled finished limestone to the stockpile) qualified for the direct use exemption under West Virginia Code § 11-15-9(b)(2). OTA found that repair parts and supplies used in type II trucks were directly used and consumed in a qualifying direct use activity, as either production of natural resources or manufacturing. The Tax Commissioner contends this determination by OTA is erroneous as a matter of law or is otherwise an abuse of discretion. We agree with the Tax Commissioner and reverse OTA on the cross-appeal.

For the purchase and use of services, machinery, supplies, and materials to be exempt under West Virginia Code § 11-15-9(b)(2) the purchased items must be directly

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when asserting the *per se* direct use exemption on municipal utility and PSD jobs, to exempt only property that physically remains on site upon completion. The interpretive rule would not by its terms extend the *per se* direct use exemption to J.F. Allen's purchases of parts and supplies that were not totally consumed on the job and that did not remain on site when the job was completed.

[11] The statutory procedure for seeking and receiving binding prospective guidance from the Tax Commissioner specific to a taxpayer is found in West Virginia Code § 11-10-5r (technical assistance advisories). Unlike a private settlement of a past tax audit and assessment (which generally applies solely to the tax period at issue and would not bind either party for future periods), technical assistance advisories are subject to public disclosure and modifications are prospective only. There is no evidence in the record or argument that J.F. Allen sought or obtained a technical assistance advisory upon which it could reasonably rely concerning the sales and use tax consequences of the purchase and use of the items at issue.

used or consumed in a qualifying activity. The qualifying activities OTA found potentially relevant in connection with the type II trucks at issue are production of natural resources and manufacturing. We address separately the scope and extent of these relevant activities to determine how the direct use exemption applies, if at all, to repair parts and supplies purchased by J.F. Allen with respect to its type II trucks.

The following sales and use tax definition of the phrase "production of natural resources" is relevant to this matter:

> (A) "Production of natural resources" means… 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 and shipment for sale, profit or commercial use of any natural resource products and any reclamation, waste disposal or environmental activities associated therewith….
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> (C) All work performed to install or maintain facilities up to the point of sale for *severance tax purposes* is included in the "production of natural resources" and subject to the direct use concept….

W. Va. Code § 11-15-2(b)(14) (emphasis supplied). Accordingly, the "production of natural resources" definition in the sales and tax statute incorporates by reference severance tax concepts concerning what constitutes the production of natural resources. In turn the severance tax law provides: "The privilege of severing and producing limestone… by quarrying or mining shall end once the limestone… is severed from the earth." W. Va. Code § 11-13A-4(e); see also W. Va. Code § 11-13A-2(c)(9)(B) (limestone production and processing "shall not include any treatment process or transportation after the limestone… is severed from the earth"). To reflect these concepts, the Tax Commissioner adopted West Virginia Code of State Rules § 110-15-123.4.3.3 stating:

> 123.4.3.3. Activities Not Included in the Production of Natural Resources. - The production of natural resources shall not include the following:
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> 123.4.3.3.a. In the case of limestone quarried or mined, any activity after the stone is severed and reduced to possession on the surface. Processing of limestone is considered to be manufacturing.

J.F. Allen does not directly challenge the efficacy of the long-standing legislative rule defining when the activity of production of limestone ends.[12] We find that, considering

[12] In its Reply Brief, J.F. Allen urges this Court to apply the direct use exemption liberally and that this Court should broaden the scope of production of natural resources in the limestone production context to encompass hauling crushed limestone to a stockpile.

these statutes and the legislative rule, J.F. Allen's type II trucks (which haul limestone crushed at the crusher and were not involved in the activity of quarrying, severing, or reducing to surface possession) were not directly used in the activity of production of natural resources for sales and use tax. The holding by OTA to the contrary is in error.

Next, we consider the scope of the activity of manufacturing for sales and use tax purposes. The sales and use tax statute defines manufacturing as follows:

> "Manufacturing" means a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed.

W. Va. Code § 11-15-2(b)(10). Again, the legislative rule provides guidance as to when the activity of manufacturing begins and ends. "Manufacturing production begins with the arrival of raw materials and ends when the property has reached that point where no further chemical, physical or other changes are to be made to the resultant property in the production process." W. Va. Code St. R. 110-15-2.46. Moreover, "[s]torage of completed products and transportation of completed products to… another site is not included in manufacturing." W. Va. Code St. R. § 110-15-123.4.2.1. The Tax Commissioner argues that manufacturing production with respect to the limestone occurred at the crusher and that type II trucks (which moved finished goods to stockpiles) are not used as part of the manufacturing production activity. We agree and to the extent the final decision of OTA provides otherwise, we find the OTA's decision to be in error.[13]

We decline to adopt such an expansive reading considering the precise and narrow language in the applicable statutes and legislative rule in the context of express statutory presumptions and burdens addressed earlier.

[13] Finally, we briefly address the activity of "transportation" as defined for sales and use tax purposes. While neither OTA nor J.F. Allen addressed or asserted that the type II truck parts and supplies at issue were directly used in J.F. Allen's activity of transportation for sales and use tax purposes, the Tax Commissioner, in its Brief to this Court, addressed the issue. The sales and use tax statute defines transportation as follows:

> "Transportation" means the act or process of conveying, as a commercial enterprise, passengers or goods from one place or geographical location to another place or geographical location.

W. Va. Code § 11-15-2(b)(24). The legislative rule expounds on this definition to address the scope of this activity for sales and use tax purposes, providing that "[t]he transportation activity [to qualify for the direct use exemption] must be conducted for others as a

In summary, we affirm the OTA decision concerning the materials and supplies used in part to maintain and repair equipment for both municipal utility and PSD projects and for other projects insofar as J.F. Allen's sole assignment of error concerns the applicability of a prior settlement to the tax years at issue. Moreover, we agree with the Tax Commissioner's cross assignment of error and reverse the OTA decision concerning materials and supplies used in maintenance and repair of type II trucks.

For the foregoing reasons, we affirm, in part, and reverse, in part, the Office of Tax Appeals' June 22, 2023, decision.

Affirmed, in part, and Reversed, in part.

ISSUED: July 1, 2024

CONCURRED IN BY:

Chief Judge Thomas E. Scarr
Judge Charles O. Lorensen
Judge Daniel W. Greear

commercial enterprise and does not include the transportation of goods by the owner of the goods…." Code St. R. § 110-15-123.4.1. Because this issue was not a basis for OTA's decision nor was this issue briefed or addressed by J.F. Allen, we decline to address it further in this decision.