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CHANGING CONCEPTS IN THE AD VALOREM SEVERANCE TAXATION OF COAL IN WEST VIRGINIA

I. INTRODUCTION

The taxation of coal is a primary source of revenue for the majority of states in which coal is an abundant natural resource. This taxation of coal is referred to as either a severance, privilege, excise, occupation, or license tax in the various states. The tax is a "levy assessed at flat or graduated rates by a government on the privilege, process, or act of commercially severing or extracting natural resources . . . and measured by the physical amount, or the gross or net value of the natural resources produced or sold." If the levy is assessed at a flat rate for each unit extracted, it is referred to as a specific severance tax, while an ad valorem severance tax is the term used to describe a levy assessed at a graduated rate. The ad valorem severance tax may be distinguished from an ad valorem property tax in that the latter is usually an annual levy based on the assessed valuation of unrecovered coal, while the former is based on the value of coal actually extracted from the ground during a specified period. Ad valorem severance taxes also differ considerably from income taxes in that the severance tax base is total production while the income tax base is net

1 Note, Coal Taxation in the Western States: The Need for a Regional Tax Policy, 16 NAT. RES. J. 415, 426 (1976).
3 The unit usually used is the short ton (2,000 pounds).
4 Ad valorem severance taxes are imposed as a certain percentage of an assessed value such as gross value, market value, gross yield, gross receipts, or net proceeds, e.g., one percent (1%) of gross receipts realized from the sale of coal.
6 Note, Coal Taxation in the Western States: The Need for a Regional Tax Policy, supra note 1, at 427.
income or profit.\(^7\)

Recent litigation at the trial court level in West Virginia has raised the issue concerning at what point in the overall process (from severing the coal from the earth in its natural state to delivering it to the ultimate consumer), the coal is to be valued and subjected to the ad valorem severance tax.\(^8\) Because this issue does not involve the specific severance taxation of coal, this Note is expressly limited to the ad valorem severance taxation of coal. Furthermore, although analogies with the taxation of other natural resources such as natural gas, timber, sand and gravel, etc., are sometimes helpful, this Note does not seek to comment directly upon the taxation of these other natural resources.

II. NATURE AND HISTORY

A. Nature

Generally, severance taxes are imposed as a means of raising revenue. Alternatively, the severance tax may be imposed as an overall or long-term policy effected by the legislature in an attempt to impose equitable tax burdens on the different segments of the economy, to maintain a high level of employment, to encourage economic growth, and to provide public security.\(^9\) Another rationale often used to support a severance tax is that it constitutes a partial atonement to the state for the value of its underground wealth diminished by mining. To a lesser degree, the taxes are justified as substitutes for property taxes where the taxable property is minerals. This rationale was adopted by the Montana court\(^10\) as follows:

The state in effect says to producers: Your operations deplete the natural resources of the state, and to the extent that you remove from the earth the natural wealth which nature has provided it, and to that extent impoverish it, you are required to pay a license tax for the use and benefit of the state, for the

\(^7\) Whiteside & Gillig, supra note 2, at 597.


privilege of extracting such natural wealth. The tax provided is not, therefore, on metals, minerals, or mine products, but rather upon the business of producing metals or precious stones, based upon annual production.\textsuperscript{11} Thus, a severance tax may be viewed either as a tax upon the privilege of producing property for economic use, or as a tax upon the privilege of removing and destroying the wealth of the state.\textsuperscript{12}

The ad valorem severance tax, as previously discussed, is a privilege tax and not a property tax or a production tax. The tax is not imposed upon the property itself, but upon the \textit{privilege} of extracting the coal from the earth.\textsuperscript{13} This is true even though the measure of the tax is the value of the coal extracted. That value serves only as a means of measuring the privilege of extraction. Furthermore, since the tax is a privilege tax, it is not subject to the traditional principles of a property tax. Most importantly, there is no constitutional provision requiring the application of a uniform rate to all classes of businesses or callings on which the privilege taxes are imposed. The legislature may exercise discretion in classifying the subjects of taxation for privilege tax purposes, although this discretion is limited by the requirement that all persons who are similarly situated must be brought within the same class, and all members of the class must be treated uniformly.\textsuperscript{14} Thus, classification for privilege tax purposes will not violate the equal protection clause of the fourteenth amendment to the Constitution of the United States\textsuperscript{15} if the classification is

\textsuperscript{11} \textit{Id.} at 34, 17 P.2d at 72.
\textsuperscript{12} Dayton, \textit{Excise Taxes in Their Relationship to Property Taxes}, 46 W. Va. L.Q. 21, 29 (1939). Dayton notes that "[t]he depletion of the land and the consequent continuing diminution of the wealth of the state" are strong arguments for a severance tax. \textit{Id.}
\textsuperscript{13} The West Virginia Supreme Court of Appeals adopted this position in Cole v. Pond Fork Oil & Gas Co., 127 W. Va. 762, 35 S.E.2d 25 (1945):

\textit{Our Legislature has studiously avoided imposing a production tax, and has resorted to the imposition of a privilege tax, whereby persons, firms, and corporations are classified according to the business in which they are engaged, and a tax collected from the gross proceeds of their business, rather than upon any product which they may produce from the earth or manufacture or process.}

\textsuperscript{14} Oliver Iron Mining Co. v. Lord, 262 U.S. 172, 179 (1922).
\textsuperscript{15} \textit{U.S. Const.} amend. XIV, § 1.
reasonable, is based on pertinent and real differences, and has as its object a purpose germane to the legislation. An application of this reasoning would be the classification of all natural resource producers in one class, all manufacturers in a second class, all wholesalers in a third class, etc. Within each of these classes, several different rates may be applicable so long as each member of the class similarly situated is taxed at the same rate. For instance, in the natural resource classification may be found coal producers, oil and natural gas producers, timber producers, etc., with the coal producer being taxed at a rate of one percent of gross proceeds and the natural gas producer being taxed at a rate of two percent of gross proceeds. So long as all coal producers are taxed at one percent and all natural gas producers are taxed at two percent, there is no violation of constitutional requirements.

A second distinction between a privilege tax and a property or production tax is that under a privilege tax a person may be classified and taxed for the simultaneous exercising of two different privileges. Since the tax is imposed upon the privilege and not upon the property, there is no double taxation even though the property may be the measure of tax for both privileges. At least in West Virginia, there is no statutory requirement nor principle of law which precludes the imposition of more than one tax upon a person who is engaged in different business activities as classified by the privilege taxing statute. Thus, a company which manufactures a product and sells the same product at wholesale could be properly taxed for both privileges upon the value of the goods manufactured and sold.

B. History

The taxation of coal in West Virginia originated with the passage of the Gross Sales Act in 1921. The Gross Sales Act

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19 1921 W. Va. Acts, ch. 110, §§ 2a-2c. This act provided in pertinent part: Upon every person engaging or continuing within this state, in the
classified under section 2a both the producers of natural resources and manufacturers. However, producers of coal were taxed at a rate of 0.4% while manufacturers were taxed at a rate of 0.2%. The Gross Sales Act was repealed in 1925 when the legislature enacted the Business and Profession Tax. The 1925 act did not materially change the tax structure except to reclassify manufacturing from section 2a to section 2b. Also, the tax rate on coal was increased from 0.4% to 0.42%.

In 1933, the Business and Profession Tax was repealed and the legislature adopted the Business and Occupation Tax. The Business and Occupation Tax was not substantially different from the Business and Profession Tax. The most notable change was the increase in tax rates to 1% for coal and 0.3% for manufacturing.

Except for rate adjustments in 1934, 1935, and 1959, the language of the statute remained unchanged until 1971, when the tax rate on producing coal was increased from 1.35% to 3.5%, and the rate for manufacturing was increased to 0.88%. The language of section 2a was also changed from “producing for sale, profit or commercial use” to “severing, extracting, reducing to possession and producing for sale, profit or commercial use.”

In 1975, an additional severance tax was imposed at the rate of 0.35%. This additional tax effectively raised the total tax burden for the producer of coal to 3.85%, which is the current tax rate. The rate for manufacturers has not been adjusted since 1971.

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27 Id. § 2a (1974 Replacement Vol.).
Gilbert Imported Hardwoods, Inc. v. Dailey\textsuperscript{30} presented the Circuit Court of Mingo County with factual circumstances which clearly demonstrated the inconsistencies in the way in which the Business and Occupation Tax was being imposed upon coal producers. In Gilbert, the petitioner was a coal producer who both owned and leased coal lands. The petitioner mined these lands through the services of a contract miner\textsuperscript{30} who severed, extracted, and delivered the coal to petitioner's tipple. After delivery, the coal was subjected to the tippling processes, wherein the coal was screened, picked, crushed, and washed.\textsuperscript{31} As a result of the tippling processes, approximately thirty percent of the raw coal delivered was removed as unsalable refuse, and the corresponding value of the coal was increased from $11.00 per ton for the raw coal to $17.50 per ton for the tippled coal.

The circuit court determined that the petitioner was the producer of the coal and was to be taxed at the producer's rate\textsuperscript{32} for the production of the coal.\textsuperscript{33} The petitioner contended that it was only taxable at the producer's rate\textsuperscript{34} for the value of the coal before the tippling processes, but otherwise was taxable under the

\textsuperscript{30} No. CA-6546 (Cir. Ct., Mingo County, W. Va. July 16, 1979).
\textsuperscript{31} A contract miner merely performs the service of severing and extracting the coal without ever obtaining any title, ownership, or property interest whatsoever in the mineral itself.
\textsuperscript{32} The screening process generally consists of passing the raw coal over a screen with holes of various sizes in it. This allows the larger chunks of coal to remain on a conveyor belt from which they are removed manually. Large rock refuse is also manually removed. The coal is then crushed to the desired size and washed further to remove refuse. This is, at most, a very general description and does not allude to more sophisticated processes which may include the use of blending-mixing bins, specific gravity flotation techniques, and the like.
\textsuperscript{33} W. VA. CODE § 11-13-2a (1974 Replacement Vol.) provides as follows:

Upon every person exercising the privilege of engaging or continuing within this State in the business of severing, extracting, reducing to possession and producing for sale, profit or commercial use any natural resource products, the amount of such tax to be equal to the value of the articles produced as shown by the gross proceeds derived from the sale thereof by the producer, except as otherwise provided, multiplied by the respective rates as follows: Coal, three and five-tenths percent . . . .
\textsuperscript{34} No. CA-6546, slip op. at 38.
\textsuperscript{35} W. VA. CODE § 11-13-2a (1974 Replacement Vol.).
AD VALOREM TAXATION

manufacturer's classification for its separate business activity of processing raw coal and preparing it for sale. The circuit court, mindful of the fact that a business entity exercising two or more privileges must be taxed accordingly, determined that the petitioner was taxable under the manufacturing classification. The pertinent statute provides that:

Upon every person engaging or continuing within this State in the business of manufacturing, compounding or preparing for sale, profit or commercial use . . . any article or articles, substance or substances, commodity or commodities, . . . the amount of the tax to be equal to the value of the article, substance, [or] commodity . . . manufactured, compounded, or prepared for sale, as shown by the gross proceeds derived from the sale thereof by the manufacturer or person compounding or preparing the same, except as otherwise provided, multiplied by a rate of eighty-eight one hundredths of one percent. The measure of this tax is the value of the entire product manufactured, compounded or prepared in the State for sale, profit or commercial use, regardless of the place of sale or the fact that deliveries may be made to points outside the state.

The petitioner was found to have been employing "technologically sophisticated processes" in its tippling activities, and as such, was neither "manufacturing" nor "compounding" the coal; rather, the petitioner's taxable activity was in "preparing" the coal for "sale, profit or commercial use." A distinction was noted, though, between the mere use of a coal tipple to load raw coal onto coal cars and the use of a technologically sophisticated process.

Thus, whether the processing of a natural resource by its producer constitutes a business activity under the manufacturing classification apparently depends to a large extent upon the degree of processing to which the resource is subjected. Passing coal through a tipple for the sole purpose of loading it into coal cars serves only to transport it closer to the ultimate consumer, but does not "prepare" that coal for use by the ultimate consumer, and is therefore not considered a manufacturing business activity.

36 Id. (emphasis as supplied by the circuit court).
37 No. CA-6546, slip op. at 51.
However, the passing of coal through a tipple, where it is "prepared, screened, graded, washed, etc.," is a prerequisite to use of the coal by the ultimate consumer, and thus falls under the "preparing for sale" classification. This is true because foreign particles present in untipped coal are removed by the tippling process, even though the chemical make-up of the coal itself is not changed by the tippling activities.

The court determined that subjecting the coal to the tippling process constituted the "using or consuming" of the same as contemplated by a related tax provision. As such, the coal was to be taxed at the production rate on its value prior to being subjected to that process and at the manufacturing rate on its value subsequent to the process. The court further determined that the production of coal ended either when the coal is sold at the mine mouth or, when it is to be delivered to coal tipple, immediately prior to being subjected to the tippling process.

The court's reasoning largely followed the tax treatment of coal brokers. Coal brokers who purchased coal and transported it to a tipple where the coal was "prepared, screened, graded, washed, etc.," were taxed under the manufacturing classification while performing these activities. Apart from this tax treatment of coal brokers, the producers of coal have traditionally been taxed at the producer's rate on the gross proceeds of the sale of coal. 

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A person exercising privileges taxable under the other sections of this article, producing coal . . . or other natural resource products the production of which is taxable under section two-a, and using or consuming the same in his business . . . shall be deemed to be engaged in the business of mining and producing coal . . . or other natural resource products for sale, profit or commercial use, and shall be required to make returns on account of the production of the business showing the gross proceeds or equivalent in accordance with uniform and equitable rules for determining the value upon which such privilege tax shall be levied, corresponding as nearly as possible to the gross proceeds from the sale of similar products of like quality or character by other taxpayers, which rules the tax commissioner shall prescribe.

(emphasis as supplied by the circuit court.)

9 A coal broker purchases coal from a mining entity and sells the same on the open market. While he retains possession of the coal he may subject it to tippling processes in the same manner as a producer.

40 W. Va. B & O Tax Reg. § 1.2b(H) Ex.3 (CCH 1974).
such coal, even though prior to sale they may subject their product to the tippling processes.\textsuperscript{41}

IV. THE VALIDITY OF THE \textit{Gilbert} Decision

At issue in \textit{Gilbert} was the proper classification of the petitioner's activities under the West Virginia Business and Occupation Tax law, a question requiring an interpretation of the statutes and a determination of their underlying legislative intent. In construing tax statutes there exists a presumption that the legislature did not intend to violate any provision of the Federal Constitution.\textsuperscript{42} Furthermore, taxing statutes are generally construed by giving great deference to the legislative intent\textsuperscript{43} as inferred from every word in the statute.\textsuperscript{44} Even though taxing statutes are to be strictly construed,\textsuperscript{45} undefined words of the statute should be given their normal everyday interpretation.\textsuperscript{46} Deference should also be given to disjunctive\textsuperscript{47} or conjunctive\textsuperscript{48} expressions by

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    \item \textsuperscript{41} W. VA. B & O TAX REGS. \textsection 1.2a(G) Ex.1 (CCH 1974).
    \item \textsuperscript{42} Hope Natural Gas Co. v. Hall, 102 W. Va. 272, 135 S.E. 582 (1926); Eureka Pipe Line Co. v. Hallanan, 87 W. Va. 396, 105 S.E. 506 (1920).
    \item \textsuperscript{43} Effect should be given to the spirit, purpose and intent of the lawmakers without limiting the interpretation in such a manner as to defeat the underlying purpose of the statute. Wooddell v. Dailey, 230 S.E.2d 466 (W. Va. 1976); State ex rel. Hardesty v. Aracoma, 147 W. Va. 645, 129 S.E.2d 921 (1963).
    \item \textsuperscript{44} Each word of a statute should be given some effect and a statute must be construed in accordance with the import of its language. Wooddell v. Dailey, 230 S.E.2d 466 (W. Va. 1976); Wilson v. Hix, 136 W. Va. 59, 65 S.E.2d 717 (1951); Fielder & Turley v. Adams Express Co., 69 W. Va. 138, 71 S.E. 99 (1911).
    \item \textsuperscript{45} Tax laws, generally, are strictly construed, and when there is doubt regarding the meaning of such laws they should be construed in favor of the taxpayer. Wooddell v. Dailey, 230 S.E.2d 466 (W. Va. 1976); State ex rel. Battle v. Baltimore & O. Ry., 149 W. Va. 810, 143 S.E.2d 331 (1965), cert. denied, 384 U.S. 970 (1966); State v. Carmen, 145 W. Va. 635, 116 S.E.2d 265 (1960).
    \item \textsuperscript{46} Undefined words and terms used in a legislative enactment will be given their common, ordinary and accepted meaning. Wooddell v. Dailey, 230 S.E.2d 466 (W. Va. 1976); Davis v. Hix, 140 W. Va. 398, 84 S.E.2d 404 (1954); Miners v. Hix, 123 W. Va. 637, 17 S.E.2d 810 (1941). If technical words are involved they will be presumed to have been used in a technical sense and will ordinarily be given their strict meaning. Wooddell v. Dailey, 230 S.E.2d 466 (W. Va. 1976); Lane v. Board of Ed., 147 W. Va. 737, 131 S.E.2d 165 (1963).
    \item \textsuperscript{47} The word "or", as used in a statute, is a disjunctive particle indicating that the various members of the sentence are to be taken separately. 73 AM. JUR. 2d \textit{Statutes} \textsection 241 (1974). \textit{See also} Carper v. Kanawha Banking & Trust Co., 207 S.E.2d 897, 921 (W. Va. 1974).
    \item \textsuperscript{48} The word "and" as used in a statute is a conjunctive particle indicating
which words or phrases in the statute may be connected. The presumption of constitutional validity of the statute,\(^4\) and the constitutional requirement that all those taxpayers similarly situated be treated uniformly,\(^5\) form the bounds within which the enumerated canons of construction must be applied.

The first concern is whether the primary purpose of the statute will be defeated if the Gilbert rationale is followed. The basic purpose of the statute is the raising of revenue.\(^6\) This purpose will not be defeated by the application of the Gilbert rationale, since producers of coal who sell their coal at the mouth of the mine will be taxed on the value of the coal at the time of the sale; producers of coal who also subject their coal to technologically sophisticated tippling processes will be taxed both at the production rate on the value of the coal prior to tippling and at the manufacturing rate subsequent to tippling; and coal brokers will continue to be taxed at the manufacturing rate on the value of the coal subsequent to the tippling process. This is not to say that the total revenue from the taxation of coal producers will not be effected, but rather that the exercise of these activities will still yield revenue.

The second concern involves the correct interpretation of the language of the statute, as well as its overall import. The provisions of each section of the statute are to be read and considered in pari materia with all other sections of the statute.\(^7\) Where the wording of the statute, or the words themselves, is clear and unambiguous, the statute or the words should be applied and not construed.\(^8\) Previous decisions have recognized that section 2 is the only portion of article 13 which provides for the imposition of

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\(^4\) See note 42 supra & accompanying text.
\(^5\) See note 14 supra & accompanying text.
\(^6\) See note 9 supra & accompanying text.
AD VALOREM TAXATION

The word "taxable" as it appears in the other sections of article 13 refers merely to the rate of tax which is imposed by section 2.55

The words or provisions subject to interpretation in section 2a include "severing, extracting, reducing to possession and producing for sale" and "except as otherwise provided." By using "and" in the former phrase, the legislature must have intended that the terms be considered jointly. As such, no real difficulty is encountered in interpreting the words "severing," "extracting," and "reducing to possession," since these words are unambiguous and, therefore, accorded their common, ordinary, and accepted meaning. However, "producing" is ambiguous and must be construed. Webster defines the term as meaning "to give birth or rise to," or to "manufacture."56 "Producing" has never been construed by the West Virginia Supreme Court of Appeals as it applies to coal. Production of natural gas ends at the well,57 while timber is said to be produced when it has been severed and delivered to the mill to be manufactured into lumber.58 The Gilbert court found no dictated meaning of the word, but interpreted it as meaning "to bring forth" from the mine59 the severed and extracted coal. Thus, production ended prior to the tippling process. This interpretation of "producing" was found to be required when the accompanying sections of article 13 of the code are read in pari materia.

The phrase "except as otherwise provided" has been construed as referring to the seventh paragraph of section 2,60 which provides for the taxation of a producer of coal "used or con-

55 Id.
56 Webster's New Collegiate Dictionary 911 (1980).
59 No. CA-6546, slip op. at 47.
sumed" in another taxable activity according to its "gross proceeds or equivalent." Since "or" is a disjunctive, the words of each phrase must be interpreted individually. Although "use" and "consume" are often used interchangeably, the legislature in this instance obviously intended a different and distinct meaning for each. Thus, whereas coal may be "consumed" to produce electricity, timber is "used" to produce lumber. Likewise, a different and distinct meaning must be given to "gross proceeds" and "equivalent." In using the disjunctive, the legislature must have foreseen the situation in which the producer of coal would not sell his coal, but instead "use or consume" it in another taxable activity. If and when this occurred, the coal was to be valued for tax purposes at the equivalent of the gross proceeds which would have been received had the coal been sold.

The final determination of the validity of *Gilbert* rests upon whether the tippling processes are a taxable activity under section 2b. Activities taxable thereunder include "manufacturing, compounding, or preparing for sale." Courts have sometimes stated that the term "manufacturing" or "manufacturer" as used in tax statutes is not susceptible of a definition that is exact and all-embracing.61 A number of cases define manufacturing, but in all these cases the courts consistently deferred to the purpose of the legislation and attempted to provide a construction in accord with what they determined to be the legislative intent.62

Besides considering the terms of the statute and the legislative intent, the extent of the use of mechanical devices should be closely examined, as should the degree or extent of the change in the appearance, form, quality, and value of the basic material used in the particular process.63 Processes which make use of mechanical devices are considered to be capital intensive, which in turn are often defined as "manufacturing."64 However, mechanical devices are used extensively for extracting the coal from the mine and transporting it to the mouth of the mine. Thus, the mere use of mechanical devices in screening, grading, crushing, and washing the coal may not of itself suffice to distin-

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63 See note 61 supra, at § 3.
guish tippling as a manufacturing process. More persuasive, though, is the degree or extent of the change in the appearance, form, quality, and value from the raw coal to the tippled coal. Coal tippling processes may not drastically change the appearance or the physical form of the raw coal, but its quality and value are affected. As a result of tippling processes performed by Gilbert, approximately thirty percent of the raw product was removed and disposed of as unsalable material. Without question, the quality of the coal was improved. Also, Gilbert's tippling processes increased the value of the coal from $11.00 to $17.50 per ton. The change in quality and value indicate that the tippling process was used to prepare the coal for sale.

Yet, courts in other jurisdictions have refused to consider the screening, picking, crushing, and washing of coal as constituting a manufacturing process. These decisions are based on the premise that there must be a transformation, a new and different article, in order for a process to be deemed manufacturing, and the tippling processes of coal were not considered to have induced such a change. The issue in both Duke Power Co. v. Clayton and Colley v. Eastern Coal Corp., however, was not the proper classification of the tippling activity under a privilege taxing statute; rather, the issue was whether the tippling of coal was a manufacturing activity sufficient to exempt the taxpayers from a sales and use tax and a property tax, respectively. Thus, these decisions are of little value in defining the activity for purposes of a privilege taxing statute. However, a process by which a company mines ores and subsequently separates the gold and silver within the ores from the refuse was found taxable under a statute notably similar to section 2b.

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67 470 S.W.2d 338 (Ky. 1971).

1933 S.D. Sess. Laws, ch. 184, § 2a, provides:
Upon every person, engaging or continuing within this State in the business of manufacturing, processing, compounding, or preparing for sale, profit or use, any article or articles, substance or substances, commodity or commodities, the amount of such tax to be equal to the value of the articles manufactured, processed, compounded or prepared for sale, as
Regardless of whether the tippling of coal constitutes manufacturing, the activity may be taxed as another privilege under section 2b. By using the disjunctive, the legislature expressed its intent to tax any of the three activities of "manufacturing," or "compounding," or "preparing for sale," rather than to tax an activity which would consist of "manufacturing, compounding, and preparing." This analysis is supported by the subsequent language appearing in section 2b that the tax is to be measured by the gross proceeds of sales by the "manufacturer or person compounding or preparing the same." Had the legislature intended to tax just one business activity, it very easily could have adopted the conjunctive particle instead of the disjunctive. Thus, under section 2b the issue cannot be limited merely to whether the tippling activity constitutes manufacturing, but also must include whether the activity constitutes preparing for sale or compounding.

The court in *Duke Power Co.* stated in dictum that subsequent to mining the coal and bringing it to the surface, the coal is processed, or prepared, for sale. The steps recognized by the court in this processing were separation of impurities, crushing, and cleaning the coal. Both the *Duke Power Co.* and the *Colley* decisions analogized the coal tippling activities to stone-crushing, an activity not generally categorized as manufacturing. But although the crushing of stone is insufficient to constitute a manufacturing activity, the tippling of coal is a requisite in preparing it for sale to the ultimate consumer. "Preparing for sale" does not connote the production of a new article with a distinctive name, character, or use; it instead merely indicates some function performed on an article of commerce before its sale to the ultimate consumer. Not only are coal tippling activities required for the purpose of removing unsalable material prior to its efficient use by the consumer, but also new federal clean air standards and air pollution control laws require the removal of foreign matter

shown by the gross proceeds derived from the sale thereof by the manufacturer...

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68-1 (Emphasis added).

69 274 N.C. at 514, 164 S.E.2d at 295.

70 See, e.g., *Shumacher Stone Co. v. Tax Comm'n of Ohio*, 134 Ohio St. 529, 18 N.E.2d 405 (1938).

often effectively before the coal may be burned. These additional requirements imposed upon coal as a result of its use as a source of energy make any analogy between the tippling of coal and the crushing of stone fallacious.

In addition, the current Business and Occupation Tax (B & O Tax) regulations recognize that when a coal broker engages in activities such as the screening, grading, and washing of coal, he may be taxed for the privilege of preparing the coal for sale.\(^7\) Obviously, a coal producer who performs these same functions is similarly situated to the coal broker while exercising this privilege. Yet, under the current B & O Tax regulations, the coal producer is taxed for exercising these privileges at the producer's rate instead of the manufacturer's rate.\(^7\) In a similar situation, the West Virginia Supreme Court of Appeals did not consider an administrative construction of a statute to be binding upon that court.\(^7\) Thus, a reasonable way to ensure a constitutional application of the statute is to classify both coal brokers and coal producers as "preparers for sale" when they are performing the tippling function. This result is inevitable when sections 2, 2a, and 2b are read in pari materia.

V. LEGISLATIVE RESPONSE TO Gilbert

Prompted by the Gilbert decision and by the threat of an impairment of tax revenues, the West Virginia Legislature has attempted to further and more clearly define the legislative intent of the tax statutes. This response came in the form of an amendment to section 2a(1) and provides in pertinent part:

(1) Coal, three and five-tenths percent. The value of coal mined and produced in this state in the exercise of the production privilege, taxable at the rates herein and in section two-l in conjunction with section two of this article, shall include in addition to the value of the mined product those values arising from the ordinary processing and preparing of such coal for sale or commercial use, where such processing and preparing is done by the producer of the coal. Ordinary processing and preparing of coal activities by the producer

\(^7\) W. VA. B & O TAX REG. § 1.2b(H) Ex.3 (CCH 1974).

\(^7\) Id. §§ 1.2a(A), (G) Exs. 1-3 (CCH 1974).

thereof are considered an integral part of the production privilege and include crushing, washing, cleaning, drying, sorting, sizing, blending, loading for shipment and the like applied in the ordinary mining of such products to make the same salable and commercially usable. The values taxable herein and attributable to such ordinary processing and preparing of coal activities will not be again taxable under the provisions of section two-b of this article to the producer of such coal. More sophisticated processing and preparing of coal activities shall be subject to the other applicable provisions of this article. This amendment makes clear the legislative intent to tax only at the coal producer's rate, and not at two different rates, those coal producers who also subject their coal to the specified tippling processes.

While this amendment removes any need for the courts to interpret business and occupation tax statutes as they apply to coal producers, the disparate treatment of coal producers and coal brokers at issue in Gilbert still remains. For, as a note to the amendment states:

The purpose of this bill is to indicate the classified status of producers of natural resource products under the production privilege section of the Business and Occupation tax law. Within the coal classification of such section of the B & O tax law (section 2a of article 13, chapter 11), the bill specifies that the measure of the tax on such privilege includes the values arising from ordinary tippling, processing and preparing for sale or commercial use by the producer of such coal and that such activities are an integral part of the single production privilege; thus codifying and continuing the present, actual practice and administration by coal producers and the State Tax Department and stabilizing normal receipts from coal production activities.

A reasonable inference from this note is that coal brokers are to be taxed at the manufacturer's rate, as before, while all coal producers are to be taxed at the producer's rate.

As previously discussed, there is no constitutional provision requiring the application of a uniform rate to all classes of busi-

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76 Id. (emphasis added).
nesses on which the privilege taxes are imposed. Also, the legislature may exercise its discretion in determining the categories of activities for privilege tax purposes. However, the equal protection clause does require that all those similarly situated and all members of the same class receive uniform treatment, unless it is shown that the disparate treatment is reasonable and based on pertinent and real differences for a purpose germane to the legislation. 77

This constitutional requirement immediately casts doubt upon the amendment. No apparent reason exists for taxing the coal producer (who also tipples his coal) at the producer's rate for the increased value created by tippling, while taxing a coal broker who performs the same activities on coal after its removal from the mine at the lower manufacturer's rate. The coal broker and coal producer are obviously "similarly situated" while performing the tippling activity, but the coal producer is penalized (when compared to the coal broker) merely because he also mines the coal he tipples. The tippling of coal is a function separable from the mining of coal, as evidenced by the marketing of both tipped and untipped coal. Since they are separable functions, the privilege of engaging in each should be taxed separately according to the privilege exercised, not the performance of some preceding privilege. Thus, by failing to resolve these inconsistencies, the legislature has opened the amendment to attack on constitutional grounds.

VI. ALTERNATIVES

In the event that the recently enacted amendment is challenged and declared unconstitutional, viable alternatives are available to the legislature to further the policy goals of the Business and Occupation Tax. These alternatives are, for the most part, methods of taxation adopted by other states.

One possible alternative is the previously mentioned specific severance tax. 78 Under a specific severance tax a flat rate would be levied against the number of units produced. This type of tax is favored for its ease of administration and application. It finds

77 See notes 14-16 supra and accompanying text.
disfavor under the policy of equitable tax treatment, though, because the relative burden on individual taxpayers will decrease with higher profits and increase with lower profits. The tax burden under a specific severance tax does not vary with cost.79

Other possible alternatives vary from state to state by the wording in the ad valorem severance tax statutes. New Mexico, for example, imposes a three-tiered Resources Excise Tax.80 The Resources Tax81 is levied on the privilege of severing natural resources and is based on the gross value of the resource at the time it is severed, without any allowable deductions for production costs. The Processor Tax82 is imposed on the privilege of processing83 natural resources and is generally based on the gross value of the resource after processing, without allowable deductions. If a resource is processed in New Mexico and the processor tax is paid, the resource is exempt from the Resources Tax. A Service Tax84 is imposed on persons severing or processing in New Mexico natural resources owned by another person and not otherwise taxed by the Resources Tax or the Processor Tax.

Montana imposes a hybrid tax by which a producer is classified either as a surface mine or an underground mine and taxed on a graduated scale based on the heating value of the coal. The tax has a flat rate floor which is applied in conjunction with a graduated ad valorem rate.85

Although these state statutes are viable options, there are reasonable alternatives available to the West Virginia Legislature that would not require an abandonment of the current taxing scheme. An immediate remedy available solely for the purpose of maintaining general revenues would be the imposition of a surtax upon the current tax rate. A related long-range remedy would be

81 Id. § 4.
82 Id. § 5.
83 Id. § 3(D) defines “processing” as smelting, leaching, refining, reducing, compounding or otherwise preparing for sale or commercial use any natural resource so that its character or condition is materially changed in mills or plants located in New Mexico.
84 Id. § 6.
the adjustment of tax rates for both the coal producing classification and the "preparing for sale" classification to meet general revenue requirements. Perhaps an even more reasonable remedy, though, would be the reclassification of the coal tippling activity of both coal producers and coal brokers from the "preparing for sale" classification to the coal producing classification. Coupled with this reclassification would be a credit allowed to coal brokers for B & O taxes already paid by the producer of the raw coal. This remedy would be more in line with the historical treatment of coal producing activities, and would allow for both satisfaction of general revenue requirements and equitable treatment of taxpayers.

VII. CONCLUSION

The Business and Occupation Tax is imposed in West Virginia upon the privilege of doing business. As such, a person may simultaneously engage in two or more activities which may each be subject to this privilege tax. Two of the activities taxable are the mining of coal and the tippling of coal. Under current and past West Virginia law, a person whose only activity is the tippling of coal is taxed at a different rate for this activity than a person who mines and tipples coal. Since the tippling activity is the same whether the person also mined the coal or not, disparate treatment exists in violation of the Equal Protection Clause of the United States Constitution. To remedy this situation, the taxing statute should be amended to accommodate coal brokers within the coal producer's tax rate, thus according the same treatment to those similarly situated.

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