

# JACKSONKELLY<sup>PLLC</sup>

589 LEE STREET EAST • SUITE 1400 • P.O. BOX 553 • CHARLESTON, WEST VIRGINIA 25322 • TELEPHONE: 304-340-1000 • TELECOPIER: 304-340-1130  
[www.jacksonkelly.com](http://www.jacksonkelly.com)

DIRECT TELEPHONE: 304-340-1230

E-mail: [jmairs@jacksonkelly.com](mailto:jmairs@jacksonkelly.com)

DIRECT TELECOPIER: 304-340-1080

August 21, 2019

RECEIVED

VIA HAND DELIVERY

Mark S. Morton, General Counsel  
West Virginia State Tax Department  
P. O. Box 1005  
Charleston, West Virginia 25324  
E-mail: [taxlegal@wv.gov](mailto:taxlegal@wv.gov)

AUG 21 2019  
WV TAX DEPARTMENT  
LEGAL DIVISION

Re: Comments on Proposed Interpretative Rule for HB 3142

Dear Mr. Morton:

Set forth below are the West Virginia Coal Association's comments on the Proposed Interpretative Rules for HB 3142.

**The West Virginia Coal Association's Comments  
on Proposed Interpretative Rules for HB 3142 (§110CSR13AC)**

On March 9, 2019, the West Virginia Legislature enacted HB3142, which provides for a 2% severance tax rate reduction for sales of thermal or steam coal, phased in incrementally over three tax years beginning July 1, 2019.

On July 22, 2019, the West Virginia State Tax Department published for public comment an interpretative rule: §110CSR13AC, "Reduced Severance Tax Rates for Thermal or Steam Coal." (the "Rule"). The West Virginia Coal Association ("WVCA") and its members conducted a review of the Rule and offer the following comments.

**Section 110-13AC-1. General.**

This section explains briefly what the Rule is intended to accomplish, lists the statutory authority for the Rule, the filing date and effective date. The WVCA has no objections to this section.

**Section 110-13AC-2. Interpretative Note.**

This section states that the Rule is to be read together with the severance tax statutes and the legislative rules promulgated thereunder. If there is any inconsistency between the Rule and the legislative rules, the legislative rules shall control. The WVCA has no objections to this section.

**Section 110-13AC-3. Definitions.**

This section provides definitions for the following terms: coal, thermal or steam coal, generating or producing electricity, electric power company, sale and broker. Section 3.2 of the Rule defines the term “Thermal or steam coal” as coal sold for the purpose of generating electricity.

Section 3.3 of the Rule defines “Generating or producing electricity” as the generation, production and/or sale of electricity by businesses subject to the business and occupation tax or any other electric power company. This term does not include generating steam, producing heat, or coal gasification separate from the generation or production of electricity.

The WVCA believes that all coal with the requisite sulfur/ash content and British thermal unit value to be burned on its own, or as part of a blend, for the production of steam should be included in the definition of “thermal or steam coal.” After all, when a coal operator severs coal, it is aware that certain properties of the coal make it useful for efficiently generating heat, steam, or electricity. Whether the combustion of that coal ultimately results in steam for electricity or some other industrial use is not up to the operator at the time it severs the coal. If the intent of HB 3142 is to encourage the production of thermal coal within the State, any coal with the physical characteristics of what is traditionally thought of as steam or thermal coal should be included, regardless of what the coal is ultimately burned for. Moreover, as HB 3142 was moving through the legislative process, it was always understood and intended that the reduced severance tax rate would apply to all non-metallurgical grade thermal coal, regardless of what the thermal coal was ultimately burned for (steam, heat, or electricity).

Section 3.6 of the Rule defines “Broker” as an agent who sells goods or property for a principal, but does not acquire title to or ownership of the goods or property, or a person who functions as an intermediary between two parties in order to arrange or negotiate an agreement or contract. (Emphasis added).

The exclusion of sales to brokers who take title to the thermal coal from the purview of HB 3142 will essentially result in the exception swallowing the rule. West Virginia’s current severance tax rate of 5% is higher than the severance tax rate of any other comparable coal-producing state. The goal of reducing the severance tax rate on thermal or steam coal is to allow West Virginia coal producers to compete with neighboring coal-producing states in the steam coal market. Lowering the cost and tax burden on coal-fired generation will also translate into reductions to the cost of household and industrial power for all state residents and businesses.

West Virginia’s thermal coal producers are competing for share of an increasingly dwindling market, as many electric utilities retool their power plants to natural gas and rely increasingly on other forms of power generation. Additionally, the market for thermal coal has become more globalized over the last 10-20 years, which has coincided with a reduction in the

reliance on long-term (5 years or more) supply contracts directly between coal producers and power companies. Under these ever-changing and challenging market conditions, the use of coal brokers has become increasingly common and necessary for thermal coal producers. The vast majority—if not all—of coal brokers take title to the thermal coal and then re-sell the coal to power generators. Generally, coal brokers will not simply act as middlemen who introduce thermal coal producers to the power generators, for fear that they will be cut out of subsequent transactions. If the Tax Department refuses to extend the reduced severance tax rate to thermal coal that is ultimately sold to a power generator, via a coal broker who takes title to the coal, the WVCA fears that very few of West Virginia's thermal coal producers will be able to take advantage of the reduction, which will negate the benefits of HB 3142 for many of the State's thermal coal producers.

The WVCA proposes that the proposed rules be modified to remove provisions excluding sales through brokers who take title to the coal from the rules. The WVCA believes that a workable solution would be for the rules to provide that the reduced severance tax rate applies, where coal is sold to a broker who then sells the taxpayer's coal to a third party for purposes of generating steam, heat, or electricity. In this case, the taxpayer must retain in its records: (1) the bill of sale or invoice showing the tons sold and sale price from the taxpayer to the broker; or (2) an attestation from the broker or end user of the taxpayer's coal that the specific batch of coal for which the reduced severance rate is claimed was consumed in the generation of steam, heat, or electricity. This would allay any concerns that taxpayers would use brokers as a way to claim the reduced rate for sales of thermal coal which was not ultimately used to generate steam, heat, or electricity.

#### **Section 110-13AC-4. Reduction of Severance Tax Rates on Thermal or Steam Coal.**

Effective July 1, 2019, the 5% (4.65% state tax rate plus the 0.35% county and municipal tax rate) severance tax imposed on thermal or steam coal is ratably reduced, over the next three years, to 3%. Specifically, effective July 1, 2019, the tax rate imposed on thermal or steam coal is reduced to 4.3%. Effective July 1, 2020, the tax rate is further reduced to 3.7%. Finally, effective July 1, 2021, the tax rate is reduced to 3%. These rates include the 0.35% severance tax imposed for the benefit of counties and municipalities. The reduced tax rates do not apply to thin seam coal taxed under W. Va. Code §11-13A-3(g). Thermal or steam coal that is taxed, based on the reduced rates provided for in HB3142, remains subject to the minimum severance tax imposed under W. Va. Code § 11-12B-3. The WVCA has no objections to this section.

#### **Section 110-13AC-5. Accounting for Sales of Thermal or Steam Coal.**

The Rule provides that the determination of whether sales of coal are considered to be sales of thermal or steam coal will be made based on the coal sales contract and whether the coal is sold to an electric power company for the purpose of generating electricity. Coal sales made using the services of a broker do not qualify as thermal or steam coal sales if the broker takes title to the coal. To qualify for the reduced severance tax rates, coal sales must occur on or after

July 1, 2019. If coal is sold by a producer to a third-party seller, marketer, processor, blender, or any other entity, other than an electric power company, either directly or through a broker, the coal is not thermal or steam coal even if it is ultimately used to generate electric power.

The WVCA maintains that such an unduly-restrictive framework would undermine the ultimate goals of HB 3142 by limiting the reduced rate to a very small percentage of thermal coal produced in West Virginia. This would undoubtedly contribute to the ongoing decline in production of thermal coal in West Virginia.

The term “production of coal” includes all activities and values arising from the severance or extraction of coal and ordinary processing activities, including cleaning, breaking, sizing, dust allaying, treating to prevent freezing and loading for shipment. Accordingly, if a taxpayer, such as a blender or processor, purchases raw coal and engages in ordinary processing activities included as part of the coal production privilege, that taxpayer may be eligible for the reduced rate on thermal or steam coal if the taxpayer sells the processed coal to an electric power company. In this case, the Rule provides that the producer of the raw coal is not eligible for the reduced rates applicable to sales of thermal or steam coal because the producer sold the coal to the processor and not directly to an electric power company. This section of the Rule includes numerous examples illustrating whether certain coal sales are considered sales of thermal or steam coal. Please refer to the WVCA’s comments above on Section 3 of the proposed rules.

The Tax Department’s rules simply do not realistically reflect the way thermal coal is sold in today’s market. The numerous examples provided in the Rule (*e.g.*, §§ 5.1.4.d & 5.1.4.e) illustrate that, in the entire chain from producer to processor to power generator, only the last processor who actually sells directly to the power generator is eligible for a reduced rate on the value it adds to the coal. Such a construction of HB 3142 is at odds with the clear legislative intent of the bill, which is to apply a reduced rate to the *severance* of coal ultimately sold for the purpose of generating steam, heat, or electricity.

If Company A severs thermal coal and then sells to Company B, who processes the coal and sells it to Company C (a power generator), the purpose of Company A’s sale to Company B should ultimately be considered a sale for the generation of steam, heat, or electricity. It is simply not realistic to expect the majority of thermal coal sellers to sell directly to power plants, with no processors or other intermediaries in the chain of sale. The proposed rule, as written, ignores the purpose or end-goal of the sale and, instead, focuses only on the immediate parties directly involved in the final transaction. By limiting the reduced rate only to the party who sells directly to a power generator, the Tax Department is ensuring that those who actually sever the coal are least likely to see a benefit from the reduced rate, thereby continuing the decline of thermal coal production in the State. The WVCA respectfully requests the Tax Department to revise the Rule to reflect that where coal is sold by a producer to a processor who after further processing sells the coal directly, or through a broker, to an electric power company for the purpose of generating steam, heat or electricity, both the producer and the processor shall be

allowed to pay the reduced rate on Thermal or Steam Coal provided by W. Va. Code § 11-13A-3.

**Section 110-13AC-6. Records.**

Any person having a right or claim to the reduced rate on thermal or steam coal must maintain adequate records to show that the coal was sold to an electric power company for the purpose of generating or producing electricity. On audit, the taxpayer should be able to provide invoices, sale contracts, and bills of receipt documenting the vendor's name, purchaser's name, the invoice date, and invoice amount.

Where coal is sold directly to an electric power company, the taxpayer must retain in its records the bill of sale or invoice showing the tons sold and the sale price of the coal sold for the purpose of generating electricity. Where coal is sold to an electric power company using the services of a broker, the taxpayer must retain the bill of sale or invoice showing the tons sold and sale price from the taxpayer to the electric power company. In addition, an attestation from the broker or end user that the specific batch of coal was consumed in the generation or production of electricity is required.

Records supporting taxpayer's claim for the reduced severance tax rate for thermal or steam coal must be retained for at least three years, or for so long as the taxable period remains open for assessment or refund. Taxpayer's failure to produce records showing that coal upon which the reduced severance tax rate was claimed qualified for that rate, may result in the coal being taxed at the 5% rate.

As stated above, the WVCA believes the rules should be modified to include sale through brokers who take title to the coal as eligible for the reduced rate. With that change, the WVCA would suggest modifying the record-keeping requirements to require taxpayers to retain (1) the bill of sale or invoice showing the tons sold and sale price from the taxpayer to the broker; or (2) an attestation from the broker or end user of the taxpayer's coal that the specific batch of coal for which the reduced severance rate is claimed was consumed in the generation of steam, heat, or electricity.

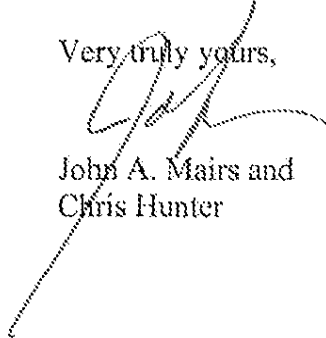
**Section 110-13AC-7. Minimum amount available for dedication under W. Va. Code § 11-13A-6a.**

W. Va. Code § 11-13A-6a provides that 5% of the severance tax on coal, including thermal or steam coal, is dedicated to and distributed for the use and benefit of the coal producing counties. Effective July 1, 2019 and thereafter, the portion of the severance tax on coal, imposed by W. Va. Code § 11-13A-3, distributed to counties and municipalities shall not be less than the amount distributed for fiscal year beginning July 1, 2018. After July 1, 2019, the minimum amount available for distribution will be \$11,975,088.09. This section of the Rule provides a method to be used by the Tax Department to make the annual distributions of the

Mark S. Morton, General Counsel  
West Virginia State Tax Department  
August 21, 2019  
Page 6

county and municipal portion of the severance tax. The distribution rules set forth in this section do not apply to the distribution of the additional tax on coal imposed for the benefit of counties and municipalities under W. Va. Code § 11-13A-6. The WVCA has no objections to this section.

Very truly yours,



John A. Mairs and  
Chris Hunter

JAM/sla

cc: West Virginia Coal Association

## PUBLIC COMMENTS AND RESPONSES

### 110CSR13AC

#### REDUCED SEVERANCE TAX RATES FOR THERMAL OR STEAM COAL

The State Tax Department received one comment from Mr. John A. Mairs, Esq. and Mr. Chris Hunter, Esq., on behalf of the West Virginia Coal Association, which is attached hereto, and is summarized with the State Tax Department's response below:

##### **Comments regarding Section 110-13AC-1. General.**

###### **Comment:**

The West Virginia Coal Association had no objection to Section 110-13AC-1.

###### **Response:**

The State Tax Department agrees.

##### **Comments regarding Section 110-13AC-2. Interpretative Note.**

###### **Comment:**

The West Virginia Coal Association had no objection to Section 110-13AC-2.

###### **Response:**

The State Tax Department agrees.

##### **Comments regarding Section 110-13AC-3. Definitions.**

###### **Comment:**

The West Virginia Coal Association objected to the definition of "generating or producing electricity" under Section 110-13AC-3.3 because the definition did not include generating steam, producing heat or coal gasification separate from the generation or production of electricity. The Comment states that all coal with the requisite sulfur/ash content and British thermal unit value burned on its own, or as part of a blend, for the production of steam should be included in the definition of "thermal or steam coal." According to the comment, certain properties of the coal make it useful for efficiently generating heat, steam, or electricity, but whether the combustion of the coal results in steam for electricity or some other industrial use is not up to the operator when it is severing the coal. The West Virginia Coal Association asserts that as HB 3142 was moving through the legislative process, it was understood that the reduced severance tax rate would apply to all non-metallurgical grade thermal coal, regardless of what the thermal coal was ultimately burned for (steam, heat, or electricity).

**Response:**

The State Tax Department has removed the definition of “generating or producing electricity” found in Section 110-13AC-3.3 from the Rule. However, HB 3142 specifically defined “thermal or steam coal” as “coal sold for the purpose of generating electricity.” Therefore, the statutory definition of thermal or steam coal still applies. See, W. Va. Code §11-13A-3(c).

**Comment:**

The West Virginia Coal Association objected to the definition of “broker” in Section 110-13AC-3.6 because it excluded sales to brokers who took title to the thermal coal. The Comment stated that this exclusion will result in the exception swallowing the rule, because most, if not all, coal brokers take title to the thermal coal and then re-sell the coal to power generators. The West Virginia Coal Association proposed that the Rule be modified to remove provisions excluding sales through brokers, who take title to the coal, from the rule. The West Virginia Coal Association suggested that the reduced rate should apply where coal is sold to a broker when the broker sells the taxpayer’s coal to a third-party for the purposes of generating steam, heat or electricity. The Comment also suggested some records that the taxpayer could maintain in order to verify the claim for the reduced rate.

**Response:**

The State Tax Department has amended the definition of coal broker to allow a broker to acquire title to the coal and re-sell it to a third-party. The Tax Department has also amended the Rule so that sales from a producer to a coal broker, or to other entities, such as marketers, processors, or blenders, may be eligible for the reduced rate for thermal or steam coal, if the coal is ultimately sold to an electric power company to be used in generating or producing electricity, so long as those entities maintain adequate records of sales and can provide an attestation that the specific batch of coal was ultimately sold for the generation or production of electricity. The definition of “thermal or steam coal” in Section 110-13AV-3.2 has also been amended to reflect this change.

**Comments regarding Section 110-13AC-4. Reduction of Severance Tax Rates on Thermal or Steam Coal.**

**Comment:**

The West Virginia Coal Association had no objection to Section 110-13AC-4.

**Response:**

The State Tax Department agrees.

**Comments regarding Section 110-13AC-5. Accounting for Sales of Thermal or Steam Coal.**

**Comment:**

The Comment objects that the Rule provides that the producer of the raw coal is not eligible for the reduced rates applicable to sales of thermal or steam coal because the producer sold the coal to a processor and not directly to an electric power company. The Comment states that this portion of the

Rule does not reflect the way thermal coal is sold in today's market. The West Virginia Coal Association does not believe that it is realistic to expect the majority of thermal coal sellers to sell directly to power plants, with no processors or other intermediaries in the chain of sale. The West Virginia Coal Association requests that the Rule be revised to reflect that where coal is sold by a producer to a processor who, after further processing the coal, sells the coal directly, or through a broker, to an electric power company for the purpose of generating steam, heat or electricity, both the producer and the processor will be eligible for the reduced rate for thermal or steam coal.

**Response:**

The State Tax Department has amended the Rule so that sales from a producer to a coal broker, or to other entities, such as marketers, processors, or blenders, may be eligible for the reduced rate for thermal or steam coal, if the coal is ultimately sold to an electric power company to be used in generating or producing electricity, so long as those entities maintain adequate records of sales and can provide an attestation that the specific batch of coal was ultimately sold for the generation or production of electricity.

The examples provided in the Rule have been amended to reflect this change.

**Comments regarding Section 110-13AC-6. Records.**

**Comment:**

The West Virginia Coal Association believes that the Rule should be modified to include sales through brokers who take title to the coal as eligible for the reduced rate. With the change, the West Virginia Coal Association suggests modifying the record keeping requirements to require taxpayers to retain (1) the bill of sale or invoice showing the tons sold and sale price from the taxpayer to the broker; or (2) an attestation from the broker or end user of the taxpayer's coal that the specific batch for which the reduced severance tax rate is consumed in the generation of steam, heat, or electricity.

**Response:**

The State Tax Department has amended its record keeping requirements to accommodate the situation where coal is sold to an electric power company through the services of broker, which has taken title of coal, or where there has been another intermediary sale of the coal. The taxpayer must retain in its records: (1) the bill of sale or invoice showing the tons sold to the broker or intermediary, and the sale price of tons sold to the broker or intermediary; and (2) an attestation from the broker or intermediary stating the number of tons sold to an electric power company or, in the case of successive sales, the number of tons sold to another broker or intermediary. The attestation should state the cost of those specific tons paid by the broker or intermediary to the producer or taxpayer for the purchase of those specific tons for which the reduced severance tax rate is claimed; and (3) an attestation from the broker or end user of the taxpayer's coal that the specific batch of coal for which the reduced severance rate is claimed was sold to an electric power company and consumed in the generation or production of electricity.

The State Tax Department has also added language dealing with the situation where there have been multiple or successive sales.

**Comments regarding Section 110-13AC-7. Minimum amount available for dedication under W. Va. Code § 11-13A-6a.**

**Comment:**

The West Virginia Coal Association had no objection to Section 110-13AC-7.

**Response:**

The State Tax Department agrees.