

**REDACTED DECISION – DK# 21-171**  
**BY: A.M. “FENWAY” POLLACK, CHIEF ADMINISTRATIVE LAW JUDGE**  
**SUBMITTED FOR DECISION ON OCTOBER 28, 2022**  
**ISSUED ON MAY 31, 2023**

**FINAL DECISION**

On September 7, 2021, the Taxpayer Services Division of the West Virginia State Tax Department (the “Tax Commissioner” or “Respondent”) issued a Notice of Assessment against Xxx Xxx Xxx, Inc. (the “Petitioner”).<sup>1</sup> This assessment was issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 10 *et seq*, of the West Virginia Code. The assessment was for Pass Through Entity tax, for tax years 2017 through 2020, for tax in the amount of \$\_\_\_\_\_, penalties and additions in the amount of \$\_\_\_\_\_, and interest in the amount of \$\_\_\_\_\_ for a total assessed tax liability of \$\_\_\_\_\_.

Thereafter, on November 1, 2021, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. *See* W. Va. Code Ann. §§ 11-10A-8(1); 11-10A-9 (West 2010).

Subsequently, notice of a hearing on the petition was sent to the Petitioner, and, in accordance with the provisions of West Virginia Code Section 11-10A-10, a hearing was held on June 27, 2022, after which the parties filed legal briefs. The matter became ripe for a decision upon the conclusion of the briefing schedule.

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<sup>1</sup> For some reason, that is not clear from the record, a second identical assessment was issued against the Petitioner on October 8, 2021.

## **FINDINGS OF FACT**

1. The Petitioner is a West Virginia corporation, incorporated in a previous year. It is in the business of developing and leasing mineral interests in West Virginia and collecting royalties on those mineral interests. Its principal place of business is A City, Illinois. Tr. P10 at 17-23.

2. The Petitioner is an S-Corporation, with one class of common stock and nine (9) shareholders, none of whom are West Virginia residents. Tr. P7 at 15-18.

3. As an S-Corporation, at the Federal level, the Petitioner files an 1120-S for S-Corporations, which includes various attachments that provide information about each shareholder's current year income and deductions, etc. Tr. P8 at 1-3.

4. Also, at the Federal level, the individual shareholders file their own individual tax returns utilizing the 1040 return. Tr. P8 at 4-6.

5. The nine (9) shareholders' income is royalty payments from the leasing of its mineral interests. Tr. P7 at 8-10.

6. When filing their personal Federal Income Taxes, the shareholders can claim a depletion deduction. This deduction is based on 15% of the gross income from the mineral interests. Tr. P9 at 16-20.

7. In West Virginia, the Petitioner (the S-Corp.) files a form PTE-100.<sup>2</sup> This form, among other things, reports the West Virginia distributed income of the non-resident shareholders. Tr. P15 at 13-17.

8. The Petitioner is required to withhold West Virginia income tax from the income distributed to the shareholders. Tr. P8 at 14-15.

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<sup>2</sup> For some of the earlier tax years at issue in this matter, the form was called an SPF-100.

9. The shareholders can then file individual West Virginia personal income tax returns, and in doing so, can claim the amounts withheld by the Petitioner as a credit. Tr. P8 at 19-23.

10. As an alternative to filing individual personal income tax returns in West Virginia, the Petitioner (the S-Corp.) can, on behalf of the shareholders, file a Form IT-140 NRC, which is a Nonresident Composite Return. This return covers all the shareholders and is treated as if there is only one Taxpayer. Tr. P9 at 4-11. For the tax years at issue in this matter, the Petitioner filed IT-140 NRCs each year.

11. At some point, the date of which is uncertain, an auditor with the West Virginia Tax Department was reviewing the tax filings of the Petitioner, and noticed an anomaly. Upon investigation, she discovered that the Petitioner was including the depletion deduction (discussed in Finding of Fact No. 6 above) in its IT-140 NRCs.<sup>3</sup> The parties exchanged emails, and then by a letter dated September 27, 2021, a Tax Department attorney informed the Petitioner that it could not claim the depletion deduction in an IT-140 NRC. *See* Petitioner's Ex. 14. Thus, the Tax Commissioner issued the assessment that forms the basis of this appeal.

12. During the evidentiary hearing in this matter, counsel for the Tax Commissioner acknowledged that for tax year 2017, the Tax Commissioner had issued the assessment outside of the applicable statute of limitations. Additionally, at hearing, the Tax Commissioner agreed to waive the additions to tax assessed in this matter.

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<sup>3</sup> The Tax Commissioner's witness was not the audit clerk who reviewed all the returns. As a result, the testimony was not entirely clear, but seemed to suggest that the Petitioner had attempted to claim the deduction on its PTE-100 return and then, due to the accounting involved, the deduction also ended up on the IT-140 NRC that the Petitioner filed on behalf of the shareholders. *See e.g.* Tr. P101-109.

## DISCUSSION

In a typical decision issued by this Tribunal, the discussion section begins with a summary of the dispute between the parties and a recitation of the applicable law. In this case, the dispute is the Petitioner's desire to take the depletion deduction on the IT-140 NRC it files on behalf of the shareholders, and the Tax Commissioner's desire to have the shareholders file individual returns if they want the deduction. We use the term "desire" deliberately, because in this matter there is no law of the case. The issue in this matter is so dependent on the minutia of accounting, that neither party can point to a statute or regulation that directly controls the question at hand. As will be discussed in greater detail below, we rule for the Tax Commissioner. As an executive branch agency, we have no ability to grant the Petitioner's desires, absent some showing of an error on the part of the Tax Commissioner, under West Virginia law.

To be sure, both parties present a variety of arguments as to why each should prevail, and we will address them in turn. First, it must be stated that the undersigned mistakenly allowed this matter to become a morass of unnecessary inquiry into the deep details of how the various tax forms are filled out. This inquiry was unnecessary because, as stated above, the Petitioner is unable to point to a single statute or regulation that says the Tax Commissioner **must**, under West Virginia law, allow the Petitioner to utilize the IT-140 NRC in order to claim the depletion deduction.<sup>4</sup> Therefore, those portions of the testimony and post-hearing briefs devoted to how the various state and federal tax forms are filled out were unnecessary.

The Petitioner makes three (3) arguments in its post-hearing brief. First, it argues that "If the depletion deduction is not permitted to be accounted for on the pass through entity return, the

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<sup>4</sup> To further complicate matters, in the Petitioner's post-hearing briefs, it becomes clear that the Petitioner really seeks to claim the depletion deduction on its West Virginia PTE-100, and then have it pass through to the IT-140 NRC composite return. Due to the undersigned not being an accountant, this accounting detail was not gleaned during the evidentiary hearing. Nonetheless, this fact does not affect our ruling.

nonresident shareholders of an S-Corporation would be subjected to West Virginia withholding tax on an amount greater than their share of the S-Corporation's West Virginia source income that is included in their federal adjusted gross incomes, which would be inconsistent with W. Va. Code § 11-21-37(a)(2).” *See* Petitioner’s Initial Brief, P17. At this point we must tip our proverbial hat to counsel for the Petitioner, who has done a yeoman’s job in this matter. The initial brief is twenty-seven (27) pages with the first argument encompassing two and a half pages, and the Petitioner is correct. If they file an IT-140 NRC, and it does not account for the depletion deduction, the shareholders will be paying more tax. As one might expect, what the Petitioner fails to mention in these two and a half pages, is the fact that if the shareholders do not want to pay more tax, they are free to file individual returns, as the Tax Commissioner has requested.

The Petitioner next argues that the instructions for the PTE-100 support accounting for the depletion deduction on the form, as opposed to doing so on individual returns. In making this argument, the Petitioner provides a series of bullet points, explaining how, if the instructions are followed, the shareholders’ West Virginia distributive income would be correctly accounted for, including the deduction at issue. At first glance, the Petitioner’s argument passes the straight face test, meaning that to a non-accountant, the path these bullet points follow seems logical. However, with this argument, the Petitioner runs into the same problem as above. The Petitioner’s last bullet point discusses how the instructions discuss **specific** modifications that either raise or lower the shareholders’ total federal income. The instructions then discuss certain lines for the entry of “other” categories. It appears that the Petitioner is relying on this “other” category as the place to account for the depletion deduction. The Petitioner is also arguing that if the depletion deduction is not listed in this “other” category then the intent of the Legislature is thwarted, because the bottom line is to arrive at the shareholders’ total federal income.

As stated above, to a non-accountant this argument seems entirely reasonable. The problem for the Petitioner is that the Tax Commissioner's argument, to a non-accountant seems just as reasonable. In plain English, the Petitioner thinks this "other" category should be the place to account for the deduction, and the Tax Commissioner says no.

The Petitioner's final argument follows a theme similar to its first two (2) arguments, namely that the composite return is defined as one filed on a group basis as though there was only one Taxpayer. *See* W. Va. Code Ann. § 11-21-51a(d) (West). Therefore, the Petitioner reasons that if the shareholders are able to claim the deduction if they file individual personal returns, they should be able to utilize the composite return to achieve the same result. The Petitioner also reiterates that the purpose of the composite return is to inform the Tax Commissioner of the proper amount of the shareholders' taxable income, which includes deductions. So, the Petitioner argues that disallowing the deductions leads to an incorrect amount of taxable income on the composite return. Finally, the Petitioner points out that the Tax Commissioner's initial reasoning for disallowing the deduction on the composite return was disproven at the evidentiary hearing. We find these arguments generally unconvincing, for the same reasons stated above.

The Petitioner is correct in its argument about the Tax Commissioner's theory of this case. Beginning with the September 27, 2021, letter to the Petitioner, continuing to the prehearing conference and finally at the evidentiary hearing, the Tax Commissioner argued that the reason the Petitioner could not claim the deduction was due to the fact that West Virginia Code Section 11-21-51a(b) states that in filing a composite return, no personal exemptions may be utilized. *See* W. Va. Code Ann. § 11-21-51a(b) (West). However, at hearing, the Tax Commissioner's witness acknowledged that, according to generally accepted accounting principles, the depletion deduction at issue in this case is not a personal exemption. As a result of this testimony, in his

post-hearing brief, the Tax Commissioner abandoned that argument. Instead, he argues that the Petitioner cannot put the depletion deduction on the PTE-100, because it is not an expense of the corporation, and the PTE-100 is only supposed to show corporate expenses.<sup>5</sup> However, upon cross examination, the Tax Commissioner's witness acknowledged that there is no **clear** statutory authority for this proposition.

ATTORNEY A: Okay, one sec. So, Schedule A for the SPF PTE returns allows for adjustment to federal income based on certain expenses, deductions and modifications, and that's where Xxx Xxx claimed the depletion deduction. What statutory provisions can you point to that prevent this method?

MS. B: There's nothing specifically that states that other than again referring to 112151A because depletion is not allowed to be deducted from the 1120S. Also, the IRS does not have a composite return because --- and I would assume for the same reason we do. It is that it should be taken at an individual level, not at a composite level.

Tr. P94 at 12-19.

Finally, the Tax Commissioner argues that he has not been arbitrary or capricious in his determination that the shareholders must file individual returns if they want to avail themselves of the depletion deduction. Specifically, he argues that West Virginia Code Section 11-21-51a(c) states that in filing a composite return, Taxpayers must do so "in a manner and form acceptable to and in accordance with instructions from the commissioner . . . ." W. Va. Code Ann. § 11-21-51a(c) (West). Interestingly, as discussed above, the Petitioner argues that the instructions for the PTE-100 counsel for a ruling in its favor, because a Taxpayer could **conceivably** use a certain line marked "other" on Schedule B to account for the deduction.

To be fair to the Petitioner, it must be noted that its contention that it would be possible to claim the deduction on the Petitioner's PTE-100 passes the straight face test. We would also note

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<sup>5</sup> Actually, the Tax Commissioner makes this argument twice, in both Section II A and II C of his Reply Brief.

that the Tax Commissioner's main argument, in both the September 27, 2021, letter and at hearing, regarding no personal exemptions being allowed on the composite return, has been abandoned. Despite all of this, we still must rule for the Tax Commissioner in this matter.

This Tribunal has given all of the Petitioner's arguments careful consideration. We rule for the Tax Commissioner, not because the Tax Commissioner has presented any particularly convincing arguments, but because as a part of the executive branch, we, except for very rare circumstances, can only correct errors of law made by the Tax Commissioner. In this matter, we are presented with the ultimate "inside the beltway" fight. Neither the Petitioner nor the Tax Commissioner can point this Tribunal to any statutory or regulatory provision that **clearly** controls. The closest argument is the Tax Commissioner's citation to West Virginia Code Section 11-21-51a(c), regarding the manner, form, and instructions of how to file a composite return. While we are aware that the written instructions for the PTE-100 do not clearly address the depletion deduction, and that the Tax Commissioner's September 27<sup>th</sup> letter was not a model of clarity, the Petitioner fails to address one inconvenient fact. The record in this matter, taken as a whole, shows that the shareholders were instructed that all they had to do to obtain the sought after deduction, was to file individual returns. When asked during the evidentiary hearing why this was not done, the answer was convenience. This brings us back to the beginning of this discussion section, and the Petitioner's/shareholders' desires. It is axiomatic that this Tribunal, as an executive branch agency, cannot, absent some statutory or regulatory mistake on the part of the Tax Commissioner, grant the Petitioner/shareholders this wish. The Petitioner has presented us with no such mistake. Perhaps they will be able to convince a reviewing court. Simply put, the Petitioner/shareholders could have filed individual returns prior to filing this appeal, or could have

done so during the period between filing and the issuance of this decision. They have consistently chosen not to do so.

### **CONCLUSIONS OF LAW**

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).

2. The West Virginia Legislature has not given the Tax Commissioner direction regarding how Taxpayers are to obtain the depletion deduction that is at issue in this matter.

3. The Legislature has given the Tax Commissioner discretion regarding how a composite return of nonresident individuals shall be filed. *See* W. Va. Code Ann. § 11-21-51a(c) (West)(a composite return shall be filed in a manner and form acceptable to and in accordance with instructions from the commissioner).

4. The Tax Commissioner has, on more than one occasion, instructed the Petitioner that the depletion deduction its shareholders seek is not to be accounted for on an IT-140 NRC.

5. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010); W. Va. Code. R. §§ 121-1-63.1 and 69.2 (2003).

6. The Petitioner in this matter has not met its burden of showing that the pass through entity tax assessment against it was erroneous as discussed above.

### **DISPOSITION**

**WHEREFORE**, it is the final decision of the West Virginia Office of Tax Appeals that:

the pass through entity tax assessment issued against the Petitioner on September 7, 2021, is hereby **AFFIRMED**.

It is further **ORDERED** that, pursuant to a remand and recalculation by both parties, the Petitioner's pass through entity tax assessment is **MODIFIED**, to reflect a total liability, including interest, as of May 12, 2023, of \$\_\_\_\_\_.

Interest continues to accrue on these unpaid taxes until fully paid. W. Va. Code Ann. § 11-10-17(a) 2010).

**WEST VIRGINIA OFFICE OF TAX APPEALS**

By: \_\_\_\_\_  
A. M. "Fenway" Pollack  
Chief Administrative Law Judge

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Date Entered