**SANITIZED DEC. – 01-702 U – BY – GEORGE V. PIPER – ISSUED - 02/28/03 – SUBMITTED FOR DECISION ON BRIEFS – 12/06/02**

## SYNOPSIS

**PURCHASERS' USE TAX -- EXEMPTIONS REQUIRE MANUFACTURING "ACTIVITIES" TO BE ON-GOING** – Purchases of raw materials for pollution monitoring services and services for the removal of contaminated waste are not exempt under W. Va. Code § 11-15-9(b)(2), 11-15-2(d)(2)(M), and 11-15-2(d)(2)(L), because Petitioner's manufacturing activities had ceased after 1997 and, therefore, the essential requirement of manufacturing "activities" had ended.

**PURCHASERS' USE TAX -- EXEMPTION STATUTES STRICTLY CONSTRUED** – Petitioner claiming exemption to taxation statute has the burden of proving clearly that it is entitled to the exemption, and the exemption shall be strictly construed against the taxpayer. Wooddell v. Dailey, 160 W. Va. 85, 230 S.E.2d 466 (1976).

**PURCHASERS' USE TAX -- PROFESSIONAL SERVICES EXCEPTION NOT APPLICABLE --** Failure of environmental laboratories to meet either the minimum education prong or the continuing education prong of the four (4)-part test set forth in 110 C.S.R. 15, § 8.1.1.1 mandates that the exception is not applicable.

## ADMINISTRATIVE DECISION

The Auditing Division issued a purchasers' use tax assessment against the Petitioner. This assessment was for the period of January 1, 1998 through June 30, 2001, for tax, interest, through June 30, 2001, and no additions to tax.

Thereafter, the Petitioner timely filed a petition for reassessment.

The briefing schedule was complete on December 6, 2002.



## FACTS

During the 1990's, Petitioner's refinery was actively engaged in the process of hydrotreating ("cleaning") used oil. After being "cleaned," the used oil becomes marketable and can be resold. In 1997, Petitioner decided to suspend its hydrotreating operations at the refinery in reaction to changing market conditions.

Specifically, some larger competitors moved their facilities out of the country and were able to hydrotreat used oil at a much lower cost.

Despite Petitioner's suspension of operations at the refinery, it continued to purchase certain goods and services. For example, because operations were suspended in 1997, Petitioner has made several purchases of liquid nitrogen from Company A. The liquid nitrogen was necessary to keep a catalyst that was used in the hydrotreating unit intact until operations were revived or, if Petitioner could not develop an economically viable method to operate the refinery, disposed of. In 1999, Petitioner permanently ceased operations and disposed of the environmentally hazardous catalyst. If Petitioner had failed to properly maintain the catalyst with the liquid nitrogen, the catalyst would have broken down and damaged the manufacturing equipment and contaminated the environment.

In addition to the liquid nitrogen purchased from Company A, Petitioner also purchased samples and analyses from Company B and Company C, and contaminated material removal services from Company D. These services were necessary to comply with an EPA order related to Petitioner's Refinery property. Various owners between the 1970's and the 1990's contaminated the property during refinery operations. However, the taxpayer who is the current owner of the facility is responsible for compliance with the EPA order and must purchase the necessary services as part of the environmental protection activity directly related to the operation and use of the plant as a manufacturing facility.

Petitioner purchased services from an individual that involved the building of a higher dike around the tank farm on the property in order to meet EPA requirements.

Petitioner also purchased services from Company E in order to remove asbestos from the facility.

In the Division's 2001 tax audit, Petitioner was assessed use tax on the purchase of the liquid nitrogen, the environmental testing services, the contaminated material removal services, the dike building services, and the asbestos removal services.

In its reply brief Division's counsel conceded that the services purchased from the individual, concerning the building of the dike around the tank farm, as well as the services purchased in connection with the removal of asbestos from its facility, would be excepted from the tax because both constituted contracting services, involving capital improvements, under the West Virginia Code.

## ISSUES AND DETERMINATIONS

The primary issue presented for determination is whether the Petitioner has shown that its purchases of liquid nitrogen, pollution control services, as well as services for the removal of contaminated material, are exempt from sales or use tax although the manufacturing activity has ceased because of economic conditions.

W. Va. Code § 11-15-9(b)(2) states, in pertinent part, that sales of services, machinery, supplies and materials directly used or consumed in the activity of manufacturing are exempt from tax.

The Code defines "directly used or consumed" in the activity of manufacturing to mean "used or consumed in those [manufacturing] activities or operations which constitute an integral and essential part of the [manufacturing] activities, as contrasted with and distinguished from those activities or operations which are

simply incidental, convenient or remote to the activities." W. Va. Code § 11-15-2(d)(1) (emphasis added).

W. Va. Code § 11-15-2(d)(2) provides a list of uses of property or consumption of services that constitute "direct use" in the activity of manufacturing. Included in this list are the following:

> (K) Maintenance or repair of property, including maintenance equipment, directly used in…manufacturing production;
> (L) Storage, removal or transportation of economic waste resulting from the activity of manufacturing;
> (M) Pollution control or environmental quality or protection activity directly relating to the activity of manufacturing.

For several years in the 1990s, Petitioner was indeed involved in hydrotreating used oil and purchased liquid nitrogen to maintain the catalyst. Without question, those purchases were not subject to sales tax because the manufacturing activities were ongoing and the liquid nitrogen was being used to maintain the catalyst.

Notwithstanding the above, the tax auditor assessed use tax for the purchases of liquid nitrogen occurring after the hydrotreating operations were shut down in 1997. A careful reading of the § 11-15-2(d)(1) indicates that there is a requirement that the use of property or the consumption of services be connected with "those activities or operations which constitute an integral and essential part of such activities, as contrasted with and distinguished from those activities or operations which are "simply incidental, convenient, or remote to such activities."

The key word is "activities" which denotes that the manufacturer's operations are ongoing rather than indefinitely shut down. Absent such a finding said purchases are subject to use tax.

The remaining issue is whether the Petitioner is correct in arguing that the Petitioner's purchases of certain environmental laboratory services are "professional services," which are excepted from use tax or consumers' sales and service tax.

The West Virginia use tax and consumers' sales and service tax apply not only to most sales of tangible personal property but also to the furnishing of most services. W. Va. Code § 11-15-8. "To prevent evasion, it shall be presumed that all sales and services are subject to the tax until the contrary is clearly established." W. Va. Code § 11-15-6.

In addition to certain statutory "exemptions" from the consumers' sales and service tax, statutory "exceptions" from that tax are provided for certain types of services, such as for "professional services." See W. Va. Code §§ 11-15-8 and 11-15-2(s). The term "professional services" is not defined in the consumers' sales and service statutes. In syllabus point 1 of Wooddell v. Dailey, 160 W. Va. 65, 230 S.E.2d 466 (1976), the Supreme Court of Appeals of West Virginia held as follows:

> The professional services which are excepted from the payment of the Consumers' Sales and Service Tax, W. Va. Code 11-15-1, et. seq., are not limited to services performed in the practice of law, theology or medicine or in pursuit of occupations specifically recognized as professions by W. Va. Code, Chapter 30, but any other profession must be clearly established as a profession by the one who asserts that services rendered in connection therewith are professional services excepted from taxation.

Consistent with this open-ended, or case-by-case, approach of Wooddell, the Legislature, by duly promulgated legislative regulations having the force and effect of law, has set forth a definition of "professional services" that (1) explicitly recognizes

certain occupations as "professional," for purpose of the exception from the consumers' sales and service tax / use tax, and (2) provides a four-part test for the State Tax Commissioner to determine, on a case-by-case basis, whether an occupation not explicitly recognized as a "professional" for purpose of the consumers' sales and service tax / use tax exception may, for that same purpose, be considered as "professional" in nature.

First, in section 2.65 of the consumers' sales and service tax / use tax regulations, 110 C.S.R. 15, § 2.65 (May 1, 1992), the Legislature provides this general definition of the term "professional services"; an activity recognized as professional under common law, its natural and logical derivatives, an activity determined by the State Tax Division to be professional, and an activity determined by the West Virginia Legislature in W. Va. Code 11-15-1 et. seq. to be professional. See Section 8.1.1 of these regulations."

Then in section 8.1.1.1 of these regulations, the Legislature provides more specific guidance:

> Professional services, as defined [(generally])] in Section 2 of these regulations, are rendered by physicians, dentists, lawyers, certified public accountants, [registered] veterinarians, physical therapists, ophthalmologists, chiropractors, podiatrists, embalmers, osteopathic physicians, and surgeons, registered sanitarians, pharmacists, psychiatrist, psychoanalysts, psychologists, landscape architects, registered professional court reporters, licensed social workers, enrolled agents, professional foresters, licensed real estate appraisers and certified real estate appraiser licensed in accordance with W. Va. Code § 37-14-1 et. seq., nursing home administrators, licensed professional counselors and licensed real estate brokers. Persons who provide services classified as nonprofessional for consumers' sales and service tax purposes include interior decorators, private detectives/investigators, security guards, bookkeepers, foresters, truck driving schools, hearing aid dealers/fitters, contractors, electricians, musicians, and hospital administrators; the foregoing listing is not all-inclusive but intended as containing examples of trades and occupations. The determination as to whether other activities are 'professional' in nature will be determined by the State Tax Division on a case-by-case basis unless the Legislature amends W. Va. Code § 11-15-1 et. seq. to provide that a specified activity is 'professional.' When making a determination as to whether other activities fall within the 'professional' classification, the [State] Tax D[ivision] will consider such things as [(1)] the level of education required for the activity, [(2)] the nature and extent of nationally recognized standards for

> performance, [(3)] licensing requirements on the State and national level, and [(4)] the extent of continuing education requirements.

(underlying emphasis added)*

The problem with the Petitioner's argument is that it fails both the minimum education prong and the continuing education prong of the four (4)-part test, to wit: Petitioner testified on cross examination that there is no specific requirement governing the licenses of environmental laboratories for any type of required continuing education and that the required education level to engage in this activity can be as little as a high school diploma.

Accordingly, the exception from the consumers' sales and service tax for "professional services," see W. Va. Code §§ 11-15-8 and 11-15-2(s), does not apply to the furnishing of "environmental services."

The Determination in this matter is supported, too, by the well-established principle that an exemption or an exclusion from a tax statute is construed strictly against the taxpayer. See syllabus point 1, RGIS Inventory Specialists v. Palmer, 209 W. Va. 152, 544 S.E.2d 79 (2001).

The issue presented in this matter involves also the following important rules of statutory construction and of administrative agency authority. '[I]f [as here] the statute is silent or ambiguous with respect to the specific issue, the question for the

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* In Widemann Associates, Inc. v. Paige, Civil Action No. 93-C-5726 (Kanawha County, W. Va. Cir. Ct. June 27, 1995) (involving private investigators), Judge MacQueen (now retired) expressed concern with what he believed was too little legislative guidance as to the scope of the term "professional services," for purpose of the consumers' sales and service tax / use tax exception. Therefore, he ruled that the exception was available only to those services explicitly listed as "professional" in the legislative regulation, 110 C.S.R. 15, § 8.1.1.1 (May 1, 1992). While the State Tax Commissioner does not acquiesce to this ruling and is required, apparently, to follow that more restrictive approach to this exception in Kanawha County only, the services of a licensed operator of a school of beauty culture are not explicitly listed as "professional" in that regulation; accordingly, under Judge MacQueen's approach, the Petitioner's argument here that its services are "professional" for purpose of this tax exception are clearly without merit.

[reviewing] court is whether the agency's answer is based on a permissible construction of the statute." Syllabus point 4, in part, Appalachian Power Co. v. State Tax Department, 195 W. Va. 573, 466 S.E.2d 424 (1995). Similarly, "the Tax Commissioner need not write a rule [or an administrative decision] that services the statute in the best or most logical manner; he [or she] need only write a rule [or a decision] that flows rationally from the statute." Id., 195 W. Va. at 588, 466 S.E.2d at __. Thus, "[I]nterpretations of statutes by bodies charged with their administration are given great weight unless clearly erroneous." Syllabus point 3, Shawnee Bank, Inc. v. Paige 200 W. Va. 20, 488 S.E.2d 20 (1997) (internal citation omitted). Finally, "courts will not override administrative agency decisions, of whatever kind, unless the decisions contradict some explicit constitutional provision or right, are the results of a flawed process, or are either fundamentally unfair or arbitrary." 200 W. Va. 20, 488 S.E.2d 2D (1997) (internal citation omitted). Finally, "courts will not override administrative agency decisions, of whatever kind, unless the decisions contradict some explicit constitutional provision or right, are the results of a flawed process, or are either fundamentally unfair or arbitrary." Appalachian Power, 195 W. Va. at 589, 466 S.E.2d at __ quoting Frymier- Halloran v. Paige, 193 W. Va. 667, 694 458 S.E.2d 780, 787 1995).

In addition to all the foregoing substantive law, a relevant procedural law is that the burden of proof is upon a petitioner-taxpayer to show that a state tax assessment is incorrect and contrary to law, in whole or in part. W. Va. Code § 11-10-9.

To that end it must be understood that the purchases in question were all made after 1997 and that Petitioner never restarted its operations.

Accordingly, it is **DETERMINED** that the Petitioner, after 1997, is not entitled to claim the aforesaid exemptions in W. Va. Code § 11-15-2(d)(1) and § 11-15-2(d)(2)(L) concerning its purchases of liquid nitrogen because the same were not used or consumed in its manufacturing "activities," a term that necessarily connotes on-going performance of operations, not merely holding a business license.

It is also **DETERMINED** that the exemption provided for in W. Va. Code § 11-15-2(d)(M) is also not applicable to Petitioner's purchases of pollution control and monitoring services because said services were not again directly related to the ongoing "activity" of manufacturing. That same finding also applies to the services purchased for the removal of contaminated material, which are not exempt under W. Va. Code § 11-15-2(d)(2)(L) because the same do not concern the removal of economic waste resulting from the "activity" of manufacturing.

**WHEREFORE**, it is the **DECISION** of the **STATE TAX COMMISSIONER OF WEST VIRGINIA** that the purchasers' use tax assessment issued against the Petitioner for the period of January 1, 1998 through June 30, 2001, should be and is hereby **MODIFIED** in accordance with the above Conclusion(s) of Law for tax, interest, on the revised tax, updated through March 15, 2003, for a total revised liability.