

CHAPTER 7

SEVERANCE TAX¹

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¶ 701 Introduction

The West Virginia Severance Tax Act became effective July 1, 1987. Prior to that date, producers of natural resources were subject to the business and occupation tax. The severance tax is similar to the former business and occupation tax imposed on persons engaged in the severance, extraction or production of natural resources within this State. A significant change is that (with the exception of timber products, limestone, oil and natural gas) the severance tax base now includes the value added to purchased natural resources by processing and treatment activities. The tax is imposed on all “producers” and processors of natural resources. The tax applies to all forms of natural resource production and is based on gross proceeds of sale or assigned gross values. There are eight natural resource classifications for determining the tax rate and the measure of taxable income. Natural resources include rock, stone, limestone, coal, shale, gravel, sand, clay, natural gas, oil, standing timber and all other forms of minerals. A minimum severance tax on coal was enacted in 1990. Effective December 1, 2005, additional severance taxes are imposed on the privileges of producing coal, natural gas and timber.

The Legislature amended the Severance Tax law in 2014 by adding a new section 11-13A-5b that creates the Future Fund in the State Treasury as a special fund. Beginning with the fiscal year ending June 30, 2014, and each fiscal year thereafter, the Secretary of Revenue is required to cause 3% of severance taxes collected under Sections 11-13A-3 and 3a that would be deposited into the General Revenue Fund to be deposited into the Future Fund. Taxes collected under these sections include taxes attributable to the severance of coal, limestone, sandstone, natural gas and oil. Because funds were taken from the State’s Rainy Day fund to balance the budget in FY 2014 and FY 2015, no monies have been deposited in the Future Fund. See exception 2, below.

There are three exceptions to this deposit requirement. They are:

- (1) The deposit is required only during fiscal years within which the balance of the Revenue Shortfall Reserve Fund (“Rainy Day Fund”) equals or exceeds 13% of the State’s General Revenue Fund budget during the preceding fiscal year.

For example, if the General Revenue Fund budget for the fiscal year ending on June 30th is \$4.1 billion, the Rainy Day Fund would need to have a balance of \$537.7 million or more, determined by the ensuing August 29th. If this requirement is not met, monies will not be deposited in the Future Fund.

- (2) The deposit may not be made in any fiscal year in which the Governor’s General Revenue Fund estimate relies on transfers from the Rainy Day Fund.

- (3) The deposit may not be made in any fiscal year for which mid-year spending reductions, hiring freezes, mid-year decreases in appropriations or transfers from the Rainy Day Fund are necessitated due to revenue shortfalls or would be necessitated if the deposits to the Future Fund were made.

In order to maximize the value of the Future Fund, the law provides that no money from the fund may be expended or appropriated until fiscal year 2020. Then, and thereafter, only the investment income of the Fund may be appropriated and expended. However, no more than the average net investment return of the Fund for the immediately preceding five fiscal years may be appropriated or expended in that fiscal year.²

Monies in the Future Fund may only be expended for (1) enhancing education and workforce development; (2) economic development and diversification; (3) infrastructure improvements; and (4) tax relief measures for the benefit of the citizens and businesses of the State of West Virginia.³

¶ 702 Persons Subject to Tax

Law: W. Va. Code §§ 11-13A-2; 11-13A-3; 11-13A-3a; 11-13A-3b; 11-13A-3c; 11-13A-3d; and 11-13A-3e

Producers: The severance tax is imposed on every person exercising the privilege of engaging in West Virginia in the business of severing, extracting, reducing to possession and producing for sale or commercial use, any natural resource product. Such taxpayers are referred to as “producers” of a natural resource. Generally, a producer is one who has ownership of the natural resource immediately after it is severed or extracted. The tax also applies to certain treatment processes and to persons who purchase or import certain natural resources for the purpose of processing them within this State for sale or commercial use.

Tax applies to the production of coal, including coal produced from waste or residue of prior mining, limestone, natural gas, including coalbed methane gas, sand and gravel, sandstone, timber and other natural resources.

Contractors: Contractors producing a natural resource for others are considered to be performing a service for a producer and are not subject to the tax. In cases where there is a dispute as to who is the producer subject to the tax, the status of the parties will be determined by the substance of their relationship. In determining whether a contractor who extracts a natural resource is a producer subject to the tax, the regulations indicate that the following elements will be considered by the Tax Commissioner:

- (1) Whether the contractor has an interest in the mineral in place;

² This limitation on expenditure is statutory and decisions of one Legislature are not binding on a subsequent Legislature.

³ *Ibid.*

- (2) Whether the contractor has an economic interest in the mineral he is extracting, giving him a right to claim a depletion allowance for federal tax purposes;
- (3) Whether the contractor is obligated to pay a royalty to another;
- (4) Whether the contract is terminable;
- (5) Whether the contractor has the exclusive right to extract the natural resource;
- (6) Whether the contractor must look to the income from the sale of the natural resource for his compensation;
- (7) Whether the contractor controls the natural resource after extraction; and
- (8) Whether the contract contains an exclusive and mandatory sales agreement.

(WVCSR § 110-13A-4.5.)

However, it has been the position of the Tax Commissioner that a contractor who has the exclusive right to mine and an economic interest in his production is still not subject to the tax if title to the mineral is in another's name when the mineral is severed.

Co-owners: Co-owners of oil and natural gas in place, lessees and others who own part or all of oil and natural gas when it is produced (except royalty recipients in kind) are treated as a "group or combination acting as a unit." If such co-owners are engaged in producing oil or natural gas through use of the same independent contract driller's services, they are considered one taxpayer and are required to report the entire gross value on a single severance tax return notwithstanding provisions of private contracts for services or separate deposits of gross receipts. (W. Va. Code § 11-13A-5; WVCSR § 110-13A-6.1.)

Lessors: Lessors, assignees and others who receive payments, as royalties, from producers of natural resources are not deemed to be producers and, therefore, are not required to file a severance tax return. Royalties include, but are not limited to, ordinary royalties, overriding royalties, lease bonuses, delay rentals, advance royalties, minimum royalties, shut-in royalties, payments for exploration rights, and the reimbursements by the lessee of lessor's property taxes. If the owner of a working interest in an oil and gas property assigns or "farms out" his interest to another party who assumes the obligations to develop and operate the property and to make payments to the assignor of an ordinary or overriding royalty, the party operating the property is deemed to be the producer and must report the entire gross proceeds of sale of the natural resource product for the severance tax without any deduction for the overriding royalty or any other royalty payable to others. A producer of natural resources who is a lessee may not deduct such royalty payments from gross value subject to the severance tax.

¶ 703 Value Subject to Tax – Generally

Law: W. Va. Code § 11-13A-2

Sales price: For natural resources severed and/or processed (except natural gas, oil, limestone or sandstone), the severance tax is levied on the “gross value” of the natural resource. The gross value is the amount received or receivable by the taxpayer for the sale of the resource. When natural resources are to be paid for at a future date, payment of the tax is also delayed until the time when the taxpayer recognizes gross income under the taxpayer’s method of accounting. Often, under a “take or pay contract,” a producer may be paid for natural resources not actually severed or extracted and such amounts may offset future purchases. In such instances, the producer is not required to pay the tax on the excess payment until such amount is credited against natural resources delivered to the purchaser. (WVCSR § 110-13A-3.7.) In related party transactions, gross value is not to be less than fair market value for natural resources of similar grade and quality.

Processing in state by purchaser: When a natural resource (except natural gas, oil, and limestone) is purchased from an unrelated party outside this State for the purpose of processing and resale or consumption within this State, the taxpayer must pay the tax on the gross value added by the processing. The gross value subject to tax is the amount received or receivable after processing less the amount paid or payable to the person actually severing the natural resource. If severed natural resources are purchased for the purpose of processing and consumption, the gross value is the fair market value of processed natural resources of similar grade and quality less the amount paid or payable to the person actually severing the natural resource.

Processing in state by foreign producer: If natural resources are severed outside this State and brought into this State by a taxpayer, for the purpose of processing and sale, the gross value subject to tax is the amount received or receivable after processing, less the fair market value of the natural resource of similar grade and quality immediately preceding the processing of the natural resource. If natural resources are severed outside of this State and brought into this State by a taxpayer for the purpose of processing and consumption, the gross value is the fair market value of processed natural resources of similar grade and quality less the fair market value of the natural resource of similar grade and quality immediately preceding the processing of the natural resource.

No deduction of expenses except certain freight charges: As a general rule, gross value is not reduced by any taxes or other expenses. (W. Va. Code § 11-13A-2(6)(F).)

Specifically, amounts paid to an independent contractor as remuneration for the severing, extracting, producing or processing of natural resources that the contractor has no ownership interest in cannot be deducted from gross value by the producer. (WVCSR § 110-13A-3.4.) However, producers of natural resources are permitted to deduct certain freight charges from the gross proceeds of sale to arrive at taxable value if the freight charges are paid by the producer to a common carrier, including

independent haulers, for the delivery of the natural resources to a bona fide purchaser. (WVCSR § 110-13A-5.7.3.)

Additionally, if a producer agrees to deliver his natural resources in his own equipment to a purchaser for a separate fee clearly set forth on the invoice or in the contract, the regulations allow a deduction for the delivery charge in the determination of gross sale proceeds. (WVCSR § 110-13A-5.7.4.) This is a limited exception to the general rule that no deduction is permitted for expenses incurred by the producer through the use of his own equipment. (WVCSR §§ 110-13A-2.7 and 110-13A-5.7.1.) This limited exception emphasizes the form, rather than the substance, of a sale. If the producer's transportation costs are not stated separately on the invoice or in the contract, they are generally not deductible.

Transportation of natural resource products to an integrated producer/processor's facility for processing which is considered part of the extraction process is not deductible for severance tax purposes, whether transported by the producer in his own equipment or by a common carrier.

Example: Assume that coal has a value of \$20 per ton at the place where production ends. If a purchaser buys the coal at the mine for that price, the producer will report the gross proceeds of sale at \$20 per ton under the coal production classification. If the purchaser buys the coal *delivered* at \$22 per ton, the producer will report the gross proceeds of sale at \$22 per ton, unless the producer either pays a common carrier \$2 per ton, or separately states the \$2 per ton charge on the invoice, in which case the producer may deduct \$2 per ton freight or delivery charges of \$2 per ton from the gross sale proceeds.

However, if an integrated producer/processor pays a common carrier \$2 per ton to transport coal from the mine mouth to its processing plant or loading facility for further processing and loading for shipment, considered as part of the mining process, such freight charges would not be deductible as outgoing freight charges in arriving at gross value.

¶ 704 Value Subject to Tax – Timber

Law: W. Va. Code § 11-13A-4(d)

The gross value of timber is the market value at the point where the tree is severed, topped and delimbed (called "bucking" in the industry), but before any further cutting is done to produce lumber. (*Burruss v. Hardesty*, 171 W. Va. 61, 297 S.E.2d 836 (1982).) If a sale occurs at that point, the taxable value is equal to the gross sale proceeds. In the absence of such a sale, taxable value is the sales price of similar timber, taking into consideration the cost of transporting the timber to a market. The regulations provide that a taxpayer may elect to use the following rules to determine the gross value of timber subject to the severance tax:

- (1) A producer who sells his logs and timber by-products after bucking operations either where the trees were felled or at a central collection point may report 75% of the gross proceeds of sale under the tax;
- (2) A producer who sells and delivers timber in the same condition as when the timber leaves the forest may report 50% of his gross proceeds of sale under the tax; and
- (3) A producer who mills or otherwise manufactures timber for sale may report 25% of the gross proceeds of sale under the tax.

(WVCSR § 110-13A-5.4.2.)

¶ 705 Value Subject to Tax – Oil and Gas

Law: W. Va. Code §§ 11-13A-2(c)(9)(A) and 11-13A-4(c)

The value of oil and gas (including liquid natural gas) is its value at the wellhead preceding transportation and transmission and any conversion or refining process. However, the value of oil and gas includes the value of products obtained by any separation process commonly employed to obtain marketable oil and gas. When the gas produced is not sold at the well-mouth, transportation and transmission expenses incurred by the producer before the point of sale are deducted from the gross proceeds of the sale. The regulations set forth alternative methods for valuing gas when the gas is not sold at the wellhead. However, the use of these methods is subject to review and audit by the Tax Commissioner. (WVCSR § 110-13A-4.8.) The alternatives are as follows:

- (1) *Actual cost method:* From the gross proceeds of the sale of natural gas, deduct the actual direct costs of transportation and transmission through the system of the producer from the well-mouth to the point of sale. This deduction must be supported with schedules and statements of cost.
- (2) *First sale ceiling price method:* Producers subject to regulation by the Federal Energy Regulatory Commission (FERC) may use the “first sale ceiling price” as determined, adjusted and published by the FERC pursuant to Section 2(21) of the Natural Gas Act of 1978. This method applies only to the production of “new gas” as defined by that Act.
- (3) *Average purchase price method:* The well-mouth value may be determined by the average purchase price of natural gas from the same pool or field or from the most proximate pool or field of the same quality and characteristics as the natural gas produced. The Tax Commissioner may disallow this method by establishing that the “average purchase price” does not accurately represent the current well-mouth value of the gas severed when compared to the ultimate selling price under present market conditions.

- (4) *Fixed percentage method*: The well-mouth value of natural gas not sold at the well-mouth may be determined by a standard allowance for transportation and transmission costs in the amount of 15% of the gross proceeds from the sale of the natural gas severed and produced. However, the Tax Commissioner reserves the right to disallow use of this method when it can be established that a 15% transportation deduction does not accurately represent the cost of transportation and transmission.

The tax does not apply to:

- (1) Free natural gas provided to any surface owner;
- (2) Natural gas produced from any well which produced an average of less than five thousand cubic feet of natural gas per day during the calendar year immediately preceding a given taxable period;
- (3) Oil produced from any oil well which produced an average of less than one-half barrel of oil per day during the calendar year immediately preceding a given taxable period; and
- (4) For a maximum period of ten years, all natural gas or oil produced from any well which has not produced marketable quantities of natural gas or oil for five consecutive years immediately preceding the year in which a well is placed back into production and thereafter produces marketable quantities of natural gas or oil. However, beginning July 1, 2013, this exemption is void and of no force or effect with respect to horizontally drilled wells unless the producer established entitlement to the exemption prior to July 1, 2013. "Horizontally drilled well" means any well that is drilled using a "horizontal drilling" method as that term is defined in W. Va. Code § 22-6A-4(b)(5).

¶ 706 Value Subject to Tax – Mining

Law: W. Va. Code §§ 11-13A-2(c)(7) and 11-13A-4(a) and (b)

Processing considered part of mining: The following treatment processes applied by the producer or contract miner to natural resources mined in this State shall be considered mining and therefore subject to the severance tax:

- (1) *Coal*: In the case of coal, the treatment processes include crushing, cleaning, drying, sorting, sizing, dust allaying, loading for shipment and freeze treatment. Production of coal will also include the severance, extraction and processing of gob piles, sludge ponds or other coal waste which, when processed, are sold as coal.
- (2) *Minerals customarily sold in crude form*: In the case of other minerals which are customarily sold in crude form, the value added by sorting, concentrating,

sintering and essentially equivalent processes to bring the mineral to shipping grade and form, and loading for shipment is subject to the tax.

(3) *Minerals not customarily sold in crude form:* In the case of other minerals which are not customarily sold in crude form, the value added by crushing, grinding and beneficiation by concentration (gravity, flotation, amalgamation or electrostatic or magnetic), cyanide process, leaching, crystallization, precipitation (but not including electrolytic deposition, roasting, thermal or electric smelting or refining), or substantially equivalent processes or combinations of processes used in the separation or extraction of the product or products from the ore or the minerals from other materials from the mine or other natural deposit is subject to the tax.

(4) *Oil shale:* The value added by extraction from the ground, crushing, loading into the retort and retorting, but not hydrogenation, refining or any other process subsequent to retorting is subject to the tax.

Processing not considered part of mining: The value added by the following treatment processes are not considered “mining” and is not subject to the tax: electrolytic deposition, roasting, calcination, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping.

¶ 707 Value Subject to Tax – Limestone and Sandstone

Law: W. Va. Code §§ 11-13A-2(c)(9)(B) and 11-13A-4(e)

The production of limestone by quarrying or mining ends once the limestone or sandstone is severed from the earth. Limestone or sandstone, which is mined, is valued at the point it is reduced to possession at the portal. Limestone or sandstone, which is quarried, is valued at the point it is severed from the wall of the open quarry.

¶ 708 Rates of Tax

Law: W. Va. Code §§ 11-13A-3, 11-13A-3a, 11-13A-3b, 11-13A-3c, 11-13A-3d, 11-13A-3e and 11-13A-6

The rates of severance tax are determined according to the classification of the resource produced and are as follows:

TAX RATES
(on gross value of the natural resource subject to tax)

NATURAL RESOURCE CLASSIFICATION	Tax Rate
Coal *	5.00%
When produced by underground mining methods from seams 37” to 47” thick	2.00%
When produced by underground mining methods from seams less than 37” thick	1.00%
When produced from waste and residue from prior mining	2.50%

Limestone or Sandstone quarried or mined	5.00%
Oil	5.00%
Natural Gas	5.00%
Natural gas – methane gas	5.00%
Sand, gravel or other mineral product not quarried or mined	5.00%
Timber produced before January 1, 2007	3.22%
Timber produced after December 31, 2006	1.22%
Timber produced after December 31, 2009	0%**
Other Natural Resources	5.00%

* The rates for coal include the 0.35% rate imposed for the benefit of counties and municipalities.

** Once the additional taxes on the privileges of severing coal, natural gas and timber imposed by W. Va. Code § 11-13V-4 expire, the regular severance tax on the privilege of severing timber resumes at the rate of 1.22% of gross value of the timber produced.

These rates do not include the minimum severance tax on coal, see ¶ 712, the additional tax on producers of coal, gas or timber, see ¶ 713, the special reclamation tax, see ¶ 714, or the special tax on coal producers, see ¶ 715.

¶ 709 Waste Coal and River Coal

Law: W. Va. Code § 11-13A-3e.

Coal produced from the waste and residue of prior mining is generally not subject to the 5% tax on the privilege of severing coal or to the minimum severance tax on the privilege of severing coal. The privilege of producing waste coal is subject to tax, however, at the 2.5% rate of tax when the producer of the waste coal also processes the waste coal for sale, profit or commercial use.

The producer of waste coal is also subject to the 2 cents per ton special tax on coal production imposed by W. Va. Code § 22-3-32 and to the 27.9 cents per ton special coal reclamation tax imposed by Section 22-3-11. See ¶ 714 and ¶ 715, below.

However, the 2.5% rate of tax applies only when the person extracting and recovering material from refuse, gob piles or other sources of waste coal located in this State subsequently processes the waste coal for sale, profit or commercial use. If a person extracts waste coal and sells the waste coal to another person either for processing or not for further processing, the value of the waste coal sold is taxed under the coal classification at the 5% rate. However, if the waste and residue reduced to possession is not predominately coal, the value of the waste and residue is taxed under the “other natural resource” classification at the 5% rate.

Processing without extracting. – If a person buys uncleaned, unprocessed waste and residue of prior mining that was extracted by another, and then washes and processes the material and prepares it for sale as coal, the value added by the processing is taxed at the 5% rate of tax.

When no tax is due. – If the extracted waste or residue from prior mining is not sold, then under W. Va. Code § 11-13A-2(c)(5) no severance tax is due. Additionally,

severance tax does not apply to any electrical power co-generation plant burning material from its wholly-owned refuse or gob pile.

River Coal. – Dredging of coal from a riverbed is subject to the 5% severance tax on the privilege of producing coal and to the 75 cents per ton minimum severance tax. Recovery of coal from a riverbed is not treated as the production of coal from the waste or residue of prior mining.

¶ 710 Credits Against Tax

Law: W. Va. Code §§ 11-13A-10, 11-13A-10a, 11-13A-16a and 11-13A-24

Annual credit allowance: Each taxpayer is entitled to a credit of \$41.67 per month (\$500 per tax year) for each month it is subject to the severance tax imposed by W. Va. Code § 11-13A-1 et seq. However, nonresidents severing timber may claim this credit only on the annual return, and no credit is allowed against the minimum severance tax imposed by W. Va. Code § 11-12B-3 or the additional severance taxes imposed by W. Va. Code § 11-13V-4.

Credit for payment of minimum severance tax on coal: The minimum severance tax imposed by W. Va. Code § 11-12B-3 is allowed as a credit against the severance tax imposed by W. Va. Code § 11-13A-3.

¶ 711 Minimum Severance Tax on Coal

Law: W. Va. Code §§ 11-12B-1 et seq.

Rate: There is a minimum severance tax of 75¢ per ton (2,000 pounds) on coal produced for sale or use including coal extracted from waste deposits.

Exemption: The minimum severance tax on coal does not apply to coal produced by underground mining methods from a seam of coal whose average thickness is 45 inches or less.

Credit against the severance tax: The minimum severance tax may be credited against 4.65% of the 5% severance tax on coal imposed by W. Va. Code § 11-13A-3. The remaining .35% of the severance tax (which is designated to go to the counties and municipalities by West Virginia statute) is not subject to credit for the minimum severance tax.

Provisions in common with the severance tax: The provisions of the minimum severance tax regarding: accounting periods, methods of accounting, annual returns, periodic installment payments of estimated tax, time and place for paying the tax, extension of time for paying the tax, place for filing returns, signing of returns, requirement of bond, records, general procedure and administration, and criminal penalties are substantially the same as for the severance tax.

Collection of tax by purchaser: If a taxpayer is delinquent in payment of the tax, the Tax Commissioner may require the first purchaser of the coal to withhold the tax due.

¶ 712 Additional Severance Tax on Coal, Gas and Timber Producers

Law: W. Va. Code § 11-13V-1 *et seq.*

Additional severance taxes are imposed for the privilege of producing coal, natural gas or timber. The additional severance taxes collected are deposited in the Workers' Compensation Debt Reduction Fund and will continue to be imposed until the unfunded liability of the Workers' Compensation Old Fund is paid or provided for. The rates of the additional severance taxes are as follows:

Coal	56 cents per ton
Natural gas	4.7 cents per MCF
Timber	2.78% of gross value

Provisions in common with the severance tax: The provisions of the additional severance taxes regarding: accounting periods, methods of accounting, annual returns, periodic installment payments of estimated tax, time and place for paying the tax, extension of time for paying the tax, place for filing returns, signing of returns, requirement of bond, records, general procedure and administration, and criminal penalties are substantially the same as for the severance tax.

General procedures and administration: The provisions of the "West Virginia Tax Procedure and Administration Act" discussed in Chapter 9 apply to the special tax.

¶ 713 Special Reclamation Tax on Coal Production for Special Reclamation Fund

Law: W. Va. Code §§ 22-3-11 and 22-3-11a

Rate: A special reclamation tax equal to 27.9 cents per ton is levied on clean coal produced in West Virginia or clean coal extracted from a refuse pile or slurry pond. The special reclamation tax is imposed upon the same tonnage (clean coal) and is owed by the same party (the producer) as the minimum severance tax. The tax also applies to tonnage of clean coal produced by underground mining methods from seams of coal whose average thickness is 45 inches or less.

No credit against severance tax: The special reclamation tax is in addition to all other taxes and is not allowed as a credit against the severance tax or minimum severance tax.

Provisions in common with minimum severance tax: The special reclamation tax is collected by the Tax Commissioner in the same manner and at the same time as the minimum severance tax, but the tax is not to be construed as an increase in either the severance tax or the minimum severance tax.

Special Reclamation Fund: A portion of the 27.9 cents per ton special reclamation tax – 12.9 cents per clean ton -- is deposited in the Special Reclamation Fund. The rest is deposited the Special Reclamation Water Trust Fund. Monies in the Special Reclamation Fund are expended in accordance with appropriations by the Legislature for the purpose of reclaiming abandoned mine sites.

Special Reclamation Water Trust Fund: A portion of the 27.9 cents per ton special reclamation tax – 15 cents per clean ton -- is deposited into the Special Reclamation Water Trust Fund and expended in accordance with appropriations by the Legislature for the purpose of meeting the water reclamation responsibilities of the State.

General procedures and administration: The provisions of the “West Virginia Tax Procedure and Administration Act” discussed in Chapter 9 apply to the special reclamation tax.

¶ 714 Special Tax on Coal Production for Mines and Minerals Operations Fund

Law: W. Va. Code §§ 22-3-32 and 22-3-32a

Rate: There is a special annual tax equal to two cents per ton of coal produced in West Virginia. The special tax is imposed upon the same tonnage (clean coal) and is owed by the same party (the producer) as the minimum severance tax. The tax also applies to tonnage of clean coal produced by underground mining methods from seams of coal whose average thickness is 45 inches or less and to coal produced or recovered from the waste and residue of prior mining.

No credit against severance tax: The special tax is in addition to all other taxes and is not allowed as a credit against the severance tax or minimum severance tax.

Provisions in common with minimum severance tax: The special tax is collected by the Tax Commissioner in the same manner and at the same time as the minimum severance tax, but the tax is not to be construed as an increase in either the severance tax or the minimum severance tax.

Mines and Minerals Operations Fund: The special tax is deposited by the Tax Commissioner in the Mines and Minerals Operations Fund in the State treasury to be expended in accordance with appropriations by the Legislature for the purpose of carrying out the statutory duties relating to enforcement of environmental regulatory programs for the coal industry.

General procedures and administration: The provisions of the “West Virginia Tax Procedure and Administration Act” discussed in Chapter 9 apply to the special tax.

¶ 715 Accounting Periods and Methods

Law: W. Va. Code §§ 11-12B-4, 11-13A-7 and 11-13V-5

A taxpayer's accounting period for severance tax return purposes must be the same as that used for federal income tax reporting purposes. If a taxpayer changes its tax year for federal income tax purposes, the taxpayer must conform for purposes of the severance tax and provide a copy of the authorization from the Internal Revenue Service for the change with its annual severance tax return.

The taxpayer's method of accounting for severance tax return purposes must be the same as the accounting method employed for federal income tax purposes. If the taxpayer's method of accounting is changed for federal income tax purposes, a conforming change must be made for the severance tax and a copy of the Internal Revenue Service's approval of the accounting change must be filed with the annual severance tax return.

¶ 716 Records

Law: W. Va. Code §§ 11-12B-14, 11-13A-18 and 11-13V-15

Taxpayers must maintain appropriate records relating to the severance tax and its computation. These records must be maintained for a period of at least three years subsequent to the return filing. In cases where the time for making an assessment has been extended, the record retention period is automatically extended.

¶ 717 Returns and Payments of Tax

Laws: W. Va. Code §§ 11-12B-5, 11-12B-7, 11-12B-8, 11-12B-9, 11-12B-10, 11-12B-11, 11-3A-8, 11-13A-9, 11-13A-9a, 11-13A-10, 11-13A-11, 11-13A-12, 11-13A-13, 11-13A-14, 11-13A-15, 11-13V-6, 11-13V-7, 11-13V-8, 11-13V-9, 11-13V-10, 11-13V-11 and 11-13V-12

Monthly returns: Monthly severance tax returns are required for taxpayers with estimated tax liability of more than \$1,000 per month. Each month's return is due on or before the last day of the following month, except the monthly return due by June 30 which is now required to be filed with the remittance on or before June 15.

Quarterly returns: If the monthly estimated tax is \$1,000 or less, a return is due quarterly within one month after the expiration of each quarter if any tax is due.

Annual returns: An annual severance tax return is required by the end of the month following the close of the taxable year. The annual return is required by every taxpayer filing monthly or quarterly severance tax returns whether or not any tax is due.

Consolidated returns: Consolidated returns may be filed for the severance tax.

Extensions: The Tax Commissioner may, upon written request received on or prior to the due date of any return, grant a reasonable extension of time for filing the tax return, if good cause is shown. Before an extension of time for filing will be granted, a tentative tax return must be filed and any tax shown to be due paid. However, an extension of time does not extend the time for payment of the tax. The Tax

Commissioner may extend the time for payment of the amount of tax shown to be due on any annual or estimated return for a reasonable period not to exceed six months from the due date of the return.

Mandatory e-Pay/e-File Information: Beginning January 1, 2015, individuals who have made total payments of \$100,000.00 and businesses that have made total payments of \$10,000.00 during the period of July 1, 2013 through June 30, 2014 are required to file and pay their West Virginia taxes electronically, unless a hardship waiver is granted by the State Tax Department. See State Tax Department's Modernized Electronic Filing (MEF) Handbook available at its website <http://www.wva.state.wv.us/wvtax/WestVirginiaStateTaxDepartment.aspx>.

Bond

Law: W. Va. Code §§ 11-12B-12, 11-13A-16, 11-13A-16a and 11-13V-13

The Tax Commissioner may require a taxpayer to post a cash or surety bond, whenever he deems it necessary to ensure compliance with the severance tax. The bond may not be less than \$500.

A nonresident person or business severing timber in this State must post a cash or surety bond before beginning to sever timber. See ¶ 723 for additional information and requirements.

¶ 719 Agreement for Processor to Pay Tax

Law: W. Va. Code § 11-13A-17(a)

In the case of natural resources other than natural gas, the Tax Commissioner may authorize the taxpayer processing the natural resource to report and pay the full amount of severance tax which would be due on the completed product. For example, since the owner/operator of a coal processing plant is engaged in a production activity for severance tax purposes, such owner/operator may be authorized to enter into agreements with independent producers from whom raw coal is purchased to pay the severance tax to this State on both the severance and processing activities. The owner/operator would presumably withhold the independent producer's share of the tax from the amount paid for the raw coal. The tax liability of the independent producer, however, is determined without any deduction for his share of the severance tax. The authorized agreement must be in writing, must permit the parties to terminate upon giving thirty days' written notice, and must permit the Tax Commissioner, upon written notice, to immediately terminate the agreement for failure of one of the parties to comply with the terms of the agreement.

¶ 720 Procedure and Administration

Law: W. Va. Code §§ 11-12B-15, 11-13A-19, 11-13V-16, 22-3-11a and 22-3-32a

The West Virginia Tax Procedure and Administration Act discussed in Chapter 9 applies to the minimum severance tax, the severance tax, the additional severance taxes, the special reclamation tax and the special tax on coal production.

¶ 721 Collection of Tax by Purchaser of Natural Gas

Law: W. Va. Code § 11-13A-17(b)(2)

Each person first purchasing natural gas after it has been produced (or after it has been produced and processed) is liable for collecting the severance tax imposed on the producer and remitting the tax to this State. The first purchaser must report purchases of natural gas monthly, showing the quantities of natural gas purchased, the price paid, and the date of purchase on a form prescribed by the Tax Commissioner. The Tax Commissioner may require the natural gas producer to remit the severance tax if he determines that this would be more efficient and effective. Where the producer of natural gas sells to the ultimate consumer, the producer must remit the tax. (WVCSR § 110-13A-17.)

¶ 722 Reports by Persons Severing Natural Gas

Law: W. Va. Code § 11-13A-17(b)(3)

On or before the last day of the month, each person severing (or severing and processing) natural gas must report to the Tax Commissioner on forms prescribed by the Commissioner the sales of natural gas for the preceding taxable calendar month, showing the name and address of the person to whom the gas is sold, the quantity sold, the date of sale, and the sales price.

¶ 723 Nonresidents Severing Timber

Law: W. Va. Code § 11-13A-16a

Nonresident timber operators must comply with the following requirements before severing timber in this State:

- (1) Obtain a business registration certificate from the State Tax Commissioner;
- (2) Obtain a forestry license from the Division of Forestry of the Department of Commerce;
- (3) Provide the Tax Commissioner with written notice of intent to sever the timber identified in the written notice, at least 30 days but not more than 90 days before severance begins, and provide all of the information required by W. Va. Code § 19-1B-6; and
- (4) Prepay with the notice the timber severance tax, or post a cash or surety bond equal to 4% of the estimated gross value of the timber to be severed, which value may not be less than stumpage value.

A nonresident timber operator is a person or company that does not have a business location in this State, or, during the three-month period preceding the date on which the application for business registration is filed, did not have a permanent office or any other permanent place of business in this State for the conduct of timbering operations.

For additional information, see Publication TSD-404 Timber Severance Tax Requirements for Nonresidents, which is available at the State Tax Department's webpage.

¶ 724 Example – Taxes on privilege of producing coal

FACTS: Assume that XYZ Coal Company, a foreign corporation, leases certain coal properties, as well as a coal preparation plant in West Virginia in 2006. On October 1, 2006, XYZ Coal Company begins operating the plant and a surface mine. XYZ Coal Company enters into two contracts for the sale of its coal.

Contract A is for the sale and delivery of 10,000 tons of severed, but not processed, coal at \$10 per ton delivered to the purchaser in XYZ Coal Company's own equipment for a stated additional delivery fee of \$1 per ton.

Contract B provides for 20,000 tons of processed coal delivered to the purchaser by common carrier for a set fee of \$20 per ton. The common carrier is paid \$2 per ton for delivery.

Assume that XYZ Coal Company fulfills both contracts A and B in the last quarter of 2006. The computation of the gross value for the contracts for severance tax purposes is as follows:

Contract A:			
10,000 tons	x	\$11.00	= \$110,000.00
LESS Freight Charges			--
10,000 tons	x	\$1.00	= <u>\$ 10,000.00</u>
Total Gross Value			\$100,000.00

Contract B:			
20,000 tons	x	\$20.00	= \$400,000.00
LESS Freight Charges			--
20,000 tons	x	\$2.00	= <u>\$ 40,000.00</u>
Total Gross Value			\$360,000.00

In addition, assume XYZ Coal Company purchases 15,000 tons of raw coal produced in West Virginia at a total cost of \$160,000. XYZ Coal Company then processes this raw coal in its leased West Virginia processing plant and sells the processed coal (10,000 tons) to a purchaser for \$200,000. The purchaser transports the coal from the plant.

Gross Sales Price	\$200,000
Less: Cost of Raw Coal	<u>-160,000</u>
Value Added	\$ 40,000

Calculation of Annual Exemption: \$41.67 x 3 months = \$125.00

The Gross Value from Contracts A and B (\$100,000 + \$360,000 = \$460,000) and the Value Added to purchased coal (\$40,000) are subject to the Severance Tax (§ 708) at the 5% rate of tax. In addition, the tons sold under Contracts A and B are subject to the Minimum Severance Tax (§ 710), at the rate of 75 cents per ton, the Special Reclamation Tax on Coal Production (§ 712), at the rate of 3 cents per ton, and the Special Tax on Coal Production (§ 713), at the rate of 2 cents per ton. XYZ Coal Company is not liable for the Minimum Severance Tax, the Special Reclamation Tax or the Special Tax on Coal Production on the purchased raw coal. The minimum severance tax paid on coal is allowed as a credit against the regular severance tax on coal. The Special Tax on Coal Production (§ 713) is not reported on the Severance Tax Return but will be reported with the Special Reclamation Tax (§ 712).

The additional severance tax on coal imposed by W. Va. Code § 11-13V-4 for the benefit of the Workers' Compensation Debt Reduction Fund applies to all tons of coal sold and is computed as follows:

Tons of clean coal produced under Contract A	10,000
Tons of clean coal produced under Contract B	20,000
Tons of clean coal produced from purchased raw coal	<u>10,000</u>
Total tons clean coal	40,000
Rate of additional severance tax on coal	<u>x 0.56</u>
Additional severance tax on coal	\$22,400

¶ 725 Severance Tax Returns

Forms for computing and reporting the various taxes discussed in this chapter are available at the State Tax Department's website:

<http://www.wva.state.wv.us/wvtax/Forms/Business/Pages/BusinessForms.aspx>

The following forms are available to print or download:

WV.CSR-1	Coal Mining Assessment & Special 2 Cent Per Ton Tax
WV/SEV-400	Severance Tax Estimate
WV/SEV-400C	Coal Severance Tax Estimate
WV/SEV-400W	Waste Coal Severance Tax Quarterly Estimate
WV/SEV-400T	Severance Tax Estimate – Timber
WV/SEV-400V	Additional Tax on Severance of Natural Resources – Monthly/Quarterly Estimated Return
WV/SEV-401	Annual Severance Tax Return
WV/SEV-401C	Annual Coal Severance Tax Return
WV/SEV-401T	Annual Timber Severance Tax Return
WV/SEV-401W	Annual Waste Coal Severance Tax Return
WV/SEV-401V	Annual Return – Additional Tax on Severance of Natural Resources

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