West Virginia Supreme Court Decision Presents Sales Tax Refund Opportunities for Natural Resources Companies

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In *Antero Resources Corporation v. Dale W. Steager, State Tax Commissioner of West Virginia*, Case No. 18-1106 (W. Va. Supreme Court of Appeals, November 17, 2020), the West Virginia Supreme Court of Appeals (the "Supreme Court") rendered a decision primarily in favor of Antero Resources Corporation ("Antero"). The matter involved an interpretation of West Virginia's direct use sales and use tax exemption for natural resource production activities, opening the door to sales and use tax refund claims for natural resource producers.

Background

Antero is a natural gas exploration and production company, and its West Virginia operations are focused on horizontal drilling in the Marcellus Shale region of the state. To carry out its natural resource production activities, Antero rents or purchases a large volume of tangible personal property for use at its well sites. In 2014, the West Virginia State Tax Department (the "Tax Department") conducted a sales and use tax audit of Antero, and issued an assessment of over $1 million. The assessment related to Antero's rental of (1) crew quarters and related equipment; (2) portable toilets, sewage systems, related water systems, and septic cleaning charges; and (3) trash trailers and waste receptacles. Antero paid the sales and use tax assessment, and then filed an appeal with the West Virginia Office of Tax Appeals ("WVOTA").

WVOTA ruled that the crew quarters and related equipment; portable toilets, sewage systems, related water systems, and septic cleaning charges; and trash trailers and waste receptacles were all directly used in the natural resource production activities of Antero, and were exempt from sales and use tax as a result. The Tax

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Department appealed the matter, and the Kanawha County Circuit Court (the "Circuit Court") reversed WVOTA's decision for all three types of rented property at issue.

Supreme Court Decision

On appeal, the Supreme Court held that both the crew quarters and portable bathrooms and related equipment were exempt under the direct use exemption but upheld the portion of the Circuit Court's decision relating to the trash trailers and waste receptacles. The Supreme Court based its decision primarily on W. Va. Code § 11-15-9(b)(2), which provides that "[s]ales of services, machinery, supplies and materials directly used or consumed in the [activity] of. . . production of natural resources" are exempt from sales and use tax. The Supreme Court also cited to W. Va. Code § 11-15-2(b)(4), which provides a list of fourteen uses of property or consumption of services that constitute direct use, as well as a shorter list of uses that are deemed not directly used. W. Va. Code § 11-15-2(b)(4) generally stands for the proposition that property or services are "directly used" in certain activities, including natural resource production, if the property or services are an "integral and essential" part of the activity, and not merely "incidental, convenient or remote" to the activity.

The Supreme Court addressed each type of rented property that was deemed taxable in the audit separately, holding as follows:

- *Crew Quarters and Related Equipment* – Antero's crew quarters are used by certain designated workers at the site. For a portion of the audit period, Antero allowed a "company man" and directional drillers to use the crew quarters; and for a portion of the audit period, only directional drillers used the living area portion of the crew quarters. These facilities are composed of an office portion from where directional drillers "steer" the well, and the Tax Department conceded that the office area was not taxable because of the direct use exemption. The remainder of the crew quarters is composed of living space, including a bedroom, bathroom, kitchen and dining area and living room/lounge area. The workers at the

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well site who use these facilities are required to remain at the drill site around the clock to maintain the continuity of the drilling operations. The Circuit Court had held that the living quarters portion of the crew quarters was for the "personal comfort" of the workers, and that the living area space was "incidental or convenient" to the production of natural gas. The Supreme Court reversed the Circuit Court's holding regarding the living area portion, determining that the entirety of the crew quarters was "necessary to allow directional drillers and company men to remain on-site to perform ongoing work related to the operation and monitoring of drilling operations." As such, the crew quarters and related equipment "were an integral and essential part of Antero's production activity, and, as such, these items were directly used in the production activity," per W. Va. Code 11-15-2(b)(4).

- *Portable Toilets, Sewage Systems, Related Water Systems, and Septic Cleaning Service* – Unlike the crew quarters, the portable toilets are used by all workers at the well site. While noting that both Antero and the Tax Department advanced several theories as to why the portable toilets and related equipment were either exempt or taxable, the Supreme Court based its determination that such items were "directly used" in the natural resource production process on the plain language of the definition of "directly used or consumed" under W. Va. Code 11-15-2(b)(4). Because the portable toilets and related equipment are an "integral and essential" part of the natural resource production activity, and not "incidental, convenient or remote" from the activity, they are exempt under the direct use exemption. The Supreme Court held that the commonly accepted meaning of the term "essential" informed its decision and noted that "it is difficult to imagine how such operations could proceed without such facilities."
- *Trash Trailers and Waste Receptacles* – The Supreme Court held that rentals of trash trailers and waste receptacles are not subject to the direct use exemption and are thus subject to sales and use tax. The Supreme Court based this determination on statutory and regulatory language stating that waste disposed of in the trash trailers and waste

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receptacles must "result from" the natural resource production activity. In the Supreme Court's estimation, the evidence in the record did not definitively show that the primary use of the trash receptacles related to waste "resulting from" the production of natural resources. While Antero presented evidence that 90% of the waste placed in its rented trash bins was "commercial waste," the Tax Department's witness testified to the contrary. The Supreme Court's decision on this point does not close to the door to producers claiming the direct use exemption for rentals of trash bins, but they must definitively show that the waste "results from" the production activity.

Industry-wide Tax Implications

The decision presents sales and use tax refund opportunities for any natural resource producers that have paid, or are currently paying, sales and use tax for rentals of crew quarters and portable toilets. Additionally, producers may be able to claim the direct use exemption for trash bins if they can demonstrate that the bins are used solely to store, remove, or transport economic waste resulting from the production of natural resources.

Per W. Va. Code § 11-10-14(l)(1) and W. Va. Code of St. R. § 110-10L-4.2, refund claims must generally be filed within three years after the due date of the return, including any extensions, or within two years from the date the tax was paid, whichever of the periods expires later. If no return was filed, the statute of limitations for filing a refund claim is two years from the time the tax was paid. The potential refund claims for portable bathroom facilities could be substantial since such rentals represent a significant ongoing cost for horizontal well producers statewide, and producers should immediately begin filing sales and use tax refund claims, whether they have paid sales tax to the vendor of such items or remitted use tax directly to the Tax Department.

For assistance navigating the refund process, contact Craig Griffith of Frost Brown Todd's Tax Practice.

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