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STATE OF WEST VIRGINIA

Department of Revenue
State Tax Department

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Joe Manchin III
Governor

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State Tax Commissioner

Technical Assistance Advisory 2010-03

Subject: Business And Occupation Tax On The Activity Of Manufacturing Synthetic Fuel -- The activity of treating coal through the **Company A** process is not subject to the West Virginia Code §11-13-2f business and occupation tax on the activity of manufacturing synthetic fuel.

Consumers Sales And Service Tax And Use Tax Exemption For Purchases Of Tangible Personal Property And Services Directly Used In Manufacturing -- The activity of treating coal through the **Company A** process is treated as manufacturing for purposes of the West Virginia Code §11-15-9(b)(2) consumers sales and service tax exemption for purchases of tangible personal property and services directly used in manufacturing.

FACTS

This Technical Assistance Advisory is in reply to a letter dated June 11, 2010, requesting issuance of a Technical Assistance Advisory pursuant to W. Va. Code §11-10-5r, determining:

- (1) That the activity of treating coal through the **Company A** process, as described in the request for a Technical Assistance Advisory, is not subject to the West Virginia Code §11-13-2f business and occupation tax on the activity of manufacturing synthetic fuel.

and

- (2) That the activity of treating coal through the **Company A** process, as described in the request for a Technical Assistance Advisory, is manufacturing for purposes of the West Virginia Code §11-15-9(b)(2) consumers sales and service tax exemption for purchases of tangible personal property and services directly used in manufacturing.

The request for a Technical Assistance Advisory reads in part as follows.

Company A is considering making capital investments in West Virginia by relocating to West Virginia one or more facilities that produce refined coal for consumption in the generation of electric power. **Company A** respectfully requests issuance by the West Virginia Tax Department of a technical assistance advisory, as provided in W. Va. Code § 11-10-5r, ruling that the production of refined coal, as described below, is not an activity subject to business and occupation tax under W. Va. Code § 11-13-2f (manufacturing or producing synthetic fuel from coal); and that the production of refined coal is manufacturing for purposes of the exemption from consumers sales and service tax provided in W. Va. Code § 11-15-9(b)(2). The material facts are as follows.

In 2009, **Company A** formed [redacted number] affiliated special purpose entities ("SPV") that are Delaware limited liability companies. Each SPV built a facility to produce refined coal, as defined in the Internal Revenue Code ("IRC") § 45(c)(7). These facilities are presently operated at various coal mines in [redacted location(s)] and were placed in service prior to December 31, 2009. Consequently, these facilities are eligible for the federal tax credit allow by IRC § 45(e)(8).

Company A would like to relocate at least four of these facilities to electric power generation plants located in West Virginia. The SPV entities will be identified at a later date when agreements with the relevant utilities are finalized. Prior to moving a refined coal facility to West Virginia, each SPV will qualify to do business in the West Virginia and obtain all necessary permits, licenses and a business registration certificate. The SPVs will be classified under code 3241 of the North American Industry Classification System, which applies to petroleum and coal products producers.

The electric power generation plants at which the refined coal facilities would be relocated all burn bituminous coal. They will not burn (a) waste coal, (b) coal or material derived from slurry ponds or (c) coal or material derived from gob piles. Under federal law, IRC § 45(e)(9)(B)(i), a refined coal facility may not include any facility the production from which is (or was) allowed a credit under IRC § 45K (or its predecessor provision in IRC § 29) for the production of synthetic fuel.

Each SPV facility will produce refined coal from raw coal feedstock that it purchases. The facility will produce refined coal by applying in precise quantities [of number redacted] proprietary chemical compounds ([redacted]), under a license from [redacted proprietary licensor], and mixing the coal and chemical compound(s) in a high speed mixer.

Each SPV facility will occupy a small footprint ([redacted]) and consists primarily of a self-contained control room/MCC, a [redacted storage facilities detail] and a mixer. The facility likely will be integrated with the power plant's incoming raw coal feed belt system.

As required by IRC § 45(c)(7)(B), burning the refined coal must reduce emissions of mercury by at least 40% and NOx emissions by at least 20% compared to burning the raw coal feedstock from which the refined coal was made. Emissions reduction testing is required at least semi-annually pursuant to stringent procedures set forth in IRS Notice 2009-90.

Assuming [redacted number] facility or of facilities] [is are] relocated to West Virginia, **Company A** expects to produce over [redacted number] tons per year of refined coal that will be burned in West Virginia electric power generation plants over the next [redacted number] years (through end of [year redacted]). Each facility will be staffed 24 hours per day, seven days per week, and 365 days per year by a total labor force of approximately [redacted number] persons each, who will be employees of a related limited liability company.

Federal Income Tax Law

To provide incentives for the development of clean coal technologies resulting in emission reductions at coal-fired electric generating plants, Congress enacted legislation in 2004 providing the owner of a refined coal facility with federal income tax credits for producing refined coal that is burned to generate electricity. The law requires at least a

20% reduction in NOx emissions and a 40% reduction in mercury emissions when burning refined coal, as compared to burning unrefined coal. This legislation was codified in IRC § 45 (electricity produced from certain renewable resources, etc.). IRC § 45(c)(7) reads, in relevant part:

(c) Resources. For purposes of this section –

(7) Refined coal.

(A) In general. The term "refined coal" means a fuel-

(i) which-

(I) is a liquid, gaseous, or solid fuel produced from coal (including lignite) or high carbon fly ash, including such fuel used as a feedstock,

(II) is sold by the taxpayer with the reasonable expectation that it will be used for purpose of producing steam, and

(III) is certified by the taxpayer as resulting (when used in the production of steam) in a qualified emission reduction.

(ii) which is steel industry fuel.

(B) Qualified emission reduction. The term "qualified emission reduction" means a reduction of at least 20 percent of the emissions of nitrogen oxide and at least 40 percent of the emissions of either sulfur dioxide or mercury released when burning the refined coal (excluding any dilution caused by materials combined or added during the production process), as compared to the emissions released when burning the feedstock coal or comparable coal predominantly available in the marketplace as of January 1, 2003. * * *

To be eligible for the federal income tax credit, the refined coal must be produced at a "qualified facility," which is defined in IRC § 45(d)(8)(B) as follows:

(d) Qualified facilities. For purposes of this section –

* * *

(8) Refined coal production facility. In the case of a facility that produces refined coal, the term "refined coal production facility" means-

(A) with respect to a facility producing steel industry fuel, any facility (or any modification to a facility) which is placed in service before January 1, 2010, and

(B) with respect to any other facility producing refined coal, any facility placed in service after the date of the enactment of the American Jobs Creation Act of 2004 and before January 1, 2010.

Definitions and special rules applicable to the credit are set forth in IRC § 45(c), which reads, in relevant part:

(e) Definitions and special rules. For purposes of this section –

* * *

(8) Refined coal production facilities.

(A) Determination of credit amount. In the case of a producer of refined coal, the credit determined under this section (without regard to

this paragraph) for any taxable year shall be increased by an amount equal to \$4.375 per ton of qualified refined coal-

(i) produced by the taxpayer at a refined coal production facility during the 10-year period beginning on the date the facility was originally placed in service, and

(ii) sold by the taxpayer-

(I) to an unrelated person, and

(II) during such 10-year period and such taxable year.

(B) Phaseout of credit. The amount of the increase determined under subparagraph (A) shall be reduced by an amount which bears the same ratio to the amount of the increase (determined without regard to this subparagraph) as-

(i) the amount by which the reference price of fuel used as a feedstock (within the meaning of subsection (c)(7)(A)) for the calendar year in which the sale occurs exceeds an amount equal to 1.7 multiplied by the reference price for such fuel in 2002, bears to

(ii) \$8.75.

(C) Application of rules. Rules similar to the rules of the subsection (b)(3) and paragraphs (1) through (5) of this subsection shall apply for purposes of determining the amount of any increase under this paragraph.

(D) Special rule for steel industry fuel.

IRC § 45(e)(9) coordinates the credit for refined coal with the credit for producing fuel from unconventional sources under IRC § 45K and its predecessor IRC § 29. More specifically, a refined coal production facility may not include a facility for the production of fuel from unconventional sources. IRC § 45(c)(9) reads:

(9) Coordination with credit for producing fuel from a unconventional source.

(A) In general. The term "qualified facility" shall not include any facility which produces electricity from gas derived from the biodegradation of municipal solid waste if such biodegradation occurred in a facility (within the meaning of section 45K) the production from which is allowed as a credit under section 45K for the taxable year or any prior taxable year.

(B) Refined coal facilities.

(i) In general. The term "refined coal production facility" shall not include any facility the production from which is allowed as a credit under section 45K for the taxable year or any prior taxable year (or under section 29, as in effect on the day before the date of enactment of the Energy Tax Incentives Act of 2005, for any prior taxable year).

(ii) Exception for steel industry coal. In the case of a facility producing steel industry fuel, clause (i) shall not apply to so much of the refined coal produced at such facility as is steel industry fuel.

Consequently, a facility producing refined coal, as defined in IRC § 45(c)(7), can never be a facility that was eligible for credit under IRC § 29 as a facility producing fuel from unconventional sources or that is eligible today for credit under IRC § 45 K, which is the successor section to IRC § 29.

(Emphasis added.)

Issues

1. Business and Occupation Tax Issue

The business and occupation tax issue submitted for determination is whether the tax imposed by W. Va. Code § 11-13-2f applies to the production of refined coal, as above described, at a conventional coal-fired electric power generating facility. As used here, "conventional coal-fired electric power generating facility" means a coal-fired power plant that does not burn waste coal or gob coal.¹ **Company A** believes the answer to this question is no; [production of] refined coal, as above described, is not the production or manufacture of synthetic fuel from coal.

The tax imposed by W. Va. Code § 11-13-2f is imposed for the privilege of manufacturing or producing synthetic fuel from coal for sale, profit or commercial use. The tax is 50 cents per ton of synthetic fuel manufactured or produced. The scope of this tax and its application depends upon whether a particular activity falls within or outside the definitions of "synthetic fuel manufactured or produced from coal" or "synthetic fuel," which terms are defined in § 11-13-2f(b)(6) and have the same meaning.

The statutory definition of these terms actually consists of two sentences, each of which is a free-standing definition unto itself, the second sentence is essentially the original definition of "synthetic fuel" enacted in 2000, with a slight modification discussed below. In 2001, the definition of "synthetic fuel" was amended and reenacted by adding what is now the first sentence of the provision. The additional definition of "synthetic fuel" added in 2001 is tied to whether the synthetic fuel is produced from the waste and residue of prior mining to which a binder or binding substance has been added. Additionally, the original definition (the second sentence) was amended to limit the reference to IRC § 29 to the language of that section as in effect on January 1, 2001.

The first sentence of the definition of the terms "synthetic fuel manufactured or produced from coal" or "synthetic fuel" states that these terms mean and include, but are not limited to, "any fuel that is made or formed into a briquette, fragment, sheet, flake or other solid* form by combining a binder or binding substance with coal dust, coal fines, crushed coal, pulverized coal, stoker fines, waste coal, coal or material derived from slurry ponds, coal or material derived from gob piles or any combination of the aforementioned materials without regard to whether any federal tax credit is, or would have been, available for or with relation to the production of such fuel." (Emphasis added.)

The second sentence within the definition of "synthetic fuel manufactured or produced from coal" or "synthetic fuel" states that these terms mean, but are not limited to, "fuel manufactured or produced from coal for which credit is allowable for federal income tax purposes under section twenty-nine of the United States Internal Revenue Code, as in effect on the first day of January, two thousand one, or for which credit would have been allowable if the synthetic fuel was produced from a facility, or expansion of a facility, that

¹ [Footnote per original request for a Technical Assistance Advisory] Three electric power generating facilities in West Virginia are capable of burning waste coal or gob coal. They are the American Bituminous Power facility located in Grant Town, West Virginia, the Morgantown Energy facility located in Morgantown, West Virginia, and the North Branch facility located in Bayard, West Virginia. To avoid any question, Company A represents that it will not relocate a refined coal facility to any of those power plants.

meets the requirement of section twenty-nine of the Internal Revenue Code or would have met the requirements on the first day of January, two thousand one, notwithstanding that such facility or expansion of a facility may have been placed in service either prior to or subsequent to the first day of January, two thousand one." (Emphasis added.)

Because refined coal will not be produced from the waste and residue of prior mining, refined coal is not synthetic fuel within the meaning of the first definition of synthetic fuel in W. Va. Code § 11-13-2f. Because the refined coal facility cannot be a facility that produces fuel from unconventional sources for purposes of the credit allowed by IRC § 29 or IRC § 45K, the successor section to IRC § 29, refined coal is not synthetic fuel within the second definition of synthetic fuel in W. Va. Code § 11-13-2f.

2. Consumers Sales and Service Tax Issue

The consumers sales and service tax issue submitted for determination is whether the production of refined coal, as above described, is manufacturing for purposes of the exemption from tax provided in W. Va. Code § 11-15-9(b)(2). **Company A** believes the answer to this question is yes, the activity is manufacturing.

"Manufacturing" is defined in W. Va. Code § 11-15-2(b)(10) and means "a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed."

Legislative rules for the consumers sales and service tax similarly define "manufacturing" as meaning "a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed. Manufacturing production begins with the arrival of raw materials and ends when the property has reached that point where no further chemical, physical or other changes are to be made to the resultant property in the production process." W. Va. Code of State Rules §110-15-2.46.

Company A believes the mixing of the coal with [one or more] chemical compound(s) in a high speed mixer, as above described, is systematic operation that transforms or converts tangible personal property, in this case bituminous coal, by physical, chemical or other means into a different form, composition or character from that in which it originally existed.

Conclusion

In conclusion, **Company A** believes that the production of "refined coal," as defined in IRC § 47(c)(7), is not the manufacture or production of synthetic fuel within the meaning of W. Va. Code §11-13-2f. **Company A** additionally believes that the production of refined coal is a manufacturing activity for purposes of the consumers sales and service tax and the exemption from tax provided in W. Va. Code § 11-15-9(b)(2), for goods and services that are directly used or consumed in manufacturing tangible personal property.

We look forward to receipt of the [Tax Department's] favorable response. Please

let us know if the Tax Department has any questions or if [the Tax Department] needs any additional information. We can meet with [Tax Department] staff, at a mutually convenient time, to discuss these matters should [the Tax Department] believe that a meeting is necessary or would be helpful.

ANALYSIS

Discussion of the Business and Occupation Tax – Synthetic Fuel Definition.

West Virginia Code §11-13-2f imposes a tax upon the activity of "Manufacturing or producing synthetic fuel from coal." The rate of B&O tax for producing synthetic coal is fifty cents per ton. See W. Va. Code §11-13-2f(a).

The term "synthetic fuel" is defined in West Virginia Code §11-13-2f(b)(6).

(6) "Synthetic fuel manufactured or produced from coal" or "synthetic fuel" means and includes, but is not limited to, any fuel that is made or formed into a briquette, fragment, sheet, flake or other solid form by combining a binder or binding substance with coal dust, coal fines, crushed coal, pulverized coal, stoker fines, waste coal, coal or material derived from slurry ponds, coal or material derived from gob piles or any combination of the aforementioned materials without regard to whether any federal tax credit is, or would have been, available for or with relation to the production of such fuel. The term "synthetic fuel manufactured or produced from coal" or "synthetic fuel" also means, but is not limited to, fuel manufactured or produced from coal for which credit is allowable for federal income tax purposes under section twenty-nine of the United States Internal Revenue Code, as in effect on the first day of January, two thousand one, or for which credit would have been allowable if the synthetic fuel was produced from a facility, or expansion of a facility, that meets the requirement of section twenty-nine of the Internal Revenue Code or would have met the requirements on the first day of January, two thousand one, notwithstanding that such facility or expansion of a facility may have been placed in service either prior to or subsequent to the first day of January, two thousand one. "Synthetic fuel" does not include coke or coke gas.

W. Va. Code §11-13-2f(6).

The Tax Department forwarded a letter to [redacted] requesting certain further information, and in response received a letter from [redacted] for **Company A**, dated September 23, 2010 which reads in part as follows:

Coal feedstock that is treated by a Facility is not formed into a briquette, fragment, sheet, flake or other solid form. Refined Coal exiting the Facility (at which point it is sold to the utility) is in the same basic approximate physical shape and form that the unprocessed coal feedstock was in before application of the **Company A** process, and does not emerge from the Facility in a changed post treatment physical form as a briquette, fragment, sheet, flake or other solid form. The [proprietary chemical(s) or compound(s)] added to the coal feedstock does not act as a binder [redacted] in the **Company A** process.

The refined coal produced through the **Company A** process will not be produced from the waste and residue of prior mining, and will not be combined with a binder or formed into a briquette, fragment, sheet, flake or other solid form. The **Company A** process does not result in a product for which the Internal Revenue Code section 29 (or successor provision) credit is or was available. Therefore, the product of the **Company A** treatment process does not appear to fit within the synthetic fuel definition set forth in W. Va. Code § 11-13-2f.

DETERMINATION -- It is the determination of the West Virginia Tax Department that the activity of treating coal through the **Company A** process, described above, is not subject to the West Virginia Code §11-13-2f business and occupation tax on the activity of manufacturing synthetic fuel.

Discussion of the Consumers Sales and Service Tax and Use Tax.

West Virginia imposes a Consumers Sales and Service Tax on sales of tangible personal property, custom software and selected services. See W. Va. Code § 11-15-3. All such sales are subject to the sales tax unless they are specifically excepted or exempted. See W. Va. Code § 11-15-6. The sales which are excepted from taxation are the sales of professional services, personal services and services provided by businesses subject to the control of the public service commission when the service or the manner in which it is delivered is subject to regulation by the public service commission. See W. Va. Code § 11-15-8. The sales that are exempted from taxation are numerous and are listed generally in West Virginia Code § 11-15-9 through 9l. It is presumed that all sales and services are subject to the tax until an exemption or exception is clearly established. See W. Va. Code § 11-15-6.

West Virginia also imposes a Use Tax that is complementary to the Sales Tax. See, W. Va. Code § 11-15A-1a. The Use Tax is imposed at the same rate as the Sales Tax, and is imposed upon the use in this State of tangible personal property and selected services purchased outside of this State or sold across state lines into this State. See W. Va. Code § 11-15A-2. Tangible personal property or services which are not subject to the consumers sales tax are also exempt from the use tax. See W. Va. Code 11-15A-3 (4)

West Virginia is a member of the Streamlined Sales and Use Tax Agreement (SSUTA). See W. Va. Code § 11-15B-1 et seq. The definitions and exemptions applicable to the Sales Tax and the Use Tax are equally applicable under the SSUTA.

Direct Use Refundable Exemption from Consumer Sales and Service Tax and Use Tax.

The term "Manufacturing" is defined in W. Va. Code § 11-15-2(b)(10) to mean "a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed."

Section 110-15-2.46 of the Code of State Rules essentially repeats large portions of the statutory definition.

Coal treated with the **Company A** process has different combustion effluent characteristics than untreated coal. It has been established that the treated coal has a different character than untreated coal. The treated coal produces significantly fewer problematic pollutants when it is burned than does untreated coal.

The process fulfills the statutory definition.

Company A is a manufacturer of treated coal for purposes of claiming the direct use in manufacturing exemption found at West Virginia Code §11-15-9(b)(2). As a manufacturer, **Company A** may claim an exemption for sales and service tax or use tax otherwise applicable on the purchase of services, machinery, supplies and material directly used or consumed in the

manufacture of treated coal. West Virginia Code §11-15-2(b)(4) defines "directly used or consumed" in manufacturing and Legislative Rule 110 CSR 15, §§123.4.2 through 123.4.3 provides a guide as to what is "directly used and consumed" in manufacturing.

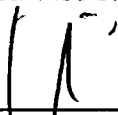
DETERMINATION – It is the determination of the West Virginia Tax Department that the activity of treating coal through the **Company A** process, described above, is manufacturing for purposes of the West Virginia Code §11-15-9(b)(2) consumers sales and service tax exemption for purchases of tangible personal property and services directly used in manufacturing.

The opinions set forth herein are based upon application of the statutory and regulatory provisions of West Virginia tax law upon the facts presented in the request for a Technical Assistance Advisory. Should the facts or the law change in any material respect, or should it appear that a material factual omission, misrepresentation or mistake has occurred, or that a mistake of law has occurred, the conclusions and findings set forth herein may no longer apply.

Precedential Value - Under W. Va. Code § 11-10-5r(b), a Technical Assistance Advisory has no precedential value except to the Taxpayer who requested the advisory, unless the Tax Commissioner specifically states that it has precedential value. Because of the uniqueness of the proprietary processes involved, this Technical Assistance Advisory is declared to have no precedential value, and may not be cited by other Taxpayers, but shall be considered to be relevant only when the material facts and laws are essentially the same as those on which this Technical Assistance Advisory is based.

Publication - Under W. Va. Code § 11-10-5r(e), the Tax Commissioner is required to release Technical Assistance Advisories to the public after they are modified to delete identifying characteristics, unless the Taxpayer waives its right to confidentiality. This Technical Assistance Advisory will be released in redacted form as Technical Assistance Advisory 2010-03.

Issued October 4, 2010



Craig A. Griffith, Tax Commissioner