

35476

IN THE CIRCUIT COURT OF KANAWHA COUNTY, WEST VIRGINIA

CHRISTOPHER G. MORRIS,)
State Tax Commissioner)
of West Virginia,)
)
Petitioner,)
)
v.)

Civil Action No. 08-AA-52
The Honorable Paul Zakaib, Jr.

HEARTWOOD FORESTLAND FUND)
LIMITED PARTNERSHIP;)
HEARTWOOD FORESTLAND FUND II)
LIMITED PARTNERSHIP;)
HEARTWOOD FORESTLAND FUND III)
LIMITED PARTNERSHIP; and)
HEARTWOOD FORESTLAND FUND IV)
LIMITED PARTNERSHIP,)
)
Respondents.)

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FINAL ORDER

INTRODUCTION

This case turns on the meaning of "agriculture and farming" for purposes of the West Virginia business franchise tax. Specifically, the issue is whether the activities of growing and managing standing timber constitute "agriculture and farming" under the business franchise tax statute. In its administrative decision, that is the subject of this appeal, The West Virginia Office of Tax Appeals (OTA) held that these activities were agriculture and farming under the business franchise tax, and that, therefore, the Respondent Partnerships, whose activities were limited to growing and managing standing timber (the Partnerships), were not subject to the tax.

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Upon the Petitioner State Tax Commissioner's appeal of that administrative decision, and after consideration of the briefs and arguments of the parties' respective counsel, the Court affirms the administrative decision and makes the follow findings of fact and conclusions of law.

FINDINGS OF FACTS

1. The facts of this case were stipulated in the Office of Tax Appeals proceeding, and the stipulations are part of the administrative record. Certain of these facts are summarized below.

2. The Partnerships are North Carolina limited partnerships that have invested in woodlands in West Virginia and manage the woodlands for the production of standing timber.

3. The Forestland Group LLC ("TFG"), a North Carolina limited liability company, manages the Partnerships.

4. TFG filed income and franchise tax returns in West Virginia, and its tax liability is not at issue in this case.

5. No single person or entity owns, directly or indirectly, a controlling interest in the Partnerships.

6. The limited partners of the Partnerships are all passive investors, most of which are organizations exempt from federal and West Virginia income tax, such as college endowments, charitable foundations, pension and profit sharing plans, and other not-for-profit entities.

7. The remaining limited partners of the Partnerships consist of for-profit institutional and individual investors.

8. Tax-exempt organizations, such as the investors in the Partnerships here, are generally exempt from federal income tax on their income other than unrelated business taxable income ("UBTI"). See § 511, *Internal Revenue Code of 1986, as amended* ("IRC").

9. The income these organizations receive from timberlands is excluded from UBTI when they limit their activities to the growing of and caring for the trees and selling the standing timber pursuant to contracts that qualify under IRC § 631(b). IRC § 512(b)(5).

10. To qualify under IRC § 631(b), these organizations (and the partnerships in which they invest) must sell the standing timber by granting rights to harvest the trees to third parties rather than harvesting the trees themselves and selling the cut logs.

11. Given these federal income tax restrictions, the Partnerships limit their operations in West Virginia, as in other states, to the growing of trees on timberland they own for the production of standing timber.

12. The Partnerships derive income by selling the harvest rights to the standing timber to third parties pursuant to contracts that satisfy the limitations of IRC § 631(b).

13. The Partnerships never cut the standing timber themselves; nor do they engage others to cut timber on their behalf.

14. The Partnerships design forestland management plans on a tract-by-tract basis, paying careful attention to each property's unique attributes, including timber quality, biological habitat, and species diversity.

15. Each management plan has two objectives: (a) to provide a competitive return to investors while being consistent with the maintenance and enhancement of the biological productivity of the tract, and (b) to ensure that at the end of the management period the overall condition of the forestland will be equal or superior to the condition at the time of acquisition.

16. The management of the forestlands owned by the Partnerships involves multiple activities required to produce and sustain standing timber and commercially viable forestland, including but not limited to replanting or naturally regenerating trees in areas that have been harvested, herbaceous weed control, woody vegetation control, fire control, and the selection of individual trees for sale and removal and the identification and maintenance of seed trees for future naturally regenerated growth potential.

17. The forest management practices utilized by the Partnerships are focused on the management of the space between trees to assure optimal sunlight, moisture and soil conditions for quality tree growth.

18. These practices are designed to encourage the natural regeneration of the forest and must account for such variables as soil quality, light conditions, residual stand composition and spacing, climate and existing timber volume.

19. These practices allow for the production of a sustainable yield of standing timber, while maintaining habitat for wildlife, promoting biological diversity, stabilizing watersheds and protecting soil fertility.

20. Each Partnership derives income for its investors, i.e. the limited partners, by periodically selling standing timber in accordance with its management plan.

21. Each Partnership chooses the types and locations of standing timber to sell in order to establish a desirable species mix, maintain the ecological health of the remaining forest, and maximize long-term investment returns.

22. The Partnerships use the following tree selection guidelines to improve the residual stand of timber that is left after harvest:

- a. Trees of the size that will increase over the management period from pulpwood to small sawtimber or from small sawtimber to large sawtimber are not sold.
- b. Higher value species are left as crop trees in the residual stand. Regardless of value, three to four hard and soft mast producing stems are left on each acre as wildlife trees.
- c. Trees that have visible quality defects, such as cat faces, frost cracks, lightning strikes, damaged tops, and visible rot are marked for removal; whereas high-quality stems, those that have no visible quality defects and which have good prospective growth potential, are left in the residual stand.
- d. Crop trees that are left in the residual stand are those that have a high live crown ratio to respond well to release from surrounding competition.
- e. Each crop tree left in the residual stand must be well spaced from surrounding competition but not left open enough to be subject to epicormic branching, wind throw, ice damage or lightning strike.

23. The Partnerships never cut the standing timber themselves; nor do the Partnerships engage others, in an agency capacity or any other capacity, to cut timber on the Partnership's behalf.

24. The Partnerships do convey the right and obligation to cut standing timber to unrelated third parties, such as independent loggers, sawmill owners, or other wood processors in exchange for the payment of money, which is done through timber cutting agreements by virtue of which the Partnership retains an economic interest in the timber until it is cut (within the meaning of IRC § 631(b)).

25. Independent loggers purchase the standing timber from the Partnerships, cut the timber for their own account, and then sell the logs to wood processors. Wood processors may also purchase the standing timber directly from the Partnerships, and either cut the timber themselves or engage loggers as their agents to harvest the timber and haul the cut logs to the mills.

CONCLUSIONS OF LAW

1. In appeals from decisions of the Office of Tax Appeals, the Circuit Court conducts its review upon the record of the proceedings before the Office of Tax Appeals, reviewing conclusions of law de novo and conclusions of fact under a clearly erroneous standard. *See Frymier-Halloran v. Paige*, 193 W. Va. 687, 458 S.E. 2d 780 (1995).

2. West Virginia Code § 11-23-6 imposes the business franchise tax “on the privilege of doing business in the state.”

3. W. Va. Code § 11-23-3(b)(8) then defines the term “doing business” as “any activity of a corporation or partnership which enjoys the benefits and protection of the government and laws of this state, except the activity of agriculture and farming” and goes on to define what is meant by “agriculture and farming.” The Office of Tax Appeals properly determined that the Partnerships’ activities were limited to agriculture and farming, with the result that the Partnerships were not “doing business” so as to be subject to the business franchise tax.

4. The Tax Commissioner on appeal to this Court now asserts that the second sentence of West Virginia Code § 11-23-6(a), nonetheless, imposes the business franchise tax on the Partnerships because they own property in West Virginia, even if they are not doing business here.

5. Neither the statute nor the regulations produce the outcome suggested by the Tax Commissioner.

6. In its entirety, West Virginia Code § 11-23-6(a) provides as follows:

An annual business franchise tax is hereby imposed on the privilege of doing business in this State and in respect of the benefits and protection conferred. Such tax shall be collected from every domestic corporation, every corporation having its commercial domicile in this State, every foreign or domestic corporation owning or leasing real or tangible personal property located in this State or doing business in this State and from every partnership owning or leasing real or tangible personal property located in this State or doing business in this State effective on and after the first day of July, one thousand nine hundred eighty-seven.

7. The Court concludes that the first sentence of this section is the only one that imposes the business franchise tax. The tax is imposed “on the privilege of doing business.” The second sentence describes the entities that may be liable for payment of the tax if the tax is imposed by the first sentence.

8. If a corporation or partnership is only engaged in the activity of “agriculture and farming,” that entity is not doing business in West Virginia, and no tax is imposed. *See* W. Va. Code § 11-23-1 (“The Legislature finds and declares that this franchise tax is imposed on the privilege of doing business in this state, and that this tax is not an ad valorem property tax imposed on the property of corporations and partnerships doing business in this state.”).

9. The Legislature further has provided an express exemption from the franchise tax for agriculture and farming. West Virginia Code § 11-23-7(h) exempts “[a]ny corporation or partnership engaged in the activity of agriculture and farming, as defined in [section 11-23-3(b)(8)].”

10. Thus, the business franchise tax is not imposed on corporations or partnerships engaged in the activity of agriculture and farming. The activity of agriculture and farming is not

merely expressly exempted from the tax to which it would otherwise be subject; the tax does not even apply to the activity in the first place.

11. The Court hereby finds that the Office of Tax Appeals properly determined that the Partnerships' activities were limited to agriculture and farming, with the result that the Partnerships were not "doing business" so as to be subject to the business franchise tax."

12. The Petitioner also disputes that the Partnerships are, in fact, engaged in the activity of agriculture and farming.

13. West Virginia Code § 11-23-3(b)(8) defines "agriculture and farming" for purposes of the exclusion from the definition of "doing business" and thus the exclusion from the franchise tax as follows:

Doing business. The term "doing business" means any activity of a corporation or partnership which enjoys the benefits and protection of the government and laws of this state, except the activity of agriculture and farming, which shall mean the production of food, fiber, and woodland products (but not timbering activity) by means of cultivation, tillage of the soil and by the conduct of animal, livestock, dairy, apiary, equine or poultry husbandry, horticulture, or any other plant or animal production and all farm practices related, usual or incidental thereto, including the storage, packing, shipping and marketing, but not including any manufacturing, milling or processing of such products by persons other than the producer thereof.

The activity of agriculture and farming shall mean such activity, as above defined, occurring on not less than five acres of land and the improvements thereon, used in the production of the aforementioned activities, and shall mean the production of at least one thousand dollars of products per annum through the conduct of such principal business activities as set forth in section ten, article one-a, chapter eleven of this code.

(Emphasis added.)

14. The foregoing definition describes both the types of activities that are considered agriculture and farming and the manner and extent to which the corporation or partnership must conduct those activities to qualify for the exclusion. The first paragraph describes the types of

activities, and the second paragraph describes the manner and extent to which the partnership must conduct the activities.

15. The Partnerships engage in qualifying activities under the first paragraph of section 11-23-3(b)(8), as their only activity is the production of woodland products (but not timbering activity) by means of cultivation of the soil.

16. The parties Joint Stipulations numbered 11, 14, 15 and 18 present compelling evidence that, through their management practices, which account for such variables as soil quality, light conditions, residual stand composition and spacing, climate and existing timber volume, the Partnerships cultivate and manage the woodlands in order to produce a sustainable yield of standing timber, a woodland product. Therefore, the Court finds that Partnerships' activities qualify as agriculture or farming activities under the first paragraph of Code § 11-23-3(b)(8).

17. Although also not raised in the record below, the Tax Commissioner would now restrict the reading of the statute's reference to "woodland products" in the definition of "doing business" by employing a strict reading of a regulatory definition of "woodland products" that applies only for certain ad valorem property tax purposes.

18. The Court recognizes that West Virginia has a different property tax regime for farm property as opposed to timberlands (and for "managed timberlands" versus other timberlands). *See* W. Va. Code §§ 11-1A-10, 11-1A-11; W. Va. Code St. R. §§ 110-1A-2, 110-1H-1 et seq.

19. Upon enacting the business franchise tax statute, the Legislature demonstrated its awareness of the separate property tax regime when it incorporated by reference a specific and

relatively narrow provision of the latter in the former. *See* W. Va. Code §11-23-3(b)(8), referencing W. Va. Code § 11-1A-10.

20. That the Legislature, in enacting the business franchise tax statute, chose not to make a similarly express reference to a specific definition of “woodland products” found only in an entirely separate property tax regulation is fully consistent with the OTA’s finding that the standing timber the Respondents grow in their woodlands are “woodland products” for business franchise tax purposes.

21. The Petitioner’s argument that, by virtue of their activities, the Partnerships are engaged in a “timbering activity,” is contrary to the plain meaning of that term. The term “timbering” means the actual logging or harvesting of the standing timber; it does not encompass the planting, cultivation, and production of the standing timber. The loggers or wood processors that buy the standing timber from the Partnerships are engaged in timbering; the Partnerships are not.

22. The West Virginia Legislature has consistently used the term “timbering” to mean the activities associated with the actual severance and logging of timber as opposed to the activities associated with the care and growing of timber prior to harvesting. The use of the term is most pervasive in the programs administered by the Forestry Division of the Department of Agriculture.

23. Pursuant to the Logging Sediment Control Act (the “Act”), persons who “conduct timbering operations, purchase timber or buy logs for resale” must obtain a timbering license from the Forestry Division of the Department of Agriculture. W. Va. Code § 19-1B-4 (entitled “Timbering license required”). The Partnerships are not subject to the licensing requirements of the Act because they do not conduct timbering operations.

24. The Legislature defines “timbering operations” as the “activities directly related to the severing or removal of standing trees from the forest as a raw material for commercial processes or purposes.” W. Va. Code § 19-1B-3(e). Implementing regulations specifically state that timbering operations “includes all aspects of logging, including but not limited to severing and delimiting of trees, cutting of the delimited tree into logs either at the point of severing or at a landing, the preparation of any skid and haul roads and the skidding or otherwise moving of logs to landings.” W. Va. Code St. R. § 22-2-2.21.

25. The Act’s definition encompasses only “activities directly related to the severing or removal of standing trees from the forest . . .” (emphasis added), and the regulation gives as examples delimiting, cutting the felled tree into logs, preparing skid and haul roads, and moving the logs to landing areas.

26. There is simply nothing in this statutory scheme to suggest, or that leaves room for an inference, that the owner of the land and standing timber engages in “timbering” simply by exercising its fundamental legal rights as a landowner: deciding which trees to sell; requiring the purchaser to operate in a fashion required by West Virginia law to qualify the landowner’s property as “managed timberland” for property tax purposes; or otherwise requiring the purchaser to leave the property in a specified condition.

27. The Petitioner’s reliance upon *Help Alert Western Kentucky, Inc. v. Tennessee Valley Authority*, 1999 U.S. App. LEXIS 23759 (6th Cir. 1999), an unpublished decision, is misplaced.

28. *Help Alert Western Kentucky, Inc.* does not stand for the proposition that selecting trees to harvest is considered logging. Of note, the court stated:

We do not believe that TVA’s actions in selecting trees to harvest and in otherwise overseeing the logging performed by outside contractors converts the logging into a TVA

activity, as opposed to a non-TVA activity. Categorical Exclusion 24 obviously contemplates some involvement by TVA, whether by contracting or by licensing for performance of the non-TVA activity. The exclusion provides no reason to suppose that TVA may not be involved in determining what timber should be harvested under contract or license.

29. Thus, contrary to Petitioner's suggestion, the analysis by the Sixth Circuit actually draws a firm distinction between the landowner's selection of trees for harvest and the logging activities conducted by the timber purchasers. Selection of trees to be sold to and harvested by a buyer does not make the seller a logger or a party engaged in timbering.

30. The Legislature has also used the term "timbering" in the severance tax provisions to signify the actual cutting or severance of the trees, rather than the activities related to growing the trees. The severance tax applies to the business of "severing timber for sale." W. Va. Code § 11-13A-3b.

31. Since "severing" in the context of the timber severance tax is strictly defined as "the physical removal of the [standing timber] from the earth," the Partnerships themselves are not subject to the tax. W. Va. Code § 11-13A-2(c)(11), (8).

32. The Partnerships sell standing timber. Logging companies or wood processors purchase the standing timber from the Partnerships so that at the time the timber is severed, it is owned by the logging company or wood processor, who is therefore liable for the severance tax.

33. Section 11-13A-16a of the Code requires nonresidents subject to the severance tax (*i.e.*, those that sever timber) to give the Tax Commissioner notice before beginning their "timbering" operation at any specific location.

34. Persons such as the Partnerships, however, who merely own standing timber and sell harvest rights to others, are not required to give notice under this severance tax provision because they are not engaged in timbering operations (the severance of timber).

35. The Legislature's consistent use of the term "timbering" is not surprising. The dictionary meaning of the term means "cutting of timber." See Webster's Third New International Dictionary 2394 (1986).

36. Undoubtedly, as a result of this widespread usage, courts have used the term timbering as a synonym of logging. See *Bullman v. D&R Lumber Co.*, 464 S.E.2d 771, 773 (W. Va. 1995).

37. The examples of West Virginia and other states' courts' consistent usage of "timbering" to signify the actual logging activity, rather than the cultivation of the trees prior to logging, are many. See, e.g., *Chesser v. Hathaway*, 439 S.E.2d 459, 460 (W. Va. 1993) (using "timbering" as a verb to describe the defendant's acts of cutting the plaintiff's standing timber); *Allen v. Vuley*, 635 N.Y.S.2d 821, 823 (N.Y. App. Div. 1996) (using "timbering activities" to mean the cutting of standing timber); *Green Pond Corp. v. Township of Rockway*, 2 N.J. Tax 273, 285-86 (N.J. Tax Ct. 1981) (using "timbering activity" to mean the harvesting of standing timber); *Huber v. Serpico*, 176 A.2d 805, 807 (N.J. Super. Ct. App. Div. 1962) (using "timbering operations" to mean the cutting and removing of standing timber); *Singleton v. McLeod*, 8 S.E.2d 908, 912 (S.C. 1940) (using "timbering operations" to mean the cutting of standing timber); *Aiken v. McMillan*, 106 So. 150, 159-60 (Ala. 1925) (using "timbering operations" and "timbering the land" to mean the cutting and removing of standing timber); *Becker v. Donalson*, 75 S.E. 1122, 1125 (Ga. 1912) (using "timbering" to mean the logging of standing timber).

38. The Partnerships never cut or sever standing timber, and they never engage others, in an agency or any other capacity, to cut the timberlands on the Partnerships' behalf. Instead, the Partnerships convey the rights and obligations to cut standing timber to unrelated

third parties, such as independent loggers, sawmill owners, or other wood processors in exchange for the payment of money.

39. Since the Partnerships are not engaged in the actual cutting and logging of the timberlands, their activities do not constitute “timbering activity” as that term is used by both the West Virginia Legislature and the West Virginia courts and as that term is understood in common usage and in the industry.

40. Thus, since the Partnerships are engaged in the production of standing timber by the cultivation and other management of their woodlands, and they are not engaged in the logging of the timber, the Partnerships’ activities are the type that are considered “agriculture and farming” under the first paragraph of section 11-23-3(b)(8).

41. The second paragraph of section 11-23-3(b)(8) describes the manner and extent to which a corporation or partnership must conduct the activities specified in the first paragraph in order to qualify for the exemption:

The activity of agriculture and farming shall mean such activity, as defined above, occurring on not less than five acres of land and the improvements thereon, used in the production of the aforementioned activities, and shall mean the production of at least one thousand dollars of products per annum through the conduct of such principal business activities as set forth in section ten, article one-a, chapter eleven of this code.

W. Va. Code § 11-23-3(b)(8).

42. This second paragraph provides two alternative ways to qualify the manner and extent of an entity’s agriculture and farming activity. First, the agriculture and farming activity will qualify if it involves the use of at least five acres of land. Alternatively, if the agriculture and farming activity involves less than five acres of land, the activity will still qualify if it produces at least \$1000 of product per annum “through the conduct of the business of farming as

the principal activity of the corporation or partnership in the manner described in W. Va. Code § 11-1A-10.” W. Va. Code St. R. § 110-23-3.10.2. The fact that these are alternatives is shown by the legislature’s use of “and shall mean” when introducing the second alternative.

43. The Court agrees with Respondents that the Partnerships meet both of these alternative requirements. First, each of the Partnerships owns over 30,000 acres of woodlands in West Virginia, well over the five-acre requirement. Second, the business of farming produces over \$1,000 of product per annum and is conducted by each Partnership as its principal activity in the manner described in W. Va. Code § 11-1A-10.

44. The Tax Commissioner is wrong, in contending, in essence that the definition of “agriculture and farming” set forth in the first paragraph of section 11-23-3(b)(8) should be disregarded in light of the limited cross-reference to the property tax statute found in the last clause of the second paragraph of section 11-23-3(b)(8).

45. The second paragraph of 11-23-3(b)(8) is not intended to change the general definition of agriculture and farming provided in the immediately preceding paragraph of the statute. To make this point perfectly clear, the legislature expressly stated in the opening of the second paragraph that it is not changing the overall definition provided in the first paragraph: “The activity of agriculture and farming shall mean such activity, as above defined”

46. That section then goes on to add a requirement, a substantiality requirement, as to the extent of the taxpayer’s activities necessary for the exclusion. This substantiality requirement does not change the types of activities that qualify as agriculture and farming activities as provided in the first paragraph. Rather, it merely tells the taxpayer the minimum amount of these activities it must have to qualify for the exclusion.

47. A person may satisfy the substantiality requirement by either (i) conducting its agriculture and farming operations on a minimum number of acres (at least 5) or (ii) producing a minimum level of annual production (at least \$1000) through the conduct of agriculture and farming as its principal business activities. As stipulated, the Partnerships satisfy both of these requirements.

48. The cross-reference at the end of the second paragraph of Section 11-23-3(b)(8) does not change the principles governing this case. First, the cross-reference is limited to the second alternative for satisfying the substantiality requirement. The second paragraph's substantiality requirement may be met either by conducting operations on at least 5 acres or by the production of at least \$1000 of product per year. The fact that these are alternatives rather than two independent requirements is shown by the Legislature's use of the language "and shall mean" introducing the second alternative. The cross-reference the Commissioner relies on modifies only the second alternative. Thus, even if the cross-reference could be read as somehow incorporating the special property tax definition of farming in direct contradiction to the express language of the franchise tax definition, it would only apply to taxpayers that did not satisfy the first alternative substantiality requirement by operating on at least 5 acres. Since the Partnerships here did operate on more than 5 acres, the cross-reference should not apply even under the Commissioner's strained construction.

49. It is also clear from the tax statutes themselves that the cross-reference in the franchise tax statute is not intended to adopt the special treatment of forestry in the property tax definition of farming for incorporation into the franchise tax definition of agriculture and farming. The cross-reference in section 11-23-3(b)(8) cannot be intended to adopt all of the rules contained in section 11-1A-10, not only because doing so would vitiate the first paragraph of

section 11-23-3(b)(8), but also because the property tax statute contains rules that are obviously irrelevant to the franchise tax.

50. In full, section 11-1A-10, entitled "Valuation of Farm Property", provides:

(a) With respect to farm property, the tax commissioner shall appraise such property so as to ascertain its fair and reasonable value for farming purposes regardless of what the value of the property would be if used for some other purpose, and the value shall be arrived at by giving consideration to the fair and reasonable income which the property might be expected to earn in the locality wherein situated, if rented. The fair and reasonable value for farming purposes shall be deemed to be the market value of such property for appraisal purposes.

(b) A person is not engaged in farming if he is primarily engaged in forestry or growing timber. Additionally, a corporation is not engaged in farming unless its principal activity is the business of farming, and in the event that the controlling stock interest in the corporation is owned by another corporation, the corporation owning the controlling interest must also be primarily engaged in the business of farming.

51. Section 11-1A-10 contains rules about various topics related to property tax, including how farm property is to be valued, the special exclusion of forestry, and how to determine whether a corporation's principal business activity is farming.

52. The Legislature could not have intended the cross-reference in the franchise tax statute to incorporate all of section 11-1A-10 because most of section 11-1A-10 is irrelevant to the franchise tax.

53. Annual revaluation of specific tangible assets for property tax purposes, the entire subject of most of section 11-1A-10, is irrelevant to determination of the treatment of a particular entity for franchise tax purposes. Moreover, forestry and growing timber is excluded from the definition of "farm property" for property tax purposes because different, special property tax valuation provisions apply to managed timberland. *See* W. Va. Code § 11-1C-10.

54. The special treatment of forestlands for the particular purposes of the property tax is irrelevant to the franchise tax and inconsistent with the franchise tax definition of agriculture and farming provided in the first paragraph of section 11-23-3(b)(8). The parenthetical in section 11-23-3(b)(8) “but not timbering activity” would be meaningless if the cross-reference were intended to remove all forestry and growing timber from the franchise tax definition of agriculture and farming. Both the property tax valuation and property tax forestry exclusion are irrelevant to the franchise tax and were not intended to be incorporated by the section 11-23-3(b)(8) cross-reference.

55. A statute must be construed as a whole, so as to make all parts harmonize and to give meaning to each. *E.g., Bullman v. D & R Lumber Co.*, 464 S.E.2d 771, 775 (W. Va. 1995). For the same reason, despite the Petitioner’s contention to the contrary, there is no disharmony between the Partnerships’ management of their timberland, as certified for property tax purposes, and the fact that they are engaged in the activities of agriculture and farming for business franchise tax purposes. Similarly, a farming corporation’s status for income tax purposes under article 24 of chapter 11 (taxable) is entirely independent of its status for business franchise tax purposes under article 23 of that same chapter (exempt).

56. The language of the cross-reference is directed and limited to the manner of determining a person’s “principal business activities.” The only part of section 11-1A-10 that deals with principal activities is the last sentence, which discusses how to determine whether a corporation has a principal activity of farming. That is the only piece of section 11-1A-10 that the cross-reference means to incorporate into the franchise tax. The franchise tax statute refers to the property tax statute for rules about how to determine whether agriculture and farming are the “principal business activities” of the taxpayer. It does not mean to adopt the portions of the

property tax statute that are irrelevant, and even directly inconsistent with, the franchise tax definition of agriculture and farming.

57. This reading is confirmed by the Commissioner's own regulation, as the Office of Tax Appeals correctly held. W. Va. Code St. R. § 110-23-3.10.2 states that the \$1000 annual product requirement must be met "through the conduct of the business of *farming as the principal activity* of the corporation or partnership *in the manner described in* W. Va. Code §11-1A-10 et seq. and the regulations related thereto." (Emphasis added.)

58. The only manner in which section 11-1A-10 deals with "principal activity" is in relation to stating that a controlling owner of a corporation must also be primarily engaged in farming in order for the corporation to be deemed to have a principal activity of farming.

59. Thus, the regulations confirm that the principal activity requirement is the only piece of section 11-1A-10 that is intended to be incorporated into the franchise tax statute.

60. As the Office of Tax Appeals properly held, based on a plain reading of the franchise tax statute as a whole and even the specific language of the cross-reference, it is clear that the cross-reference does not incorporate the property tax rule excluding forestry and growing trees from the definition of farming.

61. It is a settled rule in West Virginia, as in other states, that tax laws are generally to be construed strictly against the state and in favor of the taxpayer. *Coordinating Council for Independent Living, Inc. v. Palmer*, 209 W. Va. 274, 281, 546 S.E.2d 454, 461 (2001). "Laws imposing a license or tax are strictly construed and when there is doubt as to the meaning of such laws they are construed in favor of the taxpayer and against the State." *Id.* (citations omitted).

62. In *Ohio Cellular RSA Ltd. P'ship v. Board Pub. Works*, 198 W. Va. 416, 481 S.E.2d 722 (1996), the court cited the principle that unclear tax statutes are to be construed in

favor of the taxpayer and held, based on statutory construction principles, that FCC licenses were not subject to a property tax imposed on “personal property of every kind whatsoever.” *See also* 3A SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 66:1 (6th ed.) (“Where there is reasonable doubt of the meaning of a revenue statute, the doubt is resolved in favor of those taxed.”).

63. The only exception to this well-settled rule of strict construction against tax imposition is where the taxpayer is claiming an exemption from taxation. *Wooddell v. Dailey*, 160 W. Va. 65, 68, 230 S.E.2d 466, 469 (1976) (applying these principles to a taxpayer’s claim for exemption where the sales tax statute provided that all sales and services are presumed to be subject to tax).

64. The present case requires the court to follow the general rule for tax statutes—i.e., strictly construe the statute against the State and in favor of the taxpayers—because the statutory provision at issue imposes the tax rather than provides an exemption.

65. The business franchise tax is imposed on companies “doing business” in West Virginia. W. Va. Code § 11-23-6.

66. The statutory definition of “doing business” excludes the activities of “agriculture and farming” if the activities are conducted on at least 5 acres of land or produces at least \$1000 of product each year through the conduct of agriculture and farming operations as the principal business activities of the company. W. Va. Code § 11-23-3(b)(8).

67. Accordingly, a company whose activities are limited to “agriculture and farming” and meets the substantiality requirement that it conduct its operations on at least 5 acres of land or produce at least \$1000 of products per year is not subject to the franchise tax.

68. The provision at issue is the exclusion of “agriculture and farming” from the definition of whether a person is “doing business” so as to be subject to the tax in the first place.

69. The Court recognizes that definitions of what is and what is not taxable activity are different than exemptions from tax. Although “agriculture and farming” is statutorily removed from the definition of “doing business,” it is not thereby treated as an exemption for purposes of the statutory construction rule.

70. Courts in West Virginia and other states do not treat a taxpayer’s reliance on definitions of what is subject to tax as claims for exemption. Instead, these definitions are strictly construed against the State because they relate to tax imposition statutes rather than tax exemption statutes.

71. In *Ballard’s Farm Sausage, Inc. v. Dailey*, 162 W. Va. 10, 15, 246 S.E.2d 265, 268 & n.3 (1978), the court refused to strictly construe against a taxpayer an exclusion from the old Business and Occupation Tax manufacturing rate classification for “dressing and processing of food.” The manufacturing rate statute at issue in that case applied to the “business of manufacturing” but contained a proviso stating: “[h]owever, the dressing and processing of food . . . shall not be considered manufacturing.” The court held that the “exception to the general rule of strict construction against tax imposition where the taxpayer is claiming an exemption from taxation” did not apply “since the taxpayers [were] not claiming an exemption but [were] merely contesting the rate classification.” Instead, the court applied “the time-honored maxim that taxing statutes will be strictly construed against the State and in favor of the taxpayer.” The court then held that the taxpayer’s sausage manufacturing qualified as “dressing and processing of food” when that phrase was strictly construed against the State and in favor of the taxpayer.

72. In *Comptroller v. Maryland Specialty Wire, Inc.*, 378 A.2d 183 (Md. Ct. App. 1977), a Maryland court clearly held that the rule relating to strict construction of a tax exemption statute against the taxpayer did not apply to a taxpayer's reliance on exclusions from definitions of taxable items. The sales tax statute at issue in that case imposed tax on "retail sales" and defined "retail sale" to not include purchases of items that will be destroyed in a manufacturing operation. Interestingly, the Maryland sales tax statutes also provided an express exemption for purchases of items that will be destroyed in a manufacturing operation. Thus, like the present case, there was both an exclusion from the tax imposition statute and an exemption from the tax at issue.

73. The Maryland court determined that since it must first be determined whether the tax applies at all—that is, the tax imposition statute and the proviso to the definition of retail sale must be analyzed before the exemption statute is even relevant—the proper statutory construction rule was to construe the statute strictly against the state:

The rule relating to the strict construction of a tax exemption statute is not applicable to this case because, the exclusion of tangible personal property . . . where it is destroyed in the manufacture process is by force of the definition [of "retail sale"] and not by inclusion in the exemptions The rule that is applicable, however, is, where there is doubt as to the breadth of a tax statute, the act should be construed most strongly in favor of the taxpayer and against the taxing authority.

Id. at 186 (citations omitted).

74. Consistent with the general rules of construction in West Virginia, and just like the food processing definition at issue in *Ballard's Farm*, the agriculture and farming definition at issue here should be strictly construed against the state and most favorably to the Partnerships.

75. Although even a plain reading of the agriculture and farming definition shows that Partnerships' business of cultivating trees qualifies as agriculture and farming and is beyond the

scope or coverage of the franchise tax, there can be no doubt that the definition covers Partnerships when viewed through this proper rule of statutory construction.

76. Accordingly, the Court finds that the Partnerships' activities satisfy all of the requirements of the franchise tax definition of "agriculture and farming" found in W. Va. Code § 11-23-3(b)(8). Since the Partnerships are engaged in the activity of agriculture and farming, they are not subject to the franchise tax.

WHEREFORE, it is ORDERED and ADJUDGED that the administrative decision of the West Virginia Office of Tax Appeals in this case shall be, and hereby is, AFFIRMED in all respects, and this matter shall be removed from the docket of this Court, to all of which rulings the Petitioner's objections and exceptions are noted.

The Circuit Clerk shall mail a certified copy of this order to all counsel of record via United States first class mail.

Entered this 29th day of July, ~~2008~~ 2009
[Signature]
The Honorable Paul Zakaib, Jr., Judge
Circuit Court of Kanawha County

Prepared by:
[Signature]

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