

Cite as 11 WTD 163 (1991).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| In the Matter of the Petition |) | <u>D E T E R M I N A T I O</u> |
| <u>N</u> | | |
| For Correction of Assessment |) | |
| of |) | No. 91-110 |
| |) | |
| . . . |) | Registration No. . . . |
| |) | . . . /Audit No. . . . |
| |) | |

[1] RULE 135 AND RULE 180: EXTRACTING B&O TAX -- MOTOR TRANSPORTATION PUT TAX -- LOG HAULING ACTIVITY -- LOG LOADING ACTIVITY -- DELIVERY CONTRACT WITH BOTH ACTIVITIES. Where the taxpayer has a delivery contract to transport logs and the contract necessitates that the taxpayer perform logging and loading activities, the income from the contract is proportionately subject to Extracting B&O tax and Motor Transportation Public Utility Tax.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Petition protesting reclassification of income reported as subject to Extracting B&O tax to Motor Transportation Public Utility Tax.

FACTS AND ISSUES:

Krebs, A.L.J. -- . . . (taxpayer) is engaged in the business of logging, loading and hauling logs.

The Department of Revenue (Department) examined the taxpayer's business records for the period from January 1, 1985 through March 31, 1989. As a result of this audit, the Department

issued the above captioned tax assessment [in November of 1989] asserting excise tax liability in the amount of \$. . . and interest due in the amount of \$. . . for a total sum of \$. . . which remains due.

The taxpayer's protest involves Schedule II and IV of the audit report. In Schedule II, the auditor gave a credit for amounts reported as subject to Extracting business and occupation (B&O) tax because he concluded that they were subject to Motor Transportation public utility tax (PUT).

In Schedule IV, per taxpayer's federal income tax returns and bank deposit records, the auditor computed the amounts received for loading and hauling logs, and allowed a deduction for amounts paid out for hired hauling. The net amounts were subjected to Motor Transportation PUT. The taxpayer does not have log hauling trucks, but has equipment to load logs onto the trucks. In effect, after payments to hired haulers, the net amounts retained by the taxpayer were attributed to his loading of logs onto the hauling trucks.

The taxpayer asserts that the reclassification of his income from extracting to hauling for hire is incorrect because although he is paid for loading and hauling, the total amount paid for logging is "not insignificant". In support thereof, the taxpayer submitted a letter from the [company X] which states that the taxpayer in performance of the contract is paid for logging as well as hauling; must have logging equipment, not just a self-loader log truck; has to buck and trim the logs; and has to sort by species and type before loading. The letter further states:

Right-of-way contracts are a common contract meant to cover most phases of contract logging including timber cutting. Although not stated separately in the contracts, logging activities are not incidental to the hauling of right-of-way logs.

The taxpayer points to the definition of the extracting activity in WAC 458-20-135 (Rule 135) as "logging operations, including the bucking, yarding, and loading of timber or logs after felling, as well as the actual cutting or severance of trees". The taxpayer feels that use of the word "including" instead of "inclusive" in the definition shows that "loading" is a separate activity that is part of logging operations and thus falls within the definition of extracting.

The taxpayer further asserts that a large portion of his income was from logging operations for private individuals, not just from "loading right-of-way contracts."

DISCUSSION:

The typical "Service Logging Contract" between the taxpayer and [Company X] or some other owner of timber has the following pertinent provisions:

- 1) The taxpayer is to remove covered products (specified species and types of timber) from a designated area. Payments to the taxpayer vary according to the volume or weight of the product and the delivery point.
- 2) The deliveries are to be made within a specified period of time.
- 3) [Company X] makes payment to the taxpayer by Saturday of each week for all deliveries made through Wednesday of that week.
- 4) The taxpayer brands the covered products and marks them with the owner's brand before removal.
- 5) The taxpayer will buck and handle the covered products per owner's specifications.
- 6) The taxpayer will fall and deliver all timber necessary in owner's opinion to recover all covered products.
- 7) The taxpayer will cut to leave the lowest feasible stumps and buck to leave trim of not more than 12 inches. The taxpayer will protect streams and stream banks by avoiding falling trees into streams and clear debris from the channel and banks.
- 8) The taxpayer will fall all conifer and hardwoods of four inches diameter or larger or 30 feet or more in height.
- 9) The taxpayer will complete the truck ticket for the owner indicating the number of pieces on each load of logs before leaving the landing.
- 10) The taxpayer shall pay penalties of \$1 per high stump or the nondelivery price for volume lost or any other volume lost through negligent felling, bucking or damage lost in transit.
- 11) In the event of termination of the contract because of default, the taxpayer shall discontinue his logging operations and remove his equipment as speedily as possible.

Accordingly, the taxpayer is engaged in a variety of activities: (1) logging, that is, felling, cutting, bucking and loading of timber.

(2) stream cleaning.

(3) loading of logs in the harvesting area on trucks that will transport the logs to designated delivery points.

(4) transportation of the logs on public highways to designated delivery points. The taxpayer does this by hiring logging trucks to do the transportation.

The taxpayer is paid by the timber owner according to the species, volume and tonnage of the timber delivered to the designated delivery point.

[1] Rule 135 in pertinent part provides:

The following examples are illustrative of operations which are included within the extractive activity:

(1) Logging operations, including bucking, yarding, and loading of timber or logs after felling, as well as the actual cutting or severance of trees. It includes other activities necessary and incidental to logging, such as... stream cleaning, miscellaneous cleaning, and trail work, where such activities are performed pursuant to a timber harvest operation...

...

EXTRACTING FOR OTHERS. Persons performing under contract, either as prime or subcontractors, the necessary labor or mechanical services for others who are engaged in the business as extractors, are taxable under the extracting for hire classification of the business and occupation tax upon their gross income from such service. If the contract includes the hauling of the products extracted over public roads, such persons are also taxable under the motor transportation classification of the public utility tax upon that portion of their gross income properly attributable to such hauling. (Emphasis supplied.)

The regulation on "motor transportation", WAC 458-20-180 (Rule 180), provides that the term "motor transportation business" includes "the business of hauling for hire any extracted material" over state highways. Persons engaged in the

business of motor transportation are taxable under the motor transportation classification of the public utility tax upon the gross income of such business.

In this case, the taxpayer has gross income for the hauling of logs which he accomplishes by hiring (subcontracting) others who have logging trucks. The taxpayer has no logging trucks of his own. The amount which the taxpayer pays to the subcontractor is deductible from his gross income subject to Motor Transportation PUT. WAC 458-20-179 (15)(c). RCW 82.16.050 (3). The auditor applied Motor Transportation PUT to the difference, that is, the amount retained by the taxpayer after payments to the subcontractor, as being earned from loading the logs onto the subcontractor's logging truck. Ignoring the obvious extracting/logging activities of falling, cutting, bucking, stream cleaning and loading of timber which the taxpayer has performed to meet the species, volume and weight requirements contracted to be delivered -- which the auditor deemed as incidental to the log hauling/motor transportation -- the auditor taxed the retained income as subject to Motor Transportation PUT.

We do not agree with the auditor's disregard entirely of the taxpayer's extracting/logging activities. Just as an extracting contract which includes hauling is taxable under the Motor Transportation PUT upon that portion of the gross income attributable to such hauling, we believe that a hauling contract which includes logging activities is taxable under the Extracting B&O classification upon that portion attributable to the logging activities.

It may well be that a major portion of retained income is attributable to the activity of loading the logs. The auditor has perceived that activity to be incidental to the motor transportation activity and PUT taxable because the taxpayer had the responsibility to deliver the logs. However, the Department has construed loading services, when performed as a part of a contract which includes cutting, falling, bucking, etc. to be an integral part of an extractive activity. In this case, the taxpayer's contract included logging activities. Accordingly, we hold that some portion of the retained income must be attributable to logging and subject to the Extracting B&O tax.

Furthermore, the taxpayer in its appeal claims that a large portion of his income subjected by the auditor to Motor Transportation PUT was actually from logging/loading operations for private individuals and not related to delivery

contracts. The auditor, in assessing tax, had apparently subjected all income to PUT even where some of the income was from a loading/logging activity not related to a delivery contract.

We conclude that the matter should be remanded to the Audit Division for reclassification of some of the income as subject to Extracting B&O tax where the taxpayer can establish that he performed loading/logging activities in connection with the delivery contracts or otherwise.

The law requires a taxpayer to keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable. RCW 82.32.070 and RCW 82.16.080. The burden is therefore upon the taxpayer to provide acceptable documentation to substantiate the sought tax classification for the income in question.

DECISION AND DISPOSITION:

The taxpayer's petition is conditionally granted; the condition is that the taxpayer provide the documentation and records to support his requested reclassification of his income from that as taxed in the assessment. The matter is remanded to the Audit Division for reclassification as indicated in this Determination.

DATED this 29th day of April 1991.