Cite as Det. No. 03-0077ER, 23 WTD 317 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and Refund of	)	FINAL EXECUTIVE DETERMINATION
	)	No. 03-0077ER
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .

RULE 13501; RCW 82.04.100: EXTRACTING B&O TAX -- TIMBER HARVESTING -- With regard to timber transactions, a person is an extractor if it fells, cuts, or takes timber, for sale or for commercial or industrial use, either directly or by contracting with others for the necessary labor or mechanical services from the person's own land, or from the land of another under a right or license granted by lease or contract. A taxpayer was found to be an extractor where it harvested timber pursuant to a profit à prendre to take timber.

DIRECTOR'S DESIGNEE: Susan Price, Assistant Director, Appeals Division

NATURE OF ACTION:

Chartoff, A.L.J. – A taxpayer in the business of buying timber for harvest and sale petitions for reconsideration of Det. No. 03-0077, in which we found that the taxpayer is liable for extracting B&O tax. Taxpayer contends it is not an extractor because it does not have record title to the timber at the time it fells the timber. We conclude that, based on the relevant facts before us, including the fact that the taxpayer has a profit à prendre to take timber, the taxpayer is an extractor in accordance with RCW 82.04.100. Accordingly, we affirm our holding in Det. No. 03-0077 that taxpayer is liable for extracting B&O tax and deny the taxpayer's petition for reconsideration.[1]

ISSUES:

[1] [1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Is the taxpayer an extractor, pursuant to RCW 82.04.100, when it cuts logs pursuant to a profit à prendre to take timber?

FINDINGS OF FACT:

. . . (Taxpayer) is a . . . corporation which purchases timber for harvest and sale. On December 31, 1998, Taxpayer entered into a contract with an owner of Washington state timberlands (Landowner) for the harvest and sale of timber. Specifically, the contract states that "Seller will hold the Timberlands for sustained timber production and Buyer will annually harvest a portion of the Timber from the Timberlands and will purchase such Timber from the Seller on the stump . . . ." The contract grants Taxpayer an exclusive and irrevocable "profit à prendre"[2] with respect to all growing timber on the timberlands for a period of ten years.

The portion of the timberlands to be cut each year is negotiated on a yearly basis by the parties and set out in a harvest plan. Once the parties have agreed to a harvest plan, Taxpayer must enter upon the land and cut the timber. In this case, Taxpayer hired loggers to do the actual cutting and removal of the timber.

The contract provides that record title to the timber passes from Landowner to Taxpayer as each tree is felled. Prior to felling, Landowner bears the risk of loss or damage to the timber. After felling, the risk of loss shifts to Taxpayer.

The purchase price of the timber under the contract is negotiated quarterly and is equal to the then prevailing stumpage price[3] during the relevant pricing period and resource region. Payment is due on a monthly basis for logs that have been cut and scaled. Until payment is made, landowner retains a security interest in the logs to ensure payment.

The parties began operating under the contract in January, 1999. At that time, Taxpayer began reporting B&O taxes on a quarterly basis under both the extracting and wholesaling classifications. In August, 1999, Taxpayer amended its first and second quarter returns and filed for refund contending it previously reported under the extracting classification in error, and that it should have been reporting under the wholesaling classification only.

The Taxpayer Account Administration Division (TAA) of the Department of Revenue (Department) began a partial audit to determine whether Taxpayer's refund petition should be granted. Effective October 2000, TAA suspended the accrual of interest pending its resolution of the matter. In August 2001, TAA denied Taxpayer's petition for refund. TAA agreed with Taxpayer that it was not an extractor, but found that Taxpayer was an extractor for hire. TAA

[2] "A right to take the profits of the land by entering onto it and cutting and removing timber . . . ." *Layman v. Ledgett*, 89 Wn. 2d 906, 577 P2d 970 (1978).
[3] Price of standing timber.

issued an assessment for additional B&O taxes under the extracting for hire classification for the period January 1, 1999 through December 31, 2000.

Taxpayer filed a petition for refund and correction of assessment with the Appeals Division (Appeals) of the Department protesting TAA's finding. Appeals issued Det. No. 03-0077, which found that TAA erred when it assessed taxes at the extracting for hire rate, but also found that Taxpayer does in fact owe extracting B&O tax. Taxpayer then filed this petition for reconsideration, stating we erred when we found Taxpayer liable for extracting B&O tax. Taxpayer argues that the regulations and a close reading of the definition of "extractor" provide that an extractor must have title to the timber prior to cutting. Thus, Taxpayer reasons, because it does not obtain record title until felling, Taxpayer cannot be an extractor. In addition, Taxpayer contends that it may fit the definition of an extractor for hire, but if so, its tax liability under that classification would be zero because it is not paid to perform logging services.

ANALYSIS:

At issue in this case is whether Taxpayer is an extractor for purposes of B&O tax. An extractor is defined in RCW 82.04.100, which provides in pertinent part:

> "Extractor" means every person who from the person's own land or from the land of another under a right or license granted by lease or contract, either directly or by contracting with others for the necessary labor or mechanical services, for sale or for commercial or industrial use . . . fells, cuts or takes timber . . . . "Extractor" does not include persons performing under contract the necessary labor or mechanical services for others.

In other words, with regard to timber transactions, a person is an extractor if it:

1. fells, cuts or takes timber,
2. for sale or for commercial or industrial use,
3. either directly or by contracting with others for the necessary labor or mechanical services,
4. from the person's own land, or from the land of another under a right or license granted by lease or contract.

In this case, Taxpayer fells, cuts and takes timber for the purpose of selling the logs to third party buyers. It contracts with loggers to perform the necessary labor. The contract between Landowner and Taxpayer grants Taxpayer a profit à prendre with respect to all of Landowner's timber. A profit à prendre with respect to timber is "a right to take the profits of the land by entering onto it and cutting and removing timber . . . ." *Layman v. Ledgett*, 89 Wn. 2d 906, 577 P.2d 970 (1978). Therefore, Taxpayer takes timber from the land of another pursuant to a right

granted by contract.[4] Accordingly we find that Taxpayer fits within the definition of an extractor.

Taxpayer contends that it is not an extractor, *inter alia*, because it does not have title to the timber before felling. Taxpayer cites to WAC 458-20-13501 (Rule 13501) as authority for its position that the passage of title is the controlling factor in determining whether a taxpayer is an extractor or an extractor for hire.

Rule 13501 specifically addresses the taxation of timber transactions. Rule 13501(6) describes the taxes potentially applicable to timber sale transactions and provides in pertinent part:

> Persons who sell and/or take timber may incur either a B&O, timber excise, or real estate excise tax liability, or possibly both a B&O and a timber excise tax liability. There are a number of ways in which harvesting activities are conducted and timber is sold. The timing of the transfer of ownership of or the contractual right to sever standing timber determines which taxes are due and who is liable for remitting tax.

(Emphasis ours). Taxpayer contends that this means the "timing of the transfer of ownership" or title determines which taxes are due. However, Taxpayer is ignoring the second half of the sentence. The sentence reads "the timing of the transfer of ownership of or the contractual right to sever standing timber determines which taxes are due . . . ." In this case it is the contractual right to sever standing timber that is dispositive.

Rule 13501 goes on to describe two common timber sale arrangements and explains the tax consequences that flow from each:

> (a) **Sale of standing timber (stumpage sales).** In this type of arrangement, Seller (landowner or other owner of the rights to standing timber) sells standing timber to Buyer. Buyer receives title to the timber from Seller before it is severed from the stump. Buyer may hire Contractor to perform the harvesting activity. The tax consequences are:
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> . . .
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> (ii) Buyer is liable for both timber excise tax and B&O tax. Buyer is a "harvester" under RCW 84.33.035 and an "extractor" under RCW 82.04.100 because Buyer "from the...

[4] Taxpayer contests our interpretation of "right or license granted by lease or contract." Taxpayer argues that this reference is intended to refer to taxpayers who are harvesting timber under lease agreements or timber deeds where title to the timber has passed to the buyer prior to harvest. We disagree with taxpayer's interpretation and see no ambiguity which would require us to ignore the plain language of the statute. Det. No. 98-059, 17 WTD 194 (1998); Det. No. 01-167E, 21 WTD 272 (2002). The right or license language distinguishes a logger who has an ownership interest in timber from merely an employee or agent of the landowner, hired by the landowner for the purpose of cutting the timber for the landowner.

> land of another under a right or license...fells, cuts (severs), or takes timber for sale or for commercial or industrial use."
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> . . .
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> (b) **Sale of harvested timber (logs).** In this type of sales transaction, Seller (landowner or other owner of the rights to standing timber) hires Contractor to perform the harvesting activity. Contractor obtains all the necessary cutting permits, performs all of the harvesting activities from severing the trees to delivering the logs for scaling, and makes all the arrangements for the sale of the logs. Contractor, in effect, is performing the harvesting and marketing services for Seller. Seller retains title to the logs until after they are scaled, at which time title transfers to Buyer.
> The tax consequences are:
> (i) Seller is liable for both timber excise tax and B&O tax. Seller is a "harvester" under RCW 84.33.035 and an "extractor" under RCW 82.04.100 because Seller is "the person who from the person's own land or from the land of another under a right or license granted by lease or contract...fells, cuts (severs), or takes timber for sale or for commercial or industrial use."

In example (a), a stumpage sale, the logger buys standing timber and receives title to the timber before the timber is felled. The Taxpayer's appeal involves a stumpage sale, in that the contract provides that the logger will buy standing logs with the price based on the value of standing logs. However, this appeal differs from example (a) in that Taxpayer has a right to harvest the timber, but does not obtain record title until the logs are felled. Taxpayer contends that because of this discrepancy, the tax consequences described in example (a) do not apply. We disagree. Title is relevant to determining who owns the logs, but is not determinative of whether the taxpayer has a contractual right to harvest the logs for sale. Liability for the extracting tax is based on ownership of the logs or on a right or license granted by lease or contract. In this case, the facts show that Taxpayer harvests standing timber for sale pursuant to a right granted by contract. Therefore, Taxpayer is the extractor.[5]

Taxpayer argues that our finding in Det No. 03-0077 that Taxpayer is an extractor results in double taxation. This is because Taxpayer believes the Landowner is also an extractor. While the tax consequences to the Landowner are not before us, it appears from the facts presented here that the Landowner is not an extractor because it does not harvest logs for sale. Instead, it sells standing timber to Taxpayer. Therefore, there is no double taxation with regard to the extracting

[5] For our purposes, it is not necessary to rule on whether title or ownership of the timber passed to Taxpayer prior to felling the trees. However, we note that under similar circumstances, we have found that title or ownership did pass to the timber buyer prior to felling, despite the fact that the landowner retained bare legal title to the timber. *See, e.g.*, Det. No. 96-048, 16 WTD 170 (1997); Det. No. 02-0086, 22 WTD 169 (2003). Legal title does not have to be transferred to the timber buyer in order for the timber buyer to be considered the owner for Washington tax purposes. *Id.*

tax. However, the Landowner may be liable for Real Estate Excise Tax, if no exemption applies, or other B&O tax with respect to the sale of timber.

We note that TAA relied on Det. No. 91-142, 11 WTD 177 (1991) and Det. No. 94-095, 15 WTD 1 (1995) in ruling that Taxpayer was an extractor for hire. TAA's reliance on those determinations caused it to ignore facts, critical in this case, that were not at issue in those determinations. We caution that the tax treatment of timber transactions depends on the very specific facts of each case and it may be difficult to draw clear lessons from our past determinations.

In summary, we uphold Det. No. 03-0077's finding that Taxpayer is an extractor for purposes of the B&O tax.

DECISION AND DISPOSITION:

Taxpayer's petition for reconsideration is denied.

Dated this 3rd day of March 2004.