

ISSUE

May a small harvester deduct under RCW 84.33.074(3)(b) the unspecified and undocumented values of pulp conveyed to its commonly-owned affiliate, in exchange for harvesting and marketing services, by way of a timber deed almost five years before the harvests at issue?

FINDINGS OF FACT

The books and records of [Taxpayer] were examined by the Forest Tax Section (Forest Tax) of the Department of Revenue's (Department's) Special Programs Division for the years 2005 and 2006 (audit period). As a result of this examination, the above-referenced assessment was issued on January 12, 2007 in the total amount of \$. . . , of which \$. . . was for timber tax. . . .

Taxpayer² owned land on which timber was harvested during the audit period. Because its harvest level did not exceed two million board feet, Taxpayer qualified as a small timber harvester under RCW 84.33.035(14).³ During the audit period, Taxpayer filed its Forest Excise Tax returns as a small harvester.

Taxpayer used third party contractors to harvest and market its timber. Taxpayer claimed amounts⁴ paid to its third party contractors as deductions under RCW 84.33.074(3)(b). One of the third party contractors was a commonly-owned affiliate [The] affiliate . . . was indirectly owned by members of the same family that owns Taxpayer.⁵ Payments to the remaining third party contractors were allowed and are not at issue here.

As to the work done by [the affiliate], Taxpayer characterizes its harvesting and marketing costs as the value of pulp⁶ that it conveyed to [the affiliate] in an unrecorded timber deed . . . effective in 2001.

The deed conveyed to [the affiliate] "all of the Pulp on the Timber Property⁷ to be removed therefrom in accordance with pending harvesting plans" (Recital E), later described as "all of the Pulp that it [sic] currently yarded or standing on the Timber Property" (Section One, Property Conveyed). The conveyance was:

² Taxpayer was formed as a Washington limited partnership [in] 1995.

³ RCW 84.33.035(14) provides the definition of "small harvester":

(14) "Small harvester" means every person who from his or her 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, fells, cuts, or takes timber for sale or for commercial or industrial use in an amount not exceeding two million board feet in a calendar year. . . . (Emphasis Added)

⁴ The file contains no accounting as to how Taxpayer calculated these costs.

⁵ [The affiliate] filed its certificate of limited partnership with the Washington Secretary of State [in], 1995.

⁶ Pulp is the portion of timber that is not commercially usable as logs, but which [the affiliate] could then sell.

⁷ The Department has not been provided Exhibit A, where these Properties were to be described.

made in consideration of Grantee's payment of . . . and Grantee's [i.e., [affiliate's]] agreement to and continued performance of the duties of timber harvester and timber hauler on the Timber Property. Grantee agrees to perform such duties and accept in consideration of such agreement the proceeds from the disposition of the Pulp. The consideration referenced herein has been delivered as to the payment and as to Grantee's agreement. Grantor and Grantee agree that the Pulp will be sold in Grantor's name and an accounting for and payment of the proceeds rendered to Grantee from time to time, but in no event, later than the termination of Grantee's harvest duties or December 31, 2006, whichever earlier occurs.⁸

. . . Grantee shall pay all costs associated with the harvest, hauling, and delivery of the sawlogs and Pulp from the proceeds of the Pulp.⁹

Forest Tax disallowed Taxpayer's claimed harvesting and marketing costs as excessive and unsubstantiated and substituted the standard 35% Departmental allowance. . . . Taxpayer characterizes its method of calculating harvesting and marketing costs as its ongoing method of doing business.

ANALYSIS

Forest Excise Tax is imposed in lieu of property tax on the value of timber, and is not reported and paid until the timber is harvested. To calculate Forest Excise Tax, standard harvesters are required to use the Department's standard harvester return using published stumpage value tables, which tables are adjusted twice a year by the Department, and adjustments for logging conditions.

[1] A harvester who harvests less than two million board feet in a given calendar year may report tax as either as a standard harvester (using the stumpage tables and adjustments for logging conditions) or as a "small harvester"¹⁰ in accordance with RCW 84.33.074 by reducing the amount received for the timber by documented third party harvesting and marketing costs to arrive at the taxable measure. If such deductible costs cannot be documented, gross revenues may be reduced by a 35 percent allowance, which percentage is considered to be the standard of the industry. . .

RCW 84.33.074(3)(b) provides:

When timber is sold after it has been harvested, the taxable value is the actual gross receipts from sale of the harvested timber minus the costs of harvesting and marketing the timber. When the taxpayer is unable to provide documented proof of harvesting and marketing costs, this deduction for harvesting and marketing costs shall be a percentage

⁸ From Section Three, Consideration; Accounting.

⁹ From Section Four, Conditions and Restrictions.

¹⁰ The small harvester option was intended for those who harvest smaller amounts of timber on an irregular basis.

of the gross receipts from sale of the harvested timber as determined by the department of revenue but in no case less than twenty-five percent.

(Emphasis added.) WAC 458-40-610(10), as to “costs,” provides:

Harvesting and marketing costs. Only those costs directly and exclusively associated with harvesting merchantable timber from the land and delivering it to the buyer. The term includes the costs of piling logging residue on site, and costs to abate extreme fire hazard when required by the department of natural resources. Harvesting and marketing costs do not include the costs of other consideration (for example, reforestation, permanent road construction), treatment to timber or land that is not a necessary part of a commercial harvest (for example, precommercial thinning, brush clearing, land grading, stump removal), costs associated with maintaining the option of land conversion (for example, county fees, attorney fees, specialized site assessment or evaluation fees), or any other costs not directly and exclusively associated with the harvesting and marketing of merchantable timber. The actual harvesting and marketing costs must be used in all instances where documented records are available. When the taxpayer is unable to provide documented proof of such costs, or when harvesting and marketing costs can not be separated from other costs, the deduction for harvesting and marketing costs is thirty-five percent of the gross receipts from the sale of the logs.

(Emphasis added.) In calculating a small harvester’s tax measure, the cost of harvesting and marketing constitutes a deduction from the amount realized when the timber is sold. RCW 84.33.074(3)(b).

Taxpayer argues that it conveyed to [the affiliate] the “yarded and standing pulp” that would remain after its various timber harvests were completed -- the pulp having an unspecified value at the time of the transfer. Taxpayer made this conveyance by executing an undated “timber deed,” but “effective [in] 2001,” which reflected a contract between Taxpayer and [the affiliate] by which Taxpayer agreed to pay the cost of [the affiliate’s] future harvesting and marketing services. Taxpayer argues that the timber deed constituted the transfer of a right or license by lease or by contract, and met the requirements of WAC 458-40-610(9).¹¹ . . .

RCW 84.33.074(3)(b) requires Taxpayers to provide documented proof of their harvesting and marketing costs, and RCW 84.33.035(7), which defines “harvesting and marketing costs,” restricts these costs to only those “directly associated with harvesting the timber from the land and delivering it to the buyer and may include the costs of disposing of logging residues.” WAC 458-40-610(10) expands on this definition, providing that only documented costs of certain activities, and no more, will be allowed a basis for the deduction. . . .

Taxpayer did not provide in the course of the audit or this appeal any documentation supporting its deductions. Besides the contention that the transfer of pulp under the timber constituted – at

¹¹ Although Taxpayer cited to “WAC 458-40-610(10),” we are presuming that the correct cite is WAC 458-40-610(9) because that subsection contains the language to which Taxpayer refers.

least in part – payment to [the affiliate] for harvesting and marketing services, Taxpayer has produced no accounting or other explanation as to how the transfer of yarded and pulp to [the affiliate] under the timber deed was valued, how these values were reasonably related to the harvesting and marketing work done by [the affiliate], and how the amounts of Taxpayer's deductions were calculated.

Taxpayer instead has argued that at the time of the conveyance, the pulp had an unknown value that could not be immediately established; that it had a conditional value to be established in the future; that the pulp's actual value depended upon the market at the time the log and pulp stumpage was to be harvested; that the pulp's value depended upon both future marketing conditions and quantities and, in fact, represented a liability to Taxpayer who had to incur costs to stack and preserve it and protect it from fire and pest infestation; and these costs passed to [the affiliate] under the timber deed to the extent that pulp was harvested, stored onsite, and not delivered to a mill. Such assertions do not constitute "documentation."

[2] When harvesting and marketing costs are undocumented, the Department will allow a deduction equal to the average market value of 35 percent in accordance with WAC 458-40-610(10). Forest Tax, thus, allowed Taxpayer a 35 percent deduction. Because Taxpayer has not documented how the timber deed transferring pulp to [the affiliate] related to the deductions it took for the costs of harvesting and marketing performed by [the affiliate], its petition is denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 2nd day of April 2008.