Cite as 9 WTD 231 (1990)

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

In the Matter of the Petition For Correction of Assessment of . . .	D E T E R M I N A T I O N No. 90-108 Registration No. . . . . . ./Audit No. . . .

[1] **RULE 203** And RCW 82.04.030: DEDUCTIONS -- JOINT VENTURES --CRITERIA --RELATED ENTITIES. Where taxpayer's alleged joint ventures do not meet the criteria to establish that it had joint venture agreements with related entities, deductions taken for payments to those entities will not be recognized as nontaxable.

[2] **RULE 135 And RULE 171**: B&O TAX -- EXTRACTING -- LOGGING ROAD CONSTRUCTION -- CONSTRUCTION CREDITS. Where taxpayer/extractor has purchased a timber contract and builds logging roads, amounts received by the taxpayer as "road building credits" are not credits against the purchase price of the timber contract, but B&O taxable payments for building the logging roads benefiting the seller of the timber contract.

[3] **RULE 180 And RULE 135**: PUBLIC UTILITY TAX -- MOTOR TRANSPORTATION -- HAULING LOGS -- EXTRACTOR FOR HIRE. Persons performing logging activities for others under a logging contract are extractors for hire. A portion of the income of an extractor for hire from logging contracts attributable to hauling logs is subject to the 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: . . .
. . .

DATE OF HEARING: February 12, 1986

NATURE OF ACTION:

Petition protesting the disallowance of deductions taken for payments to alleged co-venturers in alleged joint ventures; disallowance of deductions alleged to be credits against the purchase price of a timber contract; and assessment of Motor Transportation Public Utility Tax on income from an alleged timber contract.

FACTS AND ISSUES:

Krebs, A.L.J. -- [The taxpayer] is engaged in the business of extracting timber, and selling and hauling logs. The taxpayer/corporation is owned, 50 percent each, by . . . .

The Department of Revenue (Department) examined the taxpayer's business records for the period from . . . through . . . . As a result of this audit, the Department issued the above captioned tax assessment on September 5, 1984 asserting excise tax liability in the amount of $ . . . and interest due in the amount of $ . . . for a total sum due of $ . . . . The taxpayer made a payment of $ . . . on October 30, 1984 and the balance remains due.

SCHEDULE III. Alleged Joint Venture.

The taxpayer's protest involves Schedule III of the audit report where Extracting business and occupation (B&O) tax was assessed on disallowed deductions. The auditor concluded that the taxpayer was in error for taking the deductions for the costs of hired logging and hired logging road construction. The auditor found that in all instances that the taxpayer purchased a timber sale, typically from the U.S. Forest Service. After the purchase was made, the taxpayer contracted with extractors for hire to perform the actual logging which was necessary because the taxpayer owned no logging equipment after May 1979.

The taxpayer asserts that the payments to the "extractors for hire" were actually payments to co-venturers with whom it had a joint venture arrangement. The taxpayer had no written joint venture agreement with the alleged co-venturers who were:
1) . . . .
2) . . . .
3) . . . .
. . . will be referred to as "alleged co-venturers" collectively except where necessary to refer to each individually.

The relationship between . . . and the taxpayer was that the taxpayer's principals, . . . , personally guaranteed the financing for the equipment owned by the taxpayer and used by . . . .

The relationship between . . . and the taxpayer was that the equipment used by . . . was owned by the taxpayer's principals, . . . , and financed by the taxpayer. . . . bought out the interest of . . . in 1980.

The relationship between . . . and the taxpayer was that the taxpayer financed . . . 's equipment.

In support of its claim that a joint venture arrangement existed even though there was no written agreement, the taxpayer explained that in June 1979 it sold its logging equipment to the alleged co-venturers and other persons because its principals, . . ., were in their late 50's and wanted to decrease the size of the taxpayer's business by getting out of logging contracts. The taxpayer wanted to use its credit to help men working for them to get into business for themselves and to demonstrate their experience to the U.S. Forest Service in order for them to get their own logging contracts. The taxpayer retained enough equipment to do small jobs. The records of the taxpayer and its alleged co-venturers were kept at the same place and they all used the same telephone number.

In 1979, the taxpayer began to use the alleged co-venturers almost exclusively to do the logging. If the taxpayer used other logging companies (. . .), it was done to meet deadlines and the taxpayer conceded liability for deductions taken on payments to these other companies.

As an example of the arrangement between the taxpayer and an alleged co-venturer, the taxpayer gave the following

description. The taxpayer makes a timber purchase for $800,000 and sells it after the logging has been done by an alleged co-venturer (. . ., for instance) for $1,500,000. Costs and receipts are shared as follows:

Entity	Estimated Costs	Profit	Share Received
Taxpayer	$800,000 purchase	$200,000	$1,000,000
. . .	400,000 logging	100,000	500,000

The taxpayer reported for tax purposes $1,500,000 and took a deduction of $500,000 and paid tax on $1,000,000. . . ., who was registered with the Department, reported and paid tax on the $500,000 received from the taxpayer. The taxpayer feels that it got back its "capital contribution" of $800,000 plus profit and, because the taxpayer's principal, . . . recovered the profit made by . . . .

Because the taxpayer's principals, . . ., controlled the logging operations of the alleged co-venturers, the taxpayer feels that they "wore two hats", that of the taxpayer and that of the alleged co-venturer, in the arrangements. Consequently, the taxpayer believes that in effect a joint venture existed and its gross income was reported and taxes were paid partly by the taxpayer and partly by the alleged co-venturer.

The taxpayer asserts that if it had set up the alleged co-venturers as divisions within its corporation, everything would be "under one roof" and the income would have been reported on one tax return and taxed once.

The taxpayer asserts that the auditor did not understand the relationship between the taxpayer and its alleged co-venturers, and incorrectly concluded that it was contract logging which did not entitle the taxpayer to take a deduction for the share paid over to the alleged co-venturer.

The issue is whether joint ventures existed so as to validate the taxpayer's method of deducting amounts paid to co-venturers.

SCHEDULE III. . . . Road Construction.

The taxpayer protests the disallowance of a deduction in the amount of $ . . . taken in 1981 for a payment to . . . for logging road construction.

The taxpayer explains the situation as follows. In its purchase of a timber contract from the U.S. Forest Service, provision is made for an allowance to be paid to the taxpayer for logging road construction which benefits the Forest Service. Thus, after the taxpayer has completed its logging operation, the taxpayer receives an amount for road construction based upon the board feet logged. In this case. the taxpayer received a payment of $ . . . from the Forest Service which it considered as a sort of rebate or credit against the purchase price of the timber contract. The taxpayer's bookkeeper recorded erroneously that amount as being a receipt for sale of logs to . . . and tax was paid on that amount. On discovering the error, the taxpayer took a deduction for that amount on subsequent tax returns: $ . . . in the September 1981 tax return and $ . . . in the October 1981 tax return with the explanation of "contract construction".

The taxpayer asserts that the Department's auditor had agreed to find the "rebate" nontaxable but decided to await a decision on the "alleged joint venture" issue before adjusting the tax assessment.

The issue is whether road building "rebates" or credits received by a timber contract purchaser is subject to tax.

SCHEDULE VI. Log Hauling Income.

In Schedule VI of the audit report, the auditor subjected the amount of $ . . . to Motor Transportation Public Utility Tax (PUT) at the tax rate of 1.8 percent (.018). The taxpayer had reported the amount as subject to Extracting B&O tax at the lower tax rate of .0044 and in Schedule III received a credit for such reporting.
The auditor determined that the taxpayer was an "extractor for hire" serving " . . . " and did the log hauling for them.

The taxpayer asserts that " . . . " denote areas for which it had timber contracts. The taxpayer further asserted that it logged those areas and sold the logs to . . . Company (. . .). The taxpayer further asserts that . . . Trucking, Inc. (. . .), owned by the taxpayer's principals, . . . , hauled the logs to the buyers and reported for tax purposes all of its income from contract hauling for the taxpayer.

The taxpayer stresses that in this situation it was the extractor, not the extractor for hire; and that it did not do log hauling for others but hauled its own logs or hired

another related company to do the log hauling. Thus, the taxpayer contends that it should not be subject to the Motor Transportation PUT as assessed.

DISCUSSION:

SCHEDULE III. Alleged Joint Venture.

Administrative regulation, WAC 458-20-203 (Rule 203), which has the same force and effect as the law itself, in pertinent part provides:

> Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation [or] by the same group of individuals. (Bracketed word supplied.)

Revenue Act statute, RCW 82.04.030, defines "person" in pertinent part to mean:

> ...any individual,...firm, copartnership, joint venture...

The B&O tax is imposed upon every person for the act or privilege of engaging in business activities measured, in this case, by the gross proceeds of sale or gross income of the business (RCW 82.04.220) without any deductions for costs or expenses (RCW 82.04.070-080).

Thus, in this case, the relationships and affiliations between the taxpayer or the taxpayer's principals and the alleged co-venturers do not sanction any deductions by the taxpayer from its gross income subject to tax for payments to related/affiliated persons for their sales/services rendered to the taxpayer.

The taxpayer seeks allowance of the deductions on the basis that a joint venture existed between itself and the related/affiliated persons.

[1] For Washington tax purposes, a joint venture is a separate "person". RCW 82.04.030. Although each joint venture should be separately registered, often one member of a joint venture is already registered and reports the tax liabilities of the joint venture on its tax returns. There is no requirement that the joint venture agreement be in writing if

the facts indicate the parties acted as a joint venture in performing the contract. 46 Am. Jur.2d Joint Venture, Sec. 1 (1969). Having these general considerations in mind, the Department has set forth applicable inquiries to determine whether a contract was performed by a joint venture or performed by a contractor/subcontractor arrangement. See 5 WTD 19 (1988). The applicable inquiries are whether:

> (1) The joint venture was specifically formed to perform the contract work.
>
> (2) The formation of the joint venture occurred before any of the work required by the contract had been undertaken.
>
> (3) The contract was in fact performed by the joint venture.
>
> (4) The funds were handled as a joint venture rather than as separate funds of any party to the joint venture agreement.
>
> (5) There is a distribution of money, property and/or labor so that any profit or loss incurred by the joint venture is proportionately shared by all joint venturers.

We find that, although there is evidence that requirement (5) is satisfied, the preponderance or the lack of evidence with respect to requirements (1), (2), (3) and (4) fails to support the taxpayer's contention that joint ventures existed to validate the taxpayer's deductions for payments to the entities that did the logging under timber contracts held by the taxpayer. Specifically, there is no evidence that (1) a joint venture was formed to perform the logging contract work; that (2) a joint venture was formed before any of the logging work required by the logging contract occurred; that (3) the logging contract was in fact performed by the joint venture; and that (4) the funds were handled as a joint venture rather than as separate funds of parties to the alleged joint venture agreement. With respect to the latter requirement, the evidence shows that the taxpayer received the funds from the sale of the logs and handled the funds as a separate party with no separate accounting on behalf of any joint venture entity. Even with respect to requirement (5), where the taxpayer may be said to have contributed the money when it bought the timber contract, and the alleged joint venturer may be said to have contributed the labor when it did the logging,

and the taxpayer or its principals financed or guaranteed the financing for the equipment used by the alleged joint venturers, it cannot be said that the payments by the taxpayer to the alleged joint venturers were "proportionate sharing of profits" rather than payments for work done by separate "persons". In this case, our conclusion is that the criteria for existence of a joint venture were not met. Accordingly, the tax assessment arising from the disallowance of deductions taken for payments to those entities doing the logging work must be upheld.
The fact that the taxpayer's principals, . . . , may have controlled the logging operations of the alleged joint venturers does not establish nor is it a criteria in finding whether or not a joint venture in fact existed.

With respect to the taxpayer's assertion that it could have set up the alleged joint venturers as divisions within its corporation, it must be recognized that the Department consistently assesses taxes according to what was done, not on the basis of what could have been done.

SCHEDULE III. . . . Road Construction.

In this situation, the taxpayer claims that the deduction disallowed by the auditor was a deduction taken to rectify an error by the bookkeeper in reporting a "rebate" or credit on the purchase price of a timber contract as subject to tax. The taxpayer claims that it received the rebate for its logging road construction which benefited the seller of the timber, the U.S. Forest Service.

[2] Logging road construction performed pursuant to a timber harvest operation is included within the extractive activity. WAC 458-20-135 (Rule 135). The income from such road construction business activity is subject to the Extracting B&O tax.

In this case, what the taxpayer perceives as a rebate on or credit against its purchase price of the timber contract was actually compensation for its road building activity which the seller of the timber contract valued enough to pay for. The Department has uniformly ruled that when road construction credits are granted in connection with timber contracts with the U.S. Forest Service or the State Department of Natural Resources, the timber contract purchaser is engaged in taxable road construction. Accordingly, the rebate or credit expressed in terms of money is subject to tax, and the

auditor's action in disallowing the deduction must be sustained.

SCHEDULE VI. Log Hauling Income.

[3] "Motor transportation business" includes the business of hauling for hire any extracted material over the highways of the state and over private roads. Persons engaged in the business of motor transportation are taxable under the motor transportation classification of the PUT upon the gross income from such business. WAC 458-20-180 (Rule 180).

Persons performing under contract, either as prime or subcontractors, the necessary labor or mechanical services for others who are engaged in business as extractors are taxable under the extracting for hire classification of the B&O tax. If the contract includes the hauling of the products extracted, such persons are also taxable under the motor transportation classification of the PUT upon that portion of their gross income properly attributable to such hauling. Rule 135.

The taxpayer has submitted documentation believing that it would establish that it had timber contracts to log the " . . . " areas as an extractor, not as an extractor for hire. However, upon close examination of the documents, it appears to us that the contrary is true and that the taxpayer performed as an extractor for hire.

In a November 2, 1979 letter, the taxpayer writes to . . . :

> The following is a list of the accounts owing us for retainages. According to our contracts, we have fulfilled all of our obligations and are now requesting payment.
>
> | | |
> |---|---|
> | . . . 6 sale | $ . . . |
> | . . . 4 sale | . . . |
> | . . . 2 sale | . . . |
>
> Please check with the forest service and let us know if there is still any work to be performed. Thank you.

It appears that the taxpayer had contracts from . . . to do the logging and that . . . had purchased timber contracts from the Forest Service. Otherwise, why is the taxpayer asking . . . to check with the Forest Service? . . . is apparently the

"extractor" and the taxpayer is the "extractor for hire". Rule 135.

In another letter dated October 26, 1978, . . . writes to . . . concerning the " . . . 4 Timber Sale" that its "contract logger, . . . [taxpayer]" will deliver the logs pursuant to . . . 's agreement to pay for the delivery cost. Here, the taxpayer is referred to as a "contract logger" which is what an "extractor for hire" is.

Furthermore, in its "Fire & Operating Plans", . . . lists the taxpayer as "Logging representative" and "Logging Contractor".

We conclude that in the situation in question, the taxpayer must be held to be an "extractor for hire" and that a portion of its income from the logging contracts in question is subject to the Motor Transportation PUT. Accordingly, the assessment of the PUT is sustained.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 12th day of March 1990.