

Cite as Det. No. 03-0279, 23 WTD 252 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment and Refund of)	
)	No. 03-0279
...)	
)	Registration No. . . .
)	FY . . . /Audit No. . . .
)	Docket No. . . .

RULE 684: FOREST TAX -- STUMPAGE VALUE TABLES -- QUALITY CODES -- SUBSTANTIATION OF -- "CAMP RUN." If a harvester cuts and sells timber to a mill on a "camp run" basis and fails to document the volume and quality of the harvested logs, DOR may assess taxes based on a reasonable estimate.

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.

Okimoto, A.L.J. – A timber harvester protests forest taxes assessed on sales of unsorted and unscaled timber which was based on an estimated percentage commonly used by the Department of Revenue (DOR). We deny Taxpayer's appeal.¹

ISSUE

Where a harvester cuts and sells timber to a mill on a "camp run" basis, and fails to separate and document the volume and quality of harvested logs, may DOR assess taxes based on an estimate of the volume and quality of the logs?

FINDINGS OF FACT

. . . (Taxpayer), is an owner and harvester of timber in . . . , Washington. The Audit Division (Audit) of the Department of Revenue (DOR) examined Taxpayer's records for the period January 1, 1998 through December 31, 2001. The examination resulted in the assessment of additional forest taxes of \$. . . plus audit interest of \$ Document No. . . . was issued in that

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

amount on October 15, 2002. Taxpayer timely paid the amount due and now petitions for a refund of the protested portion.

When trees are harvested it is common practice within the industry that they are sorted, scaled, and sold separately as either saw logs or pulp logs. A significantly higher value is placed on saw logs than pulp logs. Saw logs command a considerably higher price because they can be cut into boards and sold as lumber. Pulp logs can only be chipped into small pieces and used as pulp in the paper manufacturing process. Forest tax is computed based on the quality and volume of logs according to DOR tables.

In Taxpayer's case, the primary issue is the method used to value red alder hardwood logs harvested and sold to [sawmill] on a "camp run"² basis i.e., without being sorted, scaled, and measured during the years 1998-2001. Taxpayer had reported the red alder sales as a lower "quality code 3" grade.³ Audit disputed Taxpayer's lower grade. Audit contended that because Taxpayer did not have the logs scaled or sample scaled at the time of sale, Taxpayer did not have sufficient documentation or support for its use of the lower "quality code 3" grade. Therefore, in accordance with Audit's informal procedure #96-3 for "camp run" sales of timber,⁴ Audit reclassified Taxpayer's red alder sales to the higher "quality code 2" grade.

Taxpayer does not dispute that it failed to scale or sample scale the red alder logs at the time of harvest, but stated that it made more economic sense to sell all logs at the same time and on an unsorted basis. This is because [sawmill] purchased both saw logs and pulp logs during the period, thus allowing Taxpayer to transport all of its logs to the [sawmill] site for processing. At the [sawmill] site, saw logs were manufactured into boards while the pulp logs were chipped into pieces. This "one-stop" processing utilized the timber better while at the same time lowering logging costs.

In support of its lower quality code 3 grade, Taxpayer submitted an affidavit from . . . , Forest Consultant (Consultant), stating that if the logs had been graded and sorted, the actual tax burden would have been less than what was paid and reported by Taxpayer. The affidavit references several industry and state publications and tables which allegedly support Consultant's opinion that the percentage of No. 3 Sawmill logs in Taxpayer's timber sales were less than the 10% maximum allowed by the quality code 3 grade. In addition, Consultant submitted information on

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³ The term "quality code" refers to the quality of the timber being harvested and varies from species to species. Under WAC 458-40-650, "timber quality code 2" for red alder meant that 10%-50% of the timber harvested was No. 3 Sawmill grade or better whereas "timber quality code 3" meant that less than 10% of the timber harvested was No. 3 Sawmill grade or better.

⁴ The Auditor explained her application of informal procedure #96-3 as follows:

Since the loads delivered to [sawmill] were marked as "camp-run", the [DOR] foresters determined that the alder should be split for reporting purposes as 30% No. 3 sawmill and 70% less than No. 3 sawmill. This would make the Alder a quality code 2 for tax purposes.

Letter from . . . , dated January 8, 2003. Procedure No. 96-3 was implemented by DOR based on many years of experience by DOR's foresters in auditing a wide variety of timber harvests.

a 2001 sale out of the same area to substantiate his opinion. The 2001 sale was made to [buyer] on a sorted and scaled basis. Consultant stated that only 47% of the alder from that unit was 8" and larger and barely 10% of the volume was 10" and larger. The red alder Sawmill No. 3 grade applies only to logs having a gross diameter of more than 10 inches. Consultant states that the [buyer] sale would have had a higher percentage of No. 3 sawmill logs than Taxpayer's sale because the logs were cut shorter to maximize 10" and larger logs. In addition, Consultant claims that the logs on the [buyer] sale were of superior quality to Taxpayer's timber. Taxpayer also relies on information obtained during a visual inspection and appraisal of the entire area in 1996 that was ordered by the Federal Land Bank to support a loan against the property. The appraisal classified the red alder as either saw log or "chipwood"⁵ and concluded that over 50% of the total volume was chipwood. Consultant contends that these figures are consistent with Taxpayer's assertions and support his claims.

ANALYSIS

RCW 84.33.041 imposes an excise tax upon every person engaging in this state in business as a harvester of timber on privately or publicly owned land. The tax is equal to the stumpage value of timber harvested for sale multiplied by the tax rate. The stumpage value of timber is based on tables prepared by DOR under the authority of RCW 84.33.091.

Taxpayer does not dispute the stumpage value tables or the volume of timber harvested and has steadfastly maintained that he computed the volume of timber harvested pursuant to the Scribner Decimal C Scale for Western Washington as required by WAC 458-40-684 (Rule 684). Instead, Taxpayer only disputes what he considers to be an arbitrary and unsubstantiated upgrade of his harvested timber from a quality code 3 to a quality code 2. Taxpayer contends that the opinion of his forest management consultant is more reliable than the informal procedure of DOR's Audit Division.

Rule 684 explains how volumes of harvested timber are to be converted to Scribner Decimal C Scale in Western Washington.^[6] It also requires harvesters to keep records to substantiate the species and quality codes:

The following definitions, tables, and conversion factors shall be used in determining taxable volume for timber harvested that was not originally scaled by the Scribner Decimal C Log Rule. Conversions methods, other than those listed are not to be used for tax reporting purposes without prior written approval of the department.

(1) **Weight measurement.** If the original unit of measure was by weight, and the harvester has not applied for approval of sample scaling (WAC 458-40-682), the following table shall be used for converting to Scribner Decimal C. Harvesters must keep records to substantiate the species and quality codes reported.

(Bolding supplied, underlining added.)

⁵ "Chipwood" refers to logs that will be chipped into bits for use as pulp.

^[6] RCW 84.33.096; RCW 82.32.070.]

Rule 684 clearly and emphatically places the burden upon the taxpayer or harvester to “keep records to substantiate the species and **quality codes** reported.” (Bolding added.)

To determine the type of records necessary to substantiate the species and quality codes reported, it is helpful to examine DOR’s rule on sample scaling. WAC 458-40-682 (Rule 682) states:

Sample scaling shall not be used for tax reporting purposes without prior written approval of the department. To be approved, sample scaling must be in accordance with the following guidelines:

- (1) Sample selection, scaling, and grading must be conducted on a continuous basis as the unit is harvested.
- (2) The sample must be taken in such a manner to assure random, unbiased measurement in accordance with accepted statistical tests of sampling.
- (3) The sample used to determine total volume, species, and quality of timber harvested for a given reporting period must have been taken during that period.
- (4) Sample frequency shall be large enough to meet board foot variation accuracy limits of plus or minus two and five-tenths percent standard error at the ninety-five percent confidence level.
- (5) Harvesters must maintain sufficient supporting documentation to allow the department to verify source data, and test statistical reliability of sample scale systems.
- (6) Exceptions: Sampling designs and accuracy standards other than those described herein may only be used with the prior written approval of the department of revenue.

First, although Taxpayer contends that Rule 682 should be limited only to computing the volume of logs, we disagree. Rule 682(3) clearly infers that a sample may be used: “to determine total volume, species, and quality of timber harvested for a given reporting period.” (Underlining added.) Consequently, we conclude that the guidelines set by Rule 682 may be used as a guide to evaluate sampling or other documentation submitted to substantiate the species and quality of timber harvested.

In this case, we first note that Taxpayer did not apply for approval of a sample scaling methodology to document the species or quality codes of the timber harvested. In addition, the documentation submitted by Taxpayer, the [buyer] sale in 2001 and the Federal Land Bank appraisal in 1996, fall considerably short of the procedural guidelines set for sample scaling. Although the [buyer] sale may have been from the same area, it was not part of the unit sold by Taxpayer and was not performed during the same period that Taxpayer reported his sales.

Furthermore, even assuming that Taxpayer had met the Rule 682 procedural guidelines for sample scaling, the percentages of the 2001 sale do not support Taxpayer’s argument. If anything, they support the percentages used by the Department. The 2001 [buyer] sale showed

that “barely 10%” of the red alder was 10” or larger.⁷ Under Rule 650, Red Alder Quality Code 2 applies where 10% to 50% of the harvested timber is No. 3 Sawmill, i.e. larger than 10”. Therefore, under Rule 650, the [buyer] sale would also be a Quality Code 2 since “barely 10%” of the red alder was larger than 10 inches. As for the 1996 appraisal, it provided only limited information on the percentage of chipwood and had no information on the percentage of saw logs. All logs are presumed to be sawlogs unless documented to be otherwise. Accordingly, that appraisal does not provide any evidence to refute the percentages used by the Department.

Based on the information Taxpayer presented, we conclude that he has failed to properly document the quality code of his harvested timber. Rule 684 requires taxpayers to keep and maintain adequate records to substantiate the species and quality codes of their timber sales. Taxpayer failed to do so. Furthermore, the information Taxpayer presented indicates that the Department acted reasonably and in fact, supports Audit’s position. Therefore, we conclude that Audit’s estimation of “camp run” sales at 30% No. 3 Sawlogs or better, to have been neither arbitrary nor capricious and that the timber Taxpayer harvested was properly valued at a quality code 2 in the tax assessment.

DECISION AND DISPOSITION

Taxpayer’s petition for correction of tax assessment and refund is denied.

Dated this 17th day of September, 2003

⁷ Since the No. 3 Sawlog standard is actually more than 10 inches in diameter, we have presumed that Taxpayer’s reference is to that No. 3 Sawlog standard.