

Cite as Det. No. 03-0312, 23 WTD 272 (2004)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	<u>D E T E R M I N A T I O N</u>
	)	
	)	No. 03-0312
...	)	
	)	Registration No. . . .
	)	. . . /Audit No. . . .
	)	Docket No. . . .
	)	

RULE 13501: RETAIL SALES TAX -- LOGGING ROAD. A forest product company's charges to a utility company for logging road construction costs as consideration for the utility company to use the forest product company's road were classified as service activities under Rule 13501(9)(b), and were not subject to retail sales 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.

M. Pree, A.L.J. – A utility company pays a forest products company (FPC) a portion of the cost to maintain a logging road in exchange for the right to use it. The Department assessed retail sales or use tax on the payments. We conclude the payments to use the logging road are not subject to retail sales or use tax.<sup>1</sup>

ISSUE

Are payments made by a utility company to use a logging road, measured by a portion of the cost of maintaining the road, subject to retail sales or use tax?

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

## FINDINGS OF FACT

. . . (taxpayer) provides electrical utility services in Washington. . . . , the taxpayer built one of its transmission lines along an existing forest product company's (FPC) logging road.<sup>2</sup> The taxpayer has easements to use the logging road for constructing and maintaining its power line.

FPC used the road to access timber for logging, while the taxpayer used it to access its power line. FPC maintained the logging road at its expense until 1999, when the maintenance costs increased dramatically after pacific salmon were listed as an endangered and threatened species. Thereafter, taxpayer agreed to pay for a share of the maintenance costs. Its share was a percentage determined by its use of the road versus FPC's use of the road.<sup>3</sup> FPC has a contract with a third party road construction company (RCC), to maintain the logging road. The RCC charged FPC retail sales tax only for work performed on the portions of the road that traversed state land.

FPC paid the RCC the total amount charged for maintaining the road. In turn, FPC invoiced the taxpayer for its agreed upon percentage of the road company's charges.<sup>4</sup> Like the road construction company, FPC did not charge the taxpayer retail sales tax for the work performed on FPC's lands.<sup>5</sup>

Following a review of the taxpayer's books and records for the period from January 1, 1999 through March 31, 2002, The Department of Revenue's (DOR) Audit Division issued a deficiency assessment which included deferred retail sales tax on the FPC's charges to the taxpayer for maintaining the logging road. The Audit Division characterized FPC as a road contractor and the taxpayer as a consumer.<sup>6</sup> The taxpayer paid the assessment, but petitioned for refund of the deferred retail sales tax assessed plus applicable interest.

## ANALYSIS

Retail sales tax is imposed upon retail sales in Washington. RCW 82.08.020. Retail sales include charges to consumers for repairing or constructing real property or moving of earth.<sup>7</sup> RCW 82.04.050(1)(b), (2)(b). Normally, a person such as the taxpayer who has an easement or

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<sup>2</sup> . . . .

<sup>3</sup> The percentage of the taxpayer's contribution ranged from 0% to 80% depending upon the section. The taxpayer estimated it paid 25% of the maintenance costs on average.

<sup>4</sup> Some of the invoices included an agreed upon charge for rock from an FPC pit plus a . . . administration fee. According to the taxpayer, FPC paid sales/use tax on the materials. No tax was shown on the invoices reviewed.

<sup>5</sup> The road traverses a section of DNR land, for which the taxability of the charges are not at issue.

<sup>6</sup> In the response to the taxpayer's petition, the Audit Division stated that FPC was hired to construct and maintain a road. The Audit Division now recognizes the payments were not for new construction, but maintenance.

<sup>7</sup> Public road construction on federal or municipal land (but not state owned land) is excluded from the definition of retail sales under RCW 82.04.050(7). *See also* WAC 458-20-171. Retail sales tax was paid for maintaining the section of road on the DNR (state land) section, and is not at issue because the RCC charged and collected retail sales tax on that portion.

right of way across real property would be considered a consumer for repairs or maintenance charges on the property. See RCW 82.04.190; WAC 458-20-172.

However, when the road construction is part of a timber harvest operation, the logging road construction is considered an extracting activity. See *Peshastin Lumber & Box, Inc. v. State*, 61 Wn.2d 413, 378 P.2d 420 (1963); *Lyle Wood Products v. Department of Rev.*, 91 Wn.2d 193, 588 P.2d 215 (1978). In *Peshastin*, the Washington State Supreme Court ruled that the building of logging roads was an incidental part of a logging contract. In *Lyle*, the Court held that a subcontract to construct a logging road does not change the nature of the extracting activity. Former WAC 458-20-135 (Rule 135 – effective through June 16, 2000) included logging road construction in the definition of logging operations. These activities performed on a contract or subcontract basis, pursuant to a timber harvest operation, was an extracting activity, not a retail sale. Rule 135, amended during the audit period effective June 17, 2000, does not contain the same language. WAC 458-20-13501 (Rule 13501), effective July 2001, provides DOR's position specific to logging operations and adopted the foregoing principles.

We understand the taxpayer is not engaged in logging activities, and therefore, is not taxable as an extractor. However, the *Lyle Wood Products* decision recognized that the road building services need not be part of the logging activities:

If road building services are not a part of logging activities sold to the State under its prime timber contracts, they do not suddenly materialize as a part of the same activities being performed under subcontracts. The rationale of *Peshastin* is applicable to both contracts and subcontracts for logging activities. In other words, persons engaged in logging activities are not engaged in road building, for tax purposes, whether they are performing under a prime contract or a subcontract.

91 Wn.2d at 196.

FPC is engaged in logging activities, not road building, even if by separate agreement, it were to charge the road's user for road construction. FPC uses the road to haul logs. The road in question was built as a logging road and continues to be used for logging operations by its owner, FPC. We conclude the road was a logging road.

The RCC charged FPC to maintain FPC's logging road. Rule 13501(12) provides:

Constructing or maintaining logging roads (whether active or inactive) is considered an extracting activity. Income derived from this activity is subject to the extracting or extracting for hire B&O tax, as the case may be. This income is not subject to the retail sales tax.

FPC passed on a percentage of the maintenance charges to the taxpayer beginning in 1999. We find that FPC charged the taxpayer to use FPC's logging road based upon a share of FPC's logging road maintenance costs.

Under Rule 13501(9)(b), the proper tax classification for charges to use private logging roads is the service and other activities, not retail:

**Timber cruising, scaling, and access fees.** Charges for timber cruising, scaling services, and to allow others to use private roads are subject to the service and other activities B&O tax. . . .

*See also* WAC 458-20-118. Amounts received for a license to use real property are taxable under the service B&O tax classification. *Id.* Because the charges at issue were taxable under the service classification rather than as retail sales,<sup>8</sup> we conclude retail sales tax was not due on the charges.

#### DECISION AND DISPOSITION

We grant the taxpayer's petition.

Dated this 5<sup>th</sup> day of November 2003.

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<sup>8</sup> A person constructing or maintaining a logging road is a consumer of all materials incorporated into the logging road. The purchase and/or use of these materials is subject to either the retail sales or use tax. Rule 13501(12). The person constructing or maintaining the roads is responsible for remitting use tax on the value of the materials, unless that person documents that the landowner and/or timber harvester previously remitted the appropriate retail sales or use tax. *Id.*