Cite as Det. No. 97-183, 18 WTD 17 (1999)

BEFORE THE 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. 97-183
. . .	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	Warrant No. . . .

[1] RULE 135; RCW 82.12.020: USE TAX -- ROCK USED IN LOGGING ROAD CONSTRUCTION. When a taxpayer severs rock from the ground, the rock becomes tangible personal property. If the taxpayer is the consumer of the rock, the taxpayer will owe use tax on the value of the rock.

[2] RULE 135; RCW 82.12.010; ETB 4: USE TAX -- ROCK USED IN LOGGING ROAD CONSTRUCTION. The measure of the use tax for the use of rock extracted by a road builder is the total cost of extraction, not merely the taxpayer's costs.

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.

NATURE OF ACTION:

The builder of logging roads on privately owned timber lands protests the assessment of use tax on rocks taken from the land owner's property and used in the construction of the logging roads.[1]

FACTS:

A.L.J. Coffman -- The taxpayer builds logging roads on privately owned land. The logging roads are built in connection with actual timber harvest operations. The taxpayer uses rock and

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

other natural materials as fill when building the logging roads. If the taxpayer purchases the rock from a third party, the taxpayer paid retail sales tax based on the purchase price. However, when the taxpayer takes rock from quarries owned by the landowner or rock outcroppings on the landowners property and uses that rock as fill, the taxpayer did not pay retail sales tax or use tax on the value of the rock.

The Department of Revenue's (Department) Audit Division reviewed the taxpayer's books and records for the period January 1, 1991 through March 31, 1995. The Audit Division determined that the taxpayer owed use tax on the rock removed from the owner's property and assessed use tax. The initial tax assessment was based on estimated values because the taxpayer failed to provide any records. After the original tax assessment was issued, the taxpayer provided to the Audit Division load slips showing the amount of rock used, type of rock, and the point of origin.[2] The Audit Division issued a post assessment adjustment of the use tax based on an assumed value for the rock of $1.95 per cubic yard.[3]

The taxpayer argues that the rock was owned by the landowner and is applied to the landowner's road. Therefore, the rock was always real property. Alternatively, the taxpayer argues that the value of the rock is the cost of extracting not including the labor and transportation from the point of processing to the point of use.

The taxpayer, also, claims that the rock was merely dug up from rock outcroppings within 100 yards of the logging roads it was constructing. The taxpayer's position is not supported by the load slips previously provided to the Audit Division. The Audit Division did not assess use tax on rock that was moved as the taxpayer described. Therefore, the use of rock from rock outcroppings is not at issue in this appeal.

ISSUES:

[2] The load slips covered a test period. The results of the Audit Division's review of the test period were extrapolated to the entire audit period.

[3] The Audit Division relied on Audit Directive 8171.1, dated November 3, 1987, which states:

> Several years ago we made a review of records maintained by the Department of Transportation and by the Department of Natural Resources with respect to rock processing costs. Our review disclosed an average cost of $4.75 per cubic yard for crushed aggregate in stockpile. We were advised that this value would convert to $2.50 per ton. Our review indicated a cost for bank run aggregate at the pit of $1.95 per cubic yard or $1.05 per ton.
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> These values will be accepted by Audit Review without additional justification. These values should be considered for use when the contractor is provided the rock at no charge and the documents available to the contractor provide no indication as to the cost or value of the rock. It should be emphasized that these values are based on "cost" and not on equivalent values of rock sold at wholesale or retail. Cost is being used only because contractors who remove rock from pits which they own have historically been permitted to report on the basis of "cost of production".

1. Does rock become tangible personal property when it is severed from the real property and applied to the real property at a different location?

2. If the rock becomes tangible personal property, then what is the measure of the use tax?

DISCUSSION:

1. Status of the rock.

The taxpayer agrees that if it purchases rock from a third party, does not pay retail sales tax, and uses the rock in the construction of the logging roads, it is liable for the use tax based on the purchase price of the rock. WAC 458-20-135 (Rule 135) states:

> Persons constructing logging roads pursuant to timber harvest operations are subject to use tax on all materials used in such construction, except for materials on which sales tax was paid at the time of purchase.

[1] Use tax is imposed on the use of tangible personal property by the person extracting it. RCW 82.12.020. There is no question that the taxpayer removed the rock from the land. Further, there is no doubt that the taxpayer used the rock in the construction of the logging roads. Once the rock was reapplied to the land it became part of the real property. The issue is whether the taxpayer by removing the rock from the land, converted the rock to tangible personal property.

The taxpayer relies on Bryant v. Stablein, 28 Wn.2d 739, 184 P.2d 45 (1947) for the proposition that the rock was real property before it removed it from the ground and because the rock is not transported across the property line, the rock remains part of the real property. However, Bryant involved a house situated on real property that had been conveyed to a wife in a divorce action. The court cited the maxim that the status of real property or personal property is fixed on the date of acquisition and remains the same "unless changed by deed, due process of law or the working of some form of estoppel." Ibid, at 747. Relying on this maxim, the court ruled that the status as separate or community property is also so fixed. The decision in Bryant is based on Conley v. Moe, 7 Wn.2d 355, 110 P.2d 172 (1941) which was also concerned with the status of separate versus community property. We find that these cases are distinguishable from the facts in this case in that neither case involved the severing of part of the real property.

The severance or extraction of a part of the real property from the ground converts the extracted item from real property to personal property. . . . . For example, when trees are cut, they become personal property. Layman v. Ledgett, 89 Wn.2d 906, 577 P.2d 970 (1978). When rock is severed from the earth in a quarry, it becomes tangible personal property. Smithrock v. State of Washington, 60 Wn.2d 387, 374 P.2d 168 (1962). Thus, the taxpayer's extraction of rock from the landowner's property converted that rock to tangible personal property.

The taxpayer cites Smithrock Quarry, Inc., supra, for the proposition that because the rock was not processed, it did not become personal property. This case involved a claim that the State of Washington had taken Smithrock's rights to remove rock from a quarry and the measure of the damages resulting from that taking. The jury was given the instructions to determine if the rock which was loose on the surface was real or personal property. The effect of that determination was that damages were either $80,000 or $11,000. The jury found for the plaintiff and awarded damages based on the determination that the rock was personalty. The State appealed. The court stated, at 391:

> We hold that the trial court properly permitted the jury to find that plaintiff's damages were equal to the value of the rock materials which had been severed and could be sold at the date of taking and removed before the expiration of the lease. If there was error in the instructions, it favored the defendant, for the jury was told it could find that the severed rock was realty, and thus determine a question of law in favor of the defendant; whereas the law is settled that severing of rock in this manner changes the character to that of personalty.

(Emphasis added.) The rock in Smithrock had previously been blasted from the quarry. The taxpayer argues that it did not blast the rock, but only dug the rock from the surface where it occurred naturally and transported it about 100 yards. As stated above, the rock at issue in this appeal was removed from quarries owned by taxpayer's customer. The question is not whether the taxpayer blasted the rock, but whether the rock was severed from the land by someone. The Audit Division states in a memo dated July 22, 1997:

> [T]he rock listed in the audit report on which use tax is assessed is hauled from [a] geographically separate rock pit to the logging road by a hired hauler. "Dirt" is not being moved; rock is. This is not fill dirt, such as that used in landscaping. The persons hired by [taxpayer] to haul this rock provide a load slip showing the pit from which the rock was taken and the type of rock, pit run, shale, rip rap or crushed. Further, the rock was not moved a short distance, but often, several miles and along public roads. Rock was not moved from the side of the roads being constructed but from a rock pit or river bed a distance away.

(Emphasis in original.)

As stated above, there is no question that the rock was used by the taxpayer in constructing logging roads. Therefore, under Rule 135, the taxpayer owes the use tax.

2. Value of the rock.

[2] The next question is the proper measure of the use tax. RCW 82.12.020(4) states:

> The tax shall be levied and collected in an amount equal to the value of the article used by the taxpayer multiplied by the rate in effect for the retail sales tax under RCW 82.08.020.

"The value of the article used" is defined in RCW 82.12.010(1)(a) as:

> ... the consideration, whether money, credit, rights, or other property except trade-in property of like kind, expressed in terms of money, paid or given or contracted to be paid or given by the purchaser to the seller for the article of tangible personal property, the use of which is taxable under this chapter. The term includes, in addition to the consideration paid or given or contracted to be paid or given, the amount of any tariff or duty paid with respect to the importation of the article used. In case the article used is acquired by lease or by gift or is extracted, produced, or manufactured by the person using the same or is sold under conditions wherein the purchase price does not represent the true value thereof, the value of the article used shall be determined as nearly as possible according to the retail selling price at place of use of similar products of like quality and character under such rules as the department of revenue may prescribe.

(Emphasis added.) In this appeal, there is no purchase price, therefore we must determine whether the Department has established rules to determine the value. The taxpayer cites Excise Tax Bulletin 4.08.12.171 (ETB 4) where the Department states:

> In the case of fill dirt, quarry rubble, pit ran sand, gravel, rock or rip rap, and similar natural materials which are not processed after extraction, the measure of value for computing the use tax is the cost of extraction, but not including labor and transportation to the job site.

The taxpayer states that the costs of extracting the rock is minimal. The taxpayer does not have records that clearly identify the cost of extraction. However, the taxpayer claims that the cost is approximately $0.27 per yard.[4] A review of the load slips used by the Audit Division to determine the amount of rock used shows that while a loader may be capable of moving rock at the rate indicated, the loader did not, in fact, move that quantity of rock on a consistent basis. As stated above, the Department valued the rock at $1.95 per yard.[5]

The taxpayer's costs are not the only costs of extracting the rock. The taxpayer's customer also expended resources to prepare the quarry and the rock for the taxpayer's use. The customer's expenses presumably included blasting, digging, and piling the rock in the quarry. In the absence of evidence to the contrary, the Department may reasonably rely on data maintained by other state agencies to determine the extraction costs of rock used in logging road construction. Therefore, we accept the $1.95 per yard value used by the Audit Division.

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[4] The taxpayer claims that only extraction cost is the charge for a loader which is approximately $40 per hour. A loader, according to the taxpayer, can move fifteen 10-yard trucks per hour. Thus, the cost is determined by dividing $40 by 150.

[5] See, footnote 2, supra.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. This matter is remanded to the Compliance Division for collection proceedings.

Dated this 16th day of September 1997.