

Cite as Det. No. 16-0131, 35 WTD 573 (2016)

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 of)	
)	No. 16-0131
)	
...)	Registration No. ...
)	

RCW 84.33.074(3)(b) – WAC 458-40-610(11) – FOREST EXCISE TAX – DEDUCTIONS – HARVESTING AND MARKETING. Where a small harvester retains an affiliated entity to harvest and market timber and provides minimal documentation of harvesting and marketing costs, the standard 35 percent cost deduction, as required by RCW 84.33.074(3)(b) and WAC 458-40-610(11), applies.

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.

Eckholm, A.L.J. – A small harvester, that retained an affiliated entity to harvest and market timber, objects to the disallowance of its harvesting and marketing cost deduction of 50 percent of the timber sale price in determining the measure of forest excise tax due. Where the taxpayer provides minimal documentation of harvesting and marketing costs, in addition to the absence of an arm’s length transaction to verify the taxpayer’s asserted costs, the Forest Tax Section appropriately applied the standard 35 percent cost deduction, as required by RCW 84.33.074(3)(b) and WAC 458-40-610(11). The taxpayer’s petition is denied.¹

ISSUE

Where a small harvester retains an affiliated entity to harvest and market timber and provides minimal documentation of harvesting and marketing costs, did the Department appropriately apply the standard 35 percent cost deduction, as required by RCW 84.33.074(3)(b) and WAC 458-40-610(11)?

FINDINGS OF FACT

[Taxpayer] filed a Small Harvester Forest Excise Tax return for the second quarter 2014, reporting forest excise tax due on timber harvesting under Forest Practice Application (FPA) # The taxpayer reported a timber sale gross amount of \$. . . , and deducted harvesting and marketing costs of \$. . . for harvesting, hauling, and application fee, for a total taxable stumpage

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

value of \$ After applying the Enhanced Aquatic Resources Requirements (EARR) credit, the taxpayer reported and paid forest excise tax of \$

The Department of Revenue's (Department) Special Programs Division, Forest Tax Section, reviewed the taxpayer's return and FPA # . . . , and noted that [Affiliate] was listed as both the timber owner and the operator/logger, and that . . . (owner of [Affiliate] and the taxpayer) was identified as the landowner and signed the application. A Forester and Manager of the Department's Forest Tax Section met with the taxpayer, visited the location of the timber harvest, and reviewed the taxpayer's documentation of deducted costs. The taxpayer's documentation included a handwritten summary of costs and a trip log for hauling. The taxpayer related the difficult and costly nature of this particular timber harvest that involved steep slopes, rock bluffs, delicate property lines, a creek, a county road, power lines, and a residence to work around. The Forest Tax Section acknowledged the difficult aspects of this harvest but determined that, based on the taxpayer's summary records and the lack of an arm's length transaction between the taxpayer and affiliated logger, the taxpayer did not provide sufficient reliable and verifiable documentation to support its asserted harvesting and marketing cost deduction. Therefore, the Forest Tax Section applied the standard 35 percent deduction, required by RCW 84.33.074(3)(b) and WAC 458-40-610(11), in circumstances where a taxpayer's harvesting and marketing costs are not sufficiently documented, resulting in an additional amount due, including penalties and interest, of \$

The taxpayer paid the assessment and filed an appeal petition with the Department's Appeals Division, asserting that the Forest Tax Section should have taken into account the nature and location of the harvest and allowed the taxpayer's costs as deducted, amounting to 50 percent of the sale price, rather than the 35 percent allowance. The taxpayer described the difficult nature of the harvest and its decision to haul the logs to . . . to obtain a better price, asserting that the higher price ultimately benefited the Department by increasing the tax base, and that the standard 35 percent deduction does not reflect these types of circumstances. The taxpayer also indicated that it should not be penalized with a reduced deduction because it chose to log the timber itself, and that a third party would have charged at least as much as represented by the taxpayer's deducted costs. The Forest Tax Section filed a response to the taxpayer's petition explaining the basis for the application of the standard deduction, as explained above and in the Analysis section below.

ANALYSIS

A timber excise tax is imposed on every person engaging in the business of harvesting timber on privately or public owned land. RCW 84.33.041(1). The tax is equal to the stumpage value of timber harvested for sale or for commercial or industrial use, multiplied by specified rates. *Id.* Small harvesters, such as the taxpayer, are permitted to deduct the harvesting and marketing costs from the gross receipts from the timber sale to arrive at the taxable value, as follows:

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

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.

RCW 84.33.074(3)(b) (emphasis added). *See also* WAC 458-40-610(29).

RCW 84.33.074(3)(b) directs the Department to determine the allowable harvesting and marketing cost deduction where the taxpayer is unable to provide documented proof of its costs.

The Department's rules administering the timber excise tax statutes, RCW 84.33.010 through 84.33.096, are contained in Chapter 458-40 WAC. Definitions are provided in WAC 458-40-610, including the definition of "[harvesting] and marketing costs," as follows:

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 cannot 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.

WAC 458-40-610(11) [(emphasis added)]. In addition to a detailed explanation of the types of costs that may be deducted from the measure of timber excise, the rule establishes 35 percent of the gross receipts from the sale of the logs as the allowable cost deduction where a taxpayer is unable to provide documented proof of deducted harvesting and marketing costs, or when harvesting and marketing costs cannot be separated from other costs. *Id.* The 35 percent cost deduction allowance is the industry standard, and is applied in circumstances where the taxpayer has not provided sufficient or verifiable records of costs, such as documentation of third party harvesting and marketing costs. *See* Det. No. 08-0097, 28 WTD 105, 108-110 (2008). Such circumstances include where the harvest transaction is between affiliated entities, and does not contain verifiable documentation of an arm's length transaction. *Id.*

Here, the taxpayer and the harvester, [Affiliate], are both owned by the same person, . . . , the landowner. [T]he taxpayer did not engage in an arm's length transaction with a third party harvester which would have provided a way to verify the taxpayer's asserted costs. The taxpayer's documentation of its costs consists of a handwritten list of costs and a hauling schedule of the trips to . . . to market the logs. The Department recognizes that this timber harvest was difficult, but in light of the unity of ownership and interest, and lack of an arm's length transaction to verify the taxpayer's asserted costs, the Forest Tax Section appropriately

applied the standard 35 percent cost deduction, as required by RCW 84.33.074(3)(b) and WAC 458-40-610(11). The taxpayer's petition is denied.

DECISION AND DISPOSITION

The taxpayer's petition is denied.

Dated this 30th day of March, 2016.