

Cite as Det. No. 19-0179, 40 WTD 226 (2021)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 19-0179
)	
...)	Registration No. ...
)	

WAC 458-20-610; WAC 458-20-660; RCW 84.33.041; RCW 84.33.074: TIMBER EXCISE TAX – QUALIFIED SMALL HARVESTER – HARVESTING AND MARKETING COSTS – DEDUCTIONS. In calculating the measure of tax due on the sale of harvested timber, the negotiated value for standing timber, when included as part of the total price paid for the purchase of forest property, is not an allowable harvesting and marketing cost deduction from gross receipts of sale.

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.

Davis, T.R.O. – A Washington property owner objects to the Department of Revenue’s disallowance of [a] harvest cost deduction and revised assessment of timber excise tax (Timber Tax) on the sale of harvested timber.¹ Taxpayer argues that the value he negotiated and paid for standing timber, during the purchase of a parcel of forest property in 2015, should be accepted by the Department as a deductible harvesting and marketing cost against the gross receipts from sale for calculating timber tax due upon harvest and sale in 2018. We deny Taxpayer’s petition.²

ISSUE

Under RCW 84.33.041, RCW 84.33.074, WAC 458-40-610 . . . , and WAC 458-40-660 . . . , was Taxpayer entitled to use the negotiated purchase price of standing timber on property Taxpayer purchased in 2015 as a harvesting and marketing cost deduction when calculating the measure of timber excise tax after harvesting the timber in 2018?

¹ The assessment document (No. . . .) labels the tax due as “forest tax, private harvest.” Similarly, in prior determinations, we sometimes refer to the tax as “forest excise tax” or “FET.” However, because the Department refers to the tax as “Timber Excise Tax” in chapter 458-40 WAC, and the legislature uses the term “timber tax” when referring to the timber tax distribution account in RCW 84.33.081, we will refer herein to the tax as “Timber Tax.”

² Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

FINDINGS OF FACT

. . . (Taxpayer), a Washington resident, is the owner of . . . acres of forestland in . . . County, Washington. Taxpayer is a private citizen not in the business of harvesting timber. Taxpayer's purchase of this land and its timber closed, and title was transferred, [in] 2015. According to Taxpayer, at the time he purchased the land, all transferred harvestable timber was located on one . . . -acre parcel. This timber was located in Stumpage Value Area . . . for the purpose of calculating stumpage value under RCW 84.33.091 and WAC 458-40-660. Taxpayer negotiated a purchase price for the land with the seller, ultimately agreeing to pay \$. . . for the . . . acres, of which Taxpayer asserted \$. . . was to be for the land itself, and \$. . . for the value of the standing timber on the land (Timber Value). A HUD-1 Settlement Statement provided by Taxpayer dated . . . 2015 shows the Contract Sale Price for the property listed as [purchase price].³

In 2017, Taxpayer hired a private, third-party logger (Contractor) to harvest by clear-cut and sell the timber on Taxpayer's behalf in exchange for a negotiated payment of 50 percent of the sale value of general, non-[wood type], timber harvested, and 40 percent of the sale value of [wood type] harvested. Taxpayer stated the harvest was a one-time sale for Taxpayer's private benefit, and was not intended as a business or commercial activity. Taxpayer began cutting timber in December 2017 under timber harvest permit no. . . . (the Permit) as a "Small Harvester" under RCW 84.33.035(15) and WAC 458-40-610(29)(a), and completed cutting in March 2018. Taxpayer sold all harvested timber from this cut during 1st Quarter, 2018 (January through March). Taxpayer did not take bids from multiple prospective buyers, instead selling the harvested logs directly to a buyer on the commercial market. The buyer, a commercial mill, independently paid both Taxpayer and Contractor their respective negotiated shares at the time of purchase.

Following the sale, Taxpayer filed a timber sale report with the Department and paid Timber Tax of \$ Taxpayer calculated the tax due using the gross amount received for the harvested timber, less a deduction for harvest costs. Taxpayer included both the negotiated payment to Contractor and the Timber Value in the total harvest cost deduction, resulting in total deductions of \$. . . and taxable income of \$ According to Taxpayer's timber sale report, the total volume of timber Taxpayer harvested was . . . board feet of [wood type] and . . . board feet of hardwoods, for a total of . . . board feet, taken by clear-cut. The gross amount Taxpayer received for the logs from the commercial mill was \$. . . , resulting in payment owed to Contractor of \$ Taxpayer stated that the harvest was the only timber he cut or sold during the quarter and this was the only harvestable timber on the entire . . . acres.

Upon receipt of Taxpayer's report and payment, the Department's Special Programs Division, Forest Tax Section (Forest Section) examined the details of the sale, including Taxpayer records of the transaction, to determine Taxpayer's correct tax liability. During the examination, Forest Section was able to verify Taxpayer's payment to Contractor, but determined that the Timber Value was not a valid [h]arvesting and [m]arketing [c]ost under RCW 84.33.035(8), so this deduction was disallowed and the tax recalculated. Under the recalculated values, Taxpayer's new [h]arvesting and [m]arketing [c]ost deduction was \$. . . , and the resulting [t]otal [t]axable [s]tumpage [v]alue was \$

³ . . .

As a result of the Forest Section examination, on June 28, 2018, the Department issued an assessment to Taxpayer for \$. . . , including timber tax of \$. . . , interest of \$. . . , a five percent penalty for substantial underpayment of \$. . . , and a tax credit of \$. . . for the amount Taxpayer previously paid. Taxpayer objected to the assessment, and after some additional discussions with Forest Section, timely petitioned for review.

Taxpayer does not challenge the Department's calculated values with the exception that it objects to Forest Section's disallowance of the Timber Value as a deductible expense.

On review, Taxpayer provided additional email evidence documenting his negotiations for the purchase of the land parcel to demonstrate that the value of standing timber was separately bargained for by the parties and was added to the price of the land by seller as part of the total agreed sale price at the time of purchase. Taxpayer also provided a copy of the HUD-1 property settlement report from the 2015 property purchase, and a private timber appraisal report, dated August 22, 2016, stating the estimated value of standing timber on the parcel was “. . . logging truck loads and a market value of \$. . .” Taxpayer argues that the Timber Value was separately negotiated as the price of the standing timber and that the cost of the timber should be a deductible expense.

ANALYSIS

Timber Excise Tax

A Timber Tax is imposed on every person engaging in the business of harvesting timber on privately or publicly owned land. RCW 84.33.041(1).⁴ The tax is equal to the stumpage value of timber harvested for sale or for commercial or industrial use, multiplied by specified rates. *Id.* A landowner selling timber is making commercial use of that timber. WAC 458-40-626. Timber Tax is imposed on timber harvested during the previous calendar quarter and due on the last day of the month following the quarter in which the timber is harvested. RCW 84.33.086; WAC 458-40-626. Qualified small harvesters, such as Taxpayer here,⁵ are permitted to deduct harvesting and marketing costs from the gross receipts of a 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.⁶

⁴ “Harvester” means “every person who from the person’s own land or from the land of another under a right or license granted by lease or contract, either directly or by contracting with others . . . , fells, cuts, or takes timber for sale or for commercial or industrial use. . . .” RCW 84.33.035(7) (emphasis added). “Timber” means all “forest trees, standing or down, on privately and publicly owned land.” RCW 84.33.035(18). There is no dispute here that Taxpayer was a harvester of timber, which he cut from his own land using a hired third-party contractor.

⁵ Under RCW 84.33.035 and WAC 458-20-13501(14), a “small timber harvester” is a harvester who takes two million board feet of timber or less for sale in a calendar year. Small harvesters, such as Taxpayer here, are granted limited exemption from B&O tax under RCW 82.04.333. However, they must still register and pay Timber Tax.

⁶ The \$. . . allowed by Forest Section here represents a deduction of 46.6 percent of Taxpayer’s gross receipts.

RCW 84.33.074(3)(b) (emphasis added). *See also* WAC 458-40-610(11) and (29)(a). Here, according to Taxpayer’s timber sale report, Taxpayer received \$. . . in gross receipts from the sale of . . . board feet of timber and reported under the Small Harvester option.

Harvesting and Marketing Costs

The Department’s rules administering the Timber Tax statutes, RCW 84.33.010 through 84.33.096, are contained in Chapter 458-40 WAC. 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 interprets the term “harvesting and marketing costs” in WAC 458-40-610(11) as:

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.

(Emphasis added.) *See also* Det. No. 15-0355, 35 WTD 296 (2016); Det. No. 16-0131, 35 WTD 573 (2016); Det. No. 08-0097, 28 WTD 105 (2008).

Here, Taxpayer provided documented records to support its calculation of deductible costs, which were verified by Forest Section during its examination. Therefore, Forest Section was required to use Taxpayer’s values rather than the 35 percent standard deduction under WAC 458-40-610(11). However, Taxpayer’s claimed deduction included both the \$. . . payments to Contractor and the \$. . . Timber Value. Because the Timber Value is . . . not “directly and exclusively associated with harvesting and marketing merchantable timber from the land and delivering it to the buyer” under WAC 458-40-610(11), it cannot properly be included in the deduction from gross receipts under RCW 84.33.074(3)(b). We find that Forest Section properly excluded the Timber Value from the allowed deduction and was required to recalculate the tax due under RCW 84.33.074(3)(b) and WAC 458-40-610(29).

Conclusion

We find that Forest Section properly allowed Taxpayer's deduction from gross receipts for the payments it made to Contractor. However, Forest Section lacked authority to allow the claimed deduction for the original purchase price of the timber because this is not a cost "directly and exclusively associated with the harvesting and marketing of merchantable timber" under WAC 458-40-610(11). There are no other provisions that allow the deduction of the purchase price of timber from gross receipts when calculating Timber Tax. Having excluded a portion of Taxpayer's claimed deduction from gross receipts, Forest Section properly recalculated Taxpayer's tax, interest, and penalties due.⁷ We must therefore deny Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 24th day of July 2019.

⁷ If the Department determines that a tax has been substantially underpaid, the Department is required to assess a five percent penalty on the amount that was underpaid. RCW 82.32.090(2). "Substantially underpaid" under RCW 82.32.090(2) "means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due . . . and the amount of underpayment is at least one thousand dollars." Further, whenever tax is not paid when due, interest is required to be assessed. Interest is based on the amount of tax only, and calculated from the last day of the month following the final period assessed. RCW 82.32.050(1); WAC 458-20-228 (7).

Here, the amount of tax Taxpayer reported and paid during the assessment period was \$. . . , and the Department determined Taxpayer's total tax liability for the assessment period was \$. . . Therefore, the Department was required to assess a five percent substantial underpayment penalty and charge interest on the tax amount owed.