

SYNOPSIS

SEVERANCE TAX – BURDEN OF PROOF – In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon a taxpayer to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code § 11-10A-10(e) [2002]; W. Va. Code. St. R. §§ 121-1-63.1 and 69.2 (Apr. 20, 2003).

SEVERANCE TAX – TIMBER PRODUCTION – WHEN TIMBER PRODUCTION ENDS -- For purposes of the severance tax as it pertains to timber, the severing and producing of timber ends when the tree is severed, topped and delimbed. W. Va. Code § 11-13A-4(d) & W. Va. Code St. R. § 110-13A-2.12 (April 15, 1992).

SEVERANCE TAX – TIMBER PRODUCTION – TAXPAYER ELECTION OF VALUATION METHOD UNDER LEGISLATIVE RULES -- Where there is no sale of timber at the point at which severance and production ends, W. Va. Code St. R. § 110-13A-4.4.2 (April 15, 1992) permits a taxpayer to elect to determine the value of timber produced in the State of West Virginia under the valuation methodologies prescribed by § 4.4.2, rather than by the methods prescribed by § 4.4.1.

SEVERANCE TAX – TIMBER PRODUCTION – KILN DRYING AS “OTHER MANUFACTURING” -- Where a producer of timber saws or mills green lumber produced by it, and then dries it in its own kilns, kiln-drying the lumber is “otherwise manufactur[ing]” the timber for purposes of W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992).

SEVERANCE TAX – TIMBER PRODUCTION – KILN-DRIED LUMBER IS “LUMBER” -- For purposes of W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992), kiln-dried lumber constitutes “lumber” as that term is used in the legislative rule, and the gross proceeds from the sale of the kiln-dried lumber may be used to measure the value of timber produced for purposes of the severance tax pursuant to the valuation methodology set forth therein.

SEVERANCE TAX – TIMBER PRODUCTION – KILN-DRIED LUMBER IS “OTHER PRODUCT” -- Even if kiln-dried lumber does not constitute “lumber” as that term is used in W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992), it constitutes an “other product” as that term is used in the legislative rule, and the gross proceeds from the sale of the kiln-dried lumber may be used to measure the value of timber produced for purposes of the severance tax pursuant to the valuation methodology set forth therein.

SEVERANCE TAX – TIMBER PRODUCTION – BY-PRODUCTS ARE PART OF TIMBER PRODUCTION -- Bark, chips and saw dust are by-products of sawing, milling and other manufacturing and, as such, are “other products” as that term is used in W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992), and the gross proceeds from the sale of which may be used to measure the value of timber produced for purposes of the severance tax pursuant to the valuation methodology set forth therein.

CORRECTED FINAL DECISION

A tax examiner with the Field Auditing Division of the West Virginia State Tax Commissioner’s Office conducted an audit of the books and records of the Petitioner. Thereafter, on December 22, 2006, the Director of the Field Auditing Division issued a severance tax assessment against Petitioner. The assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 13A of the West Virginia Code. The assessment was for the period of January 1, 2001, through December 31, 2004, for tax in the amount of \$____, and interest in the amount of \$____, computed through January 17, 2007, for a total assessed tax liability of \$____. According to the petition for reassessment, written notice of this assessment was served on Petitioner on December 23, 2006.

Also, on December 22, 2006, the State Tax Commissioner (by the Field Auditing Division) issued a purchasers use tax assessment against Petitioner, under the provisions of Chapter 11, Articles 10 and 15A of the West Virginia Code, for the period of July 1, 2003, through June 30, 2006, for tax in the amount of \$____, interest in the amount of \$____,¹ and additions to tax in the amount of \$____, for a total assessed tax liability of \$____. According to

¹ Neither the purchasers use tax assessment nor the audit workpapers were entered into the record. Thus, this Office has no way of determining the date through which interest was computed. Neither does the record disclose whether or not the assessment has been paid. Because a petition for reassessment was filed and has not been otherwise disposed of, this Office will assume that the assessment has not been paid and that interest on the tax continues to accrue.

the petition for reassessment, written notice of this assessment was also served on Petitioner on December 23, 2006.

Thereafter, on February 15, 2007, Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. W. Va. Code §§ 11-10A-8(1) [2007] and 11-10A-9 [2005].

With regard to the purchasers use tax assessment, the only contested item was additions to tax, which the State Tax Commissioner agreed to waive. (Tr., pp. 1-2). Thus, the use tax assessment was resolved on an agreed basis.

Subsequent to filing the petition for reassessment on March 1, 2007, Petitioner's representatives met with the State Tax Commissioner, the Deputy Tax Commissioner, the Director of the Auditing Division, a Senior Auditing Supervisor and their legal counsel, to present a proposed revision of the amount of Petitioner's severance tax base (other than that reflected in the Taxpayer's originally filed returns or in the Assessment).

In response to that proposal, the State Tax Commissioner directed the Auditing Division to conduct a field review of its initial findings. That review was concluded in the latter part of 2007, and written findings of the same, indicated a severance tax liability in the amount of \$____, together with interest of \$____, for a total liability of \$____, which was greater than the original assessment. (State's Exhibit No. 2). Specifically, instead of applying Petitioner's proposed methodology, the Auditing Division's field review applied another valuation method provided for by the legislative rules. Petitioner also disagreed with the use of this valuation method. Thus, the severance tax assessment was not adjusted on the basis of the field review.

Subsequently, notice of a hearing on the petition was sent to Petitioner and its counsel and a hearing was held on November 8, 2006, in accordance with the provisions of W. Va. Code § 11-10A-10 [2002].

At the Hearing, four (4) issues were presented for determination.

1. Whether the portion of Petitioner's severance tax base, reflected in its production of lumber it sawed and later dried during the periods covered by the assessment periods should be measured by 25% of the green (undried) value of such lumber as established in a widely recognized report of such values published by an independent third party?

2. Whether the severance tax assessment overstated Petitioner's severance tax base by understating the portion of Petitioner's lumber production resulting from its purchase, at its sawmills, of logs severed by unrelated third parties for their own account (herein referred to as "gatewood")?

3. Whether the severance tax assessment mistakenly concluded that Petitioner's sale of logs it produced occurred in the forest or at a central collection point, and not at its sawmills, and, thus mistakenly applied the higher 75% of revenue method provided for by W. Va. Code St. R. § 110-13A-4.4.2.1 (April 15, 1992), rather than the 50% of revenue method for valuing its production of logs for sale as such provided for by W. Va. Code St. R. § 110-13A-4.4.2.2 (April 15, 1992).

4. Whether the severance tax assessment mistakenly only allowed a deduction from Petitioner's severance tax base of 50% of the freight expenses it incurred to deliver its products to its customers?

At the conclusion of the Hearing, counsel for the State Tax Commissioner indicated that in light of certain portions of the testimony, it might be appropriate to revise the assessment.

Specifically, with respect to the Assessment's apparent undercounting of the "gatewood" delivered to its sawmill in a city in Virginia, the parties requested and the Administrative Law Judge agreed that before a briefing schedule would be established, the Auditing Division would be given the opportunity to confirm the witness's testimony by re-examining the supporting records, all for the purpose of possibly modifying the severance tax assessment in light of such evidence.

Thereafter, on March 23, 2009, counsel for the State Tax Commissioner provided to this Office and the taxpayer a revised severance tax assessment prepared by the Auditing Division and showing severance tax due in the amount of \$____, together with interest in the amount of \$____, for a total liability of \$____ (hereinafter referred to as the "3/23/09 assessment"). In the 3/23/09 assessment, the Auditing Division reduced the computed amount of the Taxpayer's timber production to reflect the amount of "gatewood" it received at its various sawmills. In addition, to reflect the fact that the Taxpayer sold logs at its sawmills and not in the woods, the 3/23/09 assessment adjusted the percentage of log sales used for determination of its taxable value from 75% to 50%.

Thus, in the 3/23/09 assessment, the State Tax Commissioner agreed with Petitioner's position as it related to the proper treatment of gatewood to determine the tax base, (Issue 2, above) and to the appropriate percentage factor applicable to log sales (Issue 3, above). However, for the first time the State Tax Commissioner asserted that the revenues realized by Petitioner from its sale of saw dust, chips and bark during the assessment periods were subject to severance tax. Said revenues were included in the 3/29/09 assessment.

Following subsequent discussions between the parties and the Auditing Division's additional review of Petitioner's records, further adjustments were made to the severance tax

assessment. In addition to the correction of a mathematical error, the State Tax Commissioner agreed to Petitioner's position with respect to the deduction for its expenses in transporting its products to customers (Issue 4, above). As a result, on June 29, 2009, a final severance tax assessment (herein referred to as the "final assessment") was issued by the Auditing Division, filed with this Office and provided to Petitioner.

The final assessment shows severance tax due in the amount of \$____, together with interest in the amount of \$____, computed through July 1, 2009, for a total liability of \$____. Thus, there now remains for decision only the "green lumber" issue (issue 1, above) and the taxability of sales of sawdust, chips and bark, as first included in the 3/23/09 Assessment.

FINDINGS OF FACT

1. Petitioner is an integrated producer of hardwood products headquartered in a city in West Virginia. (Tr. p. 5).

2. Its primary operations consist of harvesting hardwood timber, transporting such harvested logs to its sawmills, sawing many of those logs, and other purchased logs delivered to its sawmills by other timber producers, into lumber, then, either selling that lumber as is (hereinafter, "green lumber"), or transporting the lumber to its own kilns at other locations for drying and, then, finally transporting the kiln-dried lumber (hereinafter, "KD lumber") to various customers via contract carriers. (Tr. pp. 6-11).

3. It also sells, at its sawmills, some of the harvested logs to third parties for use as veneer logs. (Tr. p. 7).

4. The green lumber it sells at its sawmills is used by third-party manufacturers to make pallets and flooring. (Tr. p. 17).

5. Petitioner's harvesting of hardwood timber consists of felling and delimiting trees in the forest. (Tr. p. 46).

6. Its sawing of logs into lumber consists of removing bark and cutting the logs into boards of varying lengths, widths and thicknesses, all according to industry standards and customer specifications. (Tr. pp. 8-9, 59-62)

7. By-products of the sawing of logs are the removed bark, chips and sawdust. (Tr. p. 20).

8. Petitioner sells the by-products to third parties for subsequent processing and use. (Tr. p. 20; Petitioner's Exhibit No. 1.)

9. Its drying of its green lumber consists of placing that lumber into kilns for varying lengths of time. The kilns are heated to varying temperatures, depending on tree species, customer specifications and other requirements. (Tr. pp. 9-10).

10. During the assessment periods, Petitioner harvested timber, through contractors, at various locations in West Virginia and elsewhere. (Tr. pp. 7-8).

11. During the assessment periods, it operated sawmills at five (5) locations in West Virginia and one (1) in Pennsylvania. (Tr. p. 11).

12. During the assessment periods, Petitioner operated dry kilns at four (4) locations in West Virginia and one (1) in Pennsylvania. Id.

13. In its financial accounting system, the records of which are annually audited by independent certified public accountants, Petitioner accounts for the various sawmills and dry kiln facilities used in its operations as separate profit centers. (Tr. pp. 13-14, 18 and 21).

14. For purposes of its financial accounting system, Petitioner determines the economic revenue attributable to its sawmills by adding its receipts from sales of green lumber to the product determined from multiplying the known quantities of various species and grades of

green hardwood lumber it saws, but does not sell as such, by prices for such products as reported in a wood industry publication known as the Hardwood Market Report. (Tr. p. 17; Petitioner's Exhibit No. 1).

15. The Hardwood Market Report is an objective, accurate and reliable publication which is issued each week and contains schedules of current prices paid in arms-length transactions by purchasers to producers at sawmills for various species and grades of green lumber during each weekly reporting period in various regional markets. (Tr. pp. 51-58).

16. Those regional markets include the Appalachian Region where all of Petitioner's sawmills are located. (Tr. p. 55).

17. For purposes of its financial accounting system, in addition to the value of the green lumber it produces, Petitioner also includes, as a separate item in the economic revenue attributable to its sawmills, the revenue it receives from the sale of by-products to others for subsequent processing. (Tr. p. 20; Petitioner's Exhibit No. 1).

18. For purposes of its financial accounting system, the expenses Petitioner attributes to its sawmills include, in addition to its direct and indirect costs of harvesting timber and sawing logs, its cost of transporting the harvested logs from the forest to its sawmills and the cost of purchasing logs delivered to its sawmills by unrelated timber producers (gatewood). (Tr. pp. 20-21; Petitioner's Exhibit No. 1).

19. For purposes of its financial accounting system, the economic revenue Petitioner attributes to its dry kiln facilities is the amount for which it sells its kiln-dried lumber products, less the value it attributes to the green lumber it puts through the drying process. (Tr. p. 21; Petitioner's Exhibit No. 1).

20. For purposes of its financial accounting system, expenses Petitioner attributes to its dry kiln facilities include, in addition to the direct and indirect costs of operating its dry kilns, the cost of transporting its kiln-dried lumber products to its customers. Id.

21. Before the Respondent's audit of Petitioner's books and records, it filed both initial and amended severance tax returns for the assessment periods, neither of which reported the value of its timber production on the basis of its financial accounting records. (Tr. pp. 24-28).

22. Following the audit of Petitioner's books and records, the State Tax Commissioner did not use the value of its timber production shown by its financial accounting records as the basis of the asserted additional severance tax liability. (Tr. pp. 28-32; Petitioner's Exhibit No. 2).

23. Now, in response to the assessment and the final assessment, Petitioner has presented evidence of what it believes its severance tax liability would be for the assessments periods if the value of its timber production were based on its financial accounting records. (Petitioner's Exhibit No. 1).

24. Based on Petitioner's financial accounting records, it values its timber production in West Virginia for the year 2001 in the amount of \$____, consisting of log sale revenue in the amount of \$____, and green lumber production (less freight costs) in the amount of \$____. (Petitioner's Exhibit No. 1).

25. Based on Petitioner's financial accounting records, it values its timber production in West Virginia for the year 2002 in the amount of \$____, consisting of log sale revenue in the amount of \$____, and green lumber production (less freight costs) in the amount of \$____. Id.

26. Based on Petitioner's financial accounting records, it values its timber production in West Virginia for the year 2003 in the amount of \$____, consisting of log sale revenue in the amount of \$____, and green lumber production (less freight costs) in the amount of \$____. Id.

27. Based on Petitioner's financial accounting records, it values its timber production in West Virginia for the year 2004 in the amount of \$____, consisting of log sale revenue in the amount of \$____, and green lumber production (less freight costs) in the amount of \$____. *Id.*

28. In computing the value of its green lumber, Petitioner has determined the value of the green lumber that was later dried in its kilns and sold as kiln-dried lumber on the basis of green lumber values established by the Hardwood Market Report.

29. Petitioner has elected to value of the portion of its timber that was not sold as logs by using the methods prescribed in W. Va. Code St. R. § 110-13A-4.4.2 (April 15, 1992), specifically § 4.4.2.3, by computing the timber value as twenty-five percent (25%) of the value of the lumber it manufactures.

DISCUSSION

The first issue to be decided in this matter involves valuing a portion of the timber produced by Petitioner. Petitioner transports a substantial portion of its lumber to its sawmills, where it proceeds to saw, mill or otherwise manufacture the timber into lumber and other wood products. Some of those wood products it sells as green lumber. The products so sold are valued at their gross proceeds, which are then multiplied by twenty-five percent (25%), to reflect the lumber's value as timber in accordance with W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992). The remaining lumber is then transported to Petitioner's kilns where it is dried.² Petitioner contends that the value of its timber that it ultimately manufactured into kiln-dried lumber should be determined by valuing the lumber as green lumber, as determined by the Hardwood Market Report, and then multiplying that value by twenty-five percent (25%), to

² For purposes of this decision and consistent with the legislative rules, a distinction that must be made between "timber" and "lumber." "Timber" refers to the trees and logs as they exist before they are sawed, milled or otherwise manufactured into lumber, timbers, cross ties, veneer or other like products. "Lumber" refers to the wood

reflect the lumber's value as timber in accordance with W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992). On the other hand, the State Tax Commissioner contends that the value of the timber should be determined by taking the gross proceeds from the sale of the kiln-dried lumber and multiplying that amount by twenty-five percent (25%), to reflect the value of the lumber as timber in accordance with W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992). The issue is whether the timber should be valued in accordance with Petitioner methodology or the State Tax Commissioner's methodology.

W. Va. Code § 11-13A-3b(a) provides for a severance tax on the privilege of severing timber. W. Va. Code § 11-13A-3b(b) imposes the tax at the rate of three and twenty-two hundredths percent (3.22%) on the gross value of the timber produced, as shown by the gross proceeds derived from the sale thereof. W. Va. Code § 11-13A-4(d) provides that the timber production privilege of severing and producing timber shall end when the tree is severed and delimbed. W. Va. Code St. R. § 110-13A-2.12 (April 15, 1992) provides that with respect to timber, processing does not include any cuts after the tree is severed, topped and delimbed. *See Burruss v. Hardesty*, 171 W. Va. 61, 297 S.E.2d 836 (1982).

In order to aid in measuring the value of timber produced, the State Tax Commissioner has promulgated and the legislature has approved legislative rules which provide guidance respecting the value of timber.

4.4. Timber Production Privilege. -- The measure of tax under this classification is the gross value of the timber at the point where the production privilege ends. This is an amount equal to the fair market value of the timber production at that point where the tree is severed and delimbed. When a sale occurs at that point, taxable value is gross proceeds of sale. In the absence of such a sale, taxable value is that amount which corresponds as nearly as possible to the gross proceeds from the sale of similar products of like quality or character determined under the following uniform and equitable rules.

products after the trees or logs are sawed or milled into boards, beams, framing or other lumber of standard dimensions and lengths.

4.4.1. In the absence of sales at the point where the timber production privilege ends, gross value must be determined in light of the most reliable and accurate information available. Such factors as the following are to be given due consideration.

4.4.1.1. Character and quality of the timber as determined by species, age, size, condition, etc.;

4.4.1.2. The quantity of timber per acre, the total quantity under consideration, and the location of the timber in question with reference to other timber;

4.4.1.3. Accessibility of the timber (location with reference to distance from a common carrier, the topography and other features of the ground upon which the timber stands and over which it must be transported in the process of exploitation), the probable cost of exploitation and the climate and state of industrial development of the locality; and

4.4.1.4. The freight rates charged by common carriers to important markets.

4.4.1.5. The timber in each particular case will be valued on its own merits. The Tax Commissioner will give weight and consideration to any and all facts and evidence having a bearing on the market value such as cost, actual sales and transfers of similar timber products, the margin between cost of production and the price realized for timber products, and royalties and rentals paid to the owner of the standing timber. The taxpayer bears the burden of keeping such records as may be necessary to prove the fair market value of his timber at the point where production ends. In the absence of such substantiation, fair market value shall be determined under Subsection [4.4.2].

4.4.2. At the election of the taxpayer, or in the absence of books and records to substantiate fair market value determined under Subsection 4.4.1, above, the following rule shall be used to determine the gross value of timber at the point where production ends.

4.4.2.1. A person who produces timber and sells his logs, and by-products of timber production and bucking operations, on the ground, either where the trees were felled in the forest or at a central collection point, shall report seventy-five percent (75%) of the gross proceeds of sale under the severance tax.

4.4.2.2. A person who produces timber, and sells and delivers his timber products, in the same condition as when those products leave the forest, to a saw mill, other manufacturer or consumer, shall report fifty percent (50%) of his gross proceeds of sale under the severance tax.

4.4.2.3. A person who produces timber and further saws, mills or otherwise manufactures the same into lumber, cross ties, timbers, veneer and other products for sale, profit of commercial use shall report twenty-five percent (25%) of his gross proceeds of sale under the severance tax. Where no sale is made, the fair market value of lumber, cross ties, timbers, veneer or other products must nevertheless be determined as provided in Section 2a of these regulations and twenty-five percent (25%) of that amount shall be reported under the severance tax.

Initially, it must be noted that Petitioner has elected to value its timber on the basis of the methodologies set forth in § 4.4.2. In its negotiations with the State Tax Commissioner, it has acceded to the valuation of the timber which was sold in the form of logs at the sawmills in accordance with the provisions of § 4.4.2.2, the 50% method. This was the basis of resolution of Issue No. 3, as set forth above.

Petitioner has also elected to value its timber that is sawed, milled or otherwise manufactured into lumber, cross ties, (mining) timbers, veneer and other manufactured products in accordance with § 4.4.2.3. With respect to its kiln-dried lumber, it does not challenge the valuation method of § 4.4.2.3 (lumber value x 25%). Instead, it contests the value placed on the lumber by the State Tax Commissioner to which the methodology is applied in determining the value of its timber.

As set forth above, Petitioner transports its timber to its sawmills, where the timber is then sawed, milled or otherwise manufactured into green lumber, cross ties, (mining) timbers, veneer and other products. Some of the green lumber is then sold to customers, and the remaining green lumber is transported to its kilns to be dried. Petitioner contends that kiln drying is a manufacturing process beyond the manufacturing processes that are identified in and intended to be covered by § 4.4.2.3. It maintains that because the green lumber is not sold prior to its transportation to the kilns, there are no gross proceeds by which the green lumber can be

valued at that point. Therefore, it must look to other sources in order to determine its value at that point. Petitioner contends that the value as determined at that point would then be subject to the methodology of § 4.4.2.3. It maintains that in the absence of a sale at that point, the value must be determined by looking to the provisions of §§ 2a.6.2 and 4.4.1. It maintains that these two provisions require looking at an independent, objective third-party source, namely the Hardwood Market Report.

There are two very basic problems with the way Petitioner contends that § 4.4.2.3 applies to it. The first is that it argues that a distinction should be made between green lumber and kiln-dried lumber for the purposes of § 4.4.2.3. It maintains that it saws, mills or otherwise produces green lumber, which it does. It maintains that the green lumber that it then sells is properly valued at the gross proceeds of sale, which is then multiplied by 25% to arrive at the value of the timber that went into the lumber. It goes on to contend that the green lumber that it transports to its kilns to be dried must be valued as green lumber and the methodology applied to that value to obtain the value of the timber produced for severance tax purposes. It contends that to obtain the value of the green lumber it must look to the Hardwood Market Report.

The problem with this contention is that the plain language of § 4.4.2.3 expressly states that it applies to “lumber.” The legislative rule makes no distinction between “green lumber” and “kiln-dried lumber,” or any other lumber, for that matter. Absent some distinction set forth in the legislative rule that would require valuation of timber based only the value of green lumber, the valuation of timber must be based on the gross proceeds from the sale of the “lumber,” regardless of whether the lumber is green or kiln-dried.

The second basic problem with Petitioner’s contention is that § 4.4.2.3 contains broad language that requires valuation of timber based on the gross proceeds from the sale of “lumber,”

whether green or kiln-dried, and *other products* as the case may be. The legislative rule states that a producer who “saws, mills or *otherwise manufactures*” timber into “lumber, cross ties, timbers, veneer and *other products*” shall report 25% of its gross proceeds under the severance tax. Given this broad language, even if Petitioner were correct in its contention that kiln-dried lumber is not “lumber” that is sawed or milled, but a product that undergoes further manufacturing that results in it no longer being considered “lumber,” it would constitute an “other product” as that term is used in § 4.4.3.2. Thus, Petitioner is required to take the gross proceeds from the sale of the kiln-dried lumber, multiply that amount by 25% and report that as the value of that timber for purposes of the severance tax.

Even if this Office were to disregard the aforementioned problems with Petitioner’s interpretation of the legislative rule, there would still be problems with Petitioner’s contention that it would be necessary to look to the provisions of §§ 4.4.1 and 2a.6.2 of the legislative rules. It is clear from the language of § 4.4.2 that a taxpayer is required to elect between the valuation method prescribed by § 4.4.1 and that prescribed by § 4.4.2. It further requires the use of § 4.4.2 when a taxpayer does not maintain books and records sufficient to substantiate fair market value under § 4.4.1. As stated above, it is clear that Petitioner has elected to use § 4.4.2 to value the logs it sold. During the presentation of its case, it has been made clear that Petitioner is using § 4.4.2.3 to value its timber, based on the value of the lumber. Having elected to use § 4.4.2, cannot the graft onto § 4.4.2 those select portions of § 4.4.1 that work to its benefit, while arguing that those portions of § 4.4.2 that it finds to be less favorable must be disregarded.

In addition, a reading of the entirety of § 4.4.1 shows that it requires the maintenance of books, records and other data respecting timber, not lumber. The provision on which Petitioner places its greatest reliance, § 4.4.1.1, requires consideration of character and quality of timber,

not the character and quality of lumber, such as is included in the Hardwood Market Report. Thus, Petitioner would be required to produce some evidence to show the value of “timber” of like character and quality, not “lumber.”

Section 4.4.1 also requires consideration of all of the factors set forth therein, at least insofar as they are relevant.³ There is nothing to indicate that a taxpayer may pick and choose those factors on which it intends to rely and those factors which it intends to disregard. It does stand to reason that those factors that are irrelevant may not and should not be considered. If Petitioner intended to use § 4.4.1 to value its timber, instead of the provisions of § 4.4.2, it has neither produced evidence to support valuations under each subsection thereof, nor shown how and why the provisions of one or more of the subsections is irrelevant and should be disregarded.

Petitioner also argues that § 2a of the legislative rules comes into play. However, this is clearly not the case. Section 4.4.2.3 provides that the fair market value of lumber, cross ties, timbers, veneer or other products must be determined under § 2a of the legislative rules if there is no sale. However, as held above and contrary to Petitioner’s argument, there is a sale of the kiln-dried lumber, whether it is considered to be “lumber” or an “other product.” The value is determined by the gross proceeds of the sale. Therefore, there is no need to resort to § 2a to determine value.

The second issue to be decided is whether bark, chips and saw dust, which are part of the timber produced by Petitioner and are by-products of the sawing, milling and other manufacturing processes, are subject to the severance tax. The provisions of § 4.4.3.2 make it clear that these by-products are subject to the severance tax. These by-products are part of the timber before application of the manufacturing processes. They result from Petitioner’s sawing, milling or other manufacturing of the timber at the sawmills. They clearly constitute “other

products” which are sold. Therefore, twenty-five percent (25%) of the gross proceeds from the sale thereof are subject to the severance tax, as provided in § 4.4.2.3.

CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon a taxpayer to show that any assessment of tax against it is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code § 11-10A-10(e) [2002]; W. Va. Code. St. R. §§ 121-1-63.1 and 69.2 (Apr. 20, 2003).

2. For purposes of the severance tax as it pertains to timber, the severing and producing of timber ends when the tree is severed, topped and delimbed. W. Va. Code § 11-13A-4(d) & W. Va. Code St. R. § 110-13A-2.12 (April 15, 1992).

3. Where there is no sale of timber at the point at which severance and production ends, W. Va. Code St. R. § 110-13A-4.4.2 (April 15, 1992) permits a taxpayer to elect to determine the value of timber produced in the State of West Virginia under the valuation methodologies prescribed by § 4.4.2, rather than by the methods prescribed by § 4.4.1.

4. Where a producer of timber saws or mills green lumber produced by it, and then dries it in its own kilns, kiln-drying the lumber is “otherwise manufactur[ing]” the timber for purposes of W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992).

5. For purposes of W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992), kiln-dried lumber constitutes “lumber” as that term is used in the legislative rule, and the gross proceeds from the sale of the kiln-dried lumber may be used to measure the value of timber produced for purposes of the severance tax pursuant to the valuation methodology set forth therein.

³ The four factors are connected by the conjunctive “and,” not the disjunctive “or.”

6. Even if kiln-dried lumber does not constitute “lumber” as that term is used in W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992), it constitutes “other products” as that term is used in the legislative rule, and the gross proceeds from the sale of the kiln-dried lumber may be used to measure the value of timber produced for purposes of the severance tax pursuant to the valuation methodology set forth therein.

7. Bark, chips and saw dust are by-products of sawing, milling and other manufacturing and, as such, are “other products” as that term is used in W. Va. Code St. R. § 110-13A-4.4.2.3 (April 15, 1992), and the gross proceeds from the sale of which may be used to measure the value of timber produced for purposes of the severance tax pursuant to the valuation methodology set forth therein.

8. Petitioner has failed to carry its burden of proving that the assessment of severance taxes against it is erroneous, unlawful, void or otherwise invalid.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the severance tax assessment issued against the Petitioner for the period of January 1, 2001, through December 31, 2004, for tax in the amount of \$____, and interest in the amount of \$____, computed through January 17, 2007, for a total assessed tax liability of \$____, as **MODIFIED** on or about June 29, 2009, for tax in the amount of \$____, and interest in the amount of \$____, computed through July 1, 2009, for a total assessed tax liability of \$____, is hereby **AFFIRMED**

Interest continues to accrue on this unpaid tax until this liability is fully paid.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that in accordance with the agreement of the parties, purchasers use tax assessment

issued against the Petitioner for the period of July 1, 2003, through June 30, 2006, for tax in the amount of \$____, interest in the amount of \$____, and additions to tax in the amount of \$____, for a total assessed tax liability of \$____, should be and is hereby **AFFIRMED** as to the tax in the amount of \$____, and interest in the amount of \$____, for a total liability of \$____. The additions to tax, in the amount of \$____, are **VACATED** in full.

Interest continues to accrue on this unpaid tax until this liability is fully paid.