

WV TIMBER SEVERANCE TAX CONSIDERATIONS FOR LANDOWNERS

INTRODUCTION

West Virginia Severance Tax applies to the act of severing, extracting, reducing to possession, and producing for sale, profit, or commercial use, a natural resource product. For timber, the value of the product immediately following severing, delimiting, and topping, is subject to severance tax.

RESPONSIBILITY FOR SEVERANCE TAX

For landowners contemplating a sale of standing timber, it is important to understand who is liable for paying the tax and under what conditions. In West Virginia, the party who has title to, or an economic interest in, the timber is responsible for paying the severance tax. This can be confusing, and clear definitions are often lacking. For example, if a landowner hires a contractor to harvest timber on the landowner's property, the landowner is responsible for the severance tax since the logging contractor does not hold title to, or economic interest in, the timber. The contractor is simply providing a service of converting the landowner's standing timber to logs and delivering them to a prearranged location. This remains the case when the contractor's payments are tied to production or when the contractor has the right to purchase the timber **after** severance. A more confusing situation occurs under an arrangement whereby the logging operator harvests the timber, the logs are sold, and the sale proceeds are split between the logging operator and the landowner. Under this situation, both the logging operator and the landowner may be deemed responsible by the W. Va. Department of Tax and Revenue for severance tax on their individual portions of the sale, since the buyer of the logs often prepares two checks: one for the logging operator and one for the landowner. Under other payment arrangements, such as when the log buyer issues one check to the logging operator who then pays the landowner, the W. Va. Department of Tax and Revenue may view the logging operator as the responsible party. If doubts exist, the landowner and the logging operator can agree in writing prior to the harvest as to which party will pay the severance tax, although this may not relieve the other party of responsibility in the eyes of the W. Va. Department of Tax and Revenue should the party who agreed to pay the severance tax fail to do so. The W. Va. Department of Tax and Revenue will not necessarily view such a contractual relationship between a buyer and a seller as establishing the actual responsibility for paying the tax.

What is necessary to transfer liability for severance tax from the landowner to the producer is a documented relationship wherein the producer has a capital investment in the standing timber, such as when the producer purchases or leases the timber from the landowner prior to its harvest. For example, if a landowner leases property and its timber to a logging operator for the purpose of harvesting timber, the logging operator, as a lessee, has an economic interest in the timber and is, consequently, liable for the severance tax. This remains the case even when the landowner receives a production royalty (or percentage of the sale price of the logs) from the lessee logging operator. The key here is the use of an agreement that establishes a purchase or lease of the standing timber.

GROSS VALUE AND RATES

Severance tax is imposed on the gross value of timber at the point where the tree has been severed, delimited, and topped. Timber is rarely, if ever, sold at this point, though. Consequently, the gross value may be determined by a cost basis, where every item of cost attributable to the production of the timber up to and including the point of severing, delimiting, and topping - including direct and indirect overhead costs - is

taken against the selling price of the logs. A reasonable markup by the taxpayer must also be included. The taxpayer bears the responsibility of keeping adequate records to support this method of determining gross value.

In the absence of adequate records to substantiate the gross value of a cost basis, the following rules may be used to determine gross value:

- A party who produces timber and sells the logs and by-products on the ground, either where the trees were felled or at a central collection point, shall report 75 percent of the gross proceeds as gross value; or
- A party who produces timber, sells, and delivers timber products, in the same condition as when those products leave the forest, to a sawmill or other consumer shall report 50 percent of the gross proceeds as gross value; or
- A party who produces timber and further saws, mills, or otherwise manufactures the timber products into lumber, cross ties, timbers, veneers, or other products for sale, profit, or commercial use, shall report 25 percent of the gross proceeds as gross value. Where no sale is made, the fair market value of the lumber, cross ties, timbers, veneers, or other products, must be determined and 25 percent of the fair market value reported as gross value.

The timber severance tax rate in West Virginia is currently 3.22 percent of gross value. If the taxpayer's timber severance tax liability exceeds \$1,000 per month, the taxpayer must file estimated severance tax returns monthly. Otherwise, the taxpayer may file quarterly. In both cases, an annual severance tax return must be filed on or before the last day of the first month after the end of the taxpayer's tax year. Each taxpayer is entitled to an annual severance tax credit of \$500.

As of July 1, 1998, all non-residents who are subject to timber severance tax must notify the West Virginia Department of Tax and Revenue thirty days prior to severing timber in West Virginia and must pre-pay, or post a bond to cover, the amount of estimated severance tax due from the timber to be severed. *Non-resident* means a person or company that does not have a permanent place of business in West Virginia for the purpose of conducting timbering operations.

Severance tax questions may be directed to the W. Va. Department of Tax and Revenue, Taxpayer Services Division, by telephone at 304-558-3333 or by mail at P.O. Box 3784, Charleston, WV 25337-3784.

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