

Background Research

Harvest Tax Issues

Western Juniper Commercialization Coalition

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Introduction

Industry members of the ad hoc Western Juniper Commercialization Steering Committee recently requested assistance from Larry Swan, author of this report, to investigate how and what Oregon harvest taxes pertain to western juniper removed by a commercial operation. Questions arose last summer (1998) when the first large-scale juniper restoration operation began harvest on private lands near Klamath Falls.

Issues

There appear to be three interconnected issues involving harvest taxes and commercial harvest of western juniper:

- Do harvest taxes apply to commercial harvest of western juniper, and if so, which ones?
- What are impacts of harvest taxes on the financial viability of existing western juniper manufacturers?
- What impact will harvest taxes have on development of a western juniper industry, and efforts to reduce watershed and rangeland acreage in poor condition due to juniper woodland densities?

Applicability of Harvest Taxes on Western Juniper Removed by a Commercial Operation

The Klamath District office of the Oregon Department of Forestry (ODF) was contacted in the Spring of 1998 to help investigate the harvest tax issue. Local ODF and Salem personnel could only respond to the question of whether or not commercial juniper harvest falls under Forest Practices Act (FPA) Rules. In their opinion, western juniper harvest falls under FPA rules. This was important first step because the ODF form which must be filed and approved prior to commercial harvest operations also serves to notify the Department of Revenue. If an operation does not fall under FPA rules, the

Department of Revenue is not be notified. ODF personnel suggested the Department of Revenue should be contacted directly.¹

The Oregon Department of Revenue was contacted in April, 1998 concerning the juniper taxation issue. Cliff Grimmel, Timber Valuation Specialist (Timber Unit, Property Tax Division), replied and said in a letter dated May 20th, 1998, that the Department does not tax western juniper for the Eastern Oregon Privilege Tax: "In our opinion, it does not have a positive stumpage value and we do not expect to see one in the near future. We do not list the species in our stumpage tables nor do we require anyone to report it." However, Mr. Grimmel also said: "There is a tax liability for the Forest Products Harvest Tax." This last statement was not explained and according to the Department of Revenue, Mr. Grimmel recently retired.

Discussions with the Department of Revenue resumed in February, 1999. Larry Richards, Timber Program Manager, was contacted (503/945-8329). Mr. Richards concurred with the gist of Mr. Grimmel's letter and reiterated that juniper would still be subject to the Forest Products Harvest Tax. He also said the Department does not have administrative authority to waive taxes. Mr. Richards said that, in his opinion, the Department would not oppose a legislative solution which would exempt juniper from both the Eastern Oregon Privilege Tax and Forest Products Harvest Tax. He believes loss of revenue would be minimal and it would not be an administrative impact.

Mr. Richards was contacted again in March (1999) concerning the Department of Revenue's interpretation of Oregon Revised Statute (ORS) language for the Eastern Oregon Privilege Tax definition of "forestland":

"Forestland" means land east of the summit of the Cascade Mountains which is not [emphasis added] assessed as farmland pursuant to ORS 308.345 to 308.365 and 308.370 to 308.407 and is not assessed by the Department of Revenue pursuant to ORS 308.505 to 308.665 or 308.805 to 308.820; and which is either being held or used for the predominant purpose of growing and harvesting trees of a marketable species and has been designated as forestland under ORS 321.805 to 321.825, or is land the highest and best use of which is the growing and harvesting of such trees. (1997 ORS 321.805 Definitions for ORS 321.805 to 321.825).

¹ A separate effort is underway to clarify how FPA rules should be applied to commercial western juniper harvest operations. It became clear last summer (1998), after trying to apply FPA rules last summer to a juniper restoration harvest site, that FPA rules were never intended for use in woodland harvest operations whose primary purpose is to restore rangeland habitat. The Office of Legislative Council has responded to a request from the Senate Agriculture and Natural Resources Committee for appropriate bill language to clarify FPA rules at they relate to commercial western juniper woodland harvest (LC 3020, dated March 2nd, 1999). A bill number had not been assigned as of the date of this report.

Based on this language, it appears that there are two reasons Eastern Oregon Privilege Tax should not apply to most juniper removed by commercial operations: 1) Lack of positive stumpage value (per Department of Revenue correspondence); and 2) Almost all juniper woodlands located on private property are assessed as farmland by county assessors.²

According to Larry Richards (telephone message, March 4th, 1999), the Department of Revenue believes that "any harvest on any land, whether or not it is forestland" is subject to Privilege Tax. Mr. Richards noted, however, that House Bill (HB) 2452 has been introduced to address this issue. HB 2452 specifies that western Oregon and eastern Oregon timber harvest privilege taxes apply only to timber harvested from forestland (HB 2452 passed the house on 2/23/99 with a vote of 54 to 2; bill was referred to Senate Revenue Committee, then to Ways and Means (2/24), and then to the Subcommittee on Natural Resources). There is also a tax court case in progress concerning the same issue.

Examples of Harvest Tax Exemptions

The legislature has previously exempted certain classes of product from harvest taxes:

Eastern Oregon Privilege Tax Exemption Examples

- Land used exclusively for growing cultured Christmas trees, and the cultured Christmas trees themselves (1997 ORS 321.415 [4]);
- Land and hardwood timber which are grown on land which has been intensively cultivated and cleared of competing vegetation for at least three years after tree planting, represent a species marketable as a fiber for inclusion in the "furnish" of manufacturing paper products, harvested on a rotation cycle within 10 years after planting, and subject to intensive agricultural practices, such as fertilization, insect and disease control, and cultivation and irrigation (1197 ORS 321.415 [5]);

Forest Product Harvest Tax Exemption Example

- "Forest products" means products made from harvested timber, but does not include products from short rotation fiber grown under agricultural conditions... (1997 ORS 321.005 [6]);

Impacts of Harvest Taxes on Financial Viability of Existing Western Juniper Manufacturers

²None of the references to ORS citations in the above paragraph appear to affect this interpretation or relate to situations where commercial juniper harvest will take place: ORS 308.345 to 308.365 relates to "Agricultural Land", ORS 308.505 to 308.665 relates to "Assessment of Designated Utilities and Companies..." and ORS 308.805 to 308.820 relates to "Gross Earnings Tax on Mutual or Cooperative Distribution Systems".

High harvest and processing costs, coupled with the costs of introducing a new species into the marketplace, means that profit margins for juniper products are razor-thin.³ The impact of harvest taxes are therefore correspondingly higher. As one long-time sawmill owner said: "If it was easy, someone else would have done it a long time ago." According to the Project Manager for REACH, Inc. (Klamath Falls), which is processing juniper for animal bedding, harvest taxes could consume close to 50% of their net profit. (Special note: This figure is expected to be reduced due to changes in harvest tax rate changes in the fall of 1998).

Impact of Harvest Taxes on Industry Development and Rangeland Restoration Objectives

Razor-thin profit margins, combined with the heightened impact of harvest taxes, will discourage business development and job creation based on juniper. This in turn means that it will be almost impossible to significantly reduce the approximately 1,000,000 acres of rangeland habitat now dominated by juniper woodlands, for which there are no economical restoration methods other than mechanical treatment (prescribed fire is not an option in these woodlands because the juniper has out-competed the ground vegetation).

Summary

Western juniper logs removed by a commercial operation are potentially subject to two harvest taxes: Eastern Oregon Privilege Tax and Forest Products Tax. The current position of the Department of Revenue is that logs removed during a commercial western juniper harvest operation are subject to the Forest Products Tax, but not the Eastern Oregon Privilege Tax. Legislation introduced this year (House Bill 2452) may write into law the Privilege Tax exemption interpretation in the case of juniper woodlands assessed as farmland. This still leaves juniper subject to the Forest Products Tax.

The combination of the Eastern Oregon Privilege Tax and Forest Products Harvest Tax can have a significant impact on the profitability of a commercial juniper operation. The Project Manager for REACH, Inc., which will be the largest juniper processor by the end of 1999, said last fall (1998) that it looked like harvest taxes could consume close to 50% of their projected net profit.

Because of extraordinarily thin margins, harvest taxes on juniper removed by commercial harvest operations could slow or stop the growth of a new small industry. Without such an industry, there is no known cost-effective method to address serious watershed conditions on over 1,000,000 acres, with hundreds of thousands acres more that are rapidly trending towards the same conditions.

³Western juniper harvesters and manufacturers face significantly higher harvest costs because of: 1) Less volume per tree and per acre than other commercial species, such as ponderosa pine; 2) Large, numerous, and flexible limbs; and 3) Lack of transportation systems and distance to primary processing facilities. Manufacturing costs are significantly higher because of: 1) High taper; 2) Shorter lengths and smaller diameter logs; 3) Large and numerous knots; 4) Various kinds of rot; and 5) Growth stresses, even in properly kiln-dried products.