

**Office of Chief Counsel
Internal Revenue Service
memorandum**

CC:DOM:IT&A:2
GHBradley - LEG-114659-97

date: JUN -2 1998

to: National Director, Speciality Taxes CP:EX:ST

from: Assistant Chief Counsel (Income Tax & Accounting)

subject: Information Returns for Timber Purchases

Your memorandum forwarded a recommendation from Cathy Layne and Tamyra Hughes of the Kentucky-Tennessee District. Ms. Layne and Ms. Hughes are concerned that payments for acquiring timber for further processing or subsequent resale to others are exempt from the information reporting requirements under § 6041 of the Internal Revenue Code. As a solution, they propose [REDACTED]

The purchase of standing timber generally follows one of two forms: the timber is purchased either for a fixed amount or for a specified rate per unit of timber to be harvested (a "pay-as-cut" contract). The purchase price of logs, *i.e.*, timber already harvested when the purchase agreement is entered into, is generally a fixed amount. Whether standing or harvested timber is purchased, the original purchaser may be the ultimate user of the timber, or the timber may be resold to another.

LAW

Section 6041(a) provides, in part, that all persons engaged in a trade or business and making payments in the course of that trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year shall render a true and accurate return to the Secretary of the Treasury setting forth the amount of those gains, profits, and income, and the name and address of the recipient of the payments.

Section 1.6041-3(d) of the Income Tax Regulations excludes payments for bills for merchandise from information reporting requirements. Also, payments to corporations, except for certain types of corporations not applicable here, are excluded under § 1.6041-3(c).

PMTA: 00208

National Director, Speciality Taxes

In a real estate transaction, § 6045(e)(1) requires the real estate reporting person to file a return with the Secretary and furnish a statement to each customer involved in the transaction, showing the gross proceeds of the transaction. However, under § 1.6045-4(c)(2)(i), "no return of information is required with respect to a sale or exchange of an interest in ... surface or subsurface natural resources (i.e., timber, water, ores and other natural deposits) or crops, whether or not such natural resources or crops are severed from the land"

Section 6050N requires every person who makes payments of royalties (or similar amounts) aggregating \$10 or more to any other person during any calendar year to make a return according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of those payments and the name and address of the person to whom paid.¹

Section 6050N was enacted as part of the Tax Reform Act of 1986. The Senate Finance Committee Report, in its explanation of the provision, states that "[e]xamples of royalty payments required to be reported under this provision include royalty payments with respect to the right to exploit natural resources such as ... timber" This provision is effective for royalty payments made after December 31, 1986. S. Rep. No. 313, 99th Cong., 2d Sess. 190 (1986), 1986-3 (Vol. 3) C.B. 190.

In addition to the information reporting provisions discussed above, §6050I requires any person engaged in a trade or business who receives in the course of the trade or business more than \$10,000 in cash in one transaction (or in related transactions) to file an information return. Under this section, when coin or currency is used for payment, a reportable transaction includes, among many other things, sales of goods or services and sales of real property (§ 1.6050I-1(c)(7)).

For purposes of § 6050I, "cash" means not only coin and currency but also monetary instruments, such as cashier's checks, bank drafts, and traveler's checks, that have a face value of not more than \$10,000. An important distinction exists under § 6050I between cash that is coin or currency and cash that is a monetary instrument. When monetary instruments, instead of coin or currency, are used, the transaction (or related transactions) is reportable only if it is a retail sale of (1) a consumer durable,

¹ Reporting of payments of royalties to certain entities (corporations, tax-exempt organizations, etc.) is not required. See § 6050N(c).

National Director, Speciality Taxes

(2) a collectible, or (3) a travel or entertainment activity. These terms, described in § 1.6050I-1(c), do not encompass the sale of timber, whether harvested or unharvested.

DISCUSSION

Purchase of Standing Timber. When a purchaser pays the owner of standing timber a specified rate for each unit of timber actually cut under a "pay-as-cut" contract, the payment for that timber is a royalty. In this situation, the payment to the landowner is subject to the reporting rules of § 6050N and is reportable unless made to a corporation (or one of the other entities specified in § 6050N(c)). In contrast, if the purchaser pays a fixed sum for standing timber, the transaction is a real estate sale that is exempt from the reporting requirement of § 6045 (§ 1.6045-4(c)(2)(i)).

Services for Cutting Timber. When a purchaser pays an independent contractor to cut timber, the payment is compensation for services rendered, and under § 6041 the payor must furnish an information return to any payee with respect to any payment that aggregates \$600 or more in a calendar year, unless the independent contractor is a corporation.

Purchase of Harvested Timber. A payment for harvested timber is not a royalty payment, whether the seller is a landowner or an independent contractor. The purchase of harvested timber is a purchase of merchandise under § 1.6041-3(d) and is not required to be reported. Similarly, when a purchaser pays a contractor a total amount that covers the purchase of timber and the service of harvesting, the total amount is considered payment for the delivered timber and is excluded from reporting requirements as the payment of a bill for merchandise.

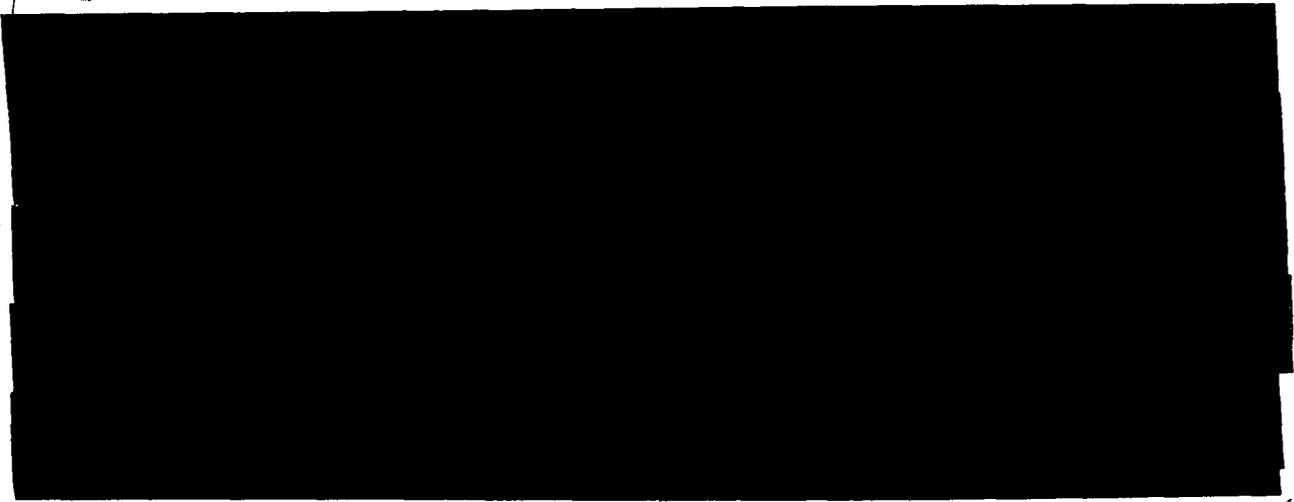
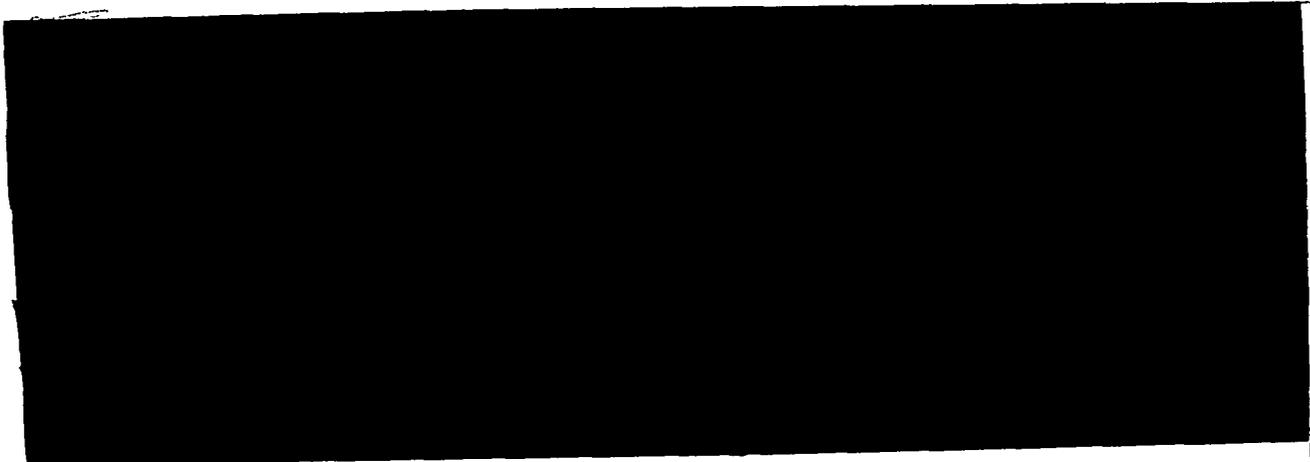
Cash Transactions. A transaction (or two or more related transactions) for the sale of timber, whether harvested or unharvested, is reportable by the seller if more than \$10,000 was received by the seller in the course of the seller's trade or business.

* * * * *

In summary, a payment for the purchase of standing timber under a "pay-as-cut" contract is reportable under § 6050N, but a fixed-sum purchase payment is not reportable under either § 6050N or § 6041. A payment for timber-cutting services is reportable under § 6041, but a payment for harvested timber is not reportable. Under § 6050I, these transactions may be reportable

National Director, Speciality Taxes

by the seller if the seller receives more than \$10,000 cash in coin or currency from the purchaser in one transaction or two or more related transactions.



DP

We appreciate having the opportunity to consider Ms. Layne and Mr. Hughes' recommendation regarding § 1.6041-3. If we may be of further assistance, please do not hesitate to contact George H. Bradley of my office at 202-622-4920.

(signed) Robert A. Berkovsky

By _____
Robert A. Berkovsky
Chief, Branch 2