

**THIS WTD IS WITHDRAWN EFFECTIVE SEPTEMBER 28, 2012,  
AND IS NO LONGER IN EFFECT. SEE ETA 3133.2012.**

Cite as Det. No. 92-231, 12 WTD 233 (1993).

BEFORE THE INTERPRETATION AND APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition	)	<u>D E T E R M I N A T I O N</u>
For Correction of Balance Due	)	
of	)	No. 92-231
	)	
. . .	)	Registration No. . . .
	)	Balance Due . . .
	)	

[1] RULE 136 -- RCW 82.04.120 -- MANUFACTURING B&O TAX --  
DEFINITION -- GIFT BASKETS. The activity of placing  
individually-wrapped food products in baskets does not  
constitute manufacturing. Accord: Det. No. 88-443,  
7 WTD 49 (1988); Det. No. 88-180, 5 WTD 307 (1988).

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.

NATURE OF ACTION:

An individual who places items in gift baskets protests the  
assessment of manufacturing tax on out-of-state sales because she  
contends that her activities do not constitute manufacturing.

FACTS:

Eggen, A.L.J. -- . . . ("taxpayer") protests the issuance of a  
balance due notice for the second quarter of 1991. The notice  
assessed manufacturing B&O tax of \$ . . . on taxpayer's out-of-  
state sales.

Taxpayer assembles gift baskets using prepackaged foods, such as  
salmon and chocolates. Taxpayer purchases the food, leaves it  
in its original packaging, and places it in wicker baskets for  
retail sale. Taxpayer does not affix her own labels to the food.  
Instead, the food retains the manufacturers' labels. Taxpayer  
describes her activities as follows:

How I sell many of my products is akin to how just about every other retailer sells its products. When a woman buys cosmetics in a department or specialty store, they often put her purchased items in a special gift box, basket, or other container. . . . Like these retailers, I merely place purchased items in a basket - I don't affix, connect, or otherwise change them in any way.

Taxpayer's in-state sales are not at issue. She properly paid retailing B&O tax and remitted retail sales tax on these sales. However, taxpayer remitted no tax with respect to her out-of-state sales. The examiner concluded that taxpayer's activities constituted manufacturing within the state and imposed the manufacturing B&O tax on the selling price of baskets sold outside the state. Taxpayer protests the examiner's classification of her activities as "manufacturing."

#### ISSUE:

Whether placing various food products in baskets, where such products retain the manufacturers' packaging and labelling, constitutes "manufacturing."

#### DISCUSSION:

[1] Persons who manufacture products in this state and sell them outside the state are taxable under the manufacturing classification of the B&O tax based upon the value of the products sold. RCW 82.04.240; WAC 458-20-136 (Rule 136). Rule 136 contains the broad statutory definition of manufacturing:

"The term 'to manufacture' embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use, and shall include the production or fabrication of special made or custom made articles." (RCW 82.04.120.) It means the business of producing articles for sale, or for commercial or industrial use from raw materials or prepared materials by giving these matters new forms, qualities, properties, or combinations. It includes such activities as making, . . . mixing, . . . packing, . . . etc. It includes also the . . . packaging . . . of food products . . . .

See also RCW 82.04.120.

In Bornstein Sea Foods, Inc. v. State, 60 Wn.2d 169, 175 (1962), the court articulated the test for determining whether a new, different and useful article has been produced:

[W]hether a significant change has been accomplished when the end product is compared with the article before it was subjected to the process. By the end product we mean the product as it appears at the time it is sold or released by the one performing the process.

In McDonnell & McDonnell v. State, 62 Wn.2d 553, 557 (1963), the court set forth specific elements to be considered in comparing the product before and after the taxpayer completes its activities:

[C]hanges in form, quality, properties (such changes may be chemical, physical, and/or functional in nature), enhancement in value, the extent and the kind of processing involved, differences in demand, et cetera, which may be indicative of the existence of a "new, different, or useful substance."

Although the Washington courts have consistently adopted a broad definition of "manufacturing," this definition has only been applied in cases where the taxpayer's processes have caused a significant change in the product. E.g., Continental Coffee Co. v. State, 62 Wn.2d 829 (1963) (roasted, blended coffee from green coffee beans); McDonnell, 62 Wn.2d 553, (1963) (split peas from whole, dried peas); Bornstein, 60 Wn.2d 169 (fish fillet from whole fish); Stokely-Van Camp v. State, 50 Wn.2d 492 (1957) (frozen fruits and vegetables from fresh fruits and vegetables); J&J Dunbar & Co. v. State, 40 Wn.2d 763 (1952) (whiskey from raw, undrinkable whiskey). Similarly, the Department has found that debarking logs constitutes manufacturing because the debarking process not only results in a more easily transportable log, but also produces waste bark, which is used as "beauty bark." Det. No. 89-393, 8 WTD 139 (1989). Cf., Custom Apple Packers of Quincy, Inc. v. Department of Revenue, 11 WTD 289 (1991) (Cooling, washing, waxing, sorting, and packing apples do not constitute manufacturing because the process both begins and ends with a raw apple. See WAC 458-20-214.)

In contrast, where the taxpayers' activities have simply involved combining individual products for purposes of resale, we have held that such activities do not constitute manufacturing. For example, in Det. No. 88-443, 7 WTD 49 (1988), a health education organization created kits containing various educational materials (e.g. posters, tapes, games, books, puppets) that it had purchased separately. In holding that the taxpayer's

activities did not constitute manufacturing, we noted, "For the most part, the taxpayer does nothing with these materials other than to select which ones go into a particular kit, put them into the plastic container, and ship them to the customer who placed the order." Further, in Det. No. 88-180, 5 WTD 307 (1988), the taxpayer assembled packages of educational materials. The packages consisted of printed materials, computer diskettes, and a variety of materials that the taxpayer purchased from others. Some of the packages were shrink-wrapped. Although we noted that "definition of manufacturing is significantly broader and includes a wider range of activities than the common usage of the term manufacture might indicate," we held that the taxpayer's activities did not constitute manufacturing.

Similarly, we conclude that taxpayer's activities in this case do not constitute manufacturing. While we recognize that the definition of "manufacturing" is very broad, we find that taxpayer's activities here, like those of the taxpayers in the two determinations outlined above, more closely resemble "marketing" than manufacturing. These activities are similar to those of a stereo shop owner who connects several separate components and sells the components as a stereo system. While a stereo system is undoubtedly "new, different, or useful" when compared to the individual components, the simple activity of connecting these components to form a system does not constitute manufacturing. In all of these situations, the taxpayers take useable, individual items and sell them as a "package." Rather than to process the individual items, changing their properties, the taxpayers simply combine the items to make them more commercially appealing. In none of these cases has the taxpayer removed the original labels and packaging prior to resale. Further, although the value of the individual items has been enhanced, this enhancement, when seen in light of the minimal processing involved, is not "indicative of the existence of a new, different or useful substance." McDonnell at 557.

In conclusion, we find that taxpayer's activities do not fall within the definition of manufacturing.

#### DECISION AND DISPOSITION:

The taxpayer's petition for correction of the notice of balance due is granted.

DATED this 25th day of August 1992.