Cite as 4 WTD 141 (1987)

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

In the Matter of the Petition For Correction of Assessment of)	D E T E R M I N A T I O N
)	No. 87-312
. . .)	Registration No. . . .

[1] **RULE 136:** RCW 82.04.120 -- B&O TAX -- MANUFACTURING -- WHAT CONSTITUTES. Cutting, sewing, and assembling materials and hardware to make a new product is manufacturing as defined by RCW 82.04.120.

[2] **RCW 82.04.440:** B&O TAX -- MULTIPLE ACTIVITIES TAX CREDIT -- NATIONAL CAN. Effective June 1, 1987, Washington manufacturers selling outside this state may take a credit against their manufacturing B&O tax for "gross receipts taxes" paid to another state on the same products being taxed in Washington.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: September 10, 1987

NATURE OF ACTION:

The taxpayer protests the assessment of manufacturing tax on the grounds that its activities do not constitute manufacturing.

FACTS AND ISSUES:

Frankel, A.L.J. -- The taxpayer's records were examined for the period January 1, 1983 through September 30, 1986. The audit disclosed taxes and interest owing in the amount of $ . . . . Tax Assessment No. . . . in that amount was issued on March 31, 1987. The taxpayer sells awnings to the general public at retail and to dealers at wholesale. It purchases the awning material and the

hardware from two different companies. The taxpayer cuts, sews and assembles the awnings and sells them under its own brand name.

At issue is the assessment of manufacturing tax on the taxpayer's out-of-state sales. The auditor concluded the taxpayer was a manufacturer in that it shipped a "new and different product" to its customers. The auditor allowed a deduction for the cost of transportation for these sales, relying on WAC 458-20-136 and 458-20-112.

The taxpayer contends its activities do not constitute manufacturing. In the alternative, the taxpayer contended the tax is invalid under Armco v. Hardesty, 467 U.S. 638 (1984).

DISCUSSION:

[1] Manufacturing tax--Persons who manufacture products in this state and sell the products out of state are taxable under the Manufacturing classification upon the value of the products sold. 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, fabricating, processing, refining, mixing, slaughtering, packing, curing, aging, canning, etc. . . .

In the present case, we find that the taxpayer's activity falls within the definition of manufacturing. The taxpayer is not merely reselling component parts. Instead, the taxpayer gives the material and hardware it purchases a new form and combination and produces an article for sale. Even the mere combining of items to achieve a special purpose product is manufacturing. See, e.g., ETB 398.04.136 (arranging, assembling, and packaging candies, toys and components into Easter baskets and Christmas gift packages constituted manufacturing). As stated in that bulletin, "the Department is not concerned with mere packaging, but rather with the end result of the taxpayer's efforts." In this case, the taxpayer not only combines items, but it cuts the material, sews it, and assembles the awning.

Our decision is supported by case law from Washington and other jurisdictions. The Washington courts have interpreted manufacturing broadly. See, e.g., McDonnell & McDonnell v. State, 62 Wn.2d 553 (1963) (splitting peas was held to be manufacturing). The court in McDonnell stated the product or substance that is sold must be compared with the substance initially received. In making the comparison, two of the factors considered included changes in function, enhancement in value, differences in demand; changes which may indicate the existence of a "new, different, or useful substance." Id. at 557. The court quoted the following from Bornstein Sea Foods, Inc. v. State, 60 Wn.2d 169 (1962): "In short, we have come to the position now where we are classifying as 'manufacturing' activities which realistically are not manufacturing in the ordinary sense at all." Id.

Several other jurisdictions also have held that one who assembles articles or fabrics that someone else has made is a "manufacturer" within the manufacturers' excise tax statute. See, e.g., Select Imports, Inc. v. Campbell, 196 F.Supp. 181, 182 (D.C. Tex. 1961). In Select Imports, the taxpayer who had purchased and assembled cigarette lighter components was liable for the manufacturer's tax.

In summary, if all the taxpayer did was to purchase material and hardware and resell material and hardware under the original brand names, we would agree that it was not a manufacturer. The taxpayer, however, makes a new product which it sells under its own trade name. Accordingly, we find the activity constitutes manufacturing.

[2] Washington's "multiple activities exemption" provision, RCW 82.04.440, provides that manufacturers who sell their products in Washington pay retailing or wholesaling tax, but are exempt from the manufacturing tax. Only Washington manufacturers selling outside the state, as the taxpayer, pay the manufacturing tax.

The taxpayer relied on Armco Inc. v. Hardesty, 467 U.S. 638 (1984) in which the Supreme Court held that West Virginia's similar manufacturing B&O tax was invalid. After Armco was issued, though, the Washington State legislature enacted a "credit fix" to take effect if Washington's multiple activities exemption was found to discriminate against interstate commerce. In the recent Tyler Pipe-National Can case, ___ U.S. ___ (1987), the Court did find that Washington's multiple activities exemption was unconstitutional. The Court remanded the cases back to the Washington Supreme Court to address the questions of remedies and refunds.

The ruling in National Can did trigger the B&O tax credit enacted in 1985.
Washington manufacturers or extractors can now take a credit against their B&O taxes for any gross receipts taxes paid to another state. The credit can be taken for all sales made on and after June 1, 1987. The taxes paid to the other state must be

taxes on the same products being taxed in Washington State. The taxpayer stated it has paid no gross receipts taxes to any other states; thus it is not entitled to the tax credit available at this time.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of Assessment No. . . . is denied.

DATED this 23rd day of September 1987