

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

In the Matter of the Petition) D E T E R M I N A T I O N
For Refund of)
) No. 89-406
)
 . . .) Registration No. . . .
) . . . /Audit No. . . .
)
)

[1] RULE 136: & RCW 82.04.120 -- MANUFACTURING TAX --
DEFINITION -- REMANUFACTURING ENGINES -- INTERSTATE
DEDUCTION. The activity of remanufacturing used
engine cores into remanufactured engines was found
to constitute manufacturing within the definition of
RCW 82.04.120 and WAC 458-20-136 (Rule 136).
Therefore sales of remanufactured engines sold and
delivered outside the state could not be deducted as
interstate sales.

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 TELEPHONE CONFERENCE: February 16, 1989

NATURE OF ACTION:

The taxpayer protests the disallowance of a requested credit
in a tax audit for sales of remanufactured engines sold and
delivered to out-of-state customers.

FACTS:

Okimoto, A.L.J. -- The books and records of . . . ,
(taxpayer), were examined for the period February 2, 1985
through December 31, 1987. An adjusted audit report resulted

in additional taxes and interest owing in the amount of \$. . . , and Document No. . . . was issued in that amount on April 04, 1989. The tax assessment has been paid in full.

The taxpayer operates an automobile engine remanufacturing plant in . . . , Washington. In the audit report the auditor refused to allow a credit request made by the taxpayer for interstate deductions not taken on remanufactured engines sold and delivered to customers outside the state of Washington. The auditor disallowed the credit request because he considered the remanufacturing of used automobile engines constituted "manufacturing" within the definition of RCW 82.04.120 and as such no interstate deduction was allowable.

The taxpayer describes his activity in his advertising material as follows:

When we receive an engine for rebuild, it is completely disassembled. All components are disposed of except for the block casting, crank, cam, connecting rods, and cylinder heads.

The block casting is washed in a caustic acid jet clean washer at 180 degrees for twenty minutes, removed, buffed with a high speed metal buffer, then fluxed for cracks, put back in the jet clean and washed for another fifteen minutes. At this point the block casting is taken to the boring bar. The boring bar operator mics a set of pistons chosen for this block, bores the block to the exact same size. The block is then put into a computerized cylinder hone. The hone is then programed to give the pistons the proper clearance, normally .002 of an inch. The block is then put in another jet clean and washed for the third time.

The crank is ground to the first undersize it will accept, .010,.020,.030, after being checked for cracks and all oil galleys purged.

The cam is ground to the proper lift and duration, then parkerized for thirty minutes for hardening.

The conrods are resized and new pin bushings installed if applicable. The cylinder heads are disassembled, cleaned, fluxed for cracks, bronze guides installed, springs checked for proper tension, and valve stems checked for wear. If .0015

wear is indicated, the valve is disposed of and chrome stem valves are installed. The valve seats are first ground to a 30 degree, then a 60 degree, and then 45 degree to proper depth. The valves are then refaced.

When a long block is purchased, lifters, rocker arms and push rods are installed. A full set of gaskets and an oil pump are supplied.

The taxpayer testified at the conference that all new components, i.e., pistons, rings, bearings, timing components, oil pumps, gaskets, push rods, and rocker arm assemblies are installed into the remanufactured engine blocks.

When the taxpayer sells a remanufactured engine, he will normally take in exchange an engine core, which is a worn out improperly-functioning engine. The taxpayer offers limited warranties for 12 and 24 month periods on these remanufactured engines.

The taxpayer argues that his activity does not constitute manufacturing, but only extends the utility of an existing product similar to the those described in ETB 213.04.173.

ISSUE:

1. Does the remanufacturing of used engine cores constitute manufacturing within the meaning of WAC 458-20-136?

DISCUSSION:

[1] Under WAC 458-20-193A, persons who manufacture products in this state and sell the same in interstate or foreign commerce are taxable under the classification manufacturing upon the value of the products so sold. RCW 82.04.120 states:

"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. (Emphasis ours.)

In interpreting this statute, we believe that an item is considered "manufactured" if either a new article, a different article, or a useful article of tangible personal property is created through the application of the taxpayer's labor or skill to materials.

Applying this criteria to the taxpayer's business activity of remanufacturing engines, it is clear that the taxpayer's activity turns a non-useful and improperly-functioning engine into a new and useful remanufactured engine.

Nor do we agree with taxpayer's argument that it is merely extending the utility of an existing engine. When the taxpayer receives the engine core, it is an improperly-functioning engine and has little utility at that time. The taxpayer takes that engine core and completely disassembles the core and replaces all components with new ones. Even the parts that the taxpayer retains are substantially altered. The engine block is rebored, the crank is "ground to the first undersize it will accept", the cam is "ground to the proper lift and duration", the connecting rods are "resized and new pin bushings installed if applicable", and the cylinder heads are "disassembled, cleaned, fluxed" Virtually all parts of the remanufactured engine are either brand new or substantially refurbished by the taxpayer. If the taxpayer had purchased new engine cores, the activity would clearly constitute manufacturing and there would be no argument. Why then should the result be different simply because the taxpayer purchases used engine cores? The activity remains the same and so do the tax consequences. In essence we believe the taxpayer is creating a new engine which is manufactured from both new and used parts and that the taxpayer's receipt of engine cores is more analogous to the purchase of additional raw materials than to the repairing of an existing engine.

In addition, the fact that the taxpayer is willing to extend 12 and 24 month warranties on these engines is indicative that these are new and different products.

We further note that this analysis is consistent with the Washington State Supreme Court's decision in Engine Rebuilders, Inc. v. State of Washington, 66 Wn.2d 147, 401 P2d 628, (1965). In that decision, the Court held that the manufacturing tax on rebuilt automobile engines sold and delivered to customers outside the State of Washington was to be computed on the "gross proceeds derived from the sale" including the value of engine cores received. Although there

is no evidence that the particular issue on appeal today was before the Court, we nevertheless believe that by not overruling the imposition of the tax, the Court has at least acquiesced to its validity. . . . Accordingly, we find that the auditor correctly concluded that the manufacturing tax applied to remanufactured engines sold and delivered to customers outside the state of Washington.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 2nd day of August 1989.