

Cite as Det. No. 95-170, 16 WTD 43 (1995)

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 Assessment of	)	
	)	No. 95-170
	)	
. . .	)	Registration No. . . .
	)	Notice of Balance Due
	)	No. BO. . .
	)	

RULE 136; RCW 82.04.120: MANUFACTURING TAX --  
DEFINITION -- PROCESSING FOR HIRE -- SIGNIFICANT  
CHANGE -- SORTING & COMPACTING SHEET METAL. The  
activity of sorting and compacting loose sheet metal  
into cubes for others is processing for hire if the  
sorting and compacting results in a "significant  
change" in the product.

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:

A taxpayer, who sorts and compacts loose scrap sheet metal into  
cubes for its owner at landfills and scrap metal yards, seeks to  
be classified as a processor for hire.<sup>1</sup>

FACTS

Okimoto, A.L.J. -- Taxpayer sorts and compacts loose sheet metal  
at automobile wrecking yards, landfills, and waste energy plants  
located throughout the state of Washington. Taxpayer had been  
reporting its receipts under the service and other activities  
business and occupation (B&O) tax classification, but now

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been  
redacted pursuant to RCW 82.32.410.

believes that it should be reporting under the lower processing for hire tax classification.

Taxpayer explained during the teleconference that it has a contract with a major scrap-metal buyer (Buyer) to sort and compact loose sheet metal into 2x2x3 foot cubes at wrecking yards and landfills. The yards receive scrap metal from their suppliers and sort it into large piles of steel items, i.e., cars and appliances, and tin, i.e., sheet metal and other small steel items. Buyer purchases these scrap sheet metal piles from the wrecking yards and landfills and hires Taxpayer to convert these large piles into compacted rectangular cubes of scrap sheet metal. The compacting of sheet metal into cubes creates a much more desirable product for recyclers in addition to making it more economical to transport.

Taxpayer primarily performs its sorting and compacting service by using a mobile crane equipped with a claw and compactor. First, Taxpayer's operator removes non-metallic items and also separates the large items into a separate pile. Next, the operator picks up a clawful of the loose sheet metal and places it into the compacting chamber contained on the mobile crane. After several clawfuls have been loaded, the top of the chamber is closed and a large rod is rammed from one end of the chamber to the other. This compacts the loose sheet metal into rough 2x2x3 foot cubes.

Taxpayer argues that this activity constitutes the manufacturing of a new, different or useful substance under RCW 82.04.120 and WAC 458-20-136 and that this activity should be taxed under the processing for hire tax classification and not the service and other activities tax classification.

Taxpayer emphasizes that steel mills that recycle the metal can't economically utilize the loose sheet metal in its non-compacted form because it does not have sufficient density. Taxpayer explains that the metal reclamation process involves heating the scrap metal in large melting pots. If only loose sheet metal is put into the pots approximately 75% of the metal would be burned up by the process. However, if compacted sheet metal cubes are used, the metal melts instead of burning and the loss is reduced to 5%. Taxpayer explains that a higher combustion temperature is created by the increased density. Taxpayer states that the same principle explains why newspapers burn so much more quickly than newspaper logs.

Taxpayer further notes that the value of the metal is also significantly enhanced. Taxpayer states that yard owners purchase scrap metal at the yards for \$15-24 per ton whereas the delivered market price for compacted sheet metal cubes is approximately \$113 per ton.

## ISSUE

Does sorting and compacting loose sheet metal into 2x2x3 foot cubes for an owner constitute a processing for hire business activity?

## DISCUSSION:

The term "processing for hire" is defined by WAC 458-20-136 (Rule 136). It states in pertinent part:

(5) The term "processing for hire" means the performance of labor and mechanical services upon materials belonging to others so that as a result a new, different or useful article of tangible personal property is produced for sale or commercial or industrial use. Thus, a processor for hire is any person who would be a manufacturer if that person were performing the labor and mechanical services upon that person's own materials.

Since Taxpayer performs its labor and mechanical services on scrap metal purchased from the yard owners and landfill owners by Buyer, Taxpayer's sorting and compacting activity satisfies that portion of the definition, i.e., performing labor and mechanical services upon materials belonging to others. Therefore, in order for us to decide whether Taxpayer should be taxed as a processor for hire, we must next determine whether Taxpayer's activity results in a new, different or useful article of tangible personal property for sale or commercial or industrial use. This latter requirement constitutes the definition of "To manufacture."

The broad statutory definition of "To manufacture" is contained in RCW 82.04.120.

"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 . . . .

This definition is further clarified in Rule 136:

[Manufacturing] 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.

(Brackets ours). In Bornstein Sea Foods, Inc. v. State, 60 Wn.2d 169, 175, 373 P.2d 483 (1962), the Washington State Supreme 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, 383 P.2d 905 (1963), the court set forth specific elements to be considered in comparing the product before and after a 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."

The issue then becomes whether sorting and compacting loose scrap sheet metal into 2x2x3 foot cubes results in a "significant change" when the metal cubes are compared with the loose unsorted sheet metal used to form them.

Applying the test in McDonnell, we first note that there is a substantial change in form from the large pile of unsorted scrap sheet metal to the 2x2x3 foot compacted metal cubes. The quality of the metal also changes, since it has now been sorted and many large impurities have been removed. Furthermore, Taxpayer testified that there has been a significant change in the physical properties of the metal. In its compacted form the metal cubes are much easier to handle, store, and transport than in the loose and unsorted piles. More importantly, however, the metal scraps can now be melted down into molten steel without burning up. The compacting process has significantly changed the combustion point of the product. Indeed, these additional properties not only enhance the value of the scrap sheet metal to the steel recyclers but also greatly increase the product's overall market value. Based on the above factors, we believe that the sorting and compacting of loose scrap sheet metal into 2x2x3 foot cubes does constitute a "significant change" resulting in a new, different or useful substance within the meaning of RCW

82.04.1202. Therefore, we find that Taxpayer should report its income from sorting and compacting loose scrap sheet metal under the processing for hire business and occupation tax classification. Taxpayer's petition is granted.

DECISION AND DISPOSITION:

Taxpayer's petition is granted. Taxpayer's file shall be remanded to the Taxpayer Accounts and Administration Division for the proper adjustments consistent with this determination.

DATED this 30th day of August, 1995.

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<sup>2</sup> We note that Taxpayer's case is distinguishable from Det. No. 94-255, 14 WTD 92, (1994). That case held that the recompressing of existing hay bales into smaller bales solely for the purposes of reducing transportation costs did not constitute a manufacturing activity. In contrast to Taxpayer's compacting activity, that case involved neither a change in the physical properties of the hay bales nor any significant change in value or demand.