

Cite as 5 WTD 307 (1988)

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

In the Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u>
<u>N</u>	
For Correction of Assessments of)	
)	No. 88-180
)	
)	Registration No. . . .
. . .)	Tax Assessment No. . .
.	
)	
)	
and)	
)	
. . .)	Registration No. . . .
)	Tax Assessment No. . .
.	

[1] **RULE 136 AND RULE 143:** B&O TAX -- PUBLISHING --
PACKAGING -- MANUFACTURING DISTINGUISHED. A
publisher and seller of educational materials does
not become a manufacturer simply by packaging some
items together as part of a series. To constitute
manufacturing, the combining of the items must
produce a new, different, or useful substance or
article of tangible personal property.

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 28, 1987

NATURE OF ACTION:

The taxpayer protests the assessment of manufacturing tax on its out-of-state sales, contending its activities constitute publishing and/or re-selling, not manufacturing.

FACTS AND ISSUES:

Frankel, A.L.J. -- . . . Associates was established in 1972 as a limited partnership. . . . Corporation, which had been formed in 1970, was the general partner. The partnership registered with the Department in 1972, describing its principal product or services rendered as "learning systems."

The taxpayer designs materials for special education students. It has sales representatives and distributes its catalogs all over the United States. Most of its business comes in through the mail on school purchase orders. The taxpayer has the materials printed by others and then packages them for shipping to its customers. The taxpayer has reported its income as either wholesaling or retailing and deducted its income from interstate sales. An examination of its records in 1975 upheld its reporting method and the deductions for the interstate sales.¹

Effective July 1, 1982, the Associates combined with the corporation and became one entity under the corporation name. In the audit at issue, the Department examined the taxpayer's records for the period January 1, 1982 through June 30, 1986. Two assessments were issued on November 18, 1986. One assessment is against the Associates for the first half of 1982 for \$. . . (. . .). The second assessment is against the corporation for \$. . . (. . .). (The Associates and the Corporation will be referred to as the taxpayer.)

At issue is the assessment of Manufacturing tax on a portion of the taxpayer's out-of-state sales. The auditor assessed tax upon income from "proprietary" merchandise which the taxpayer had reported as retail or wholesale and then deducted as interstate sales. Proprietary items are those packages of educational materials for special education students which the taxpayer assembles. The learning packages consist of printed materials, computer diskettes, and a variety of materials which the taxpayer purchases from others and then packages for

¹ That audit report found the interstate deductions were proper-- that the taxpayer sold a finished product made by others. The taxpayer stated the reading program it sold then is similar to the one it presently sells.

shipment to its customers. The auditor determined the taxpayer's activity of combining items into special packages constituted manufacturing.

The auditor accepted the taxpayer's reporting of sales of items which are manufactured by another and sold without alteration. ("non-proprietary items").

DISCUSSION:

WAC 458-20-143 states that "persons, other than publishers of newspapers, magazines or periodicals, who publish such things and do not print the same, are taxable under either the wholesaling or retailing classifications." The taxpayer contends its taxability as a wholesaler or retailer is not altered by the fact that it packages the materials for shipping and/or sells goods produced by more than one manufacturer in combinations.

The auditor relied on WAC 458-20-136 (Rule 136) and several ETBs: 398.04.136, 466.04.136, 467.04.136 and 469.04.136. Rule 136 contains the 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.

In the ETBs, the Department applied the broad definition of manufacturing to find the following activities constituted manufacturing:

- (1) Combining candies, toys, and other components into Easter baskets and Christmas gifts (ETB 398);
- (2) assembling products from component parts which were manufactured outside the state (ETB 467);

(3) rerolling paper rolls, cutting paper to specific lengths, embossing and folding paper (ETB 469); and

(4) assembling fruit bins (ETB 466).

The definition of manufacturing is significantly broader and includes a wider range of activities than the common usage of the term manufacture might indicate.

The taxpayer agrees that under the broad definition of manufacturing in RCW 82.04.120, it is a manufacturer as to the products that include software disks. Until the middle of 1985, it stated the software was produced by a company in Denver. The taxpayer stated it now has the equipment to copy the disks and agrees that this activity constitutes manufacturing. The taxpayer is liable for manufacturing B&O tax on the products that contain disks it has copied. As the auditor noted, WAC 458-20-112 provides that the taxpayer may deduct the transportation costs on its sales to points outside the state.

The taxpayer contends that it is not a manufacturer on the items it merely packages and ships to its out-of-state customers. The majority of its sales are distributed products from other publishers. In some cases, the taxpayer applies a protective wrapping ("shrink wrap") to the products. We agree that this packing activity does not constitute manufacturing. We also agree that it is not a manufacturer as to the hardware items that it merely resells to use with its reading programs. (. . .).

The taxpayer also combines some items into special packages. Some of the packages are a series of books which may be purchased separately or as a complete set. In some cases the series contains a teacher's guide and various student materials. We do not find the taxpayer's activity of selling these items together constitutes manufacturing. A publisher does not become a manufacturer simply because it publishes some books in a series or publishes teaching guides, worksheets, or other materials which can be used together. This is not combining materials to produce a "new, different or useful substance or article of tangible personal property." Instead, the materials retain their original intended character and are merely resold by the taxpayer.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. The audit will be adjusted to delete the manufacturing tax on all items that are merely resold or packaged and/or combined by the taxpayer for sale. The tax is upheld on out-of-state sales of products that include disks that the taxpayer has copied (less transportation costs).

DATED this 6th day of April 1988.