Cite as 6 WTD 371 (1988)

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. 88-354
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
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[1] **RULE 136, RCW 82.04.120**: B&O TAX -- MANUFACTURING -- SILK SCREEN PRINTING -- SHIRTS -- NEW, DIFFERENT OR USEFUL. Where taxpayer buys blank shirts and uses a silk screen process to imprint stripes, patterns, or designs on the shirts which are then sold in interstate commerce, the taxpayer's industrial activity produced a new, different or useful product which is subject to Manufacturing B&O tax.

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: . . .

NATURE OF ACTION:

Petition protesting assessment of use tax on capital assets purchased without payment of sales tax and assessment of Manufacturing B&O tax on the activity of silk screen printing of shirts.

FACTS AND ISSUES:

Krebs, A.L.J. -- . . . (taxpayer #1) has its principal place of business in . . . , Washington. Taxpayer #1 is the successor in interest to . . . (taxpayer #2). Taxpayer #2 was a successor in interest to . . .

(taxpayer #3). The three entities will be referred to collectively as "taxpayers" except when required to refer to them individually.

The Department of Revenue (Department) examined the business records of taxpayer #1 for the period from July 1, 1986 through December 31, 1986. As a result of this audit, the Department issued Document No. . . . on March 5, 1987 asserting excise tax liability in the amount of $ . . . and interest due in the amount of $ . . . for a total sum of $ . . . . The taxpayer made a payment of $ . . . on April 15, 1987 and the balance remains due.

The Department examined the business records of taxpayer #2 for the period from August 1, 1983 through June 30, 1986. As a result of this audit, the Department issued Document No. . . . on February 19, 1987 asserting excise tax liability in the amount of $ . . . and interest due in the amount of $ . . . for a total sum of $ . . . . The taxpayer made a payment of $ . . . on April 15, 1987 and the balance remains due.

The Department examined the business records of taxpayer #3 for the period from February 1, 1983 through July 31, 1983. As a result of this audit, the Department issued Document No. . . . on February 24, 1987 asserting excise tax liability in the amount of $ . . . and interest due in the amount of $ . . . for a total sum of $ . . . . The taxpayer made a payment of $ . . . on April 15, 1987 and the balance remains due.

The taxpayers are or have been engaged in the business of imprinting designs and pictures on shirts, jackets, sox and other wearing apparel, and on mats by using a silk screen process.

The taxpayer's exceptions are the same for all three entities (taxpayers), and relate to the assessment of use tax and Manufacturing business and occupation (B&O) tax.

USE TAX The auditor assessed use tax (deferred sales tax) on taxpayers' purchase/acquisition of consumable supplies and capital assets without payment of sales/use tax. The taxpayers protest the assessment of use tax (deferred sales tax) only with respect to the purchase/acquisition of capital assets. The taxpayers assert that the auditor did an incomplete audit by not compiling adequate documentation to correctly assess the use tax. The taxpayers request that the field auditor return to the taxpayers' place of business to fully and completely review all documentation relating to the use tax category.

The issue is whether the use tax as assessed is proper or whether the assessed use tax should be withdrawn until such time as the auditor fully and completely reviews all documentation.

MANUFACTURING B&O TAX The auditor disallowed the taxpayers' deductions taken for interstate wholesale sales and subjected the amounts to Manufacturing B&O tax.

The taxpayers bought finished goods, usually different kinds of shirts, and, using a silk screen process, imprinted patterns or designs on the blank shirts. The taxpayers assert that the imprinting activity is not manufacturing because no "significant change has been accomplished when the end product is compared to the article before it was subject to the process." Bornstein Sea Foods, Inc. v. State, 61 Wn.2d 169 (1962) at page 175. The Bornstein case cited a number of cases where the activity was held to be manufacturing when the taxpayers started with the same product with which

they ended, but the taxpayers contend those cases turned upon the point that the taxpayer was making the product more usable.

The taxpayers assert that they have not made the shirt "more usable"; the shirt was usable and consumable at the beginning of the process in much the same fashion that it was usable and consumable at the end of the process. The taxpayers assert that in fact the imprinted shirt is less usable and less consumable "because the market for the shirt is dramatically reduced in scope when an imprint is added."

The taxpayers assert that they begin with a useful and saleable consumer item (a shirt) and alter it with an imprint. The alteration may add some value, but it is minor in comparison to the value of the entire shirt.

The taxpayers assert they start with shirts and end with shirts, and that there is no significant difference in the use or usability of shirts being worn blank or with an imprint.

The taxpayers point to ETB 213.04.173 as stating that the activity involved in the cutting of epitaphs on tombstones did not constitute manufacturing but that the making of keys from blanks did constitute manufacturing. The taxpayers asserts that the imprinting of shirts more clearly resembles the act of altering a useful item and the cutting of epitaphs on a tombstone than any other process reviewed by the Department, or for that matter, by the courts.

For all of the above reasons, the taxpayers contend that the assessment of Manufacturing B&O tax on their activity of the printing of shirts is improper.

DISCUSSION:

The issues will be discussed in the order presented.

USE TAX The taxpayers request that the field auditor return to the taxpayers' place of business to fully and completely review all documentation pertaining to purchase/acquisition of capital assets for the purpose of correct assessment of use tax.

RCW 82.32.070 in pertinent part provides:

> Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue. . . . Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

With respect to the use tax in question, the audit report states:

> Schedule VII Purchases of Capitalized Assets or Nonrecurring Type Purchases
> This schedule asserts deferred sales or use tax on capital assets and/or other acquisitions which were not made on a routine or recurring basis. The tax is assessed since Sales or Use Tax was not documented as having been paid on these acquisitions.
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> This audit has been discussed with . . . , C.P.A., Vice President Finance, and he does not indicate any disagreement with the dollar adjustments based on the documents made available at this time . . . (Emphasis supplied.)

Accordingly, it appears to us that at the time the audit was performed the taxpayers were unable to document payment of sales/use tax on the acquisition of capital assets. Furthermore, the taxpayers did not indicate disagreement with the adjustments (assessment of tax resulted) "based on the documents made available at the time." The taxpayers simply did not have the required documents, that is, the suitable records as may be necessary to determine tax liability and are barred from questioning the correctness of the assessment. RCW 82.32.070. We conclude that the use tax as assessed was proper.

This does not mean that the taxpayers do not have a remedy. Schedule VII of the audit of the three taxpayers itemizes the capital assets subjected to use tax and the vendors. The taxpayer need only assemble the documentation to establish payment of sales tax to the vendors, and present them to the auditor. If done before the due date established by this Determination for payment of the assessments, adjustment can be made. If presented after the due date, it will be treated as an application for refund. No matter how the taxpayers proceed, there will be no withdrawal of the use tax assessment at this time merely for a "second bite at the apple" by the taxpayer.

MANUFACTURING B&O TAX The issue here is whether the taxpayers' silk screen printing of shirts is a manufacturing activity and therefore subject to the Manufacturing B&O tax measured by amounts received from interstate wholesale sales of the printed shirts.

The taxpayers contend that its silk screen printing of shirts did not result in the making of a new or different article, did not give the shirt a new use nor make it more usable, did not significantly change the form, quality or properties of the shirt, and did not add significant value to the shirt. Accordingly, the taxpayers contend they were not engaged in manufacturing.

RCW 82.04.140 provides the following definition:

> "Business" includes all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.

RCW 82.04.220 imposes the business and occupation tax:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

RCW 82.04.240 imposes the business and occupation tax (RCW 82.04.220) upon manufacturers and in pertinent part provides:

> The measure of the tax is the value of the products, including byproducts, so manufactured regardless of the place of sale or the fact that deliveries may be made to points outside the state. (Emphasis supplied.)

"Manufacturer" is defined by RCW 82.04.110 as meaning:

> . . . every person who, either directly or by contracting with others for the necessary labor or mechanical services, manufactures for sale or for commercial or industrial use from his own materials or ingredients any articles, substances or commodities. . . .

[1] And the term "to manufacture" under RCW 82.04.120 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 supplied.)

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), ... It is the local business activity of manufacturing which is subject to the Manufacturing B&O tax.

In the present case, we find that the taxpayers' industrial activity in the silk screen printing of shirts falls within the definition of manufacturing. RCW 82.04.120 and Rule 136. The taxpayers did not solely resell purchased shirts but purchased blank shirts which they processed by labor, skill and machinery so as to produce a new, different and useful product. The taxpayers' industrial activity has not only enhanced the value of the product but has increased the salability of the shirt to persons seeking to wear the latest fashionable shirt with printed stripes, patterns, or designs. Furthermore, the taxpayers' activity is within the statutory definition of "to manufacture" because it is "the production or fabrication of special made . . . articles." RCW 82.04.120.

In the Washington Supreme Court case, McDonnell & McDonnell v. State of Washington, 62 Wn.2d 553 (1963), the court held that splitting peas was manufacturing even though the split peas and whole pea remain basically and nutritionally the same product inasmuch as some people prefer split peas to whole peas. In the McDonnell case, the court made the following statement which, in our opinion, is equally applicable to the taxpayers' activity as indicated by the bracketed words supplied by us:

> There are differences in the demand for the respective products-- whole peas v. split peas [blank shirts versus printed shirts]--the demand dependent in part upon the personal preferences of the ultimate consumers. Without such a difference in demand, there would be no practical reason to engage in the operation of splitting peas [of printing shirts].

> The argument, in effect, that "pigs is pigs," or that peas are peas [or that shirts are shirts]--whether whole [blank] as at the inception or split [printed] as at the conclusion of the pea-splitting [printing] process--and, therefore, the processing should not be considered as manufacturing, was made and rejected in Bornstein, supra [Bornstein Sea Foods, Inc. v. State, 60 Wn.2d 169 (1962)]. There the change was from fish to fish fillet. In fact, in the Bornstein case (page 176) the court, referring to another case in which a manufacturer's tax was imposed, stated that ". . . the taxpayer performed a process on peas [shirts] . . . and, after the process, he still had peas [shirts]."
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> . . . as we stated in Bornstein, the end product--that is, the product or substance as it is released or sold by the one performing the process--must be compared with the substance initially received by that processor. In making the comparison, consideration should be given to the following factors: among others, changes 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." (Bracketed words and emphasis supplied.)

The taxpayer has compared its printing done on shirts as similar to the cutting of epitaphs on tombstones as discussed in ETB 213.04.173 where it states:

> Thus, the cutting of epitaphs on tombstones did not in itself constitute a manufacturing activity within the meaning of RCW 82.04.110 and RCW 82.04.120 and subsequent out-of-state sales were susceptible of an interstate exemption.

An epitaph is an inscription on a tombstone or monument in memory of the one or ones buried there and briefly in words summarizes or epitomizes a deceased person. Persons engaged in cutting epitaphs are engaged in the business activity of selling the service of "altering" tangible personal property for consumers which activity is statutorily defined in RCW 82.04.050 to be a retail sale, not manufacturing. The taxpayers' activity of printing shirts more closely resembles the staining of lumber and shingles which the Department holds to be manufacturing; see ETB 172.04.136 . . . . Other activities similar to the taxpayers' activity of printing shirts which the Department has held to be manufacturing include embossing of toilet paper, heat pressuring of decorative decals on range covers and the printing of business forms. In all of these cases, a "new, different or useful" article was produced without actually changing the basic article, that is, the lumber and shingles, the toilet paper, the range covers, and the paper used for the printing of business forms. In all of these cases, the basic article was suitable for consumers just as the unprinted shirt is suitable for consumers. Nevertheless, it was found that labor or skill was applied to produce "new, different or useful" articles for sale subject to the Manufacturing business tax. More precisely, the Department has held that the business activity of printing slogans and designs on blank T-shirts by a silk screen process falls within the statutory definition of "to manufacture" as given in RCW 82.04.120.

The definition of the term "to manufacture" in RCW 82.04.120 speaks of "new, different or useful" in the alternative, not in the conjunctive. The "result" does not have to be "new, different and useful." When comparing a blank shirt with the resulting imprinted shirt that succeeds it, the

imprinted shirt may not be characterized as "new," but surely it is a "different" shirt. However, in the world of fashion and style, a shirt imprinted with a flowery or striped pattern would be perceived as "new" as connoted by its synonyms and related words: modern, neoteric, just out, up-to-date, up to the minute, etc.

As to the taxpayers' contention that the printed shirts did not acquire "new use" or "more usable" features, again we must resort to the world of fashion and style where preferences are such that the consumer finds the imprinted shirt the "thing to wear" where a blank shirt wouldn't do. In other words, the consumer finds a "new use" for the printed shirt or finds it "more usable." Oscar Wilde is reputed to have said, "Fashion is so ugly that it has to be changed every six months." The taxpayers' silk screen process takes blank shirts and makes them new, different and useful to the consumer who generally buys according to the dictates of fashion.

For all of the above reasons and the applicable case and statutory law, we conclude that the taxpayers' business activity of printing shirts falls within the statutory definition of "to manufacture" and that the Manufacturing B&O tax was properly assessed.

DECISION AND DISPOSITION:

With respect to the Use Tax, the taxpayers' petition is denied. However, upon presentation of substantiating documentation by the taxpayers to the auditor that sales tax had been paid, adjustment of the assessment or refund will be made.

With respect to the Manufacturing B&O tax, the taxpayers' petition is denied.

DATED this 29th day of August 1988.