

Clerk File No. 309770

The City of Seattle – Legislative Department

Clerk File sponsored by: _____

Clerk File No. 309770

Department of Executive Administration Rule No. 5-111, implementing Seattle Business Tax Ordinance relating to manufacturing and processing for hire.

Related Legislation File: _____

Date Introduced and Referred:	To: (committee):
Date Re-referred:	To: (committee):
Date Re-referred:	To: (committee):
Date of Final Action:	Disposition: Filed

1/23/09

Date Filed with City Clerk

Emilia M. Sanchez

By

Committee Action:

Date	Recommendation	Vote

This file is complete and ready for presentation to Full Council. _____

Full Council Action:

Date	Decision	Vote

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-111

Seattle Rule 5-111 **Manufacturing and processing for hire.**

- (1) **Introduction.** This rule explains the application of the business license tax to manufacturers and processors for hire.
- (2) **Manufacturing activities.** 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.
- (a) "To manufacture" includes, but is not limited to:
- (i) The production of special-made articles or custom-made articles;
 - (ii) The production or fabrication of dental appliances, devices, restorations, substitutes, or other dental laboratory products by a dental laboratory or dental technician;
 - (iii) The crushing and/or blending of rock, sand, stone, gravel, or ore;
 - (iv) The producing of articles for sale, or for commercial or industrial use from raw materials or prepared materials by giving such materials, articles, and substances of trade or commerce new forms, qualities, properties or combinations including, but not limited to, such activities as making, fabricating, processing, refining, mixing, slaughtering, packing, aging, curing, preserving, canning, and the preparing and freezing of fresh fruits and vegetables; and
 - (v) The cleaning (removal of the head, fins, or viscera) of fish.
- (b) "To manufacture" does not include:
- (i) Activities which consist of cutting, grading, or ice glazing of seafood which has been cooked, frozen, or canned outside the city;
 - (ii) The mere cleaning and freezing of whole fish;
 - (iii) The conditioning of seed for use in planting;
 - (iv) The growing, harvesting, or producing of agricultural products;
 - (v) The packing of agricultural products, including sorting, washing, rinsing, grading, waxing, treating with fungicide, packaging, chilling, or placing in controlled atmospheric storage;
 - (vi) The repairing and reconditioning of tangible personal property for others; and
 - (vii) The production of prewritten computer software if the prewritten computer software is delivered from the seller to the purchaser by means other than tangible storage media, including the delivery by tangible storage media where the tangible storage media is not physically transferred to the purchaser.
- (c) Manufacturing can include the combining and/or assembly of products to achieve a special purpose as manufacturing. The physical assembly of products from various

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-111

components is manufacturing because it results in a "new, different, or useful" product, even if the cost of the assembly activity is minimal when compared with the cost of the components. For example, the bolting of a motor to a pump, whether bolted directly or by using a coupling, is a manufacturing activity. Once physically joined, the resulting product is capable of performing a pumping function that the separate components cannot.

- (i) In some cases the assembly may consist solely of combining parts from various suppliers to create an entirely different product that is sold as a kit for assembly by the purchaser. In these situations, the manufacturing B&O tax applies even if the person combining the parts does not completely assemble the components, but sells them as a package. For example, a person who purchases component parts from various suppliers to create a wheelbarrow, which will be sold in a "kit" or "knock-down" condition with some assembly required by purchaser, is a manufacturer. The purchaser of the wheelbarrow kit is not a manufacturer, however, even though the purchaser must attach the handles and wheel.
- (ii) The department considers various factors in determining if a person combining various items into a single package is engaged in a manufacturing activity. Any single one of the following factors is not considered conclusive evidence of a manufacturing activity, though the presence of one or more of these factors raises a presumption that a manufacturing activity is being performed:
 - (A) The ingredients are purchased from various suppliers;
 - (B) The person combining the ingredients attaches his or her own label to the resulting product;
 - (C) The ingredients are purchased in bulk and broken down to smaller sizes;
 - (D) The combined product is marketed at a substantially different value from the selling price of the individual components; and
 - (E) The person combining the items does not sell the individual items except within the package.
- (iii) The following examples should be used only as a general guide. The specific facts and circumstances of each situation must be carefully examined to determine if the combining of ingredients is a manufacturing activity or merely a packaging or marketing activity. In cases of uncertainty, persons combining items into special purpose packages should contact the Director for a ruling.
 - (A) Combining prepackaged food products and gift items into a wicker basket for sale as a gift basket is not a manufacturing activity when:
 - 1. The products combined in the basket retain their original packaging;
 - 2. The person does not attach his or her own labels to the components or the combined basket;

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-111

3. The person maintains an inventory for sale of the individual components and does sell these items in this manner as well as the combined baskets.
- (B) Combining bulk food products and gift items into a wicker basket for sale as a gift basket is a manufacturing activity when:
1. The bulk food products purchased by the taxpayer are broken into smaller quantities; and
 2. The taxpayer attaches its own labels to the combined basket.
- (C) Combining components into a kit for sale is not a manufacturing activity when:
1. All components are conceived, designed, and specifically manufactured by and at the person's direction to be used with each other;
 2. The person's label is attached to or imprinted upon the components by supplier;
 3. The person packages the components with no further assembly, connection, reconfiguration, change, or processing.
- (3) Processing for Hire.** "Processor for hire" means a person who performs labor and mechanical services upon property 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 his or her own materials.
- (a) In some instances, a person furnishing the labor and mechanical services undertakes to produce an article, substance, or commodity from materials or ingredients furnished in part by the person and in part by the customer. Depending on the circumstances, this person will either be considered a manufacturer or a processor for hire.
- (i) If the person furnishing the labor and mechanical services furnishes materials constituting less than twenty (20%) percent of the value of all of the materials or ingredients which become a part of the produced product; that person will be presumed to be processing for hire.
 - (ii) The person furnishing the labor and mechanical services will be presumed to be a manufacturer if the value of the materials or ingredients furnished by the person is equal to or greater than twenty (20%) percent of the total value of all materials or ingredients which become a part of the produced product.
 - (iii) If the person furnishing the labor and mechanical services supplies, sells, or furnishes to the customer, before processing, twenty (20%) percent or more in value of the materials or ingredients from which the product is produced, the person furnishing the labor and mechanical services will be deemed to be the owner of the materials and considered a manufacturer.

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-111

- (b) There are occasions where a manufacturing facility and ingredients used in the manufacturing process are owned by one person, while another person performs the actual manufacturing activity. The person operating the facility and performing the manufacturing activity is a processor for hire. The owner of the facility and ingredients is the manufacturer.

- (4) **Tax-reporting responsibilities for income received by manufacturers and processors for hire.** Persons manufacturing products in Seattle are subject to the manufacturing business license tax upon the value of the products, including by-products (see also Seattle Rule 5-044 regarding "value of products").

For example, Corporation A stains door panels that it purchases. Corporation A also affixes hinges, guide wheels, and pivots to unstained door panels. Corporation B shears steel sheets to dimension, and slits steel coils to customer's requirements. The resulting products are sold and delivered to out-of-state customers. Corporation A and Corporation B are subject to the manufacturing business license tax upon the value of these manufactured products. These manufacturing activities take place in Seattle, even though the manufactured product is delivered out-of-state.

- (a) Manufacturers who sell their products at retail or wholesale within the city are also subject to either the retailing or wholesaling business license tax, as the case may be. In such cases, the manufacturer must report under both the "production" (manufacturing) and "selling" (wholesaling or retailing) classifications of the business license tax, and claim a multiple activities tax credit (MATC) against the selling classification tax. See SMC 5.45.070 for a more detailed explanation of the MATC reporting requirements.

For example, Incorporated purchases raw fish that it fillets and/or steaks. The resulting product is then sold at wholesale in its raw form to customers located in Seattle. Incorporated is subject to both the manufacturing business license tax upon the value of the manufactured product, and the wholesaling business license tax upon the gross proceeds of sale. Incorporated is entitled to claim a MATC.

- (b) Processors for hire are subject to the processing for hire business license tax upon the total charge made to those services, including any charge for materials furnished by the processor. The business license tax applies whether the resulting product is delivered to the customer within or outside Seattle.
- (c) The measure of tax for manufacturers and processors for hire with respect to "cost-plus" or "time and material" contracts includes the amount of profit or fee above cost received, plus the reimbursements or prepayments received on account of materials and supplies, labor costs, taxes paid, payments made to subcontractors, and all other costs and expenses incurred by the manufacturer or processor for hire.

- (5) **Manufacturing—State special tax rates/classifications.** The State of Washington in RCW 82.04.260 provides several special B&O tax rates/classifications for manufacturers engaging in certain manufacturing activities. Except for the activity of manufacturing wheat into flour, the city has not adopted these special classifications, so persons performing the activities included in RCW 82.04.260 are subject to the City's manufacturing business license tax.

- (6) **Repairing and/or refurbishing distinguished from manufacturing.** The term "to manufacture" does not include the repair or refurbishing of tangible personal property. To be considered "manufacturing," the application of labor or skill to materials must result in a "new, different, or useful article." If the activity merely restores an existing article of tangible personal property to its

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-111

original utility, the activity is considered a repair or refurbishing of that property. (See Seattle Rule 5-275 for tax-reporting information on repairs.)

- (a) In making a determination whether an activity is manufacturing as opposed to a repair or reconditioning activity, consideration is given to a variety of factors including, but not limited to:
 - (i) Whether the activity merely restores or prolongs the useful life of the article;
 - (ii) Whether the activity significantly enhances the article's basic qualities, properties, or functional nature; and
 - (iii) Whether the activity is so extensive that a new, different, or useful article results.
- (b) The following example illustrates the distinction between a manufacturing activity resulting in a new, different, or useful article, and the mere repair or refurbishment of an existing article. This example should only be used as a general guide. The tax results of other situations must be determined after a review of all the facts and circumstances. In cases of uncertainty, persons should contact the Director for a ruling.

Corporation rebuilds engine cores. When received, each core is assigned an individual identification number and disassembled. The cylinder head, connecting rods, crankshaft, valves, springs, nuts, and bolts are all removed and retained for reassembly into the same engine core. Unusable components are discarded. The block is then baked to burn off dirt and impurities, then blasted to remove any residue. The cylinder walls are rebored because of wear and tear. The retained components are cleaned, and if needed straightened and/or reground. Corporation then reassembles the cores, replacing the pistons, gaskets, timing gears, crankshaft bearings, and oil pumps with new parts. The components retained from the original engine core are incorporated only into that same core. Corporation is under these circumstances not engaging in a manufacturing activity. The engine cores are restored to their original condition, albeit with a slightly larger displacement because of wear and tear. The cores have retained their original functional nature as they run with approximately the same efficiency and horsepower. The rebuilding of these cores is not so extensive as to result in a new, different, or useful article. Each engine core has retained its identity because all reusable components of the original core are reassembled in the same core. Corporation has taken an existing article and extended its useful life.

- (7) Persons manufacturing tangible personal property for commercial or industrial use are subject to the manufacturing business license tax upon the value of the property manufactured, unless a specific exemption applies. (See also Seattle Rule 5-112 on commercial or industrial use.) Persons who also extract the product used as an ingredient in a manufacturing process should refer to Seattle Rule 5-100 for additional information regarding their tax-reporting responsibilities.
- (8) A non-Seattle business who is the owner of materials processed for it in Seattle by a processor for hire is deemed to be a manufacturer in this city because of that processing.
- (9) For persons manufacturing computer hardware and software please refer to Seattle Rules 5-500 and 5-501.

Effective: January, 2009

THE CITY OF SEATTLE
DIRECTOR'S RULE
IMPLEMENTING SEATTLE BUSINESS TAX ORDINANCE
RULE 5-111

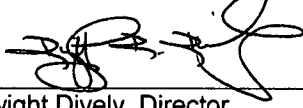
DIRECTOR'S CERTIFICATION

I, Dwight Dively, Finance Director of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Executive Administration.

DATED this 20th day of January, 2009

CITY OF SEATTLE,
a Washington municipality

By:



Dwight Dively, Director
Finance Department