

Rulings of the Tax Commissioner

Document Number: 13-224
Tax Type: BPOL Tax
Brief Description: Taxpayer was a manufacturer exempt from the BPOL tax
Topics: Classification; Local Taxes Discussion; Manufacturing Exemption; Taxpayers' Remedies
Date Issued: 12/13/2013

December 13, 2013

Re: Appeal of Final Local Determination

Taxpayer: *****

Locality: *****

Business, Professional and Occupational License (BPOL) Tax

Dear *****:

This final state determination is issued upon the application for correction filed by ***** (the "Taxpayer"), with the Department of Taxation. You appeal a final local determination denying the refund of BPOL tax paid for the 2010 through 2012 tax years to the ***** (the "County").

The local license tax and fee are imposed and administered by local officials. *Virginia Code* § 58.1-3703.1 A 5 authorizes the Department to issue determinations on taxpayer appeals of certain BPOL tax assessments. On appeal, a BPOL tax assessment is deemed *prima facie* correct, *i.e.*, the local assessment will stand unless the taxpayer proves that it is incorrect.

The following determination is based on the facts presented to the Department summarized below. The *Code of Virginia* sections, regulation, and public documents cited are available on-line at www.tax.virginia.gov in the Laws, Rules, and Decisions section of the Department's web site.

FACTS

The Taxpayer produces custom electronic devices for use by the military at its facility located in the County. Components for the devices were either purchased from unrelated manufacturers or produced in the facility. The components were then assembled into the finished product, which were then sold to the federal government.

For BPOL tax purposes, the Taxpayer was classified as a wholesale merchant. The

Taxpayer filed a request for a refund of BPOL tax paid for the tax years at issue, contending it should have been classified as a manufacturer exempt from the BPOL tax. The County denied the refund claim and issued a final determination. The County concluded that the Taxpayer merely assembled component parts manufactured by other companies and, therefore, was not a manufacturer. The Taxpayer appeals the final local determination, contending it should be classified as a manufacturer for BPOL tax purposes.

ANALYSIS

Classification

The BPOL tax is imposed on businesses and professionals for the privilege of doing business in a locality. The tax is imposed at different rates according to the classification of an enterprise. See *Va. Code* § 58.1-3706. The classifications are explained under Title 23 of the Virginia Administrative Code (VAC) 10-500-10 *et seq.* Classification of a specific business must be determined based on consideration of all the facts and circumstances. Some of the factors to be considered include:

1. What is the nature of the enterprise's business?
2. How does the enterprise generate gross receipts?
3. Where the enterprise conducts its business?
4. Who are the enterprise's customers?
5. How does the enterprise hold itself out to the public?
6. What is the enterprise's North American Industry Classification System (NAICS) code?

The Taxpayer contends that it is a manufacturer for BPOL tax purposes. Virginia localities are prohibited from imposing a license fee or tax on a manufacturer for the privilege of manufacturing and selling goods, wares and merchandise at wholesale at the place of manufacture. See *Va. Code* § 58.1-3703 C 4.

Manufacturing

The definition of a "manufacturer" is not in the *Code of Virginia*. However, the Supreme Court of Virginia has developed a test involving three essential elements in determining whether a manufacturing activity is being undertaken. These elements are: (1) original material, referred to as raw material; (2) a process whereby the original material is changed; and (3) a resulting product, which by reason of being subject to such processing, is different from the original material. *County of Chesterfield v. BBC Brown Boveri*, 238 Va. 64 (1989). For local tax purposes, a manufacturer is one engaged in a processing activity, whereby the original materials are transformed into a product that is substantially different in character from the original materials. It does not matter whether the transformation

is a step in getting the product ready for market or it is a complete process. What matters for purposes of local taxation is whether the transformation of the material takes place in the locality. See *Commonwealth v. Meyer*, 180 Va. 466, 23 S.E.2d 353 (1942).

The Taxpayer contends that processes used to build its various electronic devices constituted manufacturing because the original components were substantially changed and the finished products were different than the original components. The County asserts that the Taxpayer's production of the devices was the mere assembly of component parts rather than manufacturing.

Title 23 of the Virginia Administrative Code (VAC) 10-500-520 C provides that in order for manufacturing to occur, the:

Mere manipulation or rearrangement of the original materials is not sufficient; there must be a substantial, well-signified transformation in form, usability, quality and adaptability rendering the original material more valuable for use than it was before. Merely processing, blending, grading, etc. material is not manufacturing.

Further, this regulation provides factors used to help determine whether a process is manufacturing or assembly. Factors that suggest the production is manufacturing include, but are not limited to, whether: 1) the assembly process is complex and uses numerous parts; 2) after assembly, the components cannot be recognized without previous knowledge; and 3) the components are not readily usable for any purpose other than incorporating into the finished product.

Complexity of Assembly

The assembly process for the various devices required numerous parts. However, the tools required for the process included screw drivers, wrenches, pliers wire strippers, and glue. No specialized tools or machinery was required to produce the devices. Further, it does not appear that constructing the devices requires any specialized knowledge or skills.

Recognizability of Components

The Taxpayer has provided instruction manuals that give step-by-step instructions for constructing the devices they produce. Typically, the individual components were put together within a containing unit. The individual components could only be identified if removed from the containing unit.

Usability of Components

The components of the devices were made up of various electronics including

motherboards, video encoders, cables, LED bulbs, fixtures, wires and fixtures. It would appear that many of these components could be used on products not produced by the Taxpayer. These electronic components appear to be usable for purposes other than the Taxpayer's devices.

The Taxpayer cites *County of Fairfax v. DataComp Corp.*, 36 Va. Cir. 60 (1995) to support its position. The taxpayer in *DataComp* built personal computers by purchasing components from original equipment manufacturers and assembling and integrating these parts into computers. The Fairfax Circuit Court held that producing personal computers by assembling and integrating components was manufacturing. The Taxpayer contends that it, like the taxpayer in *DataComp*, also built its devices by assembling and integrating components.

The Department has held that the assembly of computer components in computers and peripherals constitutes manufacturing for purposes of the BPOL tax. See Public Document (P.D.) 98-154 (10/16/1998). Its rationale is that the integration of component parts into computers is analogous to the process employed in the *DataComp*. In this case, the Taxpayer was assembling component parts into integrated systems. This process was comparable to the assembly of components in both *DataComp* and P.D. 98-154.

The Taxpayer also asserts that it manufactured some of the parts for the devices at its facility in the County. The information provided, however, shows no evidence that component parts were produced or fabricated by the Taxpayer.

NAICS Classification

The Taxpayer further asserts that it is a manufacturer because it was classified as a manufacturer under the North American Industry Classification System (NAICS). The Taxpayer has not provided any evidence that it was classified as manufacturer. Regardless, for purposes of BPOL taxation, the Department has found the NAICS definitions of industries may be useful in evaluating business classification, but they are not controlling. See P.D. 11-83 (6/2/2011) and P.D. 13-25 (3/5/2013).

DETERMINATION

Based on a preponderance of the evidence, the Taxpayer's production of the custom electronic devices constituted manufacturing. Accordingly, the Taxpayer was a manufacturer exempt from the BPOL tax in accordance with *Va. Code* § 58.1-3703 C 4 for the 2010 through 2012 tax years. As such, I am remanding this case back to the County in order to issue refunds for the overpayment of tax plus applicable interest.

If you have any questions about this determination, you may contact ***** in the Office of Tax Policy, Appeals and Rulings, at *****.

Sincerely,

Craig M. Burns
Tax Commissioner

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