

TAXATION: TANGIBLE PERSONAL PROPERTY, ETC. - INTANGIBLE PERSONAL PROPERTY TAX.

Assembly of precut furniture kits-process that merely enhances items without substantially changing character of end product-is not "manufacturing" for purposes of intangible personal property classification. Retail furniture company is merchant whose inventory of stock on hand is subject to local merchants' capital tax.

The Honorable Helen H. Longest

Commissioner of the Revenue for King and Queen County

April 25, 1996

You ask whether a company engaged in the retail sale of furniture, some of which is wooden furniture it assembles from purchased precut kits, is a manufacturer for purposes of § 58.11101(A)(2) of the *Code of Virginia*. You ask also whether the property you describe is taxable as merchants' capital under § 58.13510(A).

Pursuant to § 58.11101(A)(2), tangible personal property "used in manufacturing" is not subject to local personal property taxation.¹ The term "manufacturing" is not defined by Virginia law for local taxation purposes.² The Supreme Court of Virginia has held, however, that three elements are necessary for a process to be considered manufacturing: "(1) original material referred to as raw material; (2) a process whereby the raw material is changed; and (3) a resulting product which ... is different from the original raw material."³ The Court also has held that the definition of "manufacturing" should be applied liberally, "[b]ecause the public policy of Virginia is to encourage manufacturing in the Commonwealth."⁴

It is my opinion that, applying the definition liberally, the assembly of precut furniture kits does not constitute manufacturing for the purposes of § 58.11101(A)(2). The process does not involve a raw material that is changed in any manner; there is no substantial transformation into a new or different product; there is no finished product that is different from the original raw material. The original precut furniture kit product is usable by consumers. The company's assembly of the kit merely enhances the items without substantially changing the character of the end product.

Because the property is not "used in manufacturing" and thus is not "intangible personal property" under § 58.11101, the property is subject to local taxation as either merchants' capital or tangible personal property.⁵ Section 58.13509 segregates the "capital of merchants," as defined in § 58.13510, as a class of personal property subject to local taxation. While Virginia law does not define "merchant," the Supreme Court of Virginia has held that, for purposes of Virginia's tax statutes, "[a] `merchant' ... `is a dealer in goods, wares, and merchandise, who has the same on hand for sale and present delivery."⁶

Whether a business is a "merchant" for purposes of the merchants' capital tax is a factual determination to be made on a case-by-case basis by the commissioner of the revenue.⁷ The facts you present suggest that the company is a merchant, and, if so, its "inventory of stock on hand" is subject to taxation in accordance with § 58.13510(A) as "merchants' capital."⁸

¹Section 58.11101(A)(2) classifies such property as "intangible personal property," which is subject to state taxation only. The state no longer taxes such intangible personal property. See §§ 58.11101(C), 58.11100, 58.1100.

²The definition of "manufacturing" in § 58.1602 for purposes of the Virginia Retail Sales and Use Tax Act is not controlling in interpreting exemptions from local taxation. See Op. Va. Att'y Gen.: 1984-1985 at 399, 401 n.4; 1983-1984 at 372 (both opinions construing definition in repealed § 58441.3(p)). Therefore, the fact that a corporation has an exemption from the Department of Taxation is not determinative of whether the corporation is a manufacturer for local taxation purposes.

³*Prentice v. City of Richmond*, 197 Va. 724, 72930, 90 S.E.2d 839, 843 (1956) (quoting trial court opinion); see also *Solite Corp., v. King George Co.*, 220 Va. 661, 665, 261 S.E.2d 535, 537 (1980) ("The mere blending together of various ingredients, in the absence of a transformation into a product of substantially different character, is not manufacturing.").

⁴*County of Chesterfield v. BBC Brown Boveri*, 234 Va. 64, 69, 380 S.E.2d 890, 893 (1989); see also 1993 Op. Va. Att'y Gen. 231, 233.

⁵"Tangible personal property" consists of "all personal property not otherwise classified by § 58.1-1100 as intangible personal property or by § 58.13510 as merchants' capital." Section 58.13500. Section 58.13510(A) defines "merchants' capital" as "[i]nventory of stock on hand . . . and all other taxable personal property of any kind whatsoever, except money on hand and on deposit and except tangible personal property not offered for sale as merchandise, which tangible personal property shall be reported and assessed as such."

⁶*Commonwealth v. Employees Assoc.*, 195 Va. 663, 669, 79 S.E.2d 621, 624 (1954) (quoting *White v. The Commonwealth*, 78 Va. 484, 485 (1884); see also *Commonwealth v. Meyer*, 180 Va. 466, 47273, 23 S.E.2d 353, 356 (1942) ("merchant" is person "engaged in the business of buying commercial commodities and selling them again for the sake of profit" (quoting from Century Dictionary)).

⁷See 1989 Op. Va. Att'y Gen. 334, 336.

⁸You indicate that the company consists of a corporation and a partnership, with the corporation purchasing the furniture for sale to the partnership and the partnership selling the furniture to the consumer. The merchants' capital tax applies to both wholesale and retail merchants. See 1983-1984 Op. Va. Att'y Gen. 374 (county may impose merchants' capital tax on retail and wholesale merchants and business license tax on all businesses except merchants). Accordingly, except for determining which entity is the owner of the inventory at a particular time, the company's division into wholesale and retail components is irrelevant. See § 58.13015 (providing that property is taxable to owner; property belonging to corporation or firm is to be listed by and taxed to corporation or firm). Should you, as commissioner of the revenue, determine, however, that the corporate division of the company is not a "merchant," the property in the hands of the corporate division would be taxable as tangible personal property, and property that the corporation transfers to the partnership would constitute inventory taxable to the partnership as merchants' capital.

