



This Week in State Tax (TWIST)

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Washington State: Taxpayer selling personalized pet products was engaged in manufacturing

A Tax Hearing Officer for the Washington State Administrative Review and Hearings Division recently addressed whether a taxpayer was subject to manufacturing B&O with respect to sales of personalized pet products. The taxpayer was an online seller of pet products, such as collars or tags, some of which were personalized with a pet's information, or were otherwise customized. The taxpayer had a physical location in Washington State where its machinery was located. Following an audit, the Department reclassified the taxpayer's income from retailing B&O tax to manufacturing B&O tax. The taxpayer protested on the basis that it was not engaged in manufacturing when it personalized pet products.

The statutory definition of manufacturing in Washington State encompasses a variety of processes that result in a "new, different, or useful substance or article." State courts have broadly construed this to include processes that make significant changes to a product. The have further identified several factors to be considered in determining whether the end-product is a new, different, or useful product; they include, but are not limited to, changes in form, quality, properties, enhancement in value, the extent and the kind of processing involved, and differences in demand. The taxpayer argued that its personalization process did not change the quality of the products or the chemical, physical or functional properties of the items. Rather than enhancing the value of the products, the taxpayer argued that the personalization process actually reduced the value of the products, as the item was thereafter only useful to the one customer whose product was personalized. The Hearing Officer disagreed, holding that the taxpayer was changing the physical property of the tags or collars by physically stamping or embroidering them. This, in turn, changed the functionality of the tags and collars dramatically. The tags and collars transformed from merely decorative items into a powerful method of identifying the owner of a lost pet and created a way for the owner to reunite with their lost pet, which the taxpayer agreed was the number one reason for purchase of a personalized pet product. The Hearing Officer also rejected the taxpayer's position that it was not a "manufacturer" as that term is commonly understood and that the process of stamping or embroidering was too "simple" to be considered manufacturing. In the Hearing Officer's view, the taxpayer's personalization process created a marketable product and increased the value of the tags and collars. Please contact Michele Baisler with questions on Det. No. 18-0191, 42 WTD 005 (2023).

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