Local commissioner of revenue makes determination whether process of transforming tee shirts used as underwear into fashionable outer-wear garments at manufacturing plant constitutes "manufacturing," thereby exempting manufacturer from local merchants' capital tax.

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February 21, 1996

You ask whether a business ("local manufacturer") is subject to the local merchants' capital tax, based on the following facts. The local manufacturer makes tee shirts in plants throughout Southwest Virginia, as well as purchases ready-made tee shirts from other manufacturers. These tee shirts are brought into a plant in Wythe County, where they are labeled, appliquéd, embroidered and screen printed. These garments then are prepared for shipment.

The statutory provisions regarding taxation of personal property distinguish between intangible personal property, which is subject to state taxation only, and tangible personal property, which is generally subject to local taxation. Certain personal property, "tangible in fact," is classified as intangible personal property for purposes of taxation. The General Assembly also permits localities a choice of taxation schemes on "merchants." A locality has the option of imposing on a manufacturing business either a merchants' capital tax or a merchants' license tax. The General Assembly has, however, forbidden localities from levying a local license tax "[o]n a manufacturer for the privilege of manufacturing and selling goods, wares and merchandise at wholesale at the place of manufacture." The term "manufacturing" is not defined by Virginia law for local taxation purposes. 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." 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." Whether a business is a manufacturer for purposes of taxation is a factual determination to be made on a case-by-case basis by the local commissioner of the revenue. In addition, Virginia law does not define "merchant." The Court has held, however, 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." 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.

A business engaged in manufacturing does not lose its status as a manufacturer for tax purposes merely because it conducts some nonmanufacturing activities. "When a [business] is engaged in both manufacturing and non-manufacturing activities, it will nonetheless be classified as a manufacturer for tax purposes if the manufacturing portion of its business is substantial." This
classification extends to all business activities of the business entity that are ancillary to its primary business of manufacturing. When, however, a business entity is engaged in two separate and distinct business activities-one mercantile and the other manufacturing-the Supreme Court of Virginia has permitted a locality to treat the activities differently. In Caffee v. City of Portsmouth, involving the business license tax, the Court held that a bakery that actually baked its goods in the back of the building and sold them at retail in the front was a manufacturer in the back and a retail merchant in the front. Therefore, the City of Portsmouth was permitted to levy a business license tax on the bakery's mercantile business. The city had elected to impose a license tax on merchants in lieu of a merchants’ capital tax, but it is clear that had the city imposed a merchants' capital tax, the same rationale would support imposition of that tax.

A consistent theme of local taxation is that the initial factual determination underlying a specific classification decision has been settled by the locality's commissioner of the revenue. A taxpayer aggrieved by such a determination may apply to the commissioner for correction, and "to the circuit court of the county or city wherein such assessment was made."

You state that the portion of the business activity of the local manufacturer which remains in question consists of taking raw material-the tee shirts-and either embroidering patterns or screen printing images on the shirts, thereby rendering the finished garments as fashion garments for outer wear. This process clearly would meet the first two elements of manufacturing discussed above: an original material is subjected to a process whereby it is changed. The local commissioner of the revenue, therefore, must determine whether the tee shirts have been transformed so as to emerge into new and different garments that have a distinctive name, character or use.

Based on the information you provide, the garments emerge from the process at the local manufacturer substantially different from their character when first acquired as tee shirts. Before processing, the tee shirts may have been suitable for outer-wear garments, but would ordinarily be expected to be used as underwear. After processing, the garments are suitable for use as fashion-wear outer garments. Although not dispositive, it is instructive that the process itself increases the value of the garments from their original value as tee shirts. By this measure, it is clear that a substantial transformation in the appearance and usefulness of the garments has taken place in the local manufacturer's plant.

Should the local commissioner of the revenue find that such a substantial transformation of raw materials, in fact, takes place in this portion of the business activity of the local manufacturer, then this portion of the business activity would constitute "manufacturing" under Virginia law. The Virginia Supreme Court has noted that "it is difficult to include in any one clear-cut definition all who are manufacturers and none other; and it is likewise difficult to define merchants. Many cases are borderline cases, and to expect uniformity of conclusions is to expect too much."

I am, therefore, of the opinion that, under the preceding facts, the local commissioner of the revenue may determine that the activities of the local manufacturer constitute manufacturing and the inventory is not subject to the local merchants' capital tax.

1 See VA. CODE ANN. §§ 58.11100 to 58.11118.
2 See §§ 58.13500 to 58.13522.
3 Section 58.11101(2)(2a).
4 Section 58.11101(2).
Section 58.13509.

Section 58.13703(A).

Section 58.13703(B)(4).

The 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.

Prentice v. City of Richmond, 197 Va. 724, 729-30, 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.").


County of Chesterfield v. BBC Brown Boveri, 238 Va. at 70, 380 S.E.2d at 893.

See Caffee v. City of Portsmouth, 203 Va. 928, 128 S.E.2d 421 (1962); see also § 58.15.

Id. at 930, 128 S.E.2d at 422.

Id. at 933, 128 S.E.2d at 425.

Id.

See § 58.13980(A).

Section 58.13984(A).

See Prentice v. City of Richmond, supra note 9, 197 Va. at 728, 90 S.E.2d at 842.
