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Op. 56-13

January 25, 1956

Honorable Earl W. Fase  
Tax Commissioner  
Territory of Hawaii  
Honolulu, Hawaii

Dear Sir:

This concerns the operations of certain lumber yards, some of which have mills or kilns or both and some of which have neither. Lumber yards, and at times contractors, furniture manufacturers and the like, send lumber owned by them to be milled or kiln dried at the lumber yard of another. The specific question is as to the tax rate applicable to the gross income derived from the work done upon the lumber of another by the lumber yard which performs such service.

Before taking up this specific question it is necessary to consider the status of the lumber yard which mills its own lumber. As I understand the facts it is common practice for lumber yards to do this. They all take the position that this is part of their wholesale or retail business, and merely incidental to it. I understand that you are of that view. However the question is a close one, as the milling of lumber undoubtedly is manufacturing when performed by a lumber mill. In the same way, a butcher shop is not a manufacturer although a meat packer is.

Section 5449 as amended defines "service business or calling" as follows:

"Sec. 5449. 'Service business or calling,' defined. 'Service business or calling' shall include all non-professional activities engaged in for other persons for a consideration, which involve the rendering of a service as distinguished from the sale of tangible property or the production and sale of tangible property. 'Service business or calling' shall not include the services rendered by an employee to his employer."

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The kiln drying of lumber belonging to another undoubtedly is service business. The rate is 2 1/2% under section 5455, subsection E, unless section 5455.02 applies. The question here turns on paragraph (d) of that section.

When lumber is kiln dried this is not a manufacturing process. See Indiana Creosote Co. v. McNutt, 5 N.E.2d 310, Ind., 1936. Therefore paragraph (d) does not apply irrespective of whether the kiln drying is done for another lumber yard, a contractor, or a furniture manufacturer. While the word "processed" is used in paragraph (d) it is associated with other words. All of the language must be read together under the doctrine of associated words (2 Sutherland Statutory Construction, Sec. 4908). Under this doctrine, not mere processing but processing of a kind that constitutes manufacturing, must occur before paragraph (d) can apply. Indiana Creosote Co. v. McNutt, supra.

Paragraph (d) of section 5455.02 reads as follows:

"(d) Where, through the activity of a person taxable under subsection E of section 5455, a product has been milled, processed, or otherwise manufactured upon the order of another taxpayer who is taxable upon the value of the entire manufactured product, which consists in part of the value of the services taxable under subsection E of section 5455, so much gross income as is derived from the rendering of such services shall be subjected to tax on the person rendering such services at the rate of one per cent, and the value of the entire product shall be included in the measure of the tax imposed on such other taxpayer as elsewhere provided."

Except for a correction of an error accomplished by Act 68, L. 1953 (See H. J. 1953, p. 575), this is the same as when enacted by Act 165, L. 1951, H. B. 729. As explained by the committee reports on the bill (S. C. R. 369, H. J. 1951, p. 501; S. C. R. 394, S. J. 1951, p. 893) this provision relates to "services furnished by a taxpayer and becoming part of the value of a manufactured product that is also taxed to the manufacturer."

One who contracts with another to fabricate a product for him, he furnishing the materials or in some other way retaining proprietorship of the product as it is manufactured, is himself the manufacturer of the product even though he does not do

the actual work. Charles Peckat Mfg. Co. v. Jarecki, 196 F.2d 849, C. A. 7; section 5455, subsection A, relating to manufacturing "either directly or through the activity of others." The one who actually does the manufacturing also is a manufacturer (Oster v. Department of Treasury, 37 N.E.2d 528, Ind.), but he is not taxable as such if a tax is "otherwise levied" upon his gross income, subsection A so providing. Since performance of manufacturing service for one who in point of law is the manufacturer of the product constitutes a service business or calling, subsection E applies and the services are taxed under that section at 2 1/2% (unless paragraph (d) applies) and not at the manufacturing rate.

Paragraph (d) requires a situation in which "a product has been milled, processed, or otherwise manufactured upon the order of another taxpayer". This has the same meaning as manufactured upon the order of another taxpayer, whether by milling, processing or otherwise". If a product has been "manufactured upon the order of another taxpayer" the latter taxpayer is, through the activity of the one performing the services, the manufacturer of it, also the final product is a new manufactured product, not the same one that existed before. This again is borne out by the requirement that the taxpayer giving the order shall be "taxable upon the value of the entire manufactured product, which consists in part of the value of the services" (referring to the services performed upon his order). For the services to be part of the value of an entire manufactured product manufacturing must have occurred, the word "entire" signifying that both the activity of the taxpayer performing the services on order and also the activity of the person giving the order may together comprise "the entire manufactured product". Again, the "value of the entire manufactured product" must be taxed to the person ordering the work. The word "value" connotes a manufacturer, as shown by subsection A.

Turning now to the question of the tax rate to be applied when lumber belonging to another lumber yard or to a contractor is milled upon its order, since neither the lumber yard or the contractor is a manufacturer, the work they order does not constitute tax part or all of the manufacturing of a product. Therefore paragraph (d) does not apply and the rate applicable to the one rendering the service is 2 1/2%.

When lumber belonging to a furniture manufacturer is milled upon its order, the furniture is the "entire manufactured

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product" within the meaning of paragraph (d). This is a new product, and the manufacture of it was in view when the milling was ordered. Part of the value of this new product consists in the milling. The furniture manufacturer is taxable upon the entire value. Therefore the rate applicable to the milling is 1% under paragraph (d).

Respectfully,

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Deputy Attorney General

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