



STATE OF KANSAS

## Office of the Attorney General

1st Floor, State Capitol Bldg. (913) 296-2215 Topeka, Kansas 66612

**Curt T. Schneider**  
Attorney General

September 19 , 1977

ATTORNEY GENERAL OPINION NO. 77- 301

Oscar McIntosh  
County Appraiser  
Barton County Courthouse  
Great Bend, Kansas 67530

RE: Taxation - Freeport Law - Raw Materials and Construction Work in Progress - Exemption of Kansas Manufacturers; K.S.A. 1976 Supp. 79-201f(c)

SYNOPSIS: Goods, wares and merchandise, which are manufactured in Kansas, if stored in a bonded and licensed warehouse and 35% or more of the inventory of finished products are shipped to points out-of-state, are exempt from Kansas ad valorem taxation on that percentage of the average monthly inventory which is shipped in interstate commerce. Such exemption extends only to the manufactured goods, wares and merchandise as finished products, and does not apply to the raw materials on hand and construction work in progress, and other tangible personal property belonging to the Kansas manufacturer having a Kansas tax situs.

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Dear Mr. McIntosh:

Upon receiving a letter from Richard W. Brown, an attorney from Great Bend, stating that there was some confusion in Barton County as to whether raw materials on hand and goods constituting work in progress, of a Kansas manufacturer who qualified under K.S.A. 1976 Supp. 79-201f(c) for exemption from ad valorem tax on his percentage of finished products shipped out-of-state, should also share such exemption, we visited with you by long distance and you confirmed that such controversy did exist and you would welcome a formal opinion from this office.

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Mr. Brown cited previous opinions of this office holding that the "Freeport Exemption" applied only to "finished products" and not to raw materials or construction work in progress, and asked if this office had rendered any opinions on this point since the Freeport law was amended in 1975 and recodified as K.S.A. 1976 Supp. 79-201f?

On May 5, 1975, shortly following the enactment of K.S.A. 1976 Supp. 79-201f, this office did render Opinion No. 75-201 that the new section "does now clearly exempt from Kansas tax that percent of out-of-state shipments of Kansas manufacturers, if more than 35% of finished products were in fact shipped out of state during the preceeding year." But in this opinion the point of taxability of raw materials on hand and construction work in progress was at issue.

While some important amendments were made in the Freeport Law in 1975, there was no change in the particular clause that the tax exemption applied to "Goods, wares and merchandise which are manufactured, assembled, joined, processed, packaged or labeled within this state," stored in a bonded and licensed warehouse or storage area and required records kept.

By use of the past tense of "manufactured, etc." we believe it is clear that the legislature intended the law to apply only to goods, wares and merchandise in the final state, ready for sale on the open market and capable of being shipped in interstate commerce.

In fact, all subsections of this entire law deal with the federal constitutional prohibition against states taxing property moving in interstate commerce. The very concept of "free port" involves a designated place in a taxing district where property moving in interstate commerce may rest temporarily without being subjected to local taxation. Such a tax haven is unavailable to property which has not in any way commenced an interstate journey.

The main amendments made by the 1975 legislature in this law was to strike two clauses: "stored as above described" (which referred to property coming into Kansas from out-of-state and stored in a bonded warehouse) and "upon leaving such warehouses or storage areas shall be exempt." (The legislature wanted to allow Kansas manufacturers to enjoy the tax exemption of products stored in a bonded warehouse, just like out-of-state manufacturers). Also, since a tax exemption was being granted to Kansas taxpayers, it had to be recodified in Chapter 79 Article 2, on Exempt property.

Many manufacturing states have such tax exemption laws. The Michigan statute puts Detroit automobiles into interstate commerce the moment they roll off the assembly line, and are put in a bonded warehouse, awaiting shipment.

Here are some definitions from Words and Phrases:

"Manufactured" is a process of converting raw materials into a finished product, which is a new and different article with a distinctive name, character and use.

"Manufactured Article" comes into being through human or mechanical manipulation of raw materials into a new product.

No article is "manufactured" until it is put into condition for sale on the open market for the purpose for which it is intended to be used.

"Manufacture" is defined as the operation of making goods or wares of any kind.

In our opinion the "goods, wares and merchandise", granted tax exemption by K.S.A. 1976 Supp. 79-201f(c), are restricted to manufactured products ready for sale on the open market and capable of being used for the purpose for which they were made. Where a Kansas manufacturer has a history of shipping more than 35% of his finished products out-of-state, then it is a fair legislative presumption that, when the inventory of finished products is housed in a bonded and licensed warehouse or storage area, at least 35% thereof has already "commenced" movement in interstate commerce. Out-of-state shippers of finished products, using a Kansas bonded warehouse or storage area for an interrupted journey through Kansas, have such a presumption. Kansas shippers should be treated equally.

Construction work in progress can in no way be said to be ready for shipment in interstate commerce as "manufactured" products.

It is true that raw materials are shipped in interstate commerce. But there is a rule that movement in importation or interstate commerce ceases when the raw materials arrive at their final destination and are put to use for the purpose for which they were imported or shipped interstate. Youngstown Sheet and Tube Co. v. Bowers, 358 U.S. 534, 79 S.Ct. 383, 3 L.Ed. 2d 490 (1959).

We believe that the raw materials, when they arrive at the manufacturing site in Kansas and are then put to use for the purpose intended, any interstate shipment ceases and the raw materials acquire a Kansas tax situs. That tax situs continues during the

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process of construction work in progress. It is not lost until the raw materials, as component parts of a new finished product, commence a new interstate shipment when they become clothed with an exemption against state taxation, not so much because of K.S.A. 1976 Supp. 79-201f(c), but because of Article 1, Section 8, clause 3 of the Constitution of the United States of America.

Very truly yours,



CURT T. SCHNEIDER  
Attorney General

CTS:CJM:gw