

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #02-30**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of sales tax to [LARGE DEVICE] at manufacturing plant.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is a manufacturer and holds an industrial machinery authorization issued by the Tennessee Department of Revenue.

The taxpayer is expanding the manufacturing process facilities at its [CITY], Tennessee location. The facility under construction is a [LARGE DEVICE], including enclosures, used in the manufacturing of [PRODUCT]. The manufacturing process unit under

consideration dries the product and protects the integrity of the product from [DAMAGING AGENTS] that would otherwise render the product unusable for its intended purpose. In addition, the manufacturing process unit prevents the venting of particulate emissions to the environment in compliance with the Environmental Protection Agency (EPA) regulations. The [LARGE DEVICE] consists of a process heater, dryer, fans, separation and transfer equipment and a large process enclosure specifically designed and constructed to carry out the drying function and emission controls of the unit. The drying process is part of the overall manufacturing process at the site.

The [LARGE DEVICE] enclosure is essential to provide a controlled process climate suitable for manufacturing the product. The enclosure is an integral part of the manufacturing process used to protect and maintain the process and the product during the drying process, and contains no office or workspaces. It is purely a drying unit used as part of the overall manufacturing process. The manufacturing process could not be operated as intended without this enclosure. The [LARGE DEVICE] enclosure feature serves the dual purpose of accomplishing the drying process of the product and preventing the emission of particulate materials as required by the EPA. The [LARGE DEVICE] and enclosure contain the following features:

1. Pilings - Are necessary to support the structural steel supporting the process equipment.
2. Concrete Foundation – Designed to support the supporting structural steel that supports the process equipment, the spray dryer chamber, and separation equipment. Also provides an essential moisture/[DAMAGING AGENTS] barrier between the process and the earth.
3. Structural Steel – Most of the steel is exempt as necessary to support process equipment. This equipment is not freestanding. Additional steel is installed to support flooring and siding – items that are essential for carrying out the intended purpose of the [LARGE DEVICE], and the integrity of the process and product.
4. Pre-cast Concrete Wall Panels and Siding – These are specially designed and manufactured panels essential for carrying out the intended purpose of the [LARGE DEVICE], and the integrity of the process and The Product, and are not used in normal structural construction. The Enclosure is heated to and maintained at [TEMPERATURE] degrees F. to prevent condensation of moisture inside the [PROCESSING EQUIPMENT]. The dryer internals are humid and condensing moisture breeds [DAMAGING AGENT] growth in the [PRODUCT]. [TOXINS] can result. Affected product must be discarded. The siding enables control of the environment inside the enclosure to prevent moisture condensation. The enclosure is neither cooled nor climate controlled for personnel comfort (except cooled where necessary to protect electrical components).

The external and internal sides of the siding and panels are typically painted for corrosion protection and cleanliness, but are not finished with drywall, fixtures, etc.

5. Roofing – Serves the same purpose as Pre-Cast Panels and Siding, maintaining temperature around the [PROCESSING EQUIPMENT] and providing a barrier from contamination. Again, the roofing structure is specifically designed and manufactured for carrying out the intended purpose of the [LARGE DEVICE], and the integrity of the process and product, in addition to emissions control and is not typical of normal structural construction.

6. Floor Plating – The floor plating is a necessary part of the process. The floors act as a barrier to prevent powder passing from level to level. Powder accumulations are controlled to prevent [DAMAGING AGENTS] and dust explosions.

The [LARGE DEVICE] enclosure is an integral part of the operating process. It has been specifically designed and constructed to provide control of critical process parameters, essential to the successful and safe manufacture of [PRODUCT].

The [LARGE DEVICE] also contains dusts and particulate matter that may escape from the [PROCESSING EQUIPMENT] during [PROCESSING CHANGES AND/OR CLEANING]. The [CITY] site is regulated by the EPA, under [STATUTE]. Without the [LARGE DEVICE] enclosure, it would be very difficult, if not impossible, to maintain compliance with permit requirements for particulate emissions. Due to the unique nature of its construction, the [LARGE DEVICE] and enclosure essentially serve the dual primary roles of manufacturing and pollution control (as required by the EPA), in that the unit is essential in the manufacturing of salable product and in the prevention of emitting harmful emissions to the environment prohibited by EPA regulations that may pose a health risk to the public.

QUESTION

Does the [LARGE DEVICE] in its entirety (including enclosures), as described within, qualify as industrial machinery for purpose of exemption from the sales or use tax?

RULING

The entire [LARGE DEVICE] is not industrial machinery because the enclosure is not industrial machinery. The machinery and equipment portions of the unit, however, are industrial machinery.

ANALYSIS

The industrial machinery exemption, T.C.A. Sec. 67-6-206, provides that “[a]fter June 30, 1983, no tax is due with respect to industrial machinery.” The term “industrial machinery” is defined in T.C.A. Sec. 67-6-102(13), which reads in pertinent part:

"Industrial machinery" means:

(A) Machinery, apparatus and equipment with all associated parts, appurtenances and accessories, including hydraulic fluids, lubricating oils, and greases necessary for operation and maintenance, repair parts and any necessary repair or taxable installation labor therefor, which is necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises, or pollution control facilities primarily used for air pollution control or water pollution control, where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one's principal business....

Further, a taxpayer is required to apply for and receive an industrial machinery authorization from the Department before qualifying for the exemption. See TENN. COMP. R. & REGS. 1320-5-1-1.06.

Under the foregoing authority, to be "industrial machinery", three tests must be satisfied. These tests, for ease of analysis, can be labeled "who, what and how." Who is the taxpayer, what is the tangible personal property for which exemption is sought, and how is the property used?

First, with respect to the "who" test, to qualify for the exemption, the taxpayer must be someone who, as his principal business, engages in fabrication or processing of tangible personal property for resale and consumption off the premises. The facts given indicate that the taxpayer meets this requirement. Further, under the regulation, a taxpayer that qualifies must obtain an industrial machinery authorization from the Department. The taxpayer has done so, and for purposes of this ruling, it is assumed the authorization obtained is valid and correct.

The next part of the test asks the question, "what is the tangible personal property for which exemption is sought?" To satisfy this part of the test, the answer must be "machinery, apparatus and equipment with all associated parts, appurtenances and accessories, including hydraulic fluids, lubricating oils, and greases necessary for operation and maintenance." This part of the test is crucial in deciding the issue here, and will be discussed in detail after consideration of the next part of the test.

The final part asks, "how is the property used?" To be exempt the answer must be "necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises." From the facts given, there is little doubt that the [LARGE DEVICE], including enclosure, is necessary to the production of the product. If that is the primary purpose of the [LARGE DEVICE], it is primarily for fabrication or processing. See Woods v. General Oils, Inc., 558 S.W.2d 433 (Tenn. 1977).¹

¹ General Oils was decided under an earlier version of the definition of "industrial machinery" which contained a "direct" requirement, unlike the present statute. However, the court's decision was based on the primary use of the equipment, rather than on whether such use was direct. 558 S.W. 2d at 436.

However, even though the use of the [LARGE DEVICE] may be “necessary to, and primarily for, the fabrication or processing of tangible personal property for resale and consumption off the premises”, the question asked is whether the unit, in its entirety, including the enclosure, constitutes industrial machinery. Returning to the “what” test, it can be seen that the definition is not written to include anything and everything used in fabrication or processing. Moreover, if all property used in fabrication or processing were industrial machinery, it would not be necessary to have a detailed definition using the terms “machinery, apparatus and equipment” and listing items such as “hydraulic fluids, lubricating oils, and greases.” And other exemptions and reduced tax rates applicable to manufacturers, such as the industrial materials exemption, T.C.A. Sec. 67-6-102(24)(E)(i) and the special rates for energy fuels and water used by manufacturers, T.C.A. Sec. 67-6-206(b) would be rendered redundant by such an interpretation of the industrial machinery exemption. The question that is left, then, is whether items other than machinery, apparatus, and equipment, specifically the enclosure, will qualify as industrial machinery. From the detailed facts given in the ruling request, it is apparent that the enclosure is a structure or building. In Tibbals Flooring Co. v. Olsen, 698 S.W.2d 60 (Tenn. 1985) (“Tibbals I”), the court considered a “lumber pre-dryer,” described as a large building, and found it not to be industrial machinery. The court adopted a definition of “machinery” and “equipment” that reads:

According to Webster’s New International Dictionary (1976) the word “machinery” means “machines as a functioning unit”; and “equipment” is “the physical resources serving to equip a person [such as] the implements (as machinery or tools) used in an operation or activity ... all of the fixed assets other than land and buildings of a business enterprise.”

Id. at 62.²

In Tibbals Flooring Co. v. Huddleston, 891 S.W.2d 196 (Tenn. 1994)(“Tibbals II”), the court considered a “dry kiln” and again rejected the proposition that it was industrial machinery. The court adopted the above-quoted definition from Tibbals I and then stated:

Although the dry kiln is, no doubt, a specially insulated building, it is just that, an insulated building. It cannot be characterized as “machines functioning as a unit,” although it does house machines which function as a unit. Nor can it appropriately be considered “a collection of component parts ‘designed for a specific mechanical or chemical action or operation.’” Although the dry kiln houses a collection of component parts that are designed to [description of function], the dry kiln itself is simply the structure that houses the machines. ... Certainly, a dry kiln cannot reasonably be described as “equipment,” which has been described as excluding buildings.

Id. at 199.

² Tibbals I was decided under the earlier, less expansive definition of “industrial machinery” described in footnote 1. However, the language regarding “machinery” and “equipment” appears in the current definition as well, and is still appropriate in light of the opinion in Tibbals II, discussed in the following.

It appears that the function of the enclosure does not differ in any material way from that of the pre-dryer and the dry kiln in Tibbals I and Tibbals II. The enclosure here is not industrial machinery. Therefore, the entire [LARGE DEVICE] is not industrial machinery. However, the machinery within the unit is industrial machinery.

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APPROVED: _____
Ruth E. Johnson
Commissioner

DATE: 9/6/02 _____