

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING # 02-34**

**WARNING**

**Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.**

**SUBJECT**

Application of sales and use taxes to a manufacturing operation involving packaging.

**SCOPE**

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

**FACTS**

The “Taxpayer” is a worldwide manufacturer with locations in Tennessee. The Taxpayer’s Tennessee location produces several lines of products for wholesale sale to distributors/retailers. This is designated as the Taxpayer’s “Line A” at its Tennessee location. Also at this location, the Taxpayer receives bulk quantities of tangible personal property (hereinafter referred to as “instruments”) manufactured at another (non-Tennessee) location owned by the same parent company or by a foreign supplier. Taxpayer packages these instruments at its Tennessee location to be prepared for wholesale sale to distributors/retailers. This is referred to as “Line B” at the Tennessee location. The Taxpayer has not specified whether the majority of its revenue at the Tennessee location will be from Line A or Line B activities.

Line A is a traditional, yet highly automated assembly line operation. Line A activities utilize the majority of the floor space in the Taxpayer’s factory. Line B is largely a manual operation that is automated at the conclusion of the process. Line B essentially uses manual labor and automated equipment to place multiple instruments, produced at another location, into a pre-molded, clear “see-through” plastic container. The Taxpayer states these instruments are not marketable by the Taxpayer in the bulk state in which they are received.

After the plastic containers are loaded with instruments, they are fed through an assembly machine wherein a pre-printed cardboard backing is adhered to the container. The end product is called a “blister pack.” Multiple blister packs are then further assembled into

sales displays. The blister pack will accompany the product to the consumer, but the displays do not accompany the product to the consumer.<sup>1</sup>

Everything processed within the Taxpayer's Tennessee location is shipped to centralized warehouses, where it is in turn distributed to customers for sale.

## QUESTIONS

1. Does the Taxpayer meet Tennessee's definition of a manufacturer for the Tennessee location?
2. Does the machinery and equipment used specifically in Line B operations qualify as "industrial machinery"?

## RULINGS

1. (a) If the majority of the revenue for the Tennessee location is from the traditional Line A manufacturing operations of the Taxpayer, the Taxpayer will qualify as a manufacturer at the Tennessee location.  
  
(b) Due to pending litigation, the Department chooses not to issue a ruling if the majority of the Taxpayer's revenues at the Tennessee location are from the Line B packaging of products otherwise manufactured at other locations.
2. (a) If the Taxpayer qualifies as a manufacturer because of its Line A operations at the Tennessee location, the Line B packaging equipment used to install or fabricate packaging that will accompany the product when it is sold at retail will be exempt as industrial machinery.  
  
(b) Due to pending litigation, the Department chooses not to issue a ruling in regard to any other equipment used on Line B.

## ANALYSIS

In order to qualify as a manufacturer in Tennessee for sales and use tax purposes, the taxpayer must be

...one whose principal business is fabricating or processing tangible personal property for resale.

Tenn.Code Ann. § 67-6-206(b)(2). In addition, the determination of whether the Taxpayer qualifies as a manufacturer is a location specific determination.

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<sup>1</sup> The Taxpayer's representative supplemented the written facts previously provided by adding this information by telephone on July 9, 2002.

If at least 51 percent of a taxpayer's revenues at a given location are derived from fabricating or processing tangible personal property for resale, the taxpayer is considered to be a manufacturer at that location.

*Beare Co. v. Tennessee Dept. of Revenue*, 858 S.W. 2d 906 ( Tenn. 1993); citing *Tennessee Farmers Cooperative v. State*, 736 S.W.2d 87, 91-92 (Tenn.1987).

The Commissioner has used the 51 percent test on a location-by-location basis to determine the principal business of a taxpayer for many years. To be considered a manufacturer for the purposes of sales and use tax exemptions and reduced rates provided by Tenn. Code. Ann. § 67-6-206, the taxpayer is required to manufacture at least fifty one percent (51%) of the gross sales made from the location. *Tennessee Farmers Cooperative v. State* p. 89.

The facts presented do not indicate the amount of the Taxpayer's revenues from Line A or Line B activities at its Tennessee location. While the majority of the floor space at the Tennessee location is dedicated to Line A activities, this does not necessarily mean the majority of the revenue or gross sales at the location is from Line A activities. Since the majority of the Taxpayer's revenue at the Tennessee location may either be from Line A or Line B activities, both possibilities must be considered.

### **When Line A Activities Produce the Majority of Revenue**

If Line A activities involving the traditional manufacturing of products account for the majority of the revenue at the Tennessee site, the Taxpayer will qualify as a manufacturer at this location. Therefore, the first test for application of the reduced rates and exemptions afforded to manufacturers is met. The Taxpayer will be entitled to make application and receive an industrial machinery authorization from the Department of Revenue for this location pursuant to TENN. COMP. R. & REGS. 1320-5-1-1.06. However, the industrial machinery exemption provided by Tenn. Code Ann. § 67-6-206(a) does not apply to all machinery or equipment purchased by a manufacturer. Machinery and equipment that will qualify as exempt "industrial machinery" is defined at length by Tenn. Code Ann. § 67-6-102(13). In this ruling, the Taxpayer is only concerned with the application of the exemption to the machinery and equipment used in Line B activities at the Tennessee location.

From the facts presented, machinery used on Line B will package products otherwise manufactured at other locations. Among the statutory definitions of exempt "industrial machinery" there is one that specifically applies to packaging equipment:

Machinery used to package manufactured items, where the use of such machinery is by a person whose principal business is fabricating or processing tangible personal property for resale.

...

To “package” as used in this subdivision, refers only to the fabrication and/or installation of that packaging which will accompany the product when sold at retail;

Tenn. Code Ann. § 67-6-102(13)(E). It is important to note that this special definition of industrial machinery does not require that a taxpayer must have manufactured the items packaged. Since the Taxpayer will qualify as a manufacturer at the location if Line A activities produce a majority of its revenue, machinery used on Line B to fabricate or install packaging will be exempt; provided the packaging accompanies the product when it is sold at retail. Since the blister packaging will accompany the product when it is sold at retail, machinery used on Line B to blister package products will be exempt. It is not necessary to determine if the Line B activities standing alone qualify the taxpayer as a manufacturer at this location for an exemption to apply to such equipment.

However, any other machinery used on Line B, including any machinery used to assemble the blister packs into displays that will not accompany the product when it is sold at retail, will not qualify as “industrial machinery” under Tenn. Code Ann. § 67-6-102(13)(E). It appears it would be necessary to determine that equipment used on Line B qualifies as exempt “industrial machinery” under the definition of Tenn. Code Ann. § 67-6-102(13)(A) for any other equipment to be exempted. Tenn. Code Ann. § 67-6-102(13)(A) in relevant part exempts machinery that is

...necessary to and primarily for the fabrication or processing of tangible personal property for resale and consumption off the premises...where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one’s principal business....

Due to pending litigation, this ruling does not address this further consideration.

### **When Line B Activities Produce the Majority of Revenue**

If Line B activities produce the majority of the revenues from the Tennessee location, the principal business of the Taxpayer at the Tennessee location would be the Line B operation. In this case, Tenn. Code Ann. § 67-6-102(13)(E) exemption would only apply if the Line B activities of the Taxpayer constitute “fabricating or processing tangible personal property for resale.” Effectively, this means the Taxpayer’s Line B packaging equipment would also have to qualify as industrial machinery under the definition of § 67-6-102(13)(A).

The Department of Revenue has previously taken the position that when the principal business at the location is the packaging of items otherwise manufactured elsewhere the

exemption of § 67-6-102(13)(A) does not apply to the packaging machinery. This position has been contested, and is presently the subject of pending litigation.<sup>2</sup> Therefore, the Commissioner exercises her discretion pursuant to Tenn. Code Ann. § 67-1-109(a) to decline to rule on this issue at this time.

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Charles Moore  
Special Tax Counsel

APPROVED: 

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Ruth E. Johnson  
Commissioner of Revenue

DATE: 9-5-02 

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<sup>2</sup> In support of its contention that packaging alone constitutes fabricating or processing, the Taxpayer has cited an unreported chancery court decision. The litigation pending involves the same issue, but a different taxpayer.