

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 95-07**

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 the sales and use tax to contract of [THE TAXPAYER] for construction of an [MACHINE] at the [ENTITY X] in [CITY], Tennessee.

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 his detriment.

FACTS

The taxpayer, [NAME], has entered into a cost-plus-fixed-fee contract with the [AGENCY A], an agency of the federal government to design, fabricate, assemble, install and demonstrate a nuclear weapons effects [MACHINE] at the [ENTITY X] in [CITY],

Tennessee. The taxpayer has provided a copy of the contract and attachments thereto which are attached as an addendum to this ruling.

The taxpayer will act as the general contractor with respect to the project and in this capacity will direct the assembly, checkout and acceptance tests of the [MACHINE] at [ENTITY X] and will provide training to an operations crew to be selected by [AGENCY A] or its agent. The completed [MACHINE] will be installed in a specially designed test building specially constructed solely for that purpose. For example, the walls of the facility will be a minimum of thirty-six inches thick to protect the surrounding environs from the harmful effects associated with the high levels of radiation that will be produced at the facility. The building will have no other purpose and will be in all respects functionally integrated with the intended use of the [MACHINE].

The [MACHINE] itself rides on specially-constructed rails which are mounted to reinforced piers constructed as part of the building. Similarly, the control systems for the [MACHINE] will be specifically designed and constructed for the sole purpose of operating the [MACHINE]. The [MACHINE] could be removed from the building only if disassembled. An artist's depiction of the completed [MACHINE] is attached as an addendum to this ruling. The completed [MACHINE] will be approximately 150 feet long, 75 feet in width and 26 feet in height. The device will weigh approximately four million pounds.

The cost to disassemble, move, reassemble and test the [MACHINE] in a new building designed for its use, including the cost of the new building, would in all likelihood exceed the replacement value of the [MACHINE]. It is specifically submitted as part of the request for this ruling that it is the intent of the parties that the [MACHINE] become a permanent addition to the real property.

The contract also anticipates that [THE TAXPAYER] will use some government provided property in fulfillment of the contract.

QUESTION

Whether charges for design, engineering, consulting, fabrication, assembly, installation, demonstration and training under the contract as described above are subject to sales and use tax.

RULING

Under the facts provided, [THE TAXPAYER] is contracting to improve real property. Therefore, charges made by [THE TAXPAYER] for its services, including the services specifically identified above, will not be subject to sales or use tax. [THE TAXPAYER] will, however, be subject to use tax on the purchase price of any items of tangible personal property used in Tennessee in fulfillment of the contract.

ANALYSIS

The first issue presented is whether the x-ray [MACHINE] to be provided by [THE TAXPAYER] under the contract should be regarded as tangible personal property after installation or as a fixture attached to real property. The general rule of law relating to fixtures is restated in *Harry J. Whelchel Co. v. King*, 610 S.W. 2d 710 (Tenn. 1980) wherein the Court stated that

[i]n Tennessee only those chattels are fixtures which are so attached to the freehold that from the intention of the parties and the uses to which they are put, they are presumed to be permanently annexed or removal thereof would cause serious injury to the freehold. The usual test is said to be the intention with which the chattel is connected with realty.

(citing *Memphis Housing Authority v. Memphis Steam Laundry-Cleaner, Inc.*, 225 Tenn. 46, 463 S.W. 2d 677 (1971) which quoted *Hickman v. Booth*, 131 Tenn. 32, 173 S.W. 438 (1915)). The controlling test as to whether an item is attached to realty is the intention and purpose of the erection. *Hubbard v. Hardeman County Bank*, 868 S.W. 2d 656 (Tenn. Ct. App. 1993). For the purpose of this ruling it has been stipulated that it is the intent of the parties that the [MACHINE] become affixed to realty. This statement of intent accords with the objective facts provided. The [MACHINE] produces radiation such that it can only be used inside the specially constructed building to prevent the escape of radiation. The size of the [MACHINE] (four million pounds in weight) is such that it could not be removed from the building without disassembly. The purpose of the [MACHINE] is such that it appears highly unlikely that it will have a useful life outside of its intended present installation. Therefore, it is concluded that the [MACHINE], when completed and installed, will become real property. [THE TAXPAYER] will therefore be considered to be a contractor improving realty for the purpose of applying the sales and use tax.

T.C.A. Section 67-6-209 imposes a use tax on the use of tangible personal property by a contractor in fulfillment of the contract. T.C.A. Section 67-6-209(b) provides in relevant part as follows:

[w]here a contractor or subcontractor . . . uses tangible personal property in the performance of a contract, or to fulfill contract or subcontract obligations, whether the title to such property be in the contractor, subcontractor, contractee, subcontractee, or any other person, or whether the title holder of such property would be subject to pay the sales or use tax . . . such contractor or subcontractor shall pay a tax at the rate prescribed by Section 67-6-203 measured by the purchase price of such property, unless such property has been previously subjected to a sales or use tax, and the tax due thereon has been paid.

Therefore, under T.C.A. Section 67-6-209(b), [THE TAXPAYER] will be subject to the contractor's use tax on all materials used in construction of the [MACHINE]. The tax base will be the purchase price paid by [THE TAXPAYER] for the items of tangible personal property. In the facts, it is stated that [THE TAXPAYER] will act as a general contractor, which indicates that subcontractors will be used. If tangible personal property is obtained by [THE TAXPAYER] from subcontractors, then [THE TAXPAYER] will owe use tax on the purchase price paid by [THE TAXPAYER] to the subcontractor for the property. If a subcontractor is used to provide and install tangible personal property which becomes real property after installation, then tax will only be owed on the materials used by the subcontractor.

Under the contract, some provisions anticipate the use by [THE TAXPAYER] of government-provided property. To the extent that this property is tangible personal property which has not previously been subject to a sales or use tax, [THE TAXPAYER] will be subject to use tax on any property which it uses in Tennessee.

Steven Thomas
Deputy General Counsel

APPROVED: Ruth Johnson, Commissioner

DATE: 3/2/95