

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #98-13**

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 and use tax to the fabrication and sale of industrial [PRODUCTS].

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

Prior to [DATE 1], [COMPANY A], located in Tennessee, fabricated and installed industrial [PRODUCTS]. The installation occurred throughout the world with more than [NUMBER]% of installations occurring outside Tennessee. The fabricated material was shipped from [CITY 1 - IN TENNESSEE] for installation at the various job sites. Under these facts it was the position of the Department of Revenue that [COMPANY A] was a contractor rather than a manufacturer for purposes of applying sales and use tax.

Beginning [DATE 1], [COMPANY A] separated its fabricating and installation operations into two separate corporations. [COMPANY A] accomplished this by causing a second corporation, [THE TAXPAYER] to be established. All of [COMPANY A]'s assets and liabilities relating to its fabricating division were transferred to Taxpayer. Initially, [COMPANY A] was the sole shareholder of Taxpayer. However, in order to complete the transaction, the current shareholders of [COMPANY A] became, in proportion to their interests in [COMPANY A], the shareholders of Taxpayer. [COMPANY A] and Taxpayer maintain separate physical locations, separate books and records, a separate payroll, and separate management.

Beginning [DATE 1], Taxpayer now conducts all of the fabrication business. Specifically, it acquires the raw material, fabricates the industrial [PRODUCTS], and sells them either to [COMPANY A] for installation or to the ultimate owner of the product. The sales are made prior to installation of the fabricated material. For the purposes of this letter ruling, it is assumed that this activity constitutes at least fifty-one percent of Taxpayer's gross revenue at this location.

All fabricated material is sold and shipped by Taxpayer FOB the job site. Title and risk of loss do not pass to the purchaser, whether the purchaser is [COMPANY A] or the ultimate owner, until delivery at the job site. Shipment may be made by any of the following modes:

1. Shipment by Taxpayer in vehicles owned by it;
2. Shipment by Taxpayer in vehicles owned by [COMPANY A] but leased to Taxpayer;
3. Shipment by common carrier under contract with Taxpayer;
4. Shipment by common carrier under contract with the ultimate owner;
5. Shipment by common carrier under contract with [COMPANY A].

QUESTIONS

1. Does Taxpayer qualify as a manufacturer, entitled to make tax exempt purchases of industrial materials for future processing and manufacture into industrial [PRODUCTS] for resale?
2. Does Taxpayer qualify for the reduced rates and/or exemptions from sales and use tax for certain utilities and energy fuels used by manufacturers?
3. At what time did Taxpayer become qualified for treatment as a manufacturer?
4. If the answer to Question 3, above, is not immediately, how much time must transpire before Taxpayer would qualify as a manufacturer?
5. For shipments made from Taxpayer's location to job sites outside the state of Tennessee, which of the five modes of shipment listed in the facts constitute a taxable event in Tennessee?

ANSWERS

1. Yes, Taxpayer is a manufacturer, entitled to the exemption for industrial material for future processing, manufacture, or conversion into articles of tangible personal property for resale. Therefore, Taxpayer is entitled to use a valid resale certificate to purchase material for fabrication into industrial [PRODUCTS].
2. Yes, Taxpayer is a manufacturer, entitled to the exemptions and/or reduced rates from sales and use tax for certain utilities and energy fuels used by manufacturers.
3. Under the facts presented, Taxpayer became a manufacturer for sales and use tax purposes on [DATE 1], the point at which it became a separate corporation with a separate location. However, to qualify for any exemption as a manufacturer, Taxpayer must obtain proper authorization from the Department of Revenue.
4. Due to the answer to Question 3, this question does not require an answer.
5. Under the facts provided, with title passing at the job site, goods delivered to an out-of-state job site in any of the following five ways will be tax exempt: (a) goods shipped out-of-state by Taxpayer in vehicles owned by Taxpayer; (b) goods shipped out-of-state by Taxpayer in vehicles owned by [COMPANY A] but leased to Taxpayer; (c) goods shipped out-of-state by common carrier under contract with Taxpayer; (d) goods shipped out-of-state by common carrier under

contract with the ultimate owner; and (e) goods shipped out-of-state by common carrier under contract with [COMPANY A].

ANALYSIS

1. Industrial materials are exempt if used by Taxpayer in the manner described in T.C.A. §67-6-102(23)(E)(i):

Industrial materials...for future processing, manufacture or conversion into articles of tangible personal property for resale where such industrial materials...become a component part of the finished product or are used directly in fabricating, dislodging, sizing, converting or processing such materials or parts thereof.

By administrative rule, materials used directly in fabricating, dislodging, sizing, converting or processing which do not become a part of the finished product must be consumed within twenty-five (25) consecutive calendar days in order to qualify for this exemption. TENN. COMP. R. and REGS. 1320-5-1-.40; *The Quaker Oats Company v. Jackson*, 745 S.W.2d 269, 270-271 (Tenn. 1988). Materials which become a component part of the finished product are not subject to this twenty-five day limitation.

Under the facts presented, Taxpayer purchases raw material which it fabricates into industrial [PRODUCTS] for resale. Pursuant to T.C.A. §67-6-102(23)(E)(i), Taxpayer may purchase such material tax exempt using a valid resale certificate.

2. T.C.A. §67-6-206 provides certain exemptions and reduced rates for manufacturers. Subsection (b) provides either a reduced rate or an exemption from sales tax for certain utilities and energy fuels used by manufacturers:

(b)(1) Tax at the rate of one percent (1%) is likewise imposed with respect to water when sold to or used by manufacturers. Tax at the rate of one and one-half percent (1.5%) shall be imposed with respect to gas, electricity, fuel oil, coal and other energy fuels when sold to or used by manufacturers.



(3) Such substances shall be exempt entirely from the taxes imposed by this chapter whenever it may be established to the satisfaction of the commissioner, by separate metering or otherwise, that they are exclusively used directly in the manufacturing process, coming into direct contact with the article being fabricated or processed by the manufacturer, and being expended in the course of such contact. Whenever the commissioner determines that the use of such substances by a

manufacturer meets such test, the commissioner shall issue a certificate evidencing the entitlement of the manufacturer to the exemption, and a certified copy thereof shall be furnished by the manufacturer to the manufacturer's supplier of such exempt substances. The certificate may be revoked by the commissioner at any time upon a finding that the conditions precedent to the exemption no longer exist. The commissioner's action as to the granting or revoking of a certificate shall be reviewable solely by a petition for common law certiorari addressed to the chancery court of Davidson County.

T.C.A. §67-6-206(b)(1) and (3).

To qualify for these exemptions, the taxpayer must meet the definition of "manufacturer." A "manufacturer" is defined as "one whose principal business is fabricating or processing tangible personal property for resale." T.C.A. § 67-6-206(b)(2). Manufacturing is a taxpayer's principal business if at least fifty-one percent of the taxpayer's revenue at a given location is derived from fabricating or processing tangible personal property for resale. *Tennessee Farmers' Cooperative v. State Ex Rel. Jackson*, 736 S.W.2d 87, 91-92 (Tenn. 1987).

Under the facts presented in this ruling request, Taxpayer is principally engaged in the fabrication of industrial [PRODUCTS]. These [PRODUCTS] are sold to others for use and consumption off the premises. Taxpayer is therefore a manufacturer entitled to the exemptions and reduced rates provided in T.C.A. §67-6-206. Availability of these reduced rates or exemptions is contingent upon application and authorization as required by the statute and TENN. COMP. R. and REGS. 1320-5-1-.15.

3. The facts provide that [COMPANY A] separated its fabricating and installation operations into two separate and distinct corporations on [DATE 1]. As of that date, all of [COMPANY A]'s assets and liabilities relating to its fabricating division were transferred to Taxpayer, and Taxpayer began maintaining a separate physical location, separate books and records, a separate payroll, and separate management. Initially, [COMPANY A] held all shares of Taxpayer, eventually transferring those shares to [COMPANY A]'s shareholders in proportion to their interests in [COMPANY A].

As noted above, to qualify as a manufacturer for sales and use tax purposes, at least fifty-one percent of a taxpayer's gross revenue must be derived from fabricating or processing tangible personal property for resale. *Tennessee Farmers' Cooperative*, 736 S.W.2d at 91-92. The fifty-one percent test is applied on a location-by-location basis to determine the principal business of the taxpayer. *Id.*

Under the facts, Taxpayer was established not only as a separate location, but as a separate corporation altogether on [DATE 1]. Therefore, Taxpayer qualified as a manufacturer at that time. However, availability of the exemptions relating to utilities and industrial material is also contingent upon the authorization and procedures required by TENN. COMP. R. and REGS. 1320-5-1-.15 and 1320-5-1-.68, respectively.

4. Due to the answer to Question 3, this question does not require an answer.

5. Retail sales in Tennessee are subject to sales and use tax under T.C.A. §67-6-101 et. seq. A retail sale is defined as a taxable sale of tangible personal property to a consumer or to any person for any purpose other than for resale. T.C.A. §67-6-102(23)(A). Taxpayer sells its industrial [PRODUCTS] either to [COMPANY A] for installation or to the ultimate owner of the product. Clearly, industrial [PRODUCTS] sold to the ultimate owner constitute retail sales. Additionally, T.C.A. §67-6-209 imposes a contractor's use tax on tangible personal property used by a contractor in the fulfillment of a contract. Therefore, sales made to [COMPANY A] for installation also constitute retail sales. *Honest Abe Log Homes, Inc. v. Huddleston*, No. 01-A-01-9405-CH-00224, 1994 Lexis 635 (Tenn. Ct. App. November 2, 1994).

However, retail sales which occur outside Tennessee will be nontaxable as sales occurring in interstate commerce. TENN. CODE ANN. §67-6-313(a); *Eusco, Inc. v. Huddleston*, 835 S.W.2d 576, 582 (Tenn. 1992). For Tennessee sales tax purposes, the place where title to tangible personal property is transferred to the buyer is determined under the applicable provisions of the Uniform Commercial Code. *Eusco, Inc.*, 835 S.W.2d at 579, citing *Illinois Cent. Gulf R.R. v. State*, 805 S.W.2d 746 (Tenn. 1991) and *Volunteer Val-Pak v. Celauro*, 767 S.W.2d 635 (Tenn. 1989). The Uniform Commercial Code provides in pertinent part:

(1)...Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the chapter on Secured Transactions (chapter 9 of this title), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading:

(a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) if the contract requires delivery at destination, title passes on tender there.

T.C.A. §47-2-401(1) and (2).

Therefore, Taxpayer and the buyer, whether [COMPANY A] or the ultimate owner, can reach an explicit contractual agreement as to the manner in which title passes, except the seller cannot retain title once the goods are shipped or delivered to the buyer. The facts provided indicate that all fabricated material is sold and shipped FOB the job site so that title and risk of loss do not pass to the buyer until delivery at the job site, notwithstanding the method of shipment. If these terms are explicitly agreed to in a contract between Taxpayer and the buyer, then goods delivered to an out-of-state job site in any of the following five ways will be tax exempt: (a) goods shipped out-of-state by Taxpayer in vehicles owned by Taxpayer; (b) goods shipped out-of-state by Taxpayer in vehicles owned by [COMPANY A] but leased to Taxpayer; (c) goods shipped out-of-state by common carrier under contract with Taxpayer; (d) goods shipped out-of-state by common carrier under contract with the ultimate owner; and (e) goods shipped out-of-state by common carrier under contract with [COMPANY A].

David A. Gerregano, Tax Counsel

APPROVED: _____
Ruth E. Johnson, Commissioner

DATE: 3-6-98