

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING # 01-32**

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

Sales/use tax status of manufacturer following formation of single-member limited liability company.

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 Company is a manufacturing company, which currently holds an industrial machinery authorization (“M number”) issued by the Tennessee Department of Revenue. The company has a wholly owned Tennessee subsidiary (hereinafter “Subsidiary”) that acts as the sales and marketing organization of the Company. The proposed transaction is a conversion of Subsidiary into a single-member limited liability company (hereinafter “SMLLC”). After the conversion, for both Federal and Tennessee tax purposes, the former subsidiary would be disregarded as an entity separate from the Company.

QUESTION

Will the Company retain its industrial machinery authorization subsequent to the conversion of Subsidiary into SMLLC, if newly-created SMLLC is no longer considered a separate entity?

RULING

The company may retain its industrial machinery authorization for the qualified manufacturing location following the formation of SMLLC, if there is no change in operations at the location for which the authorization was issued.

ANALYSIS

There are three exemptions or reduced rates of tax available to manufacturers – industrial machinery, reduced rate and/or total exemption for energy fuel and water, and industrial materials.¹

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....**

(Emphasis supplied.)

Special tax treatment is afforded energy fuel and water “sold to or used by manufacturers” under the provisions of T.C.A. Sec. 67-6-206(b).² T.C.A. Sec. 67-6-206(b)(2) states “[f]or the purpose of this subsection, "manufacturer" means **one whose principal business is fabricating or processing tangible personal property for resale.** (Emphasis supplied.)

Both the industrial machinery exemption and the energy fuel and water provisions impose a requirement that the taxpayer’s principal business must be “fabricating or processing tangible personal property for resale.” Further, a taxpayer must obtain an industrial machinery authorization from the Department before qualifying for the exemption and/or reduced rate. *See* TENN. COMP. R. & REGS. 1320-5-1-1.06.

The industrial materials exemption, T.C.A. Sec. 67-6-102(24)(E)(i) and TENN. COMP. R. & REGS. 1320-5-1-.40, does not have a similar principal business requirement and needs no further discussion here.

In *Tennessee Farmers’ Coop. v. State ex rel. Jackson*, 736 S.W.2d 87 (Tenn. 1987), the Tennessee Supreme Court upheld the Department’s long-standing use of a “51% test” to

¹ The ruling request refers to the “Tennessee manufacturers sales tax exemption;” however, there are three separate exemptions and/or reduced rates available to manufacturers, and each of these exemptions must be separately considered.

² In some cases, a reduced rate of tax is applicable to these items. In other cases, a total exemption applies. *See* T.C.A. Secs. 67-6-206(b)(1) and (3) through (7), 67-6-702(b).

determine a taxpayer's principal business for purpose of the exemption and reduced tax rates for industrial machinery and energy fuels and water. The court stated:

The Commissioner has used the 51 percent test **on a location-by-location basis** to determine the principal business of a taxpayer for at least twenty years. Under this test, to be considered a manufacturer for the purposes of T.C.A. § 67-6-206, the taxpayer is required to manufacture at least 51 percent of the gross sales made **at each location**.

Id. at 89. (Emphasis supplied.) It is clear the “51% test”³ is applied to each location, not to the whole entity. *See also The Beare Co. v. Tennessee Dept. of Revenue*, 858 S.W.2d 906 (Tenn. 1993) (applying the 51% test at two locations of the same taxpayer, with opposite results at each location).

Consequently, if Subsidiary is converted into SMLLC, and if SMLLC is disregarded for Tennessee tax purposes, the fact that SMLLC is not considered a separate entity from the Company does not change the tax status of the location for which the industrial machinery authorization (“M number”) was issued, as long as there is not a change in the operations at the location for which the authorization was issued.

Owen Wheeler
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APPROVED: Ruth E. Johnson
Commissioner

DATE: December 21,2001

³ While the term “51% test” is commonly used, the actual requirement is that more than 50% of the gross sales at a location is derived from fabricating or processing tangible personal property for resale.