

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 11-28**

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 Tennessee sales and use tax to municipalities contracting with a construction manager.

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

[TAXPAYER] is a construction management firm located in [CITY], Tennessee. The Taxpayer offers AIA B801 CMA contracts (hereinafter the “AIA Contracts”)¹ to local governments in Tennessee such as municipalities, who utilize the Taxpayer’s construction management services for construction projects.

Under the AIA Contract, the Taxpayer consults with the municipality on aspects of its construction project such as the hiring of construction employees, bidding the project out to multiple prime contractors, issuing contracts and purchase orders to the contractors, troubleshooting any problems that may arise, meeting with the architect and municipality to advise as to cost-saving measures, and helping the municipality complete close-out documents. Within this process, the Taxpayer also issues purchase orders on behalf of the municipality to the municipality’s vendors for materials. The municipality provides the purchase orders in electronic format and the Taxpayer prints the purchase orders using the Taxpayer’s computers and printers. The municipality mails the invoices it receives from its vendors to the Taxpayer, who then matches the invoice to the purchase order. Finally, the Taxpayer processes the municipality’s payments to those vendors by printing checks using blank checks provided by the municipality. The Taxpayer sends the purchase order, the original invoice, and the check to the municipality so the checks can be signed and sent to the vendors.

The Taxpayer does not function as a general contractor in the construction project, makes no sales of tangible personal property to the municipality, and does not install or otherwise handle tangible personal property that is used in the construction project.

Under the AIA Contract, the Taxpayer also provides payroll functions to the municipality. The Taxpayer processes the municipality’s construction employees’ payroll with municipality provided checks. These payroll checks, along with the associated timesheets and reports, are forwarded to the municipality for signatures and distribution.

The Taxpayer does not place its employees on the municipality’s payroll, and does not provide its own employees. The Taxpayer merely assists the municipality in locating, screening, and hiring their own construction personnel. The municipality, with the Taxpayer’s consultation, hires its own employees to complete the project under the municipality’s existing employee policies. In addition, the Taxpayer does not control the details of the municipal construction project. The AIA Contract provides in pertinent part:

With respect to each Contractor’s own work, the Construction Manager shall not have control over or charge of and shall not be responsible for

¹ The “AIA B801 contract” is the standard name for this type of contract, which is used in the construction management industry. The Taxpayer also offers “at-risk” contracts, in which the Taxpayer acts much like a general contractor. Under the at-risk contract, the Taxpayer’s employees perform some of the work in the construction project; in addition, the Taxpayer purchases materials for use in the construction project. The Taxpayer does not enter into both an AIA Contract and an At-Risk Contract to a municipality with respect to the same project. Rather, the Taxpayer and the municipality will enter into either one contract or the other. Note that the Taxpayer’s at-risk contracts are not at issue in this letter ruling.

construction means, methods, techniques, sequences or procedures, or for safety precautions and programs in connection with the Work of each of the Contractors, since these are solely the Contractor's responsibility under the Contract for Construction. The Construction Manager shall not be responsible for a Contractor's failure to carry out the Work in accordance with the respective Contract Documents. The Construction Manager shall not have control over or charge of acts or omissions of the Contractors, Subcontractors, or their agents or employees, or any other persons performing portions of the Work not directly employed by the Construction Manager.

The Taxpayer does not provide the municipality with a performance bond, or become financially responsible for the quality or completion of time of the project. Rather, each trade contractor contracts directly with the municipality and provides a performance bond for their own scope of work. In addition, the Taxpayer does not provide any equipment or tools to the municipality for use in the construction project. Each trade contractor provides their own equipment and tools. In the event that the municipality completes the construction project, the municipality either buys or rents its own equipment and tools. The Taxpayer is paid a lump-sum fee for its services under the AIA Contract.

The Taxpayer has requested clarification on the issue of whether its AIA Contract would render the municipality's purchases taxable in order to provide potential clients with a correct understanding of the application of the Tennessee sales and use tax.

QUESTIONS

1. Are the municipality's construction-related purchases exempt from the Tennessee sales and use tax?
2. Does the fact that the municipality enters into the AIA Contract cause those purchases to become subject to the Tennessee sales and use tax?

RULINGS

1. Yes. A Tennessee municipality's construction-related purchases are exempt for purposes of the Tennessee sales and use tax.
2. No. The fact that a Tennessee municipality enters into an AIA Contract does not cause purchases made by the municipality to become subject to the Tennessee sales and use tax.

ANALYSIS

Under the Retailers' Sales Tax Act, TENN. CODE ANN. § 67-6-101 *et seq.*, retail sales of tangible personal property and certain enumerated services in Tennessee are subject to the sales and use

tax, unless an exemption from taxation applies.²

1. Purchases by a Municipality

A Tennessee municipality's construction-related purchases are exempt for purposes of the Tennessee sales and use tax.

As noted above, under the Retailers' Sales Tax Act, retail sales of tangible personal property and certain enumerated services in Tennessee are subject to taxation, unless an exemption applies. In particular, TENN. CODE ANN. § 67-6-329(a)(4) (Supp. 2010) exempts "[a]ll sales made to the state or any county or municipality within the state."

Therefore, purchases made by a municipality within the state of Tennessee are not subject to the Tennessee sales and use tax. This exemption extends to the purchase of materials by the municipality for its construction project.

2. AIA Contract

The fact that a Tennessee municipality enters into an AIA Contract with the Taxpayer for construction management services does not cause purchases made by the municipality to become subject to the Tennessee sales and use tax.

Under TENN. CODE ANN. § 67-6-329(a)(4), sales made to the state, or any county or municipality within the state, are exempt from the Tennessee sales and use tax. Thus, if the state of Tennessee, or any county or municipality within the state of Tennessee, purchases materials for use in construction projects, the purchases will be exempt from the Tennessee sales and use tax. The municipality's eligibility to claim the exemption under TENN. CODE ANN. § 67-6-329(a)(4) with respect to its own purchases remains unchanged regardless of its contractual relationship with the Taxpayer.

The facts indicate that when the Taxpayer is operating under an AIA Contract with a municipality, the municipality itself acquires the materials for use in its construction project. Importantly, the Taxpayer does not purchase any materials, install any materials, or provide any of its own employees to the municipality. Rather, the Taxpayer merely processes purchase orders and payments for the municipality as part of its management services. Specifically, the Taxpayer issues purchase orders on behalf of the municipality to the municipality's vendors for materials. The municipality provides the purchase orders in electronic format and the Taxpayer prints the purchase orders using the Taxpayer's computers and printers. The municipality mails the invoices it receives from its vendors to the Taxpayer, who then matches the invoice to the purchase order. The Taxpayer processes the municipality's payments to those vendors by printing checks using blank checks provided by the municipality. The Taxpayer sends the

² TENN. CODE ANN. § 67-6-102(79) (Supp. 2010) defines a "retail sale" as a "sale, lease, or rental for any purpose other than for resale, sublease, or subrent." A "sale" is defined in pertinent part as "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration," and includes "the furnishing of any of the things or services taxable" under the Tennessee sales and use tax laws. TENN. CODE ANN. § 67-6-102(81)(A)&(D). TENN. CODE ANN. § 67-6-102(92)(A) defines the term "tangible personal property" in relevant part as "personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses."

purchase order, the original invoice, and the check to the municipality so the checks can be signed and sent to the vendors. These services are simply part of the Taxpayer's management service offered under the AIA Contract.

In addition, the Taxpayer does not act as a general contractor when operating under the AIA Contract. The Taxpayer does not place its employees on the municipality's payroll, and does not provide its own employees to the municipality to perform the work in the construction project. The Taxpayer does not become financially responsible for the completion of the municipal construction project or provide a performance bond. Finally, the Taxpayer does not control the details of the municipal construction project when operating under the AIA Contract. The AIA Contract specifically provides, "[w]ith respect to each Contractor's own work, the Construction Manager shall not have control over or charge of and shall not be responsible for construction means, methods, techniques, sequences or procedures, or for safety precautions and programs in connection with the Work of each of the Contractors, since these are solely the Contractor's responsibility under the Contract for Construction." Therefore, the AIA Contract does not cause the municipality's purchases to become taxable.

Although not at issue in this letter ruling, note that the Taxpayer's services under the AIA Contract are not subject to Tennessee sales and use tax. The Retailers' Sales Tax Act also imposes the sales tax on certain services. The sales tax does not apply to all services; rather, it only applies to retail sales of those services specifically enumerated by the statute. *Ryder Truck Rental, Inc. v. Huddleston*, 1994 WL 420911 (Tenn. Ct. App. 1994). Additionally, even if a service is not specifically enumerated by the statute, the service may be subject to the sales tax where charges for the service are included in the sales price of a taxable good or service. *See* TENN. CODE ANN. § 67-6-102(82)(A) (defining the term "sales price"). In this case, the Taxpayer's consulting and payroll services are not specifically enumerated under the Retailers' Sales Tax Act and are not sold in conjunction with taxable goods or services, and are thus not subject to the Tennessee sales and use tax.

Note as well that contractors are generally liable for the "contractor's use tax" when the contractor uses tangible personal property in the performance of the contract. Specifically, TENN. CODE ANN. § 67-6-209(b) (Supp. 2010) provides that where a contractor or subcontractor defined as a "dealer"³ uses tangible personal property in the performance of the contract, or to fulfill contract or subcontract obligations, "such contractor or subcontractor shall pay a tax at the rate prescribed by § 67-6-203 measured by the purchase price of such property." However, in this case, the Taxpayer is not acting as a contractor; the contractor's use tax under TENN. CODE ANN. § 67-6-209(b) therefore does not apply.

³ TENN. CODE ANN. § 67-6-102(25)(K) defines a "dealer" in pertinent part as one who uses "tangible personal property, whether the title to such property is in such person or some other entity, and whether or not such other entity is required to pay a sales or use tax, in the performance of such person's contract or to fulfill such person's contract obligations, unless such property has previously been subjected to a sales or use tax, and the tax due thereon has been paid."

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APPROVED: Richard H. Roberts
Commissioner of Revenue

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