

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 12-15**

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

The application of the Tennessee sales and use tax to natural gas sold to a manufacturer for use in [REDACTED] ovens.

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] (the "Taxpayer") operates [TYPE OF FACILITY] in [TENNESSEE]. The Taxpayer produces [FOOD PRODUCTS FOR RESALE]. [REDACTED].

The Taxpayer uses natural gas in the [REDACTED] ovens at its Tennessee [FACILITIES].¹ The ovens in question are direct-fired models, meaning that the natural gas burners are located within

¹ The Taxpayer has received authorization from the Department to pay the reduced 1.5% sales tax rate set forth under TENN. CODE ANN. § 67-6-206(b)(1) (2011) with respect to its purchases of natural gas.

the [OVEN] chamber. Because the gas burners are located within the [OVEN] chamber itself, the chemical energy created by the burners comes into direct contact with the in-process [FOOD PRODUCTS], completely enveloping the [OVEN] chamber and any exposed portions of the in-process products.

There are four specific types of direct-fired gas ovens used in the Tennessee [FACILITIES] (collectively referred to as the “Ovens”):

1. [REDACTED] Ovens. [REDACTED]. These are tunnel ovens where [FOOD PRODUCTS] travel through an [OVEN] chamber or tunnel on a metal mesh conveyer. The [FOOD PRODUCTS] are subjected to chemical energy from a series of gas burners that are situated within the chamber, both above and below the conveyer mechanism. The [FOOD PRODUCTS] sit in grid pans that rest on the conveyer mechanism. The grid pans are open on top and, as such, the chemical energy created by the natural gas comes into direct contact with the portion of the product that is exposed in the top of the pan.
2. [REDACTED] Ovens. [REDACTED]. These are tunnel ovens where [FOOD PRODUCTS] travel through an [OVEN] chamber on a solid “band line” conveyer. The [FOOD PRODUCTS] are subjected to chemical energy from a series of gas burners within the chamber, situated both above and below the band line. [REDACTED], the [FOOD PRODUCTS] sit directly on the band line (*i.e.*, no pans are necessary). As such, the entire product is exposed to the chemical energy created by the natural gas, with the exception of the bottom edge, which sits directly on the solid conveyer mechanism.
3. [REDACTED] Ovens. [REDACTED]. These are tunnel ovens where [FOOD PRODUCTS] travel through the [OVEN] chamber in magnetized grid pans that rest on a magnetized conveyer mechanism. These ovens utilize natural gas burners situated at various points above the [OVEN] chamber, with blowers that evenly distribute the resulting chemical energy throughout the chamber. The blowers ensure a constant flow of chemical energy throughout the chamber, with the energy flowing above, below, and to the sides of the conveyer mechanism and the in-process products thereon. Because the grid pans are open on top, the portion of the [FOOD PRODUCTS] that is exposed in the top of the pan comes into direct contact with the chemical energy created by the natural gas.
4. [REDACTED] Ovens. [REDACTED]. [REDACTED], the [FOOD PRODUCTS] sit directly on an open metal mesh conveyer system. Thus, each side of the product is directly exposed to the chemical energy created by the natural gas, including the bottom edge.

All of the Ovens share the following common features: 1) the chemical energy created by the natural gas burners is evenly distributed throughout the [OVEN] chamber; and 2) some portion of the in-process product is always directly exposed to the chemical energy created by the natural gas. Additionally, there is no scenario in which a [FOOD PRODUCT] going through one of the Ovens is completely shielded from the chemical energy created by the natural gas.

Some of the Ovens are already separately metered (the “Metered Ovens”). The Taxpayer is able to provide accurate estimates of the natural gas used in each unmetered Oven (the “Unmetered Ovens”), and can also install meters on such Ovens.

RULING

Does the natural gas used in the Ovens come within the scope of the exemption found under TENN. CODE ANN. § 67-6-206(b)(3) (2011)?

Ruling: The natural gas comes within the scope of the exemption found under TENN. CODE ANN. § 67-6-206(b)(3) (2011), to the extent that it is used in Metered Ovens. However, natural gas used in the Unmetered Ovens is not exempt under TENN. CODE ANN. § 67-6-206(b)(3).

TENN. COMP. R. & REG. 1320-5-1-.15 (1983) imposes a number of requirements with respect to the exemption under TENN. CODE ANN. § 67-6-206(b)(3). Even if the natural gas qualifies for the exemption, the Taxpayer may not make tax-exempt purchases for a particular location until it has applied for and received an authorization to do so.

ANALYSIS

Under the Retailers’ Sales Tax Act, TENN. CODE ANN. § 67-6-101 *et seq.*, the retail sale in Tennessee of tangible personal property is generally subject to the Tennessee sales and use tax. Because natural gas is defined as tangible personal property,² retail sales of natural gas in Tennessee are subject to the sales and use tax unless an exemption from taxation applies. *See* TENN. COMP. R. & REG. 1320-5-1-.15(1) (1983) (providing that all sales of energy fuels, including natural gas, are subject to the sales and use tax, unless exempt).

TENN. CODE ANN. § 67-6-206(b)(1) (2011) imposes the sales tax at the rate of 1.5% with respect to retail sales of natural gas, when sold to or used by manufacturers.³ For purposes of TENN. CODE ANN. § 67-6-206(b), the term “manufacturer” is defined as “one whose principal business is fabricating or processing tangible personal property for resale.” TENN. CODE ANN. § 67-6-206(b)(2). However, TENN. CODE ANN. § 67-6-206(b)(3) provides that retail sales of natural gas, electricity, fuel oil, coal, and other energy fuels will be entirely exempt from the sales and use tax “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 the contact.”

Thus, for the exemption under TENN. CODE ANN. § 67-6-206(b)(3) to apply to the Taxpayer’s purchases of natural gas for use in a particular Oven, the following requirements must be met:

² TENN. CODE ANN. § 67-6-102(91)(A) (2011) defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched;” the definition expressly includes electricity, water, gas and steam.

³ Although not relevant to this letter ruling, the 1.5% sales tax rate under TENN. CODE ANN. § 67-6-206(b)(1) is also applied to retail sales of electricity, fuel oil, coal and other energy fuels, when sold to or used by manufacturers.

1) the Taxpayer must be a manufacturer; 2) the Oven must be metered; 3) the natural gas must be exclusively used directly in the manufacturing process; 4) the natural gas must come into direct contact with the products being fabricated or processed by the Taxpayer; and 5) the natural gas must be expended in the course of the contact with such products.

Unmetered Ovens

The exemption under TENN. CODE ANN. § 67-6-206(b)(3) does not apply to natural gas used in Unmetered Ovens.

The second requirement listed above is not met because the Unmetered Ovens are not separately metered. The Taxpayer has stated that it is able to provide accurate estimates of the natural gas used in each Unmetered Oven. However, estimates are insufficient to establish entitlement to the exemption. The Tennessee Supreme Court has stated that the burden is on the taxpayer to establish the exemption, and any well-founded doubt is sufficient to defeat a claimed exemption from taxation. *See Am. Airlines, Inc. v. Johnson*, 56 S.W.3d 502, 506 (Tenn. Ct. App. 2000) (quoting *Rogers Group, Inc. v. Huddleston*, 900 S.W.2d 34, 36 (Tenn. Ct. App. 1995)); *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196, 198 (Tenn. 1994); *United Cannery, Inc. v. King*, 696 S.W.2d 525, 527 (Tenn. 1985)). Basing natural gas usage on a mere estimate gives rise to sufficient doubt as to the amount of the exemption to which the Taxpayer may be entitled; the Taxpayer's claim to exemption is therefore unsupported with respect to the Unmetered Ovens.

Metered Ovens

The exemption under TENN. CODE ANN. § 67-6-206(b)(3) applies to natural gas used in Metered Ovens.

First, the facts indicate that the Taxpayer comes within the definition of "manufacturer" under TENN. CODE ANN. § 67-6-206(b)(2), which defines the term as "one whose principal business is fabricating or processing tangible personal property for resale." The Taxpayer fabricates [FOOD PRODUCTS] for resale to [REDACTED].

The second requirement is satisfied because the Metered Ovens are metered separately from the rest of the facility.

Third, the Taxpayer exclusively uses the natural gas directly in the manufacturing process, as indicated by the fact that the natural gas is used inside the Metered Ovens at the Taxpayer's Tennessee facilities to [PRODUCE] the products.

The fourth requirement is met because the natural gas comes into direct contact with the products being fabricated or processed by the Taxpayer. Importantly, the gas itself does not need to touch the products. In discussing the exemption under TENN. CODE ANN. § 67-6-206(b)(3), the Tennessee Supreme Court specifically held that "[i]f the chemical energy which is produced by burning fossil fuels comes into contact with articles being made, then the exemption applies." *AFG Indus., Inc. v. Cardwell*, 835 S.W.2d 583, 586 (Tenn. 1992). Thus, the exemption will apply if the "chemical energy" produced by burning the gas comes into direct contact with the Taxpayer's [FOOD PRODUCTS]. Each of the Taxpayer's products is exposed in full or in part

to the chemical energy. Because the gas burners are located within the [OVEN] chamber itself, the chemical energy created by the burners comes into direct contact with the in-process [FOOD PRODUCTS], completely enveloping the [OVEN] chamber and any exposed portions of the in-process products.

Fifth, the natural gas is completely expended in the course of contact with the Taxpayer's [FOOD PRODUCTS].

Accordingly, the exemption under TENN. CODE ANN. § 67-6-206(b)(3) applies to natural gas used in Metered Ovens.

Requirements regarding the exemption

TENN. COMP. R. & REG. 1320-5-1-.15 (1983) ("Rule 15") imposes a number of requirements with respect to the exemption under TENN. CODE ANN. § 67-6-206(b)(3).

Rule 15(4) states that manufacturers who qualify for energy fuel or water at the reduced rate under TENN. CODE ANN. § 67-6-206(b)(1) must apply for an authorization to purchase energy fuel or water on a tax-exempt basis.⁴ A separate application must be filed for each manufacturing or processing location. *Id.* Thus, even if the natural gas qualifies for the exemption under TENN. CODE ANN. § 67-6-206(b)(3), the Taxpayer may not make tax-exempt purchases for a particular location until it has received an authorization to do so.

Rule 15(3) provides that manufacturers authorized to purchase and use energy producing fuels or water must furnish a certified copy of the authorization given by the Commissioner enumerating what energy fuels or water the manufacturer may purchase without paying sales or use tax to the vendor. In the event the manufacturer purchases energy fuels or water that "do not come into direct contact with or become a component part of an article being fabricated or produced for sale," the manufacturer is liable for the tax on those energy fuels or water upon which no tax has been paid to the vendor. *Id.*

Rule 15(7) requires vendors to report the total sales of energy fuel and water sold to manufacturers with any other sales of energy fuels, water and any other tangible personal property and taxable services. Manufacturers purchasing energy fuel and water without paying the appropriate tax to the vendor, when tax is due, must include and indicate the amount of purchases of energy fuel and water on their returns, and pay the appropriate tax directly to the Department. *Id.*

Finally, Rule 15(8) requires that manufacturers and processors authorized to buy any energy fuel or water without paying any tax to the vendor must maintain accurate records showing what energy fuel or water has been used in a manner so as to be completely exempt from tax. Such manufacturers and processors must also maintain accurate records showing the total purchases of exempt energy fuel or water. *Id.* In cases of electricity, natural or artificial gas, water, and any

⁴ The Application for Industrial Machinery Exemption can be found on the Department's website at <http://state.tn.us/revenue/forms/sales/fl303101.pdf>.

other item that is metered, accurate meter readings showing readings of the exempt portion and the total purchases of energy fuel and water at least once each month, preferably at the time the readings are made by or for the vendor for billing purposes, shall be maintained by the manufacturer or processor. *Id.*

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