

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #98-09**

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

Taxability of liquid heat transfer agent used by a manufacturer.

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

[THE TAXPAYER] uses high temperatures in certain [PRODUCT 1] and [PRODUCT 2] production areas to produce products for resale. The high temperatures are achieved through a system that utilizes a heat transfer agent (hereinafter "fluid") characterized by a very high boiling point. This highly specialized fluid, under nominal pressure of [POUNDS] per square inch, can be heated to [TEMPERATURE]° F. without vaporizing. The fluid is in [NUMBER] closed loop systems consisting of [COMPONENTS] instruments and controls. This is a proprietary system that is designed and engineered as an integrated process to produce products for resale by [PROCESS]. The fluid, an integral part of the system, has an indefinite life within the closed loop systems with losses occurring only from leakage and evaporation at pump seals, flanges, valve packing, etc. The highly integrated, proprietary production process used by [THE TAXPAYER] will not function without the specialized heat transfer fluid.

QUESTION

Is the liquid heat transfer agent subject to sales or use tax?

RULING

No.

ANALYSIS

Pursuant to T.C.A. § 67-6-206(a) industrial machinery is exempt from sales and use taxes. Industrial machinery is defined in T.C.A. § 67-6-102(12), which states 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, ... where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one's principal business ...

This statute was amended by Ch. 762, Public Acts of 1984, effective May 9, 1984 (the "1984 amendment"). Prior to the 1984 amendment, the definition read, in pertinent part:

(A) Machinery, including repair parts and any necessary repair or taxable installation labor therefor, which is directly and primarily

utilized in fabricating or processing tangible personal property for resale ... where the use of such machinery or equipment is by one who engages in such fabrication or processing as his principal business ... T.C.A. § 67-6-102(8)(1983).

As can be seen by comparing the present language and the language prior to the 1984 amendment, the amendment broadened the definition. The Tennessee Supreme Court in *AFG Industries, Inc. v. Cardwell*, 835 S.W.2d 583 (Tenn. 1992) stated that the effect of the amendment was “the statutory definition of industrial machinery has been expanded ... to include ‘apparatus, and equipment with all associated parts, appurtenances, and accessories.’ ” *Id.* at 585.

In addressing the instant ruling request, first, it is clear that the fluid itself is not machinery or equipment. Neither is the fluid a hydraulic fluid, lubricating oil, or grease. The next inquiry is whether the fluid is an apparatus. In *AFG Industries, supra*, the Tennessee Supreme Court defined apparatus as:

the "totality of means by which a designated function is performed or a specific task executed," *The American Heritage Dictionary* (1969), and as "a set of materials or equipment designed for a particular use." *Webster's Ninth New Collegiate Dictionary* (1990). It contemplates a collection of component parts "designed for a specific mechanical or chemical action or operation." *Webster's Third New International Dictionary* (1976). 835 S.W.2d at 585.

In determining that a tin bath used in production of glass was an apparatus, the *AFG Industries* court went on to state:

Under these definitions, it is apparent that the tin bath operates as an apparatus whose primary function is to shape and cool the molten glass while conveying the glass from the furnace to the annealing oven for ultimate tempering. The molten tin is an integral part of the bath, performing several functions previously done by rollers and polishers. It is both an accessory to and an associated part of the tin bath apparatus. Also, its primary character in the glass making process is not changed by the fact it is used in its liquid state. 835 S.W.2d at 585.

In *Tibbals Flooring Co. v. Huddleston*, 891 S.W.2d 196 (Tenn. 1994) the Tennessee Supreme Court held that an entire system qualified as industrial machinery, without regard to whether each component of the system itself was used in a manner such as to qualify for the exemption. This approach, under which entire “systems” could qualify as industrial machinery, would exempt the fluid. The fluid is an integral part of the system, in the same manner that the tin was an integral part of the tin bath apparatus in *AFG Industries*.

As explained previously in this analysis, since the 1984 amendment to the definition of industrial machinery, the “directly and primarily” requirement was

replaced with a “necessary to, and primarily for” requirement. There is no longer a requirement that industrial machinery directly act on the product being fabricated or processed. Here, while the fluid has no direct contact with the product, the fluid is necessary to the functioning of the system. While the fluid at issue in this ruling does not directly act upon the product being fabricated or processes, as the liquid tin did under the facts in *AFG Industries*, it should not be disqualified from treatment as industrial machinery since it is a part of a system that no doubt qualifies as industrial machinery.

As previously mentioned, the fluid is not a hydraulic fluid, lubricating oil, or grease. These items were not specifically included in the definition of industrial machinery until they were added by Ch. 917, Public Acts of 1992 (the “1992 amendment”). However, the 1992 amendment uses the term “including” which would not necessarily exclude liquids not specifically mentioned from qualifying as industrial machinery, if such liquid otherwise met the definition. See 2A SUTHERLAND STATUTORY CONSTRUCTION, § 47.23 (4th Ed. 1984).

In light of the foregoing analysis, the liquid heat transfer agent qualifies as industrial machinery when used as indicated in the facts. This ruling does not relieve the requirement that the taxpayer apply for and receive an industrial machinery authorization from the Department of Revenue, as required by TENN. COMP. R. & REGS. 1320-5-1-1.06.

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APPROVED: Ruth E. Johnson
Commissioner

DATE: 3-4-98