

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #01-17**

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

Applicability of the sales and use tax to the fabrication, sale and installation of custom [TANGIBLE PERSONAL PROPERTY].

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 in the business of fabricating and installing [TANGIBLE PERSONAL PROPERTY], generally for business customers. Some of their customers are classified as tax-exempt entities. Less than 1% of their work is residential. Taxpayer performs most of its work on-site at the customer's place of business (both within and outside of Tennessee). There are occasions when the tangible personal property is fabricated in Tennessee, then shipped outside of Tennessee to be assembled and installed at the customer's place of business.

In some cases taxpayer purchases the raw materials, consisting of [MATERIALS], and in other cases the raw materials are furnished to taxpayer by the customer. Taxpayer builds and installs the custom ordered tangible personal property (generally [TANGIBLE PERSONAL PROPERTY]). Once installed, some of the products become permanently affixed to the real estate while others remain personalty. In a few cases, taxpayer fabricates the tangible personal property, but does not install it. In those cases the customer may take delivery in Tennessee or it may be shipped to a location out of Tennessee.

When taxpayer contracts with its customers to provide them with [TANGIBLE PERSONAL PROPERTY], taxpayer charges its customers one price which includes the [TANGIBLE PERSONAL PROPERTY] and the installation. The customer is billed by taxpayer and makes no separate payment to the installer.

QUESTIONS

How does the Tennessee sales and use tax apply in the following scenarios:

1. Taxpayer custom-fabricates the tangible personal property using materials that taxpayer has purchased and taxpayer installs the tangible personal property in Tennessee.
2. Taxpayer custom-fabricates the tangible personal property using materials that the customer has purchased and taxpayer installs the product in Tennessee.
3. Taxpayer custom-fabricates tangible personal property using materials that its customer has purchased and installs the tangible personal property in Tennessee and the customer is a tax-exempt entity.
4. Taxpayer custom-fabricates the tangible personal property using materials that taxpayer purchases and installs the tangible personal property outside of Tennessee.

5. Taxpayer custom-fabricates the tangible personal property in Tennessee using materials that taxpayer's customer has purchased, and installs the tangible personal property outside of Tennessee.
6. Taxpayer fabricates the tangible personal property in Tennessee using materials that taxpayer's customer has purchased, but does not install or subcontract the installation of the tangible personal property.
7. Taxpayer fabricates the tangible personal property in Tennessee using materials that taxpayer has purchased, but does not install or subcontract the installation of the product. Taxpayer arranges delivery of the product to a location outside of Tennessee.
8. Taxpayer fabricates the tangible personal property in Tennessee using materials that taxpayer has purchased, but does not install the product. Taxpayer's customer accepts delivery of the product at taxpayer's place of business in Tennessee for transportation outside of Tennessee.

RULINGS

1. If taxpayer custom-fabricates tangible personal property that is installed as a component part of a building, taxpayer should pay sales tax on the materials that it purchases from Tennessee vendors and use tax on those materials taxpayer purchases from out-of-state vendors. When the tangible personal property is installed as a component part of a building, taxpayer should not collect tax from its customers.

If taxpayer custom-fabricates tangible personal property that remains tangible personal property after installation or delivery, taxpayer can purchase materials on a resale certificate. Taxpayer should collect tax on the sale price and installation fee from its customer.

2. Taxpayer is responsible for the use tax on the materials furnished to it by the customer, provided the customer has not previously paid the sales or use tax. If a church or private nonprofit college or university has title to and provides the materials to taxpayer and taxpayer uses the materials "for church, private nonprofit college or university construction", taxpayer is exempt from paying the use tax on those materials. However, the exemption for a private nonprofit college or university is only from state sales tax, not the local tax.

If the tangible personal property becomes part of realty upon installation, no sales tax will be collected from the customer. If the tangible personal property remains personalty upon installation, taxpayer will collect tax from

the customer, unless the customer is a tax-exempt entity or is otherwise exempt from paying tax.

3. The customer's tax-exempt status does not inure to taxpayer's benefit as regards whether or not taxpayer should pay sales or use tax on the materials furnished by the customer. If a church or private nonprofit college or university has title to and provides the materials to taxpayer and taxpayer uses the materials "for church, private nonprofit college or university construction", taxpayer is exempt from paying the use tax on those materials. However, the exemption for a private nonprofit college or university is only from state sales tax, not the local tax. Taxpayer should not collect sales tax from the tax-exempt customer, regardless of whether the tangible personal property becomes part of realty upon installation or remains tangible personal property.
4. If taxpayer custom-fabricates tangible personal property that is installed as a component part of a building, taxpayer should pay sales tax on materials purchased from Tennessee vendors and use tax on materials purchased from out-of-state vendors. Taxpayer should not collect any tax from its customers.

If, however, taxpayer fabricates tangible personal property which remains personalty after installation, taxpayer can purchase the materials on a resale certificate and only charge sales tax to those customers who take title or possession of the tangible personal property in Tennessee unless the customer was exempt from payment of tax.

5. Taxpayer is responsible for the use tax on the materials furnished to it by the customer, unless the sales or use tax has been previously paid by the customer. If a church or private nonprofit college or university has title to and provides the materials to taxpayer and taxpayer uses the materials "for church, private nonprofit college or university construction", taxpayer is exempt from paying the use tax on those materials. However, the exemption for a private nonprofit college or university is only from state sales tax, not the local tax.

Taxpayer should collect sales tax on the fabrication charge if the customer took title to or possession of the tangible personal property in Tennessee and the customer was not tax-exempt. Tennessee tax is not due on installation charges made for tangible personal property installed outside Tennessee, but these charges must be separately billed to the customer to be distinguished from other charges which are taxable.

6. If taxpayer's customer has furnished the materials, taxpayer should pay use tax on the materials, unless the customer has previously paid the tax thereon. If the customer takes title or possession of the tangible personal property in Tennessee, taxpayer should also collect and remit sales tax on the charges for fabrication of the tangible personal property, unless the customer is exempt from tax. If the customer takes neither title nor possession of the tangible personal property in Tennessee, taxpayer should not collect tax on the fabrication charge.
7. Taxpayer should purchase the materials on a resale certificate. Sales tax should be collected from the customer only if the customer takes title to or possession of the tangible personal property in Tennessee and the customer is not exempt from the payment of Tennessee tax.
8. Taxpayer should purchase the materials on a resale certificate. Taxpayer should collect Tennessee tax from the customer (unless the customer is exempt from the tax), regardless of where the customer might transport the property.

ANALYSIS

1. Taxpayer custom-fabricates the tangible personal property using materials that taxpayer has purchased and taxpayer installs the tangible personal property in Tennessee.

If taxpayer fabricates tangible personal property that is installed as a component part of a building, taxpayer should pay sales tax on the materials purchased from Tennessee vendors and use tax on materials purchased from out-of-state vendors.¹ Tenn. Code Ann. §§67-6-209(b), 67-6-210(a) and Tenn. Comp. R. & Regs. 1320-5-1-1.01 and 1320-5-1-1.03(2). The materials purchased by taxpayer are not resold, but are used by taxpayer in the performance of its contract to fabricate custom-made [TANGIBLE PERSONAL PROPERTY] that will be installed as realty. Taxpayer is the end user of the materials. Therefore, when the tangible personal property is installed as realty, taxpayer cannot use a resale certificate to purchase the materials used in the fabrication process. Tenn. Code Ann. §67-6-203(a).

On those occasions when the tangible personal property becomes a part of realty upon installation, taxpayer should not collect tax on the tangible personal property or fee for installation. Taxpayer is acting as a contractor and is

¹ When a contractor is the end-user of materials that do not become a component part of a building and are not re-sold, i.e. fabricates tangible personal property for its own use, the contractor would pay use tax on the "fair market value" of the item(s) fabricated. See Tenn. Code Ann. §67-6-209(a)

considered the user and consumer of the materials used in the fabrication and installation processes. This type transaction generally does not constitute a sale. Tenn. Comp. R. & Regs. 1320-5-1-.27(2) clarifies that the fee for installation of tangible personal property that becomes part of real property is not subject to tax:

Charges made for installing tangible personal property which becomes a part of real property, are not subject to the Sales or Use Tax. The person so installing the property shall be liable for any Sales or Use Tax that may be due, if any, on property bought and/or used in making the installation.

If taxpayer fabricates tangible personal property that remains tangible personal property after installation or delivery, taxpayer is using the materials to fabricate tangible personal property that is resold. A “retailer” is a person engaged in the business of making a taxable sale of tangible personal property to a consumer or any person for any purpose other than for resale. See Tenn. Code Ann. §67-6-102(23) – (24)(A). “Retail sale” includes “[t]he installing of tangible personal property which remains tangible personal property after installation where a charge is made for such installation, whether or not such installation is made as an incident to the sale thereof,” See Tenn. Code Ann. §67-6-102(24)(F)(vi). Pursuant to Tenn. Comp. R. & Regs. 1320-5-1-.40(1), under this scenario, taxpayer can purchase the materials on a resale certificate.

Materials and taxable services bought for future ... conversion into articles of tangible personal property for resale, where such materials become a component part of the finished products, are not subject to Sales or Use tax.

However, the finished tangible personal property which is sold at retail or installed as tangible personal property is taxable, as is the charge for installation (with exceptions as noted below). See Tenn. Code Ann. §67-6-202. Tenn. Comp. R. & Regs. 1320-5-1-.27(1) provides:

Charges for installing tangible personal property, whether made as a part of and in connection with the sale of the tangible personal property, or whether made for installing tangible personal property which has been sold in a separate ... transaction when the property remains tangible personal property when installed are subject to the Sales and Use Tax. Tangible personal property which is sold and attached to real property, but which will ordinarily be removed by the owner ..., shall be deemed to be personal

property and the installation charges therefore shall be subject to the Sales and Use Tax.

On those occasions when the taxpayer purchases materials, but does not know, at the time of purchase, whether the materials will be used to fabricate tangible personal property that eventually is installed as realty or is sold as personalty, Rule 8 applies. Tenn. Comp. R. & Regs. 1320-5-1-.08 applies to contractor/dealers who are engaged in the business of “erecting, building or otherwise improving, altering and repairing real property” and the business of selling those same materials to others, where the materials remain personalty. Pursuant to Rule 8, when taxpayer is purchasing materials, but does not know how the materials will be used, taxpayer can purchase all the materials on its resale certificate. Subsequently, if some of the materials are used to fabricate tangible personal property that is installed as realty, taxpayer should pay the use tax on the portion of the materials used. Rule 8(2) requires a monthly accounting for the use of materials purchased pursuant to the rule.

2. Taxpayer custom-fabricates the tangible personal property using materials that the customer has purchased and taxpayer installs the product in Tennessee.

If the materials are furnished by taxpayer’s customer, taxpayer should pay use tax computed on the purchase price of the materials. Taxpayer is not required to pay tax on the materials if tax has previously been paid. See Tenn. Code Ann. §§67-6-209(b) and 67-6-102(K) and Tenn. Comp. R. and Regs. 1320-5-1-1.01 and 1320-5-1-1.03. See also, *Pan Am World Services, Inc. v. Jackson*, 754 S.W.2d 53, 56 (Tenn. 1988). The only exceptions to this rule are provided in Tenn. Code Ann. §67-6-209(b) and Tenn. Comp. R. & Regs. 1320-5-1-1.01. If a church or private nonprofit college or university, is the title holder and provides the materials to taxpayer and taxpayer uses those materials “for church, private nonprofit college or university construction”, taxpayer is exempt from paying the use tax on those materials. However, the exemption for a private nonprofit college or university is only from the state sales tax, not the local tax. Tenn. Code Ann. 67-6-209(b)

If the tangible personal property becomes part of realty upon installation, no sales tax will be collected from the customer. If the tangible personal property remains personalty upon installation, taxpayer will collect tax from the customer, unless the customer is a tax-exempt entity or is otherwise exempt from paying tax.

3. Taxpayer custom-fabricates tangible personal property using materials that its customer has purchased and installs the tangible personal property in Tennessee and the customer is a tax-exempt entity.

The analysis of this issue follows the analysis as set forth in Issue Two, including the exception for churches, nonprofit colleges and universities. Generally, even though taxpayer is fabricating tangible personal property for a tax-exempt entity, taxpayer does not get to take advantage of the tax-exempt status. Taxpayer remains liable for paying any use tax on the materials used in the fabricating process, with the exception as noted in Issue Two for churches, nonprofit colleges and universities.

Since taxpayer's customer is a tax-exempt entity, taxpayer should not charge the customer sales tax on the charges for fabrication of the tangible personal property or the installation thereof. See Tenn. Code Ann. §67-6-322.

4. Taxpayer custom-fabricates the tangible personal property using materials that taxpayer purchases and installs the tangible personal property outside of Tennessee.

If taxpayer purchases materials to fabricate tangible personal property in Tennessee, but installed in another state as a component part of a building, taxpayer owes the sales or use tax on the materials. Taxpayer also owes sales or use tax on those materials purchased in Tennessee and then shipped out of state for on-site fabrication of tangible personal property that is installed as a component part of a building. Tenn. Code Ann. §§67-6-209(b), 67-6-210(a), Tenn. Comp. R. & Regs. 1320-5-1-1.01, and 1320-5-1-1.03(2). (Keep in mind Tenn. Comp. R. & Regs. 1320-5-1-.08 as discussed in Issue One). If, however, taxpayer purchases materials from an out-of-state vendor for the purpose of fabricating the tangible personal property in another state (on-site construction in the other state), and the materials are temporarily stored in Tennessee, no sales or use tax is due in Tennessee on those materials. This is an import for export. See Tenn. Code Ann. §67-6-313 and *Young Sales Corp. v. Benson*, 450 S.W.2d 574 (Tenn. 1970).

If taxpayer purchases materials in Tennessee that are used to fabricate tangible personal property in Tennessee, then exported to another state where the tangible personal property remains personalty upon delivery or installation, the transaction is a sale at retail. Taxpayer can purchase the materials on a resale certificate. " 'Sales for resale' means those whereby a supplier of materials, supplies ... makes such tangible personal property ... available to legitimate dealers actually selling such property ... as such, or which becomes [a] ... supply in a manufacturing or processing operation." Tenn. Comp. R. & Regs. 1320-5-1-.62(1). See also Tenn. Code Ann. §67-6-102(8). Tenn. Comp. R. & Regs. 1320-5-1-.40(1) provides that "[m]aterials ... bought for future processing, manufacturing or conversion into articles of tangible personal property for resale, where such materials become a component part of the finished products are not subject to Sales or Use Tax." If title to and possession of the tangible personal

property passes outside of Tennessee, sales tax will not be collected from the customer.

5. Taxpayer custom-fabricates the tangible personal property in Tennessee using materials that taxpayer's customer has purchased, and installs the tangible personal property outside of Tennessee.

If the customer provides the materials to taxpayer, at taxpayer's Tennessee headquarters and taxpayer fabricates the tangible personal property in Tennessee, taxpayer should pay use tax on those materials even if the tangible personal property is to be installed in another State as a component part of a building. The taxpayer is the end user and consumer of the materials. *Nasco v. Jackson*, 748 S.W.2d 193, 195 (Tenn. 1988). Taxpayer will not be liable for the use tax if taxpayer's customer has already paid the applicable tax. See the exceptions noted in Issue Two for church, nonprofit college and university construction.

If the customer takes title to or possession of the tangible personal property in Tennessee, the taxpayer should charge Tennessee sales tax to the customer (unless the customer presents a valid resale certificate or is otherwise exempt from the payment of taxes). This is considered a "retail sale" (as discussed earlier). It does not matter if the tangible personal property is later transported out of Tennessee for installation. See *Jack Daniels Distillery v. Jackson*, 740 S.W.2d 413, 416 (Tenn. 1987) and Tenn. Comp. R. & Regs. 1320-5-1-.29. If taxpayer separately bills the customer for out-of-state installation charges, those installation charges are not subject to Tennessee sales tax.

If title and possession pass to taxpayer's customer outside of Tennessee, taxpayer should not collect Tennessee sales tax on the sales price.

6 - 8. Taxpayer custom-fabricates the tangible personal property in Tennessee using materials that taxpayer's customer has purchased, but does not install or subcontract the installation of the tangible personal property.

Taxpayer custom-fabricates the tangible personal property in Tennessee using materials that taxpayer has purchased, but does not install or subcontract the installation of the product. Taxpayer arranges delivery of the product to a location outside of Tennessee.

Taxpayer custom-fabricates the tangible personal property in Tennessee using materials that taxpayer has purchased, but does not install the product. Taxpayer's customer accepts delivery of the product at taxpayer's place of business in Tennessee for transportation outside of Tennessee.

If the customer provides the materials, taxpayer should pay use tax computed on the purchase price of the materials. Taxpayer is not required to pay tax on the materials if tax has previously been paid. See Tenn. Code Ann. §67-6-209(b) and 67-6-102(K) and Tenn. Comp. R. and Regs. 13230-5-1-1.01 and 1320-5-1-1.03 See the exceptions noted in Issue Two for church, nonprofit college and university construction.

If taxpayer's customer takes title to or possession of the tangible personal property in Tennessee, taxpayer will then collect sales tax from the customer, unless the customer presents a valid resale certificate or is otherwise exempt from paying sales taxes in Tennessee. This is considered a "retail sale" as was discussed earlier. It does not matter if the customer intends to transport the tangible personal property out of Tennessee. See *Jack Daniels Distillery v. Jackson*, 740 S.W.2d 413, 416 (Tenn. 1987). Tenn. Comp. R. & Regs. 1320-5-1-.29 which provides:

(1) If a nonresident of Tennessee purchases articles of tangible personal property ... from a dealer in Tennessee, and the sale is delivered to the vendee in Tennessee, the sale is not one of interstate commerce, and is subject to the Sales Tax. It is immaterial that the property will be later transported outside the State.

....

If the tangible personal property is delivered outside of Tennessee so that neither title nor possession pass to the customer while the tangible personal property is in Tennessee, taxpayer should not collect sales tax from the customer. If the taxpayer purchases the materials, tax will be owed as discussed in Issue One.

Georgia Ann Blythe Felner
Tax Counsel

APPROVED: Ruth E. Johnson
Commissioner

DATE: 7/27/01