

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 20-02

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax professional before relying on any aspect of this ruling.

SUBJECT

The application of an exemption from the Tennessee sales and use tax to equipment and materials purchased for the construction and installation of [REDACTED] steam facility on property owned by the United States government in [CITY,] Tennessee.

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") produces [REDACTED] products for the [FEDERAL GOVERNMENT], and commercial customers. The Taxpayer is the federal government's primary contractor for the operation and management of [A MANUFACTURING PLANT] ("MP") in [CITY], Tennessee.

[MP] is [REDACTED]. [MP] has state-of-the-art equipment and capabilities for [REDACTED]. The manufacturing that occurs at [MP] is powered by steam. [REDACTED].

The steam is delivered through a continuous closed loop system where the steam used in the production process reverts to water and is then recovered and converted back into steam. As a result, the same steam and water is used over and over in the production process. The steam is a reusable resource and the [MP] steam plant and loop operates as a resource recovery system.

In [MONTH, YEAR], the Taxpayer received a [CONTRACT] to design, build, and commission a new [REDACTED] steam facility (the "Facility") at [MP].¹ The Facility will consist of the physical building and [A TANK FARM]. [REDACTED]. The [TANK FARM] will be used exclusively for steam production for use in the manufacturing process.

The new Facility will replace an existing [REDACTED] steam facility. Like the existing facility, the new Facility will include a closed loop system where steam and water are recovered and continuously recycled for use in the manufacturing processes. The steam produced by the new Facility will be used exclusively in the manufacturing process to directly power the various [REDACTED] manufacturing processes carried out at [MP]. The Taxpayer's [CONTRACT] includes both the construction of the Facility itself and the installation of the [MACHINERY AND EQUIPMENT] within the Facility.

The Taxpayer plans to use subcontractors who will purchase the [MACHINERY AND EQUIPMENT] that will be used directly in the steam production process. The Taxpayer also plans to use subcontractors to purchase construction materials for building the Facility itself.

RULING

Is the purchase of equipment and materials by the Taxpayer or its subcontractors for the construction and installation of the Facility at [MP] exempt for purposes of the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-209(e) (2018)?

Ruling: Yes, the purchase of equipment and materials by the Taxpayer or its subcontractors for the construction and installation of the Facility at [MP] is exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-209(e) (2018) as long as the equipment and materials become component parts of the Facility.

ANALYSIS

Under the Retailers' Sales Tax Act,² the retail sale in Tennessee of tangible personal property and specifically enumerated services are subject to the sales and use tax, unless an exemption applies.³

¹ The Department of Revenue has issued the Taxpayer a Tennessee Manufacturing and Processing Industrial Machinery, Energy Fuels and Water Sales and Use Tax Certificate of Exemption.

² Tennessee Retailers' Sales Tax Act, Ch. 3, §§ 1-18, 1947 Tenn. Pub. Acts Ch. 22, §§ 22-54 (codified as amended at TENN. CODE ANN. §§ 67-6-101 to -907 (2018)).

³ TENN. CODE ANN. § 67-6-102(76) (2018) defines a "retail sale" as "any 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

The Retailers' Sales Tax Act also imposes the use tax at the same rate as the sales tax on "the purchase price of each item or article of tangible personal property that is not sold, but is used, consumed, distributed, or stored for use or consumption in this state; provided that there shall be no duplication of the tax."⁴ "Use" is defined broadly to include "the exercise of any right or power over tangible personal property incident to the ownership thereof."⁵

Under Tennessee law, a contractor is generally liable for the "contractor's use tax" when the contractor uses tangible personal property in the performance of a contract, unless an exemption applies. Specifically, TENN. CODE ANN. § 67-6-209(b) (2018) provides that where a contractor or subcontractor defined as a "dealer"⁶ uses tangible personal property in the performance of a 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."

TENN. CODE ANN. § 67-6-209(e) provides an exemption from sales and use tax for "the sale or use of materials and equipment purchased or used for construction or installation, by a contractor, subcontractor or otherwise, of, in or as a part of any electric generating plant or distribution system, *any resource recovery facility where steam or electric energy is produced*, or any coal gasification plant or distribution system owned or operated by the United States or any agency thereof created by an act of congress[.]"⁷

The Department has established regulatory guidance in TENN. COMP. R. & REGS. 1320-05-01-.102 (1974), ("Rule 102") which describes the application, limitation, and administration of the exemption found in TENN. CODE ANN. § 67-6-209(e).⁸ Specifically, Rule 102 provides:

Tangible personal property *which actually becomes a component part* of an electric generating plant or distribution system owned or operated by the United States or any of its agencies, . . . is exempt from the Sales or Use Tax. This exemption applies without regard to who purchases the tangible personal property, and without regard to the

consideration." TENN. CODE ANN. § 67-6-102(78)(A) (2018). "Tangible personal property" includes "property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses." TENN. CODE ANN. § 67-6-102(89)(A).

⁴ TENN. CODE ANN. § 67-6-203(a) (2018).

⁵ TENN. CODE ANN. § 67-6-102(94)(A).

⁶ TENN. CODE ANN. § 67-6-102(23)(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."

⁷ Emphasis added.

⁸ It is important to note that this rule was enacted in 1974. In 1974, the exemption in TENN. CODE ANN. § 67-6-209(e) only applied to "materials and equipment purchased or used for construction or installation, by a contractor, subcontractor or otherwise, of, in or as a part of any electric generating plant or distribution system." TENN. CODE ANN. § 67-3004 (Supp. 1974). The statute was subsequently amended and the exemption expanded in 1980 when the following language was added: "any resource recovery facility where steam or electric energy is produced, or any coal gasification plant or distribution system." 1980 Tenn. Pub. Acts Ch. 563 §1. Although the rule has not been updated, it is reasonable to conclude that its application extends to those facilities and plants that were added to the statute after the rule was promulgated.

form of any contract involved for the installation of the property as a part of such a system. The exemption provided for herein does not apply to any tangible personal property as a part of such a system. The exemption provided for herein does not apply to any tangible personal property or taxable service which is used in the process of installing the exempt property, when such property does not become a component part of the electric generating plant or distribution system.⁹

Additionally, Rule 102 also contemplates contractors and subcontractors will provide exemption certificates when making purchases of tangible personal property to be used in building such plants and systems when such tangible personal property becomes a component part of the plant or system:

Contractors and sub-contractors purchasing tangible personal property to be used as a component part of an electric generating plant or distribution system may furnish their supplier an exemption certificate for each purchase in lieu of the Sales or Use Tax on such sales. Dealers making such sales shall keep such certificates as part of their records. Any dealer who has made any sales which would otherwise be exempt because of this rule and regulation, but who fails to obtain an appropriate exemption certificate at the time of making the sale, shall nevertheless be liable for the payment of any Sales or Use Tax which would otherwise be due on such a transaction.¹⁰

THE FACILITY AT [MP]

As noted above, TENN. CODE ANN. § 67-6-209(e) provides an exemption from sales and use tax for materials and equipment purchased or used for the construction or installation of a resource recovery facility owned by the federal government where steam or electric energy is produced.¹¹ The exemption applies to purchases made by both contractors and subcontractors, so long as the materials and equipment become a component part of the facility.¹²

In *Hall Contracting Corp. v. Tidwell*,¹³ the Tennessee Supreme Court addressed the limitation of this exemption as it applied to an electric generating facility. In that case, the court determined that, to be exempt, the tangible personal property must be used in or as part of the “plant,” which it defined as:

- a. The line building, machinery, apparatus, fixtures, employed in carrying on a trade or mechanical or other industrial business.
- b. A factory, workshop for the manufacture of a particular product.

⁹ TENN. COMP. R. & REGS. 1320-05-01-.102(1). (Emphasis added.)

¹⁰ TENN. COMP. R. & REGS. 1320-05-01-.102(2).

¹¹ TENN. CODE ANN. § 67-6-209(e) (2018).

¹² *See id.*; TENN. COMP. R. & REGS. 1320-5-1-.102(1) (1974).

¹³ 507 S.W.2d 697 (Tenn. 1974).

- c. A piece of equipment or set of machine parts functioning together for performance of a particular operation.¹⁴

The court applied those definitions to a pipeline that supplied natural gas to an electric generating plant but that could be used to serve other natural gas customers in addition to the electric generating plant.¹⁵ The court concluded that the pipeline was not “a part of an electric generating plant” for purposes of the exemption,¹⁶ reasoning that the ordinary meaning of “plant,” as defined above, did not encompass a fuel delivery system.¹⁷

Thus, in order to qualify for the exemption, the tangible personal property must be *used in or as a part* of the resource recovery facility where steam is produced, such that the tangible personal property becomes a component part of the resource recovery facility where steam is produced.¹⁸ But the exemption “does not apply to any tangible personal property or taxable service which is used in the process of installing the exempt property, when such property does not become a component part of the [resource recovery facility where steam is produced].”¹⁹

The Taxpayer’s new Facility will include a closed loop system where the steam and water produced within the system will be recovered and continuously recycled and used in powering the manufacturing processes occurring at [MP]. The steam is therefore a reusable resource and the Facility operates as a “resource recovery facility where steam is produced” for purposes of TENN. CODE ANN. § 67-6-209(e). As [MP] is owned by the United States government, the materials and equipment purchased by the Taxpayer or its subcontractors that become a component part of the Facility are exempt from the Tennessee sales and use tax under TENN. CODE ANN. § 67-6-209(e).²⁰

It is important to note that both the physical building and the [TANK FARM] qualify for the exemption. In the Taxpayer’s case, the [TANK FARM] will be used exclusively in the steam production process. Thus, the [TANK FARM] is *used in or as a part* of the resource recovery facility where steam is produced and the materials and equipment that become a component part of the [TANK FARM] are exempt from the Tennessee sales and use.

EXEMPTION CERTIFICATES

¹⁴ *Id.* at 698-99 (citing WEBSTER’S NEW INTERNATIONAL DICTIONARY).

¹⁵ *Id.* at 699.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ TENN. COMP. R. & REGS. 1320-05-01-.102(1).

¹⁹ TENN. COMP. R. & REGS. 1320-05-01-.102(2).

²⁰ The Taxpayer acknowledged in its ruling request that the exemption, if applicable, “does not cover construction equipment, tools, and other supplies not actually incorporated into the steam plant project, and that the subcontractors must pay tax on those items.”

In order to purchase items that are exempt pursuant to TENN. CODE ANN. § 67-6-209(e) without payment of the tax, the Taxpayer and its subcontractors must follow the procedures set forth in TENN. COMP. R. & REGS. 1320-05-01-.102(2), which states the contractors or subcontractors purchasing the tangible personal property used in the [resource recovery facility where steam is produced] may furnish their supplier an exemption certificate for each purchase in lieu of the Sales and Use Tax on such sales.²¹

Additionally, as noted above, the Taxpayer plans to use subcontractors to purchase the [MACHINERY AND EQUIPMENT] that will be used directly in the steam production process. To the extent the Taxpayer's subcontractors are purchasing industrial machinery, the Taxpayer's subcontractors may not use the Taxpayer's industrial machinery authorization to make exempt purchases. However, they may apply for their own respective exemption authorization numbers, which will apply only to the Taxpayer's project.

TENN. CODE ANN. § 67-6-209(b) requires a contractor or subcontractor to pay Tennessee sales or use tax on purchases of tangible personal property used in the performance of a contract. This is because the contractor or subcontractor is the user and consumer of such tangible personal property. However, TENN. CODE ANN. § 67-6-206(a) (2018) provides that no tax is due on industrial machinery. The definition of "industrial machinery" includes all qualifying items that are used by a manufacturer. TENN. CODE ANN. § 67-6-102(44)(A)(i) (2018). Therefore, if an item qualifies for the industrial machinery exemption, the purchase of the item is exempt, regardless of who actually makes the purchase and installs the item. Further emphasizing this fact, TENN. CODE ANN. § 67-6-209(c) (2018) states that the contractor's use tax described above shall not apply if the contractor or subcontractor and the purchases made by the contractor or subcontractor would otherwise be exempt.

Thus, a subcontractor installing qualified industrial machinery for the Taxpayer may apply to the Tennessee Department of Revenue for its own industrial machinery authorization number. Such an industrial machinery authorization number will enable the subcontractor to purchase the industrial machinery for the Facility exempt from the Tennessee sales and use tax.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: 2/10/2020

²¹ A copy of the exemption certificate referred to in TENN. COMP. R. & REGS. 1320-5-1-.102(2) may be found on the Department's website, available at <https://www.tn.gov/content/dam/tn/revenue/documents/forms/sales/f1306701.pdf> (last visited January 10, 2020).