

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 23-03

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 of a pilot treatment facility and pumping station for additional wastewater capacity.

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 City of [REDACTED] is a Tennessee municipality (the "Municipality"). The Municipality intends to enter into a contract for the construction of a pilot treatment facility and a reclaimed water booster pump station (collectively, the "Facility") for additional wastewater capacity.

The Municipality will own and operate the Facility. The Municipality will contract with unrelated contractors (the "Contractors") to construct the Facility. In the course of constructing the Facility, the Contractors will purchase materials required to construct the Facility and equipment to be used in the Facility. The equipment and materials will consist of (i) processing equipment, including pumps, tanks, piping, and related equipment necessary to process sewage, (ii) concrete, reinforcing materials, and other building materials necessary for the construction of the foundations and enclosures necessary for the processing equipment, (iii) building materials (masonry, steel, roofing, doors, and mechanical and electrical components) necessary for the construction of the buildings needed to operate the Facility, and (iv) site materials, including asphalt, crushed stone and other materials required to construct roadways, walkways, and vehicle parking at the Facility.

Reclaimed Water Booster Pump Station

The purpose of the reclaimed water booster pump station (the "pump station") is to increase the quantity of flow and pressure of the reclaimed water that is delivered to the southeast portion of the Municipality. Reclaimed water is a sustainable alternative to potable water that the Municipality uses for irrigation customers that is produced from wastewater effluent.

The pump station will consist of a masonry building and shingled roof with four pumps housed inside the building. The building will also house various electrical panels and instrumentation for remote control of the pumps and will be conditioned to prevent overheating/freezing of the equipment during the summer/winter months. The pump station will also include a davit crane that will be suspended above the pumps to aid in the removal of a pump from the pump base to the roll-up door for loading when repair or replacement of a pump becomes necessary. The pump station includes various valves for isolation and flow control, in addition to ductile iron piping for appropriate restraining of joints. The pump station will rest on a slab on grade and is intended to remain in place permanently.

The pump station will pull water from the reclaimed water distribution system and pump to allow the Municipality to increase the pressure into the distribution system in the southeast portion of the Municipality. The pump station will only be used for reclaimed water that is produced from the treatment facility in the northern part of the Municipality.

Pilot Treatment Facility

The purpose of the pilot treatment facility is to determine appropriate treatment technologies, based on the water quality of the Municipality's wastewater and reclaimed water. The Municipality will use the information gained in its proposal for full construction of a new clean water facility in the southeast area of the Municipality.

The pilot treatment facility is a temporary metal building that will be constructed adjacent to the pump station on the same site that will provide smaller scale advanced technologies for the evaluation of

wastewater treatment for the southeast area of the Municipality. The building will have a metal roof and will be divided into four areas, the laboratory, the electrical room, the mechanical room, and the process room. The laboratory will include tabletops and cabinets where the wastewater will be measured and analyzed. The process room will house the pilot equipment for treatment, along with electrical wiring and instrumentation controls. Valves and restrained fittings will be used to isolate flow and prevent flow disruption. Pipe material will be either PVC or ductile iron, depending on the area of the pilot facility. The building will rest on a slab on grade. Several roll-up garage doors are included to facilitate the installation/removal of the process equipment and will extend the full 18-foot height of the building.

The water for use by the pilot treatment facility will also pull from the reclaimed water distribution system located in the northern part of the Municipality. The Municipality is piloting advanced treatment processes to see what levels of treatment can be obtained with the water. Depending on the level of treatment obtained in the pilot treatment facility, the Municipality will pursue reuse options when it designs its larger treatment facility that will eventually be constructed in the southeast area of the Municipality.

Most of the equipment used in the pilot treatment facility will be leased. The Municipality's consultant has negotiated three equipment lease agreements with three different vendors. In each case, the vendor will arrange for delivery of the equipment to the project site and a vendor representative will set up the equipment. The consultant will pass the lease payments through on the Municipality's invoices so that the Municipality is making the lease payments.

The Municipality's employees will operate the pilot treatment facility but will send samples to an external laboratory for analysis. The pilot treatment facility will be in operation for one year once the final construction has been completed. At the conclusion of the project, the building will remain on the property, and the leased equipment will be returned to the individual vendors. Any smaller equipment the Municipality purchases directly, such as glassware and small instruments used for laboratory analysis, will be moved to the treatment facility in the northern part of the Municipality.

RULINGS

1. Are the purchases of materials by the Municipality's Contractors for the construction of the pump station and the purchases of the equipment to be used in the pump station subject to Tennessee sales and use tax under TENN. CODE ANN. § 67-6-209(b) (2022)?

Ruling: No. The purchases of materials by the Municipality's Contractors for the construction of the pump station and the purchases of equipment to be used in the pump station are exempt from Tennessee sales and use tax pursuant to TENN. CODE ANN. § 67-6-206(a) (2022).

2. Are the purchases of materials by the Municipality's Contractors for the construction of the pilot treatment facility and the purchases of the equipment to be used in the pilot treatment facility subject to Tennessee sales and use tax under TENN. CODE ANN. § 67-6-209(b)?

Ruling: No. The purchases of materials by the Municipality's Contractors for the construction of the pilot treatment facility and the purchase of equipment to be used in the pilot treatment

facility are exempt from Tennessee sales and use tax pursuant to TENN. CODE ANN. § 67-6-206(a).

3. Are the payments for leased equipment used in the pilot treatment facility subject to the Tennessee sales and use tax?

Ruling: The Municipality qualifies for the governmental entity exemption in TENN. CODE ANN. § 67-6-329(a)(4) (2022). As long as the Municipality complies with the requirements listed in TENN. COMP. R. & REGS. 1320-05-01-.55, the equipment lease payments will not be subject to Tennessee sales and use tax.

ANALYSIS

TENN. CODE ANN. § 67-6-209(b) (2022) states that where a contractor or subcontractor defined as a “dealer”¹ 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.” Consequently, 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.²

Pump Station

The purchases of materials by the Municipality’s Contractors for the construction of the pump station and the purchases of the equipment to be used in the pump station are not subject to Tennessee sales and use tax because they are exempt as purchases of industrial machinery.

TENN. CODE ANN. § 67-6-206(a) (2022) exempts “industrial machinery” from the sales and use tax. “Industrial machinery” is defined in pertinent part in TENN. CODE ANN. § 67-6-102(46)(A)(i) (2022) as

[m]achinery, apparatus and equipment . . . or pollution control facilities primarily used for air pollution control or water pollution control, where the use of such machinery, equipment or facilities is by one who engages in such fabrication or processing as one’s principal business, . . . or such use by a county, municipality, or water and wastewater treatment authority created by private act or pursuant to the Water and Wastewater Treatment Authority Act, compiled in title 68, chapter 221, part 6, or a contractor pursuant to a contract with the county, municipality, or water and wastewater treatment authority for use in water pollution control or sewage systems.

¹ TENN. CODE ANN. § 67-6-102(23)(K) (2022) 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.”

² TENN. CODE ANN. § 67-6-209(c) (2022).

“Pollution control facilities” is broadly defined to include “any system, method, improvement, structure, device or appliance appurtenant thereto used or intended for the primary purpose of eliminating, preventing or reducing air or water pollution.”³

The broader definition of “pollution control facilities” is instructive here. The Municipality and its contractors may purchase any system, method, improvement, structure, device, or appliance appurtenant thereto used or intended for the primary purpose of eliminating, preventing, or reducing water pollution tax exempt.⁴

The pump station increases the quantity of flow and pressure of the reclaimed water that is delivered to the southeast portion of the Municipality. Making use of reclaimed water is a part of a system for reducing water pollution because municipal wastewater cannot simply be discharged without being treated; water reuse allows for the disposal of large quantities of wastewater. The pump station is a piece of the Municipality’s water pollution control system because it allows for reclaimed water to be distributed to areas where that water may be used. As for the pump station’s primary use, it is primarily used for the control of water pollution because it only pulls reclaimed water from a water treatment center.

Because of its role in distributing treated water as a part of a system designed to reduce water pollution, the pump station would qualify as a pollution control facility. Accordingly, the purchase of materials by the Municipality’s Contractors for the construction of the pump station and the purchase of equipment to be used in the pump station are exempt from Tennessee sales and use tax as purchases of industrial machinery.

Pilot Treatment Facility

The purchases of materials by the Municipality’s Contractors for the construction of the pilot treatment facility and the purchase of equipment to be used in the pilot treatment facility are also exempt from Tennessee sales and use tax as purchases of industrial machinery. The purpose of the pilot treatment facility is to determine appropriate treatment technologies, based on the water quality of the Municipality’s current wastewater and reclaimed water. The Municipality plans to use the information it gains from the pilot treatment facility to pursue viable reuse options when it designs its larger treatment facility that it plans to eventually construct in the southeast area of the Municipality.

Determining appropriate water treatment technologies for the Municipality is a part of the Municipality’s system for reducing water pollution. “Pollution control facilities” is broadly defined to include “any system, method, improvement, structure, device or appliance appurtenant thereto used or intended for the primary purpose of eliminating, preventing or reducing air or water pollution.”⁵ The water used in the pilot treatment facility is pulled from the reclaimed water distribution system. The pilot treatment facility then applies advanced treatment processes to that reclaimed water. In a narrow context, the pilot treatment facility is reducing the pollution in the water that it pulls when it

³ TENN. CODE ANN. 67-6-102(46)(A)(ii) (2022).

⁴ See Tenn. Dept. Rev. Ltr. Rul. 20-05 (June 16, 2020) (where materials for the construction of the buildings necessary to operate a Pollution Control Facility are included within the scope of the exemption. Materials for the construction of roadways, walkways, and vehicle parking at the Facility are also included within the scope of the exemption).

⁵ TENN. CODE ANN. 67-6-102(46)(A)(ii).

subjects that water to advanced treatment processes. In a broader context, the use of the pilot treatment facility is intended for the purpose of reducing water pollution in the Municipality. In either context, the pilot treatment facility qualifies as a pollution control facility. Accordingly, the purchase of materials by the Municipality's Contractors for the construction of the pilot treatment facility and the purchase of equipment to be used in the pilot treatment facility are exempt from Tennessee sales and use tax as purchases of industrial machinery.

Equipment Lease Payments

Sales made directly to a county or municipality in Tennessee are not subject to sales and use tax, provided the county or municipality furnishes the vendor with a properly executed exemption certificate. In addition, in order to qualify for the exemption, the county or municipality must be the party making the purchase of property or taxable service, must obtain title to the property or service immediately upon delivery, and must make payment directly to the dealer supplying the property or service.⁶

As noted above, the Municipality's consultant has negotiated three equipment lease agreements with three different vendors. In each case, the vendor will arrange for delivery of the equipment to the project site and a vendor representative will set up the equipment for use by the Municipality's employees. The consultant will pass the lease payments through on the Municipality's invoices so that the Municipality is making the lease payments directly to the vendor. As long as the Municipality provides each vendor with a properly executed exemption certificate, the lease payments will not be subject to Tennessee sales and use tax.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: April 4, 2023

⁶ TENN. CODE ANN. § 67-6-329(a)(4) (2022); TENN. COMP. R. & REGS. 1320-05-01-.55 (2022).