

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 23-08

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

Whether a wholly owned single member limited liability company qualifies for the sales and use tax industrial machinery exemption and the business tax exemption for manufacturers if it elects to be treated as a corporation for federal income tax purposes.

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 detriment.

FACTS

[REDACTED] (hereinafter the "Parent"), is a Tennessee corporation headquartered in [CITY], Tennessee, with offices in [REDACTED] and [REDACTED]. Parent operates a [REDACTED] fabrication plant at its [REDACTED] location and provides design services, [REDACTED - INSTALLATION AND SERVICES RELATED TO INSTALLING ITS FABRICATED GOODS], project management, and detailing.

Parent is in the business of selling [FABRICATED GOODS] to other contractors, consumers, and users as well as [INSTALLING GOODS] for others. All [INSTALLATION] services are contractually Parent's responsibility, whether it uses its own employees and/or subcontractors.

Parent is expanding its operations in [REDACTED]. It currently leases [REDACTED - PROPERTIES]. The [PROPERTIES] consist of Parent's contractor office, a physically separate fabrication facility, and two buildings used to support fabrication operations. Parent established a new legal entity named [REDACTED], (the "Taxpayer") and will transfer all machinery, equipment, and personnel specifically involved in fabrication to the Taxpayer. The [PROPERTIES] will be resurveyed combining a part [REDACTED - MULTIPLE ADDRESSES] to become one distinct property location with an entrance separate from [ADDRESS]. The existing lease agreement with the property owner of the [PROPERTIES] will be terminated. The Taxpayer will enter into a new agreement with the property owner to lease [PROPERTY] where it will maintain its fabrication operations (the "New Fabrication Location"). Parent will enter into an agreement with the property owner to lease the remainder of [ADDRESS] where it will maintain its contractor operations.

The Taxpayer was formed under Tennessee law as a single member limited liability company ("SMLLC") wholly owned by Parent. The Taxpayer will elect to be treated as a corporation for federal income tax purposes.

The Taxpayer will only fabricate [FABRICATED GOODS] for resale and use off the premises. There will be no [INSTALLATION SERVICES] provided under any of the Taxpayer's contracts. At least 51% of the Taxpayer's gross sales will be from the sale of [FABRICATED GOODS] at the New Fabrication Location. The [FABRICATED GOODS] will be sold to Parent and third parties. Title and possession of the [FABRICATED GOODS] will be passed from the Taxpayer to the customer at the job site to which it is shipped.

RULINGS

1. Will the Taxpayer qualify for the sales and use tax exemption for industrial machinery and reduced rates for water and energy fuel as provided by TENN. CODE ANN. § 67-6-206?

Ruling: Yes. The Taxpayer will be treated as a separate entity from Parent and will qualify for the sales and use tax exemption for industrial machinery and reduced tax rates for water and energy fuel.

2. Does the answer change if the Taxpayer does not elect to be treated as a corporation and remains a disregarded entity for federal income tax purposes?

Ruling: Yes, the answer changes. The Taxpayer would be disregarded for Tennessee sales and use tax purposes and treated as a division of Parent. It would not be able to sell to the Parent, and its sales to third parties would be that of the Parent. Parent's eligibility may fluctuate based on where it derives most of its revenues.

3. If Parent moved its manufacturing operations as described above to a separate location and did not create a separate entity, would Parent qualify for an industrial machinery exemption as a manufacturer at the New Fabrication Location?

Ruling: Maybe. Parent's eligibility for the industrial machinery exemption will fluctuate based on where it derives most of its revenues.

4. Will the Taxpayer qualify as a manufacturer for business tax purposes?

Ruling: Yes. The Taxpayer, having elected to be treated as a corporation for federal income tax purposes, will qualify as a manufacturer for business tax purposes because it is primarily engaged in the fabrication of [GOODS] for resale and consumption off the premises.

ANALYSIS

For Tennessee state and local tax purposes, a limited liability company is classified in the same manner as it is classified for federal income tax purposes, unless otherwise provided.¹ Treas. Reg. § 301.7701-2(a) (current through July 17, 2023, 88 FR 45372) provides that a business entity with only one owner is classified as a corporation or is disregarded as an entity separate from its owner. A disregarded entity's activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.²

Treas. Reg. § 301.7701-3(b) (current through July 17, 2023, 88 FR 45372) provides that, by default, a business entity with one owner is classified as disregarded as an entity separate from its owner. Treas. Reg. § 301.7701-3(c), known as the "check-the-box" provision,³ allows for a business entity to elect on Form 8832 to be treated as an association taxable as a corporation. If a SMLLC has made a valid election to be taxable as a corporation, then it will be treated as a separate entity for Tennessee state and local tax purposes. If a SMLLC does not make an election or elects to be treated as a disregarded entity on Form 8832, then it will be disregarded as an entity separate from its owner for Tennessee state and local tax purposes, unless an applicable statute requires otherwise.⁴

¹ TENN. CODE ANN. § 48-249-1003 (current through 2023 Reg. Sess. of the 113th Gen. Assembly) provides that for state and local tax purposes, "a foreign or domestic LLC shall be treated as a partnership or an association taxable as a corporation as such classification is determined for federal income tax purposes." TENN. CODE ANN. § 48-211-101 (current through 2023 Reg. Sess. of the 113th Gen. Assembly) provides almost identical language. These statutes show the legislature's intent to classify limited liability companies for Tennessee state and local tax purposes in the same manner that they are classified for federal income tax purposes. See also Tenn. Dept. of Rev. Ltr. Rul. 06-40 (Dec. 15, 2006).

² Treas. Reg. § 301.7701-2(a) (current through July 17, 2023, 88 FR 45372).

³ Federal Form 8832 provides the applicable boxes to check. <https://www.irs.gov/pub/irs-pdf/f8832.pdf> (last visited July 19, 2023).

⁴ See, e.g., TENN. CODE ANN. §§ 67-4-2006(a)(6) (2022); 67-4-2007(d) (2022); and 67-4-2106(c) (2022). These statutes apply to persons subject to the franchise and excise taxes.

The sales and use tax industrial machinery exemption is granted to entities whose principal business is the fabrication or processing of tangible personal property for resale and consumption off the premises.⁵ An activity is a taxpayer's principal business if more than fifty percent of its revenues at a given location are derived from fabricating or processing tangible personal property for resale; this is known as the "51% test."⁶ Each location of a taxpayer will be considered separately in determining whether the taxpayer qualifies or is disqualified as a manufacturer at that location.⁷

Contractors who fabricate and install products to realty, such as [REDACTED], typically will not qualify as a manufacturer.⁸ This result is driven by the fact that under Tennessee law, contractors are not considered the reseller of tangible personal property that they install.

1. *The Taxpayer will qualify for the sales and use tax exemption for industrial machinery and reduced rates for water and energy fuel.*

Because the Taxpayer elects to be treated as a corporation for Federal income tax purposes, it will be treated as a separate entity from Parent for Tennessee sales and use tax purposes. This separation will allow its sales of [FABRICATED GOODS] to be included in the 51% test, while its parent's sales of contracting services will be excluded. Because the Taxpayer only fabricates [FABRICATED GOODS] for resale at the New Fabrication Location to third parties and Parent, which is a separate entity, more than 50% of the Taxpayer's revenue will be from sales of [FABRICATED GOODS] fabricated for resale and consumption off the premises.⁹ Accordingly, the Taxpayer will qualify as a manufacturer at the New Fabrication Location and will be eligible for the industrial machinery exemption from sales and use tax and reduced rates for water and energy fuel.¹⁰

2. *Under the facts provided, the Taxpayer will not qualify for the sales and use tax exemption for industrial machinery and reduced rates for water and energy fuel if it does not elect to be treated as a corporation because the Taxpayer will be treated as a division of Parent; and, Parent's eligibility may fluctuate based on where it derives most of its revenues.*

If the Taxpayer does not elect to be treated as a corporation for federal income tax purposes and is treated as an entity disregarded as separate from Parent for federal income tax purposes, it will be

⁵ TENN. CODE ANN. § 67-6-102(46)(A)(i) (2022); TENN. CODE ANN. § 67-6-206(b)(2) (2022).

⁶ *Tenn. Farmer's Coop. v. State ex rel. Jackson*, 736 S.W.2d 87, 91-92 (Tenn. 1987); see also *Beare Co. v. Tenn. Dept of Revenue*, 858 S.W.2d 906, 908 (Tenn. 1993).

⁷ TENN. CODE ANN. § 67-6-209(c) (2022); see also *Alley-Cassetty Coal Co., Inc. v. Johnson*, No. M2003-02327-COA-R3-CV, 2005 WL 729180 *6 (Tenn. Ct. App. March 29, 2005).

⁸ The transfer of tangible personal property by a contractor who contracts for the installation of such tangible personal property as an improvement to realty does not constitute a sale, except as otherwise provided, and the contractor shall not be permitted on this basis to obtain the benefit of any exemptions or reduced tax rates available to manufacturers. TENN. CODE ANN. § 67-6-209(c) (2022); see also TENN. COMP. R. & REGS. 1320-05-01-.103(1) (2000).

⁹ The Taxpayer will have to collect sales tax on its sales to Parent pursuant to TENN. COMP. R. & REGS. 1320-05-01-.08 (1984), which states that "suppliers making sales of materials and supplies to contractor-dealers and delivering such materials and supplies to a job site for use, or tagging or marking particular materials and supplies for a particular job being performed by the contractor-dealer, shall collect the applicable Sales and Use Tax on those sales."

¹⁰ Tax at the rate of one percent (1%) is imposed with respect to water when sold to or used by manufacturers. Tax at the rate of one and one-half percent (1.5%) shall be imposed with respect to gas, electricity, fuel oil, coal and other energy fuels when sold or used by manufacturers. TENN. CODE ANN. § 67-6-206(b)(1).

treated as a disregarded entity for Tennessee sales and use tax purposes. In this situation, the Taxpayer will be treated as a division of Parent, and its sales to the Parent will not exist.

For purposes of the 51% test, only the revenue from sales of [FABRICATED GOODS] fabricated at the New Fabrication Location that is sold to third parties (the "Fabrication Sales") will be considered properly derived from fabrication of tangible personal property for resale. Any transfer of [FABRICATED GOODS] from the division to Parent, which uses the [FABRICATED GOODS] in performing its [INSTALLATION SERVICES], does not constitute a sale, and will not be considered to be receipts derived from sales of fabricated tangible personal property for resale or consumption off the premises. Instead, when Parent [INSTALLS] its [FABRICATED GOODS] for others, those sales are considered installation sales ("Installation Sales").¹¹

To qualify for the industrial machinery authorization, Parent would need to sell to third parties, with more than 50% of its revenues being from Fabrication Sales. If the Parent does not meet the 51% test, it is not permitted to obtain the benefit of any exemptions or reduced tax rates available to manufacturers under § 67-6-102(46)(E) or § 67-6-206.¹² Under Parent's operational structure outlined in the facts, whether Parent qualifies as a manufacturer may fluctuate depending on its revenue from Fabrication Sales in relation to its revenue from Installation Sales.

- 3. Parent's eligibility for the industrial machinery exemption will fluctuate based on where it derives most of its revenues.*

Parent derives its revenues from multiple sources. The [FABRICATED GOODS] fabricated at the New Fabrication Location is sold in two types of transactions: Fabrication Sales and Installation Sales. Only the revenue derived from the Fabrication Sales will count towards whether Parent is a manufacturer under the 51% test. Parent may qualify for the industrial machinery authorization at the New Fabrication Location if its facts indicate that it derives more than 50% of its revenues from Fabrication Sales. As addressed above in section 2, whether Parent qualifies as a manufacturer may fluctuate depending on its revenue from Fabrication Sales in relation to its revenue from Installation Sales.

- 4. The Taxpayer will qualify as a manufacturer for business tax purposes.*

The business tax is a privilege tax on the privilege of doing business by making sales of tangible personal property and services within Tennessee and its local jurisdictions.¹³ Tenn. Code Ann. § 67-4-712(b)(2), as amended by the Tennessee Works Tax Act of 2023, 2023 Public Acts Ch. 377, § 3, provides an exemption from the business tax for "[a] person primarily engaged in the fabrication or processing of tangible personal property for resale and consumption off the premises with respect to the sales of such property made from the manufacturing location or from a storage or warehouse facility that is situated within a ten-mile radius of the manufacturing location."

For business tax purposes, a "manufacturer" is generally the same as it is for purposes of the sales and use tax industrial machinery exemption, and includes establishments primarily engaged in

¹¹ See TENN. CODE ANN. § 67-6-209(c).

¹² *Id.*

¹³ See TENN. CODE ANN. § 67-4-701 *et seq.* and TENN. COMP. R. & REGS. 1320-04-05-.01, *et seq.*

fabricating [FABRICATED GOODS]. Similar to sales and use tax, the business tax exemption for manufacturers will be applied on a location-by-location basis.¹⁴

To sum up the qualifications for the manufacturer's exemption to the business tax, a taxpayer must: 1) qualify for the exemption on a per location basis;¹⁵ 2) be engaged in fabricating and processing tangible personal property for resale and consumption off the premises;¹⁶ 3) derive more than 50% of the business's gross receipts from manufacturing; and 4) make its sales from the manufacturing location or from a storage or warehouse facility situated within a ten-mile radius of the manufacturing location.¹⁷

The Taxpayer is primarily engaged in the fabrication of [FABRICATED GOODS] for resale and consumption off the premises at the New Fabrication Location in Shelbyville, thus satisfying all four requirements to be exempt from business tax. Accordingly, the Taxpayer qualifies as a manufacturer eligible for the manufacturing exemption to the business tax if the Taxpayer elects to be treated as a corporation for federal tax purposes.

APPROVED: David Gerregano
Commissioner of Revenue

DATE: August 24, 2023

¹⁴ "A business which engages in business activity in several places, in different locations and through different outlets, must obtain a license from and pay the initial license fee to the appropriate local officer and must pay at least the minimum business tax to the Department for each place, location or outlet; and it must report gross sales and tax due for each separate location." TENN. COMP. R. & REGS. 1320-04-05-.28(1) (September 16, 2016).

¹⁵ *Id.*

¹⁶ TENN. CODE ANN. § 67-4-712(b)(2).

¹⁷ *Id.*