

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #96-31**

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 sales and use tax to the fabrication, sale and installation of shutters.

SCOPE

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 his 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 his detriment.

FACTS

The "Taxpayer" is in the business of fabricating and installing custom shutters, generally for residential customers. A representative of the Taxpayer visits the customer's home and measures the window(s) where the shutters will be installed to determine the size of shutters needed. The Taxpayer buys the raw materials, consisting of plywood, aluminum, hinges, paint, glue and shipping materials, and fabricates the shutters in its workshop. The Taxpayer retains an independent contractor to install the shutters of the Taxpayer's customers. The shutters are installed in buildings. Generally, the shutters are permanently mounted to a window frame by screws. The shutters themselves are not free-standing structures nor are they easily removable. Once the shutters are attached to

the window frame, they remain permanently in place. The structures are not removed if the owner moves. The Taxpayer, or its independent contractor, installs 100% of the shutters that the Taxpayer fabricates. The Taxpayer does not sell shutters to any other contractor, fabricator, wholesaler or retailer, and the Taxpayer does not sell any shutters that are not installed by its employees or its independent contractors.

When the Taxpayer contracts with its customers to provide them with custom-manufactured and installed shutters, the Taxpayer charges its customers one lump sum which includes the price of the shutter and the installation. The customer is billed by the Taxpayer; the customer makes no separate payment to the installer.

ISSUES

1. Should the Taxpayer pay sales tax on its purchases of raw materials?
2. May the Taxpayer use a resale certificate when purchasing raw materials?
3. Should the Taxpayer charge sales tax to its customers?
4. If the Taxpayer should charge sales tax to its customers, should sales tax be charged on:
 - a. the value of the raw materials?
 - b. the value of the labor to fabricate the shutters?
 - c. the profit or markup portion of the sales price?
 - d. the installation charges?

RULINGS

1. For Tennessee sales tax purposes, the Taxpayer is a contractor and should pay sales tax on its purchases of raw materials.
2. The Taxpayer may not purchase raw materials using a resale certificate, because as a contractor the Taxpayer is the consumer and user of the raw materials.
3. Because the Taxpayer is the user of the raw materials and should pay sales tax on its purchase of raw materials, the Taxpayer should not charge its customers sales tax.
4. Because the Taxpayer is a contractor and because the shutters are installed on buildings, the Taxpayer should not charge its customers sales tax on the raw materials, the labor, the markup or the installation of the shutters.

ANALYSIS

1. PURCHASES OF MATERIALS AND SUPPLIES USED IN FABRICATION
OF SHUTTERS ARE SUBJECT TO TENNESSEE SALES TAX

Taxpayer is a “person”, as the term is defined in T.C.A. § 67-6-102(20), for Tennessee sales and use tax purposes. Taxpayer is also a “dealer” according to the definition set forth in T.C.A. § 67-6-102(6)(K) which states that a dealer may be defined as a person 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.

T.C.A. § 67-6-209(b), quoted in part below, imposes Tennessee use taxes on the use of tangible personal property by a contractor in fulfillment of a contract unless sales or use taxes have been previously paid on the property.

Where a contractor . . . hereinafter defined as a dealer uses tangible personal property in the performance of the contract, or to fulfill contract or subcontract obligations, whether the title to such property be in the contractor, subcontractor, contractee, subcontractee, or any other person, or whether the title holder of such property would be subject to pay sales or use tax, . . . such contractor or subcontractor shall pay a tax at the rate prescribed by § 67-6-203 measured by the purchase price of such property, unless such property has been previously subjected to sales or use tax, and the tax due thereon has been paid . . .

As a general rule, when a contractor fabricates tangible personal property in a manner changing the form thereof and then uses the property, the Tennessee sales and use tax applies to the fair market value of the fabricated property. T.C.A. § 67-6-209(a) provides:

Where a . . . contractor erects or applies tangible personal property, which the . . . contractor has manufactured, produced, compounded or severed from the earth . . . such person so using the tangible personal property shall pay the tax herein levied on the fair market value of such tangible personal property when used, without any deductions whatsoever; provided, that the foregoing shall not be construed to apply to contractors or subcontractors who fabricate, erect or apply tangible personal property which becomes a component part of a building, and which is not sold by them as a manufactured item.

TENN. COMP. R. & REGS. 1320-5-1-1.03(2) makes the following provisions concerning contractors who fabricate tangible personal property which they apply as a component part of a building.

Contractors . . . and sub-contractors who are not in the business of selling tangible personal property which they fabricate to erect or apply as a component part of a building shall pay the sales or use tax on the purchase price of the materials and supplies used in connection with their contract work.

As set forth in the analysis in Section 3 below, Taxpayer is not in the business of selling tangible personal property, and the shutters fabricated by Taxpayer are installed as component parts of buildings. The above quoted statutes and rule make it clear that Taxpayer must pay Tennessee sales and use taxes on the purchase price of materials and supplies it uses to fabricate shutters to be installed as a component part of buildings.

2. TAXPAYER MAY NOT USE A RESALE CERTIFICATE TO PURCHASE MATERIALS AND SUPPLIES USED TO FABRICATE SHUTTERS

For purposes of the Tennessee sales tax, T.C.A. § 67-6-102(23(A) defines the term “retail sales” or “sale at retail as follows:

“Retail sales” or “sale at retail” means a taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose other than for resale. “Retail sales” or “sales at retail” means and includes all such transactions as the commissioner, upon investigation, finds to be in lieu of sales. Any sales for resale must, however, be in strict compliance with rules and regulations promulgated by the commissioner. Any dealer making a sale for resale which is not in strict compliance with rules and regulations shall be personally liable for and pay the tax;

TENN. COMP. R. & REGS. 1320-5-1-.68(3) makes the following provisions concerning resale certificates:

Certificates of resale may not be used to obtain tangible personal property or taxable services to be used by the purchaser, and not for resale; such use shall be grounds for the Commissioner to revoke the registration certificate of the dealer wrongfully making use of such certificate of resale. In addition to this penalty, it is a misdemeanor to misuse the certificate of registration and resale certificates for the purpose of obtaining tangible personal property or taxable services without the payment of the Sales or Use Tax when it is due.

A dealer who is a retailer may purchase tangible personal property for resale without payment of Tennessee sales and use taxes if he furnishes his supplier with the appropriate resale certificate. However, as set forth in Section 3 of the analysis below, Taxpayer is not a retailer in the business of selling tangible personal property. The materials and

supplies being purchased by Taxpayer are not resold, but are used by Taxpayer in the performance of its contracts to fabricate and install custom-made shutters on houses and buildings. Therefore, Taxpayer cannot use a resale certificate to purchase the materials and supplies it uses to fabricate shutters.

3. CUSTOMERS ARE NOT REQUIRED TO PAY SALES TAX ON THE CHARGES MADE BY TAXPAYER FOR INSTALLED CUSTOM-MADE SHUTTERS

T.C.A. § 67-6-202(a) imposes the Tennessee sales tax as follows:

For the exercise of the privilege of engaging in the business of selling tangible personal property at retail in this state, a tax is levied at the rate of six percent (6%) of the sales price of each item or article of tangible personal property when sold at retail in this state; . . .

TENN. COMP. R. & REGS. 1320-5-1-.27 makes the following provisions concerning charges for installation of tangible personal property which becomes a part of real property:

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.

Whether Taxpayer should collect sales tax from its customers on charges made for installed custom shutters turns on whether the shutters are tangible personal property chattels or real property fixtures.

In Tennessee the primary test for distinguishing chattels from fixtures is not the manner in which the property is affixed to the freehold, but the intention with which the chattel is connected with the realty. Such intent may be shown by applying an objective test which considers the type of structure, the mode of attachment and the use and purpose of the property. *Harry J. Whelchel Company v. King*, 610 S.W.2d 710 (Tenn. 1980). Chattels are fixtures when they are so attached to real property that, from the intention of the parties and the uses to which such chattels are put, they are presumed to be permanently annexed. If the chattel is intended to be removable at the pleasure of the owner, it is not a fixture. *Magnavox Consumer Electronics v. King*, 707 S.W.2d 504 at 507 (Tenn. 1986) quoting *Hickman v. Booth*, 173 S.W. 438 (Tenn. 1914)

The test applied in *Whelchel* was also applied in *General Carpet Contractors, Inc. v. Tidwell*, 511 S.W.2d 241 (Tenn. 1974) where carpet was installed by the tackless strip method allowing easy removal. The carpet was held to be a fixture improving the real property because the parties intended to install the carpet permanently. The carpet was installed with the intent that it remain attached to the realty for the length of its useful life to the owner of the realty.

The shutters which Taxpayer fabricates are custom-made to fit the windows of the buildings upon which they are installed. It is represented that the shutters are permanently mounted to a window frame by screws. The shutters are not free-standing structures nor are they easily removable. Once the shutters are attached to the window frame, they remain permanently in place. The structures are not removed if the owner moves. The fact that the shutters are custom-made to fit the windows of the buildings to which they are attached, their mode of attachment to the buildings, their use and purpose and the intent that they remain attached to the realty supports the conclusion that they become a part of the realty to which they are attached and are real property fixtures rather than tangible personal property chattels.

Since the shutters in question become a part of the realty when installed, the Tennessee sales and use tax does not apply to charges made for the shutters and their installation.

4. NONE OF TAXPAYER'S CHARGES TO ITS CUSTOMERS FOR
SHUTTERS CUSTOM-FABRICATED AND INSTALLED
ARE SUBJECT TO SALES AND USE TAXES

As set forth in Sections 1 through 3 of the above analysis, none of Taxpayer's charges to its customers for shutters custom-fabricated and installed are subject to Tennessee sales and use taxes. However, Taxpayer must pay sales and use taxes on the materials and supplies it uses to fabricate the shutters.

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